

Auto Q3 wrap: Strong margins and a focus on direct

Q3 results were strong for auto-exposed names, with earnings largely exceeding street estimates across the universe. The average beat of 30.8% was led by Allstate at 70.9%. Key themes for the quarter included strong margins given continued low accident frequency, and a focus on direct distribution – especially as Allstate makes progress on its transformative growth plan.

Taking a step back, our view remains that any long-lasting frequency benefits (excess earnings) will be priced away as carriers compete for share. Additionally, if carriers object to offering price-competitive direct products and continue to stick to their existing channels to please their agents, we'd expect a continued shift in market share to the likes of Progressive and Geico, similar to that seen in the 2015-2018 hard market that drove PIF growth.

In short, we expect an acceleration and an increased urgency to the “[omniwars](#)” we outlined earlier this 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 (potential long-term LAE benefit).

Given the dynamic, we'd imagine that all eyes (State Farm, Farmers, AmFam, etc) are on Allstate as it revamps its offerings to be more price competitive and accommodative of varying customer channel preferences. Its success would prompt other carriers to follow suit.

Q3:20 earnings table

Source: Company reports, Inside P&C

Firm:	Operating EPS by firm						
Period:	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	VAR	Beat/Miss
Progressive	\$ 1.33	\$ 1.31	\$ 1.92	\$ 1.84	\$ 1.88	41.4%	9.3%
Allstate	2.84	3.13	3.54	2.45	2.94	3.5%	70.9%
Kemper	1.93	1.45	2.43	1.20	1.36	(29.5%)	37.4%
Mercury General	0.78	0.21	1.07	1.86	1.23	58.5%	16.0%
Horace Mann	0.64	0.75	0.78	0.67	0.82	28.1%	20.6%
Average	-	-	-	-	-	20.4%	30.8%

Complete earnings press releases for the quarter are linked below:

Firm	Progressive	Allstate	Kemper	Mercury General	Horace Mann
Press Release	PR	PR	PR	PR	PR

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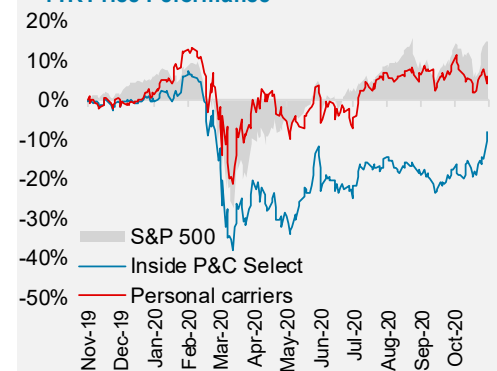
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Composite	YTD px chg.	P/B
Large comm.	(11.6)%	0.9x
Regional	(19.8)%	1.3x
Specialty	(6.2)%	1.6x
Personal	5.8%	1.8x
Bermuda	(14.4)%	1.1x
Florida	(39.5)%	0.8x
Brokers	2.7%	-
IPC Select	(8.2)%	1.2x
S&P 500 Fin.	(11.8)%	-
S&P 500	9.7%	-

1YR Price Performance



Margins benefit from lower accident frequency with Covid curbing general mobility

Similar to the second quarter, the effects of lower auto accident frequency resulted in improved underwriting results. It's important to recognize, as outlined in our [October frequency report](#), that these benefits are diminishing on a forward basis. This is due to a combination of shrinking frequency benefits (estimated -7% in October up from -15% in September), elevated severity and a continued low rate environment which should price away any long-term excess margin as carriers compete for share.

On average, the auto-exposed names had a 1.2pt improvement in their Q3 combined ratios to an average 92.8%. Larger names including Progressive and Allstate recorded 4.1pt and 0pt improvements respectively to 87.8% and 91.6%. Root, which recently IPO'd, registered a Q3 combined of 253.6%, up 33.9pts YoY. [We have outlined our thoughts on Root in detail in a recent report.](#)

Exhibit: Headline underwriting results

Source: Company reports, Inside P&C

Firm:	Headline combined by firm					
Period:	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	VAR
Progressive	91.9%	92.4%	86.9%	87.7%	87.8%	(4.1)pts
Allstate	91.6%	88.7%	84.9%	89.8%	91.6%	(0.0)pts
Kemper	91.7%	94.5%	94.2%	93.0%	93.6%	1.9pts
Mercury General	98.6%	103.2%	95.9%	88.2%	94.3%	(4.3)pts
Horace Mann	96.2%	90.3%	88.6%	95.4%	96.5%	0.3pts
Average	94.0%	93.8%	90.1%	90.8%	92.8%	(1.2)pts
Root	219.7%	NA	NA	NA	253.6%	33.9pts

More specifically, declines in auto loss ratios drove margin expansion for the quarter. On average, auto loss ratios declined 6.5pts to 65.5%. Large names like Progressive (both direct and agency), Geico and Allstate all recorded declines. Progressive's loss ratio in direct dropped 5pts to 66.4%, and in its agency channel by 4pts to 67%. Geico's loss ratio fell 1.3pts to 80.3% and Allstate brand auto registered an 8pt decline to 59.7%. Hartford does not provide an auto loss ratio, but its auto combined fell 14.4pts YoY to 81.3%.

Exhibit: Auto segment loss ratios

Source: Company reports, Inside P&C

Firm:	Auto loss ratios by firm					
Period:	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	VAR
Progressive direct	71.4%	73.8%	65.7%	50.3%	66.4%	(5.0)pts
Progressive agency	71.0%	71.4%	64.6%	53.2%	67.0%	(4.0)pts
Geico	81.6%	85.4%	74.3%	62.1%	80.3%	(1.3)pts
Allstate brand auto	67.7%	67.4%	61.1%	48.3%	59.7%	(8.0)pts
Travelers auto	70.1%	76.1%	65.9%	57.5%	56.4%	(13.7)pts
Kemper specialty	73.8%	75.0%	76.0%	69.8%	68.0%	(5.8)pts
Mercury General*	74.4%	79.8%	70.6%	61.0%	68.8%	(5.6)pts
Horace Mann auto	65.8%	72.0%	65.8%	53.2%	57.6%	(8.2)pts
Average	72.0%	75.1%	68.0%	56.9%	65.5%	(6.5)pts
Root direct loss & LAE	126.0%	106.0%	103.2%	78.9%	102.7%	(23.3)pts

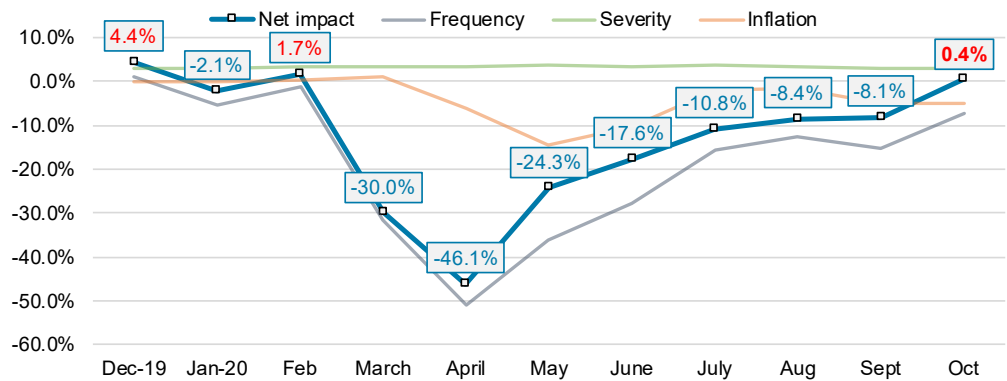
* Headline loss ratios, auto loss ratios not available

* Hartford auto combined declined 14.4pts YoY to 81.3%

While carriers continued to benefit from low frequency in Q3, it is important to recognize that loss ratios are on the rise from lows in Q2. From Q2 to Q3, loss ratios rose 8.6pts, and the rise is likely to continue, especially when considered alongside severity and low premium inflation. Our [previous analysis](#) shows that, when considered together, October's net impact to loss was 0.4% (a headwind). Carriers have largely had net benefits since February 2020 as Covid-19 led to substantial shutdowns earlier this year.

Auto factor net impacts

Source: State level DOT, BLS, Inside P&C



Turning to Q3 frequency statistics, September featured an estimated 15% decline in accidents, while July/August had -15% and -13% respectively. The average 14.5% was below Q2's average of -38.3%. Beyond the quarter, the directional trend of diminishing frequency benefits continued in October with a figure of -7%.

As seen below, frequency figures vary by state. This makes sense given different state cultures and responses to the pandemic. Iowa's figure is based on fatalities (as opposed to number of accidents), and the low base results in a higher (%) volatility.

Exhibit: Estimated monthly auto accident frequency (YoY % change by state)

Source: State DOTs, Inside P&C

Flag	State	%DWP	Jan	Feb	March	April	May	June	July	August	Sept	Oct
	Texas	9.2%	7%	7%	-21%	-49%	-33%	-18%	-15%	-17%	-14%	-4%
	Alabama	1.5%	-4%	1%	-22%	-52%	-28%	-12%	-8%	-17%	-10%	-13%
	Ohio	2.8%	-13%	7%	-30%	-50%	-33%	-20%	-15%	-22%	-17%	5%
	Florida	8.2%	-1%	-1%	-25%	-51%	-32%	-17%	-13%	-16%	-5%	11%
	Iowa	0.7%	14%	-15%	-41%	-23%	-30%	-37%	38%	68%	4%	14%
	NYC	N/A	-16%	-15%	-38%	-76%	-69%	-61%	-50%	-43%	-45%	-43%
	Vermont	0.2%	-21%	7%	-45%	-61%	-42%	-33%	-34%	-32%	-26%	-22%
	Maine	0.3%	-8%	1%	-30%	-46%	-24%	-23%	-26%	-20%	-8%	-6%
	Average	-	-5%	-1%	-32%	-51%	-36%	-28%	-15%	-13%	-15%	-7%

*Figures adjusted for lagged data (adjustment factor based on average monthly lag)

The table below quantifies the low frequency figures from major carriers including Geico, Progressive and Allstate for the quarter. Across the board, frequency figures remained low, but they have begun to reverse trend as seen above.

Progressive’s management also disclosed that its bundled customers were driving less during rush hour, as compared to its younger drivers who are more likely to be working in jobs that can’t be done from home.

Exhibit: Auto frequency statistics

Source: Company reports, Inside P&C

Frequency:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20
Geico (YTD)									
Property	(2.5)%	(3.0)%	(3.0)%	(3.0)%	(2.5)%	(3.0)%	(13.0)%	(38.5)%	(30.0)%
Collision	(2.5)%	(3.0)%	(3.0)%	(3.0)%	(2.5)%	(3.0)%	(13.0)%	(25.0)%	(25.0)%
Personal	(2.5)%	(3.0)%	(3.0)%	(3.0)%	(3.0)%	(1.5)%	(10.0)%	(38.5)%	(30.0)%
Bodily	(2.5)%	(3.0)%	0.0%	0.0%	0.0%	0.0%	(7.0)%	(38.5)%	(30.0)%
Progressive (YTD)									
Personal auto	(2.0)%	(3.0)%	(3.0)%	(3.0)%	(3.0)%	(3.0)%	(18.0)%	(29.0)%	(25.0)%
Bodily injury	(3.0)%	3.0%	(3.0)%	(3.0)%	(2.0)%	(3.0)%	(12.0)%	(28.0)%	(26.0)%
Auto property	(3.0)%	3.0%	(3.0)%	(4.0)%	(4.0)%	(4.0)%	(18.0)%	(30.0)%	(28.0)%
Collision	(2.0)%	3.0%	(4.0)%	(5.0)%	(4.0)%	(4.0)%	(23.0)%	(30.0)%	(25.0)%
PIP	(3.0)%	3.0%	(4.0)%	(5.0)%	(6.0)%	(5.0)%	(20.0)%	(33.0)%	(28.0)%
Allstate (YoY)									
Gross claims PD	(2.7)%	(2.5)%	(1.6)%	(0.8)%	2.0%	(2.2)%	(12.0)%	(46.4)%	(28.6)%
Gross claims (BI)	(0.7)%	(2.5)%	(1.2)%	(2.1)%	(0.5)%	(3.2)%	(11.2)%	(49.2)%	NA

Beyond figure disclosures, management earnings calls continued to detail the impacts of Covid-19 on miles driven and auto accident frequency. Notable takeaways from Progressive included details on miles driven, and Allstate’s CEO Thomas Wilson pointed to hypothetical impacts of reduced commuting.

Progressive	<p><i>“We look at this from state to state. There’s really a variety of vehicle miles traveled and ranges. It’s still now much obviously higher than the trough of 40%, it’s right around 10-ish, 10% to 15% across the country.”</i></p> <p>CEO Susan Griffith</p>
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Allstate	<p><i>“And so given that about 1/3 of the time people are in their cars, they’re driving to and from work, so if even a small portion of people, so if 25% of the people commute less, that’s a pretty big drop. And we will react to that when we can.”</i></p> <p>CEO Thomas Wilson</p>
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Turning to Q3 severity statistics, figures remain elevated prior to pre-pandemic levels. As referenced above, severity remains a partial offset to frequency benefits seen within the subsector, and a key item to monitor going forward.

Exhibit: Auto severity statistics

Source: Company reports, Inside P&C

Severity:	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20
Geico (YTD)									
Property	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	8.0%	10.0%	11.0%
Collision	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	8.0%	8.0%	8.0%
Bodily	6.0%	6.0%	7.0%	7.0%	7.0%	8.0%	5.0%	11.0%	11.0%
Progressive (YTD)									
Total auto	4.0%	3% - 5%	8.0%	8.0%	7.0%	3%-7%	11.0%	10.0%	9.0%
Bodily injury	3.0%	4.0%	8.0%	9.0%	8.0%	8.0%	9.0%	10.0%	11.0%
Auto property	3.0%	4.0%	7.0%	6.0%	6.0%	6.0%	14.0%	14.0%	10.0%
Collision	8.0%	8.0%	7.0%	7.0%	6.0%	6.0%	5.0%	0.0%	2.0%
PIP	1.0%	2.0%	8.0%	6.0%	7.0%	6.0%	12.0%	20.0%	17.0%
Allstate claims (YoY)									
Paid claims (PD)	7.7%	7.4%	6.1%	8.8%	5.1%	6.0%	7.7%	20.4%	7.9%

As outlined in previous quarters, trends 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.

On growth, brands with recognized direct channels continue to shine

As discussed last quarter, direct channels at large brands (Progressive and Geico) continue to benefit from increased shopping, specifically in the direct channel. During Progressive's call, management outlined how these trends are extending to commercial lines as well. Additionally, Allstate's continued revamp of its direct offering (more details below) confirm trends outlined in our note, [Progressive: Let the omni-wars begin](#).

Looking at Q3 auto PIF growth, Both Progressive's direct and agency channel registered the highest PIF growth at 13.7% and 9% respectively. Direct was up 1.5pts YoY and its agency channel was down 1.4pts. Geico too (mostly direct) had meaningful growth at 6.7%, up 1.1pts YoY. It's important to recognize that Geico's growth is on a much larger base, so while it's lower on a (%) basis, the growth is higher on a nominal basis. For example, on a YoY basis, Geico grew PIF by 1.2mn policies. This compares to Progressive's direct PIF growth of 1.1mn, albeit representing a higher percentage growth figure. Other auto-exposed names were flat or down with Allstate growing PIF at 0.1% and other carriers losing policies.

Exhibit: Auto YoY PIF growth

Source: Company reports, Inside P&C

Firm:	Auto PIF growth					
Period:	Q3:19	Q4:19	Q1:20	Q2:20	Q3:20	VAR
Progressive direct	12.2%	12.1%	10.8%	13.0%	13.7%	1.5pts
Progressive agency	10.5%	10.0%	8.4%	8.5%	9.0%	(1.4)pts
Geico	5.6%	6.4%	6.5%	8.3%	6.7%	1.1pts
Allstate brand auto	2.4%	1.5%	0.6%	0.6%	0.1%	(2.3)pts
Travelers auto	0.2%	0.6%	1.0%	2.1%	2.9%	2.6pts
Hartford auto	-6.6%	-5.8%	-5.1%	-3.3%	-3.7%	2.9pts
Mercury General auto	0.2%	-1.6%	-3.6%	-4.2%	-3.9%	(4.1)pts
Horace Mann auto	-5.4%	-6.5%	-6.6%	-6.7%	-7.9%	(2.6)pts
Average	2.4%	2.1%	1.5%	2.3%	2.1%	(0.3)pts
Root	NA	151.8%	89.7%	51.6%	35.5%	NM

Beyond the quarter, and comparable to many other industries, social distancing is impacting more than just miles driven and accident frequency. We think auto carriers are not immune to what's looking to be a global acceleration in direct/digital/online methods of shopping and will pressure other large carriers to adopt the channel in a cost-efficient way that prices policies accordingly, accelerating what we've outlined in previous [notes](#).

This is especially seen at Allstate, which has revamped its direct offering. It is working to be price competitive by providing discounts dependent on how customers shop, and it has rolled the Esurance brand into its Allstate brand to consolidate ad spend. This contrasts with many competitor direct products (excluding Progressive/Geico) that push equally priced quotes to all channels, or try to prioritize customer acquisition through agents.

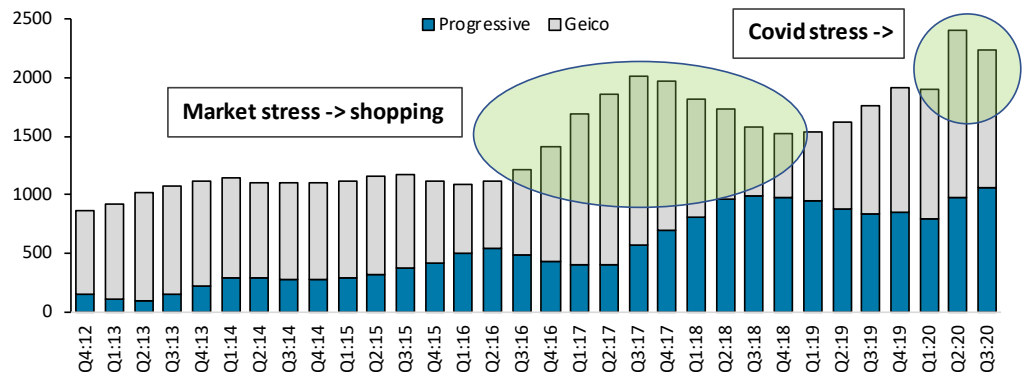
Allstate	<p><i>"You're correct in that if you buy direct today, you get what you pay for, so you don't pay for an agent. So you don't – <u>your price is 7% lower if you buy direct from the company.</u> But that's for only for new customers. We're not going back to existing customers and saying, "Hey, how would you like a 7% price reduction?" because they are happy with their existing relationships. They bought from those agents. They have – we cross-sell them through those agents."</i></p> <p>CEO Thomas Wilson</p>
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While growth at Allstate has yet to pick off due to the offsetting impact of the Esurance drop, we believe the company is being watched closely by other large auto carriers, which have also been losing auto market share to Progressive and Geico for years. Success for Allstate would prompt other carriers to follow suit.

The change in strategy threatens a somewhat zero-sum market dynamic for simple-needs auto customers that has benefited Geico and Progressive for years. As the two top of mind carriers with cheap/direct auto policies, they have faced limited competition for customers that have left the agency channel, especially during hardening markets.

Exhibit: Progressive and Geico LTM nominal PIF growth (k), direct channel

Source: Company reports, Inside P&C



It's worth noting that if carriers object to price competitive direct channels and continue to stick to their channels (unlike Allstate) to please their agents, we'd expect to see a continued shift in market share to the likes of Progressive and Geico, similar to that seen in the 2015-2018 hard market that drove PIF growth.

We'd note Allstate and State Farm in particular already have the brand awareness, high earned premium bases to spread advertising expenses, and pre-existing 10-figure advertising budgets that all overcome the barriers to entry issues faced by smaller brands or start-ups.

However, other issues include segmentation and pricing in a new channel with a different customer profile, customer experience without prior direct learnings and no friendly agency staff to rely on – as well as scale challenges for central services for new direct offerings.

Additionally, after years of questioning whether Progressive could migrate into bundled “Robinson” more-complex-needs customers without jeopardizing their low-needs, low-cost offering, the same question applies for these carriers now looking to trade down market into low-needs direct.

Beyond personal auto, Progressive outlined that direct trends are extending to other lines of business as well. This was in part attributed to changing demographics. For example, younger truckers have been more comfortable signing up for policies direct.

Progressive

“What I will say is that the direct-to-consumer side really has increased on the commercial side. So our commercial business has always been majority from the agents. It’s a more complicated product, and we are seeing more direct-to consumer on the commercial side. That trend likely would have been happening over time as people felt comfortable with the products they’re buying, it really depends on complexity. But I will say that on our -- in our for-hire transportation, it’s the strongest in our direct channel where those new ventures are coming in directly to Progressive.”

CEO Susan Griffith

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

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