Auto Q4 wrap: On the road again

Auto exposed names saw strong fourth quarter results with earnings continuing a streak of beats against Street estimates. The average beat of 38% (excluding Root) was led by Mercury General and Allstate at 100% and 54%, respectively. Key themes for the quarter were comparable to both Q3 and Q2, including favorable frequency which benefitted margins, and continued growth outperformance for carriers with strong direct distribution channels.

With InsurTechs in focus, a notable takeaway from the quarter was Root's PIF growth. While on an annual basis the percentage growth was impressive, the carrier has not actually grown PIF since Q1:20, likely due to strong pricing action the firm has taken to reduce its loss ratio. Our most recent work on Root can be found here.

Q4:20 earnings table

Source: company reports, Inside P&C

Firm:	Operating EPS by firm						
Period:	**Q4:19**	**Q1:20**	**Q2:20**	**Q3:20**	**Q4:20**	**VAR**	**Beat/Miss**
Progressive	$ 1.31	$ 1.92	$ 1.84	$ 1.88	$ 1.83	39.7%	8.9%
Allstate	3.13	3.54	2.45	2.94	5.87	87.5%	54.1%
Kemper	1.45	2.43	1.20	1.36	1.59	9.7%	2.6%
Mercury General	0.21	1.07	1.86	1.23	1.38	542.9%	100.0%
Horace Mann	0.75	0.78	0.67	0.82	1.13	50.7%	24.2%
Average	-	-	-	-	-	**146.1%**	**38.0%**
Root	(2.30)	NA	(0.19)	(2.20)	(0.72)	**NM**	**0.02 Miss**

More generally, the quarter has not changed our view on the sub line of business. We expect any long-lasting frequency benefits to be likely priced away as carriers compete for share. Additionally, carriers that object to offering price competitive direct products to please their agents will likely see a continued loss in market share to names like Progressive and Geico.

In short, our views reflect an acceleration and an increased urgency to the "omniwars" thesis we outlined last year. Similarly, we could see an acceleration of technology adoption by consumers like telematics (to capture lower miles driven benefit) and self-service claims through mobile apps (offering a potential long term LAE benefit).

Given the dynamic, all eyes are likely on Allstate as it revamps its offerings to be price competitive and accommodative of varying customer channel preferences. Success for Allstate would likely prompt other large carriers to follow suit.

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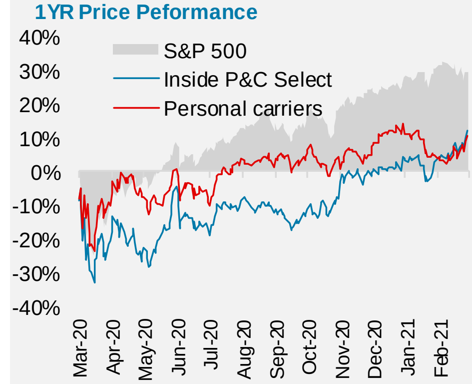
Composite	YTD px chg.	P/B
Large comm.	14.8%	1.0x
Regional	17.9%	1.5x
Specialty	14.5%	1.6x
Personal	(2.6)%	1.8x
Bermuda	3.5%	1.1x
Florida	22.0%	1.0x
Brokers	3.7%	-
IPC Select	9.0%	1.2x
S&P 500 Fin.	13.9%	-
S&P 500	2.3%	-

1YR Price Peformance



Source: SNL, Inside P&C

Low accident frequency remains in play and margins see the benefit

Like the past two quarters, lower auto accident frequency resulted in improved underwriting results. It is important to recognize that even if accident figures ultimately rebase at lower levels that margin benefits will likely be priced away as carriers compete for share. Other offsets to margins would include any long-lasting increases to carrier severity figures (more below).

On average excluding Root, the headline combined ratios for auto-exposed names improved 4.1pts to 89.7%. Firms that saw the largest drops included Mercury General with a 9.9pt reduction to 93.3%, followed by Allstate and Progressive at 4.7pts and 3.9pts to 84% and 88.5% respectively. On the other hand, Root saw a net combined ratio of 316.1%, up 132.5pts YoY. There are many factors influencing Root's net figures including high R&D and S&M spend. We have written on Root in detail, and believe the carrier has many challenges ahead.

Headline underwriting results

Source: company reports, Inside P&C

Firm:	Headlne combined by firm					
Period:	**Q4:19**	**Q1:20**	**Q2:20**	**Q3:20**	**Q4:20**	**VAR**
Progressive	92.4%	86.9%	87.7%	87.8%	88.5%	(3.9)pts
Allstate	88.7%	84.9%	89.8%	91.6%	84.0%	(4.7)pts
Kemper	94.5%	94.2%	93.0%	93.6%	92.4%	(2.1)pts
Mercury General	103.2%	95.9%	88.2%	94.3%	93.3%	(9.9)pts
Horace Mann	90.3%	88.6%	95.4%	96.5%	90.2%	(0.1)pts
Average	**93.8%**	**90.1%**	**90.8%**	**92.8%**	**89.7%**	(4.1)pts
Root	183.6%	NA	NA	258.8%	316.1%	132.5pts

Headline margins have largely benefitted from declines in auto loss ratios. On average, fourth quarter auto loss ratios declined by 6.5pts to 68.6%. Not all loss ratios are created equal given different expense loads (lower expenses -> lower premiums -> higher loss ratios), but the directional improvements remain clear. Leading the pack was Travelers with a 13.5pt improvement to 62.6%, however it's worth noting that the figure included 4pts of calendar year adjustments relating to favorable frequency in prior quarters. Notably, this followed a comparable adjustment in Q3 for the first half of 2020. Progressive, which is known to be a quick adjuster to market trends, saw a 5pt and 2.3pt improvement in its direct and agency businesses respectively.

Auto segment loss ratios

Source: company reports, Inside P&C

Firm:	Auto loss ratios by firm					
Period:	**Q4:19**	**Q1:20**	**Q2:20**	**Q3:20**	**Q4:20**	**VAR**
Progressive direct*	73.8%	65.7%	50.3%	66.4%	68.8%	(5.0)pts
Progressive agency*	71.4%	64.6%	53.2%	67.0%	69.1%	(2.3)pts
Geico	85.4%	74.3%	62.1%	80.3%	80.7%	(4.8)pts
Allstate brand auto	67.4%	61.1%	48.3%	59.7%	60.1%	(7.3)pts
Travelers auto	76.1%	65.9%	57.5%	56.4%	62.6%	(13.5)pts
Kemper specialty	75.0%	76.0%	69.8%	68.0%	71.4%	(3.6)pts
Mercury General*	79.8%	70.6%	61.0%	68.8%	68.3%	(11.5)pts
Horace Mann auto	72.0%	65.8%	53.2%	57.6%	67.7%	(4.3)pts
Average	**75.1%**	**68.0%**	**56.9%**	**65.5%**	**68.6%**	(6.5)pts
Root direct loss & LAE	106.0%	103.2%	78.9%	99.7%	86.9%	(19.1)pts

** Headline loss ratios, auto loss ratios not available*

Note: Hartford auto combined declined 12pts YoY to 88.3%

From firms that disclose the figure, it's evident that reductions in underlying picks are driving loss ratio improvement, and that the peak benefits were seen during Q2:20. Since then, loss ratios have been on the rise due to premium rebates, rate action, and a rise in accident frequency.

Auto segment underlying loss ratios

Source: company reports, Inside P&C

Firm:	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	Q4:20	YoY
Allstate brand auto	65.3%	66.7%	68.1%	**67.4%**	60.6%	46.9%	58.7%	59.6%	**(7.8)pts**
Travelers auto	68.7%	69.9%	69.8%	**76.5%**	65.7%	56.0%	57.6%	63.8%	**(12.7)pts**
Kemper preferred auto	69.4%	70.3%	69.5%	**73.5%**	66.1%	54.3%	65.4%	72.9%	**(0.6)pts**
Kemper specialty auto	74.5%	76.3%	74.9%	**76.0%**	76.5%	68.5%	68.5%	71.4%	**(4.6)pts**
Horace Mann	70.9%	72.8%	66.7%	**71.9%**	66.5%	50.1%	56.8%	67.4%	**(4.5)pts**
Average	**69.8%**	**71.2%**	**69.8%**	**73.1%**	**67.1%**	**55.2%**	**61.4%**	**67.0%**	**(6.0)pts**

Turning to Q4 frequency statistics, carriers including Allstate, Progressive, and Geico disclosed sizeable reductions in frequency. Allstate provides quarterly statistics which show that gross claims (PD) were down 28.7% YoY for Q4. The figure is flat in comparison to Q3 which saw a 28.6% decline in gross claims (PD). The full-year average sits at a decline of 28.9% - in line with full-year figures provided by Progressive and Geico.

Auto frequency statistics

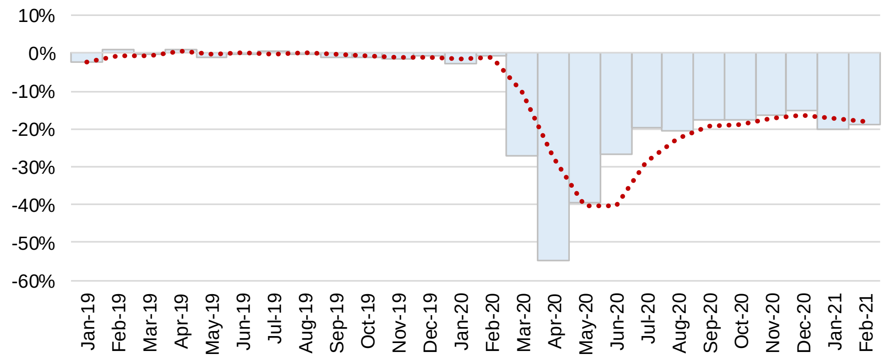
Source: company reports, Inside P&C

Frequency:	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	Q4:20
Geico (YTD)									
Property	**(3.0)%**	(3.0)%	(3.0)%	(2.5)%	**(3.0)%**	(13.0)%	(38.5)%	(30.0)%	**(29.0)%**
Collision	**(3.0)%**	(3.0)%	(3.0)%	(2.5)%	**(3.0)%**	(13.0)%	(25.0)%	(25.0)%	**(23.5)%**
Personal	**(3.0)%**	(3.0)%	(3.0)%	(3.0)%	**(1.5)%**	(10.0)%	(38.5)%	(30.0)%	**(29.0)%**
Bodily	**(3.0)%**	0.0%	0.0%	0.0%	**0.0%**	(7.0)%	(38.5)%	(30.0)%	**(29.0)%**
Progressive (YTD)									
Personal auto	**(3.0)%**	(3.0)%	(3.0)%	(3.0)%	**(3.0)%**	(18.0)%	(29.0)%	(25.0)%	**(24.0)%**
Bodily injury	**(3.0)%**	(3.0)%	(3.0)%	(2.0)%	**(3.0)%**	(12.0)%	(28.0)%	(26.0)%	**(25.0)%**
Auto property	**(3.0)%**	(3.0)%	(4.0)%	(4.0)%	**(4.0)%**	(18.0)%	(30.0)%	(28.0)%	**(27.0)%**
Collision	**(3.0)%**	(4.0)%	(5.0)%	(4.0)%	**(4.0)%**	(23.0)%	(30.0)%	(25.0)%	**(23.0)%**
PIP	**(3.0)%**	(4.0)%	(5.0)%	(6.0)%	**(5.0)%**	(20.0)%	(33.0)%	(28.0)%	**(28.0)%**
Allstate (YoY)									
Gross claims PD	**(2.5)%**	(1.6)%	(0.8)%	2.0%	**(2.2)%**	(12.0)%	(46.4)%	(28.6)%	**(28.7)%**
Gross claims (BI)	**(2.5)%**	(1.2)%	(2.1)%	(0.5)%	**(3.2)%**	(11.2)%	(49.2)%	NA	**NA**

The numbers are also in line with, albeit lower than, figures seen from our state DOT analysis. The largest reductions were seen during Q2, sequentially rose for Q3, and then stayed roughly flat for Q4. Regarding the higher magnitude, the analysis only considers 8 regions that amount to ~30% of industry auto DWP. In previous reports we reference a simple average for the states which include Texas and Florida, but we have recently adjusted the figure to a premium weighted average as we expect it to be more aligned with ex post loss trends reported by carriers.

State DOT average estimated auto accident frequency (premium weighted)

Source: State DOTs, Inside P&C



Serving as a partial offset, severity figures have remained elevated, particularly in bodily injury (BI) and personal injury protection (PIP). As we have outlined in previous quarters, heightened severity figures are grounded in increased driving speeds, bad debt from customers who have elected for extended payment terms, supply chain disruption, and increased pricing for auto parts.

Disclosed Q4 severity figures from Geico and Progressive are clearly elevated on an annual basis, however Allstate's paid claims severity figures show a clear downtrend back to more "normal" levels, with Q2:20 having been primarily impacted quarter (comparable to frequency).

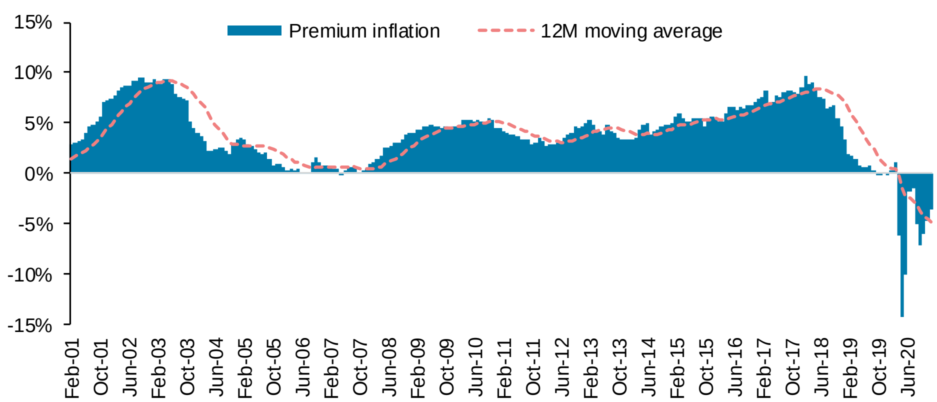
Auto severity statistics

Source: company reports, Inside P&C

Severity:	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	Q4:20
Geico (YTD)									
Property	**5.0%**	5.0%	5.0%	5.0%	**5.0%**	8.0%	10.0%	11.0%	**9.0%**
Collision	**5.0%**	5.0%	5.0%	5.0%	**5.0%**	8.0%	8.0%	8.0%	**9.0%**
Bodily	**6.0%**	7.0%	7.0%	7.0%	**8.0%**	5.0%	11.0%	11.0%	**12.5%**
Progressive (YTD)									
Total auto	**5.0%**	8.0%	8.0%	7.0%	**7.0%**	11.0%	10.0%	9.0%	**10.0%**
Bodily injury	**4.0%**	8.0%	9.0%	8.0%	**8.0%**	9.0%	10.0%	11.0%	**12.0%**
Auto property	**4.0%**	7.0%	6.0%	6.0%	**6.0%**	14.0%	14.0%	10.0%	**9.0%**
Collision	**8.0%**	7.0%	7.0%	6.0%	**6.0%**	5.0%	0.0%	2.0%	**5.0%**
PIP	**2.0%**	8.0%	6.0%	7.0%	**7.0%**	12.0%	20.0%	17.0%	**14.0%**
Allstate claims (YoY)									
Paid claims (PD)	**7.4%**	6.1%	8.8%	5.1%	**6.0%**	7.7%	20.4%	7.9%	**5.1%**

Auto CPI YoY percent change

Source: BLS, Inside P&C



On growth, brands with strong direct channels continue to outperform

As discussed heavily, direct channels at large brands (Progressive, Geico) continue to benefit from both secular trends and Covid-related incentives to shop online. While marginal, Progressive even highlighted small increases in direct distribution seen in its commercial lines business, albeit remaining in large an agency driven distribution model.

Progressive	*"We did see a shift in 2020 based on the fact that a lot of agencies were closed. … So we have seen a little bit of a shift. The majority of it is still through agents. Some of the products can be complex and people want to be able to have that guidance and that counseling."* **CEO Tricia Griffith**

Auto carriers are not immune to the global acceleration in direct-to-consumer (DTC) methods of shopping, especially for simple needs customers. These secular trends will continue to pressure large carriers to adopt the channel in a cost-efficient way that prices policies based on how customers shop.

Looking at Q4 auto PIF growth, Progressive and Geico continue to lead the pack with 11% (personal auto) and 4.6% PIF growth respectively. Progressive's growth was led by its direct channel which saw 12.9% YoY PIF growth. It's worth recognizing Geico's high growth on a percentage basis given its already massive market share in the direct channel. While Root saw the highest YoY figure at 14.7%, it has actually seen a reduction in auto PIF since Q1:20 which is highly worrisome.

Auto YoY PIF growth

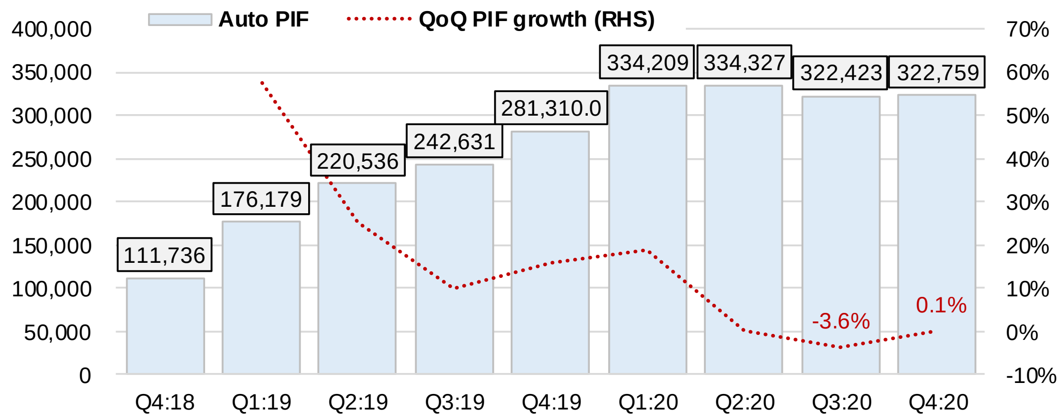
Source: company reports, Inside P&C

Firm:	Auto PIF growth					
Period:	**Q4:19**	**Q1:20**	**Q2:20**	**Q3:20**	**Q4:20**	**VAR**
Progressive direct	12.1%	10.8%	13.0%	13.7%	12.9%	0.8pts
Progressive agency	10.0%	8.4%	8.5%	9.0%	8.9%	(1.1)pts
Geico	6.4%	6.5%	8.3%	6.7%	4.6%	(1.8)pts
Travelers auto	0.6%	1.0%	2.1%	2.9%	3.2%	2.7pts
Allstate brand auto	1.5%	0.6%	0.6%	0.1%	-0.4%	(1.9)pts
Hartford auto	-5.8%	-5.1%	-3.3%	-3.7%	-3.7%	2.1pts
Mercury General auto	-1.6%	-3.6%	-4.2%	-3.9%	-4.0%	(2.4)pts
Horace Mann auto	-6.5%	-6.6%	-6.7%	-7.9%	-7.9%	(1.4)pts
Average	**2.1%**	**1.5%**	**2.3%**	**2.1%**	**1.7%**	(0.4)pts
Root	151.8%	89.7%	51.6%	32.9%	14.7%	(137.0)pts

Root's recent results show a significant deceleration in its YoY growth from 151.8% in Q4:19 to 14.7% in Q4:20. More recently, the firm has not grown policies since Q1:20. This is particularly troubling given that its entire business model is predicated on (1) perfecting direct distribution and (2) lowering prices for its supposedly better customers – two things that should be fueling its growth relative to incumbents. Root attributed this to the pandemic and a pullback in its marketing spend, although we believe this to be related to its profitability profile. Root has set ambitious targets for 2021 with a target DWP ranging $805mn-$855mn. This represents a growth rate ranging from 31%-39% when compared to 2020's $617mn in DWP.

Root auto PIF and sequential growth (%, RHS)

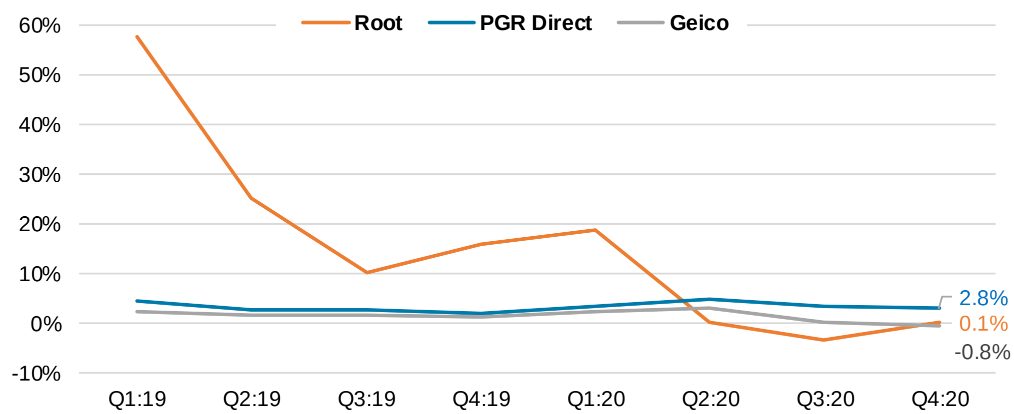
Source: company reports, Inside P&C



While previously the fastest growing name in the business in Q2/Q3 of 2020, Root's sequential PIF growth fell below both Progressive and Geico. And for context, Geico and Progressive direct have substantially larger PIF bases at ~19mn and 9mn respectively. Root currently sits at 323k.

Root sequential auto PIF growth against main competitors

Source: company reports, Inside P&C



In summary, auto continues to be a rapidly shifting business segment that is worth monitoring - especially given that it represents roughly 70%/36% of industry personal/total lines DWP. In the short to medium term, the line will likely see margin fluctuations as the frequency environment normalizes, and longer term, carriers will be forced to adapt to changing consumer shopping patterns (= DTC/omnichannel). Additionally, InsurTech entrants such as Root and Metromile will remain in focus given their high valuations and unclear growth trajectories.

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

The content of this report includes opinions based on publicly disclosed financials and management commentary.