Q1 Preview: Big Freeze bites earnings estimates

Next week Q1 earnings season kicks off, which will stretch over the next 1-2 months. Travelers, a bellwether for the P&C group, will release its figures on Tuesday the week after the next along with WR Berkley, and it will be followed by a frenzy of releases over the following two weeks.

Over the recent weeks, the Street's Q1 earnings estimates had sharp swings as the quarter's expected gains from the favorable pricing and loss cost trends built since Q3 were partially offset by the losses from the Big Freeze in Texas.

Below are the noteworthy themes we are following:

- **Rate in excess of trend** will be at the top of the agenda for P&C carriers across all lines as margin pressures may be building from higher economic activity, higher mobility, lower unemployment, and the reopening of courts with a backlog of pending cases.
- **Pricing** commentary will be a topic of focus as the market is increasingly being framed as at or around the point of moderation in certain lines including property, particularly by brokers. Also, reinsurers' perspective on what appeared to be a softer-than-expected (again) 1.4 renewal season will be topical. We are not entirely convinced that the cycle has legs for the remainder of the year. We would also note that the Marketscout data that came out earlier this week showed a pricing increase of 6.8% for Q1:21 vs.7.1% for Q4:20 and 6.25% for Q3:20.
- **Catastrophe losses** from Progressive's and Allstate's monthly disclosures suggested an above-average cat quarter driven by Winter Storm Uri in Texas. Uri, which was termed "unmodeled", is running at <$15bn, according to disclosures from insurers to reinsurers. But with scope for the loss to develop there are scenarios where it could ultimately stretch towards $20bn. Despite the lack of pre-announcements for the time being, the losses from Australia's March floods and – to a lesser degree - the Ever Given incident in the Suez Canal will be a source of noise for reinsurers.
- **The Chubb-Hartford** merger saga is far from over per the market chatter and stock prices. In the absence of expansive commentary, both firms' rhetoric around the possible merger will be scrutinized for clues. Others will also be queried about the broader implications and read-across.
- **Corporate tax change & impact on investment portfolio:** Although early days, investors will also look for commentary surrounding President Biden's proposals on taxation and any consequent updates on investment asset reallocation. Relatedly, we expect some scrutiny on which carriers have exposure to the Biden's $2.3bn infrastructure plan with likely beneficiaries largely involving construction risk writers (e.g. builders' risk, commercial and contractor GL, commercial auto/trucking, inland marine, surety, and workers' comp).
- **InsurTechs** had a strong selloff in response to not particularly bad Q4 earnings releases. The new generation insurers will add excitement to the quarter's earnings once again as investors seem to demand positive surprises.
- **The market will anticipate less noise on commercial reserves:** With not much of an attempt to kitchen sink year-end results, similar trends should continue with the Q1 earnings season.

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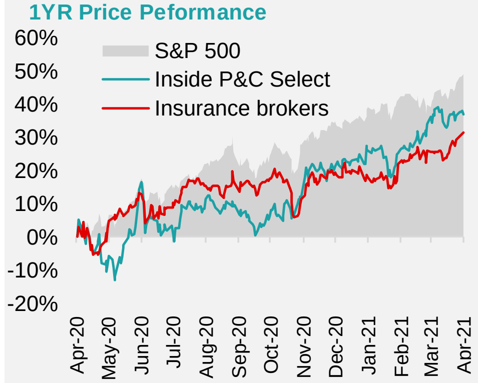
Composite	YTD px chg.	P/B
Large comm.	12.3%	1.0x
Regional	17.4%	1.5x
Specialty	18.4%	1.7x
Personal	0.7%	1.9x
Bermuda	7.0%	1.2x
Florida	15.7%	1.0x
Brokers	8.4%	-
IPC Select	9.6%	1.3x
S&P 500 Fin.	18.0%	-
S&P 500	9.1%	-

1YR Price Peformance



Source: SNL, Inside P&C

Q1 P&C earnings calendar (announced firms only)

Source: Company reports, SNL

MO/YR	MON	TUES	WED	THURS	FRI	SAT
APR 2021	12	13	14	15 Progressive Truist	16	17
	19	20 Travelers WR Berkley	21 RLI	22	23	24
	26 Brown & Brown	27 Arch Chubb Marsh & McLennan	28 Cincinnati Everest RenRe Selective	29 AJ Gallagher Amerisafe Erie Hanover Willis Towers Wat.	30	1 Berkshire
MAY 2021	3 Argo	4 Mercury	5 Allstate ProAssurance UPC	6 State Auto	7	8
	10	11	12	13	14	15
	17	18	19	20	21	22

The Texas Big Freeze frostbites

In the first quarter, many P&C carriers are set to benefit from favorable year-over-year comparison against Covid charges in Q1 last year, and higher rates in excess of trend that were telegraphed by commercial carriers in the recent quarters.

As of yesterday, 20 of the 29 firms within Inside P&C Select with more than three estimates available are expected to grow earnings in Q1. On aggregate, the industry earnings are expected to increase by 20% year-over-year.

The biggest EPS growth is expected at the firms with substantial Covid losses incurred in Q1:20. Recall, in Q1 last year in the early days of the pandemic many P&C firms incurred losses associated with the pandemic (mostly IBNR). Recognition of the losses was (and remains) highly inconsistent across firms, as some carriers preferred to charge total expected losses up front, while others chose to wait for more data to come.

Below are the reported Covid loss points for all companies that incurred pandemic losses in Q1:20. The firms should see corresponding margin benefits from the YoY comparison absent additional Covid losses.

Q1:20 Covid loss points on the combined ratio

Source: Company reports, SNL

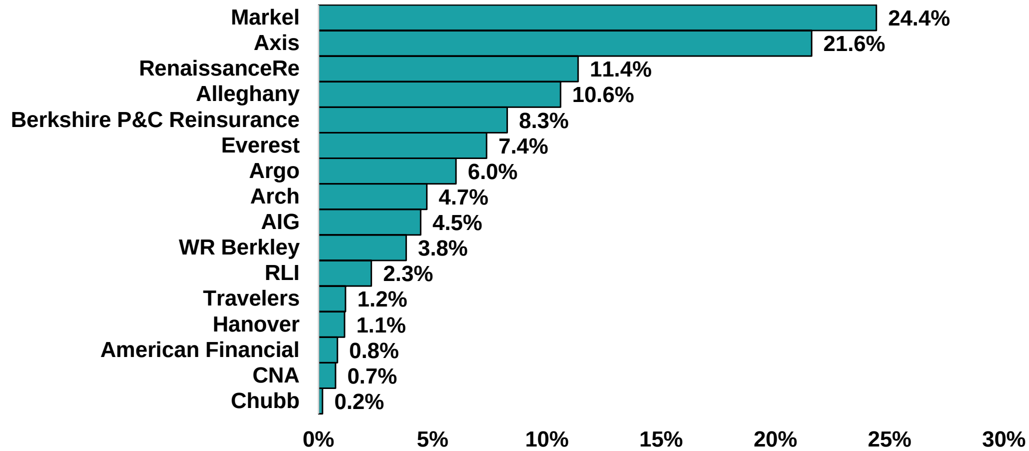


Exhibit: Q1 consensus EPS change (YoY)

Source: FactSet

Company	Peer group	Q1-20 EPS	Q1-21E consensus	% chg	Est. #
State Auto	Regionals	-$0.18	$0.00	NM	3
Markel	Specialty	-$9.38	$11.72	NM	5
Axis	Bermuda	-$1.94	$1.00	NM	10
AIG	Large Comm.	$0.11	$1.00	811%	17
RenRe	Bermuda	$0.76	$3.67	383%	11
CNA	Large Comm.	$0.40	$0.94	136%	4
Argo	Bermuda	$0.36	$0.76	111%	5
Alleghany	Other	$4.99	$7.90	58%	3
Arch	Bermuda	$0.46	$0.70	52%	12
Everest Re	Bermuda	$4.03	$5.84	45%	10
Cincinnati	Regionals	$0.84	$1.11	32%	7
Selective	Regionals	$0.84	$1.06	26%	7
WR Berkley	Specialty	$0.69	$0.84	21%	10
Travelers	Large Comm.	$2.62	$2.94	12%	20
Hanover	Regionals	$2.23	$2.47	11%	6
Chubb	Large Comm.	$2.68	$2.91	9%	16
Allstate	Personal	$3.54	$3.79	7%	18
Horace Mann	Personal	$0.78	$0.83	6%	5
Berkshire	Other	$3608.56	$3801.96	5%	4
RLI	Specialty	$0.66	$0.67	1%	7
AFG	Specialty	$1.88	$1.74	-7%	5
United Ins	Florida	$0.21	$0.19	-8%	4
Hartford	Large Comm.	$1.34	$1.22	-9%	16
Progressive	Personal	$1.92	$1.72	-10%	18
Heritage	Florida	$0.27	$0.23	-14%	5
Donegal	Regionals	$0.43	$0.30	-30%	3
United Fire	Regionals	$0.05	$0.03	-36%	3
Kemper	Personal	$2.43	$1.38	-43%	6
FedNat	Florida	$0.30	-$1.65	-NM	4

A few weeks ago, analysts expected an even more positive quarter. By the end of last year, commercial carriers began more broadly reporting margin expansion potential as rate appeared to outrun loss trends on both an earned and written basis. This resulted in two waves of positive post-earnings revisions in Q3 and Q4.

However, the benefit from the rate in excess of trend was partially offset by the expectation of elevated cat losses, primarily from Winter Storm Uri that is estimated to trigger claims that could ultimately be as high as $20bn. As we discuss later, February cat loss disclosures from Allstate and Progressive point to an above average cat quarter.

In mid-February, the Q1:21 consensus estimates fully recovered the negative revisions associated with the pandemic, largely on the back of the positive rhetoric around the commercial underwriting margins. However, the flurry of negative revisions in late February and early March associated with Winter Storm Uri offset the favorable margin impact on Q1, where consensus earnings are now back to October 2020 levels. That said, on the scale of the full year 2021 the impact of the Q1 revisions is substantially less meaningful. Similarly, the full year 2022 estimates remained largely stable over the recent weeks.

For perspective, S&P 500 Q1 earnings estimates have been in a steady uptrend ever since they bottomed in the middle of last year.

Exhibit: Inside P&C Select earnings revisions (aggregate earnings)

Source: FactSet

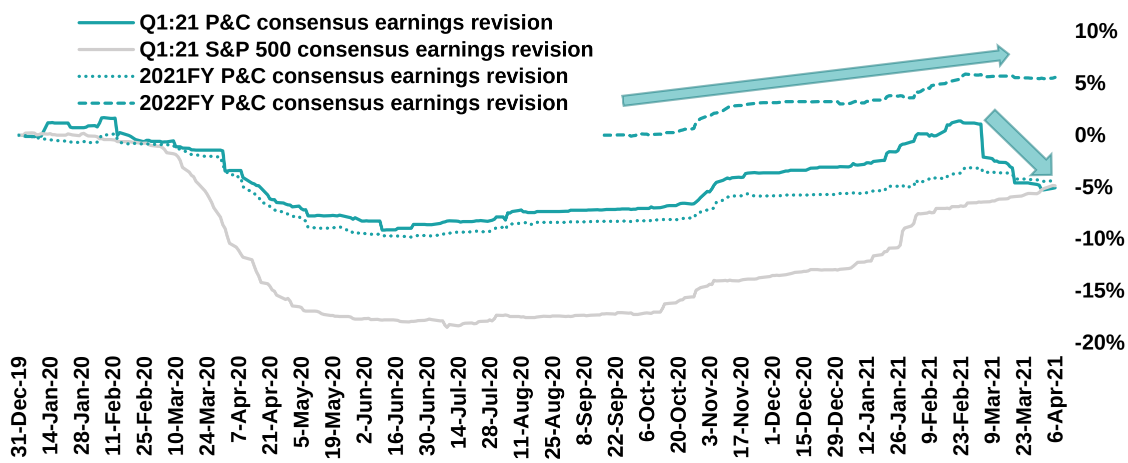
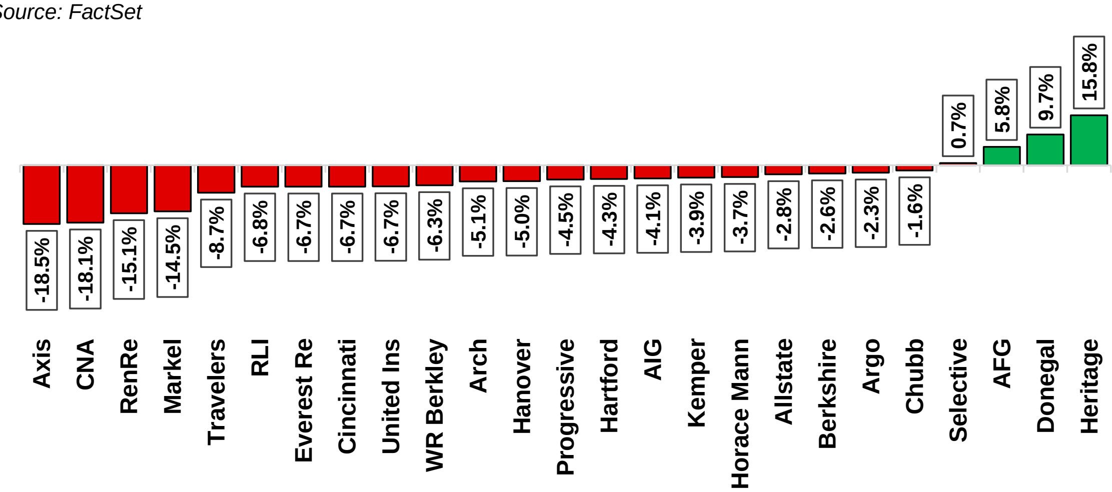


Exhibit: EPS consensus change on Q1:21 earnings since March 1, 2021 by company

Source: FactSet



Cat losses in focus

The first quarter is expected to be an incredibly heavy cat loss quarter for what is normally a light cat period. Most losses will be driven by Winter Storm Uri – a single double-digit billion loss event.

The Texas winter storm is a highly unfamiliar event with an enormous breadth of its impact, which led to an extremely wide estimated loss tally. There is still no agreement on where approximately within the widely cited range of $10bn to $20bn the losses will land, although as reported by Inside P&C's news team the current information insurers have provided to reinsurers skews to a sub-$15bn loss.

A case remains though for the loss to move higher owing to elevated uncertainty around the "unmodeled risk", including the potential for mold damage and complications/loss amplification arising from the pandemic.

Allstate's February weather losses amounted to $577mn pre-tax, substantially higher than in the same month in prior years (expectedly). This included $566mn net losses from the winter storm in Texas and $1.3bn gross losses. As a back of the envelope exercise, the number implies around a $14bn loss tally for the industry using Allstate's 9.6% market share in Texas across cat-exposed lines. However, note that the storm will have caused losses outside of the Lone Star State as it impacted most US states from Northwest to South and Northeast – albeit early modelling estimates are believed to have over-stated the non-Texas portion of the loss.

Similarly, Progressive reported $86mn in cat losses across all products, net of $40mn recovered under its $80mn XoL treaty.

Exhibit: February cat disclosures

Source: Company reports

Company	February 2021 cat losses	vs Feb 2020	vs Feb 2019	Notes
Allstate	$577mn	NA	282%	$1.3bn gross, $566mn net losses from Uri
Progressive	$86mn	642%	966%	$40mn recovered under $80mn XoL treaty

To date, no reinsurer has pre-announced its cat loss estimates, but we expect announcements to arrive in the coming weeks.

Australia's March floods and Suez Canal blockage will likely add more noise reinsurance losses. The March floods in Australia were reportedly the most destructive in many decades. Aon estimated the total losses from the flood at $1.2bn.

Similarly, Suez Canal blockage can cause material losses. Although hull damage will likely be limited, there are potential losses related to perishable goods and supply chain disruption from the Ever Green and other ships blocked in the canal for at least six days in late March. There is no clarity on how much the Suez Canal crisis would end up costing the industry, but at the least, it adds additional volatility to loss expectations.

Lastly, Covid losses remain a lingering issue. After massive Covid-related charges in Q1 and Q2, pandemic-related incurred losses moderated in Q3 and Q4. Most of the current ~$40bn total incurred pandemic losses are BI-related that still have more room to play out, with substantial losses also driven by event cancellation. Furthermore, there remains a potential for more long-tail losses to crop up from the casualty and credit side.

Exhibit: 2020 Covid incurred losses

Source: Company reports

Company	Q1 Covid losses	Q2 Covid losses	Q3 Covid losses	Q4 Covid losses	2020 Covid losses as % of NEP	2020 combined ratio
Chubb	$13mn	$1,365mn	$0mn	$0mn	4.5%	96.1%
AIG GI	$272mn	$458mn	$185mn	$178mn	4.6%	104.3%
Berkshire P&C Re	$225mn	$350mn	$113mn	$276mn	7.9%	106.5%
Markel	$325mn	$0mn	$47mn	-$11mn	6.4%	98.0%
Everest	$150mn	$160mn	$125mn	$76mn	5.9%	102.9%
Arch	$87mn	$173mn	$12mn	$0mn	4.2%	92.9%
Axis	$235mn	$0mn	$0mn	$125mn	8.2%	109.6%
Hartford (P&C)	$0mn	$213mn	$37mn	$28mn	2.3%	96.4%
Alleghany	$153mn	$135mn	$51mn	$76mn	6.9%	102.1%
Travelers	$86mn	$114mn	$133mn	$31mn	1.3%	95.0%
CNA	$13mn	$182mn	$0mn	$0mn	2.5%	100.9%
WR Berkley	$65mn	$85mn	$0mn	$21mn	2.5%	94.9%
American Financial	$10mn	$105mn	$0mn	$0mn	2.3%	95.5%
RenaissanceRe	$104mn	$0mn	$19mn	$173mn	7.5%	101.9%
Cincinnati	$0mn	$65mn	$7mn	$13mn	1.4%	98.1%
Argo	$26mn	$17mn	$17mn	$13mn	4.1%	106.2%
Hanover	$13mn	$6mn	$0mn	$0mn	0.4%	94.4%
RLI	$5mn	$6mn	$4mn	$3mn	2.1%	92.0%

Commercial rates and margins in focus

Pricing discussions during the third quarter and in-between earnings suggest that the sustained market hardening remains a consensus view. However, in an environment where earned rate in excess of trend is more broadly manifesting in commercials' reported margins rising - and with interest rates trending up - how much further carriers can push the current firming cycle is the key question for the commercial carriers' bull case.

According to the outlook voiced on the fourth-quarter earnings calls by the leading industry executives, carriers remain universally bullish on rates.

CB	*"The level of rate and rate of increase was the strongest since this part of the underwriting cycle began approximately 3 years ago. I expect the favorable underwriting conditions to continue."* ***- Evan Greenberg, CEO of Chubb***

TRV	*"Given the headwinds facing the industry, we expect the favorable pricing environment to continue for some time."* ***- Alan Schnitzer, CEO of Travelers***

More recently, a number of leading industry executives doubled down on this forecast at Inside P&C live conference in late March.

MKL	*" I'm not sure you can continue to compound 10 and 15% forever, but I think the market still needs to continue to pursue rate increases because 24 to 36 months of increases after close to 15 years of mostly declines, is not going to get us where we need to be."* ***- Richie Witt, Co-CEO of Markel***

Ascot	*"I think we'll continue in 2021 and 2022 ... I think we'll still see increases but I think it will start to be a little bit more stable. And then other lines that had been more recent to get started on those changes like cyber, I think goes we'll see go on for a little bit longer."* ***- Elizabeth Johnson, CUO, North America at Ascot***
AXS	*"I think there's enough uncertainty still in the channel, and the fact that on certain lies we are not yet at adequacy, there's a very good likelihood this continues on through 21 and into 22. We will all live to figure that out as we go forward, but the underlying fundamentals would suggest that's exactly where we are headed."* ***- Peter Wilson, CEO of Insurance at Axis***

While margin prospects for commercial carriers seem promising with written rate in excess of trend providing some tailwind for margins on the go-forward basis, we would point out several possible hurdles for the bull case.

First, rate increases will not last long. In fact, some pricing surveys (e.g. CIAB) and company rate disclosures (e.g. Travelers) suggest that the rate moderation is already in play.

Second, there is significant uncertainty around the economic reopening implications on frequency and severity trends, including reopening of courts with a backlog of pending cases.

Third, written rate in excess of trend does not necessarily translate to a corresponding margin expansion if assumptions on trend prove incorrect. And this could happen as we enter a new normal, with the economy emerging from a pandemic.

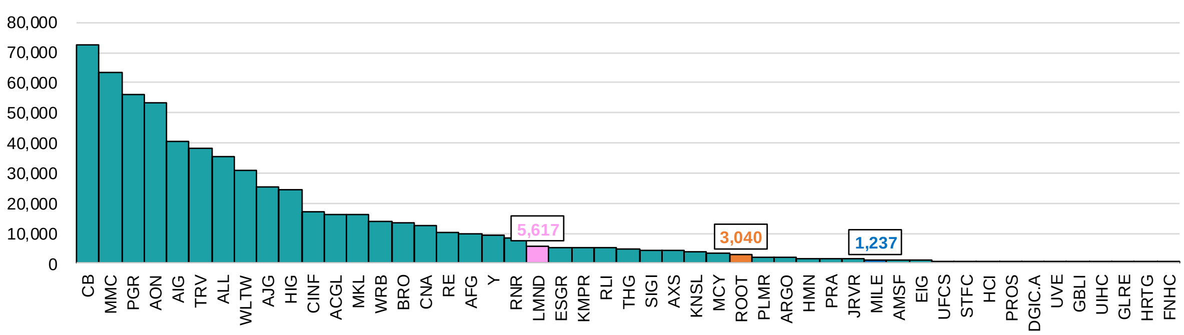
We expect rates and margins to become one of the most hotly discussed topics on Travelers' and Chubb's earnings calls early in the reporting season. Recall, during Q4 calls, Chubb and Travelers management suggested accelerating rate in excess of trend, pointing to a larger underlying margin tailwind going forward. Whether this will translate into a real ROE expansion remains to be seen.

InsurTech growth and margins to come under scrutiny

InsurTech valuations continue to reflect favorable sentiment, even following recent selloffs and growing short interest. More specifically, growth prospects are keeping valuation multiples high. We continue to expect leadership teams to highlight everything being done to advance their mousetraps and create "delightful experiences". Additionally, we are paying close attention to Root's loss ratios. Margins have shown improvement in recent quarters, however, it is unclear how much of this stems from recent frequency benefits that have benefited the peer group as a whole.

Exhibit: IPC Select market capitalization ranked ($mn)

Source: SNL, Inside P&C



Growth figures will need a "pick-me-up" to push stocks higher

Importantly, PIF growth remains a key metric to follow given current valuation levels. Coming into the quarter, the field is showing mixed results. On the high end, Lemonade has been able to maintain high sequential growth, while Root, on the other hand, has seen PIF growth stall in recent quarters.

As discussed in previous quarters, it's important to distinguish that Lemonade focuses on renters and has been both taking share and attracting new customers into its market. In contrast Root has been focused on competing in auto against major direct-to-consumer (DTC) carriers, including Geico and Progressive. The competitive dynamic has led to growth reversals in states where Root has taken strong rate action as loss ratios remain unsustainable.

Exhibit: PIF - Nominal & percent growth

Source: Company reports, Inside P&C

Firm, PIF growth	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	Q4:20
PIF nom growth (QoQ)								
Lemonade	62,736	71,181	119,499	80,867	86,207	84,835	127,153	59,489
Root (Auto)	64,443	44,357	22,095	38,679	52,899	118	(11,904)	336
Progressive (Direct)	316,800	193,100	187,600	150,500	259,800	381,300	266,700	107,100
Geico	342,000	228,000	276,000	222,000	380,000	550,000	40,664	(150,664)
PIF % growth (QoQ)								
Lemonade	20.3%	19.2%	27.0%	14.4%	13.4%	11.6%	15.6%	6.3%
Root (Auto)	57.7%	25.2%	10.0%	15.9%	18.8%	**0.0%**	**-3.6%**	**0.1%**
Progressive (Direct)	4.5%	2.6%	2.5%	2.0%	3.3%	4.7%	3.1%	1.2%
Geico	2.0%	1.3%	1.6%	1.3%	2.1%	3.0%	0.2%	**-0.8%**

Further highlighting the competitive dynamics in auto, Metromile (founded nearly a decade ago) has roughly 92k policies and saw ~4% and 8% annual PIF growth in 2020 and 2019.

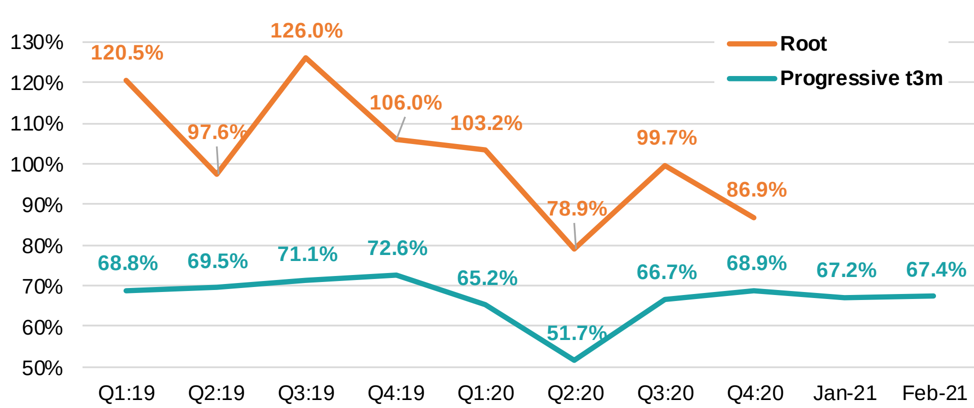
Root's margins could falter as the Covid frequency benefit fades

Recall, Covid's impact on auto accident frequency have had favorable and sizable impacts on auto loss ratios. Last year, Progressive even saw a 42.3% loss ratio during the month of April. The figure is now back up to 69.1% as of February.

In recent quarters Root has been vocal about its improved loss ratios and that it should be seen as a sign of their UBI program beginning to work. That said, it is still not entirely clear how much of the improvement stems from favorable market conditions that have benefitted other carriers as well.

Root direct loss & LAE ratio against Progressive auto loss ratios

Source: Company reports, Inside P&C



If margins falter this quarter as significant reopening progress has been made around the country, it could further hurt Root's stock and long-term prospects in the eyes of investors.

Auto: Frequency benefits could be coming to an end

Covid's impact on mobility heavily affected the insurance business in 2020. While some insurers were adversely affected, such as writers with contingency/events cancellation exposure, auto-exposed names such as Progressive, Allstate, and Geico benefitted from favorable frequency trends. The favorable frequency ultimately led to wider underwriting margins that offset lower investment yields.

That said, as states are now mostly open for business, frequency benefits are moderating. This is evident in our state DOT accident analysis, and Progressive's monthly disclosures which are considered highly accurate and reflective of current market dynamics. We would highlight that this seems to be the consensus view on the Street and any deviation could renew investor interest in the personal auto space. Our view remains that carriers will compete away any lasting excess margins. The secular winners will be those with exposure to competitive direct-to-consumer (DTC) policy distribution channels like Progressive and Geico.

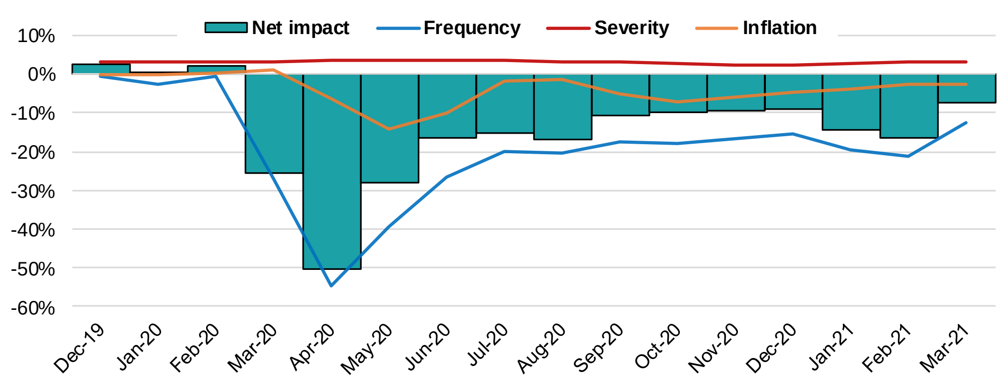
Frequency benefits … cloudy outlook with some sunshine

As discussed in our recent auto frequency note, auto accident frequency appears to be trending back to pre-Covid levels as restrictions ease and businesses re-open. Combined with a historically low rate/inflation environment, carrier margins have also been trending back to pre-Covid levels. Comparable to previous quarters, we expect loss ratios to rise on a sequential basis but remain subdued on a YoY basis as either (1) a completed vaccine rollout, and/or (2) further premium deflation is needed for benefits to be fully depleted.

In March, our estimated frequency figure came in at -12.4% (when using 2019 as a base). This was up from -21% in February and -19.4% in January. Compounded with factors such as pricing and severity from the BLS, we estimated March's net benefit to losses to be -7.3%. This is up from -16.4% last month.

Auto accident frequency net benefits

Source: State level DOT, Inside P&C



It is all about growth again for brokers

For brokers, the focus is transitioning from expense management back to growth. Economy-sensitive brokers are set to benefit from the improving macro environment, with this particularly true for the Big 3 with their heavy exposure to consulting and benefits.

The pricing environment will also remain a strong organic growth tailwind, which – combined with a rebound in exposure units – may warrant organic expansion in high mid-single-digits towards the end of the year.

Pricing environment that is expected to stay at least stable will remain a strong organic growth tailwind, which combined with a rebound in exposure units may warrant organic expansion in high mid-single-digits towards the end of the year.

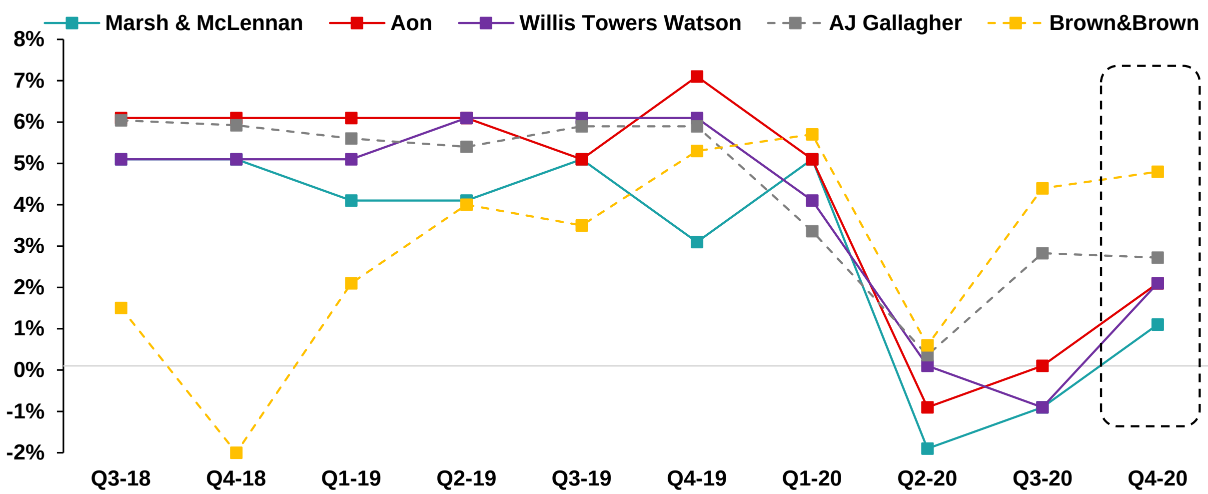
With broker organic growth expectations across 2021 quarters scattered between 3% and 5%, we see a strong upside surprise potential on growth for brokers later in the year.

The earnings in the peer group will be watched for updates on the macro environment and upgrades on growth guidance.

Note, on its investor day over two weeks ago AJ Gallagher already moderately upgraded its growth outlook for Q1 from “3%-4%” to “4% or higher”.

Broker organic growth (quarterly data)

Source: State level DOT, Inside P&C



Elsewhere, the language from Aon’s management on the Willis merger remedies will be highly watched. Like Inside P&C’s news arm recently revealed, Aon is looking to separately divest a block of Willis' European businesses and Willis Re. This is a significant update from Q4 when Aon management shared the expectation for no significant falloffs from the transaction.

This is in line with our base case scenario for the deal we shared earlier that Aon and Willis are likely to divest certain assets but are unlikely to surrender the deal given its strategic appeal and the degree of predisposition both company managements displayed.

Investors and analysts will also be examining Aon and Willis executives on any updates around the timing of the deal in light of the recent developments.

AJ Gallagher's perspective on M&A opportunities in reinsurance space will also be scrutinized, given that the broker is widely being cited as the most likely acquirer of Willis Re.

Truist's report next Thursday will – as is traditional - be the first broker data point in the earnings season.

In summary, we expect this quarter to be a mixed bag of pricing commentary (positive on commercial and pressured on reinsurance and personal); reserve releases partially offset by discussion surrounding catastrophe losses; and the industry's ability to hold the line on underlying loss cost trends.

This research report was written by Insider Publishing's Research team which includes Amit Kumar, Gianluca Casapietra, and Dan Lukpanov.