Property Casualty Intelligence Briefing

Inside P&C by The Insurance Insider

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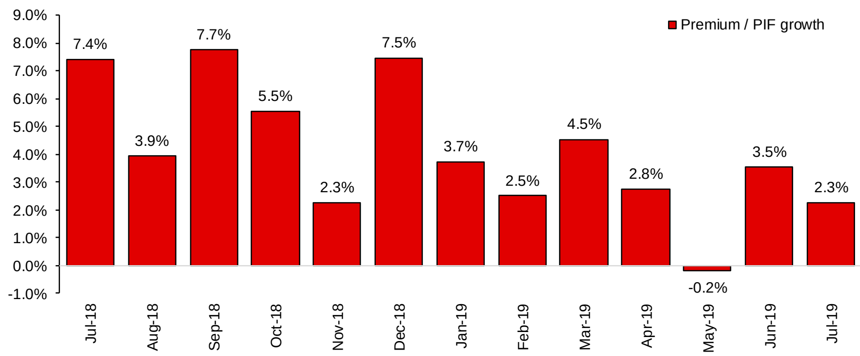
PGR: POSITIONED TO OUTLAST PEERS

Progressive's July results point to continued downward pressure on pricing as firms compete for market share in personal auto. The firm experienced $25.1mn in property catastrophe losses, and $20.6mn in unfavorable reserve development – its 9th month of adverse out of the last 10.



On Wednesday, Progressive released its July results with operating EPS up 8.4% to $0.59 per share YoY. Other highlights included 12% growth in total NWP, 31% growth in the firm's net investment income, and a 1.5pt deterioration in the firm's combined ratio to 90.3%, driven by another month of adverse development.

Looking past the headline numbers, the results show that Q2:19 personal auto trends are continuing, with decelerating top line led by both weaker PIF growth and lower premium per PIF growth.

Specifically, Progressive's personal auto premium per PIF was 2.3% in July, down from 7.4% last year, and 11.6% at its peak in March 2018. Recall, CPI data shows the subsector as a whole has seen premium inflation at historical lows not seen since 2007 **(Auto CPI Report)**.

As expected, Progressive's margins are moving in tandem with premium trends, albeit driven largely by adverse development rather than accident year loss ratio deterioration thus far. The July auto combined ratio was 89.9% versus 88.2% YoY. On a TTM basis the combined ratio is now at 90.5%, up just modestly from a low of 89.8% in September of last year but still at excellent levels. Lower price increases and rising severity have acted as a headwind on margins but benign frequency has so far served as an offset across the industry. However, it is worth noting Progressive's margins are well ahead of its target levels, and management has ample room to sacrifice margins to optimise its growth plans for market share.

We expect margin erosion will be widely seen across the personal lines group. With other trends directionally clear, frequency remains the most likely wildcard to monitor. That said, Progressive has a wide margin of safety, and could likely outlast its peers if further headwinds take shape – and would likely be in a better place to re-accelerate share gains as it did in the last cycle.

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Index	QTD	YTD
Large Cap	0.2%	21.5%
Regional	(1.2)%	10.8%
Specialty	2.7%	22.6%
Personal	(5.7)%	15.4%
Bermuda	3.4%	29.6%
Florida	(7.9)%	(23.8)%
IPC Select	(1.4)%	8.4%
S&P 500	(3.4)%	13.3%
S&P Fin.	(6.1)%	8.8%

Source: S&P Global, Inside P&C

PROGRESSIVE: COMPETING FOR SHARE IN PERSONAL AUTO

- ***Operating EPS growth of 8.4% to $0.59***
- ***Personal lines NWP growth 11.9% to $3.7bn with PIF growth of 0.9%***
- ***Pricing headwinds evident in production metrics - YoY Change in NWP / Average PIF down to 2.3% from 7.4%***

On Wednesday, Progressive released its July results, and they point to continued competition in personal auto as firms compete for market share. Premium per PIF, a very rough proxy for pricing, is still decelerating, and the firm's combined ratio is slowly increasing. Additionally, top line growth continued its deceleration to 12.2% in the firm's personal lines business. While the headline numbers may appear somewhat negative, it is worth remembering Progressive's margins are well ahead of peers and its own target levels, and management has ample room to sacrifice margins to optimise growth plans for market share.

Highlights for July included:

- **Operating EPS:** 8.4% growth to $0.59.
- **Net investment income:** 31% growth to $90mn.
- **Underwriting income:** down 1.1% to $332mn.
- **Combined ratio:** up 1.5pts to 90.3%, driven by the property segment.
- **Auto premium:** 2.3% increase per policy, down from high of 11.6% in March 2018.
- **Catastrophes:** $25.1mn property cats, 18.8pts on property CR and 0.01pts on firm wide CR.
- **Reserve development:** Unfavorable development added 0.6pts to the combined in July, marking 9 months of adverse development out of 10. This is a notable string of adverse development, which could also put pressure on loss picks going forward.

EXHIBIT: PROGRESSIVE JULY RESULTS

Source: Company Reports, Inside P&C

	PGR Monthly					
$mn	Jul-18	Apr-19	May-19	Jun-19	Jul-19	VAR
Operating EPS.	$ 0.54	$ 0.65	$ 0.40	$ 0.36	$ 0.59	8.4%
NWP	3,286	3,670	2,663	2,794	3,676	11.9%
NII	68	81	89	92	90	31.0%
Loss and LAE	2,061	2,232	1,925	1,981	2,401	16.5%
Operating expenses	649	745	618	607	744	14.7%
U/W income	336	422	229	200	332	(1.1%)
Cats	0.0%	3.2%	3.5%	0.1%	0.0%	0.0pts
PPD	-0.7%	0.8%	0.3%	1.3%	0.6%	1.3pts
AY ex-cat LR	69.4%	62.7%	66.7%	70.7%	69.5%	0.1pts
Loss ratio	68.7%	66.7%	70.5%	72.1%	70.1%	1.4pts
Expense ratio	20.1%	20.7%	21.1%	20.6%	20.2%	0.1pts
Combined ratio	88.8%	87.4%	91.6%	92.7%	90.3%	1.5pts

Over the past year, Progressive's sequential total PIF growth has ranged around 0.5% to 1.1%. In July, totally PIF grew by 0.9% to 21.8m. This is down modestly from 1.1% in both 2018 and 2017.

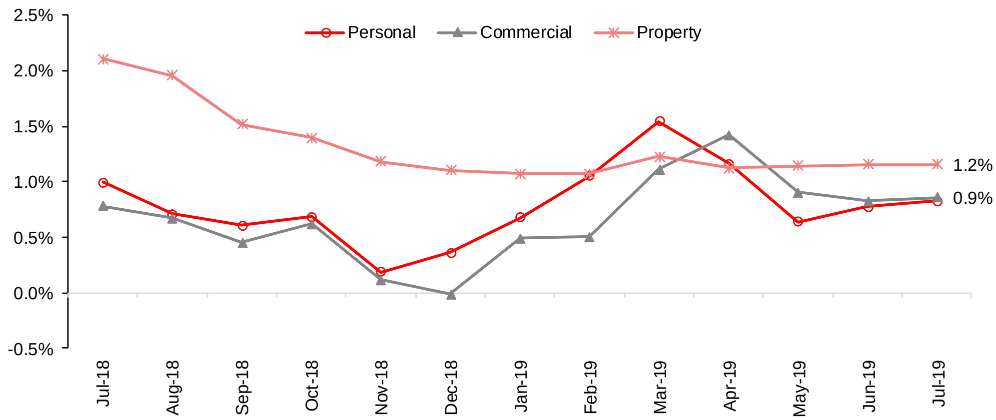
PIF growth has become harder across the personal lines sector as firms more aggressively compete to defend share and reduce the type of wholesale re-underwriting actions and price increases that drives shopping from consumers.

Recall, as a low cost producer with superior segmentation on pricing, Progressive tends to do better in a high churn market with more opportunities to quote (more “at bats”). PIF growth remained fairly strong across the board**:**

- **Personal:** 0.8% growth to 19mn – 0.9% in Direct and 0.7% in Agency
- **Commercial:** 0.9% growth to 740k.
- **Property:** 1.2% growth to 2.1mn.

EXHIBIT: PROGRESSIVE SEQUENTIAL PIF GROWTH

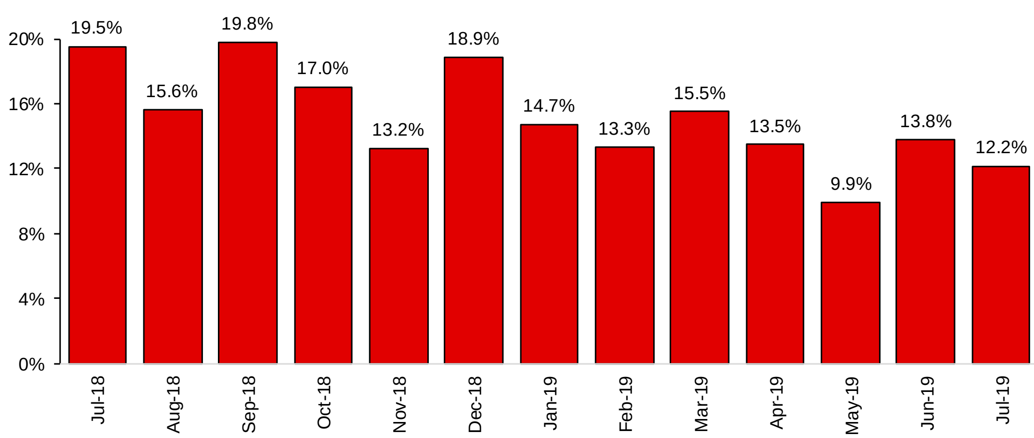
Source: Company Reports, Inside P&C



Turning to top line, the rate of net written premium growth continues to slow, driven by a combination of weaker YoY PIF growth and, more significantly, lower premium per unit.

EXHIBIT: PERSONAL LINES NWP GROWTH

Source: Company Reports, Inside P&C

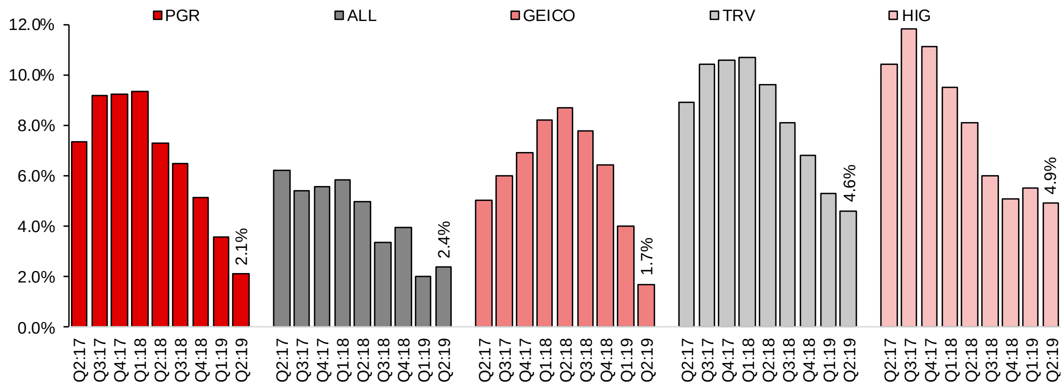


Progressive's results follow pricing and growth trends heavily discussed in our personal auto report and auto CPI report published earlier this week.

Firms are competing for share following a long period of retrenchment, and as a result personal auto renewal premium per policy growth has fallen across the subsector (= driven by weaker pricing).

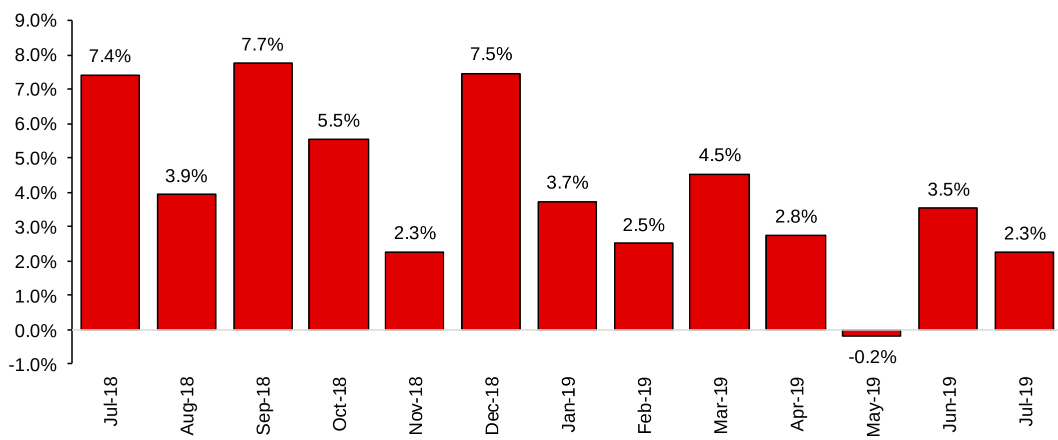
EXHIBIT: PERSONAL AUTO PREMIUM PRICING GROWTH

Source: Company Reports, Inside P&C



Progressive's July results show that the trend is still in motion. As seen in the firm's personal lines segment, which accounts for 84% of Progressive's July net written premiums, premiums per PIF growth slowed to 2.3%, down from highs of 11.6% early last year.

EXHIBIT: PGR PERSONAL LINES PRICING



The pressure on written premiums per PIF is significant as both medical vehicle prices continue to rise at a stable rate from increasingly complex procedures, and expensive auto components, particularly for newer vehicles.

EXHIBIT: BLS INFLATION DATA – VEHICLE AND MEDICAL

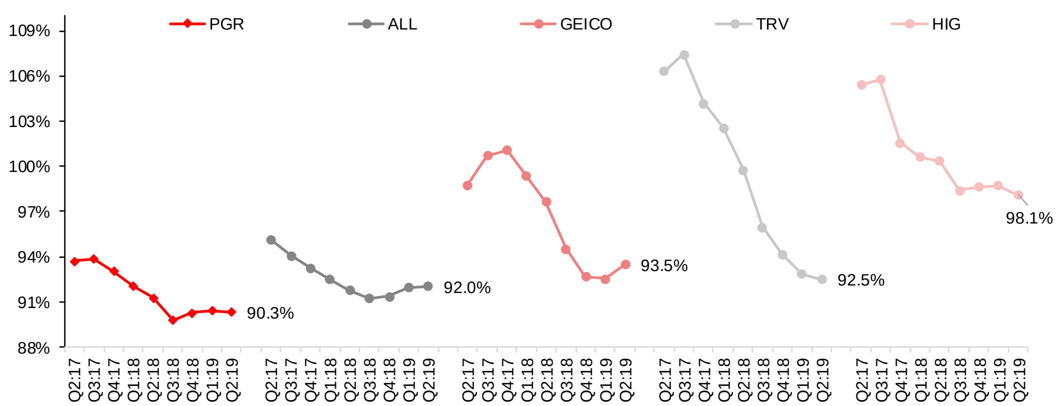
Source: BLS, Inside P&C

CPI severity	Jul-18	Aug-18	Sep-18	Oct-18	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	3M Avg	1YR Avg
Body work	2.9%	3.3%	2.7%	3.2%	3.2%	3.2%	2.5%	2.6%	2.4%	3.2%	3.0%	3.9%	4.0%	**3.6%**	**3.1%**
Maint. & repair	2.3%	2.3%	2.2%	2.0%	2.3%	2.3%	2.6%	2.8%	3.7%	3.8%	3.4%	3.5%	3.3%	**3.4%**	**2.9%**
Parts & equp.	0.1%	0.4%	0.4%	1.2%	2.1%	2.2%	2.1%	1.9%	1.8%	1.9%	1.9%	1.9%	1.4%	**1.8%**	**1.6%**
Medical care	2.3%	1.9%	2.0%	1.9%	2.4%	2.6%	2.4%	2.4%	2.3%	2.3%	2.8%	2.8%	3.3%	**3.0%**	**2.4%**
Physician serv.	0.6%	0.3%	0.5%	0.4%	0.8%	0.6%	0.5%	0.7%	0.1%	0.3%	0.3%	0.4%	0.7%	**0.5%**	**0.5%**
Hospital serv.	4.6%	4.2%	3.8%	3.3%	3.5%	3.7%	2.3%	2.0%	1.8%	1.2%	1.3%	0.5%	0.8%	**0.9%**	**2.4%**
Avg vehicle	*1.8%*	*2.0%*	*1.8%*	*2.2%*	*2.6%*	*2.6%*	*2.4%*	*2.4%*	*2.6%*	*3.0%*	*2.8%*	*3.1%*	*2.9%*	***2.9%***	***2.5%***
Avg medical	*2.5%*	*2.1%*	*2.1%*	*1.9%*	*2.2%*	*2.3%*	*1.8%*	*1.7%*	*1.4%*	*1.3%*	*1.5%*	*1.3%*	*1.6%*	***1.4%***	***1.7%***
Avg. total severity	**2.1%**	**2.1%**	**1.9%**	**2.0%**	**2.4%**	**2.4%**	**2.1%**	**2.0%**	**2.0%**	**2.1%**	**2.1%**	**2.2%**	**2.2%**	**2.2%**	**2.1%**
Auto premium	**7.4%**	**6.4%**	**6.6%**	**6.7%**	**5.5%**	**4.6%**	**3.4%**	**2.0%**	**1.7%**	**1.4%**	**0.7%**	**0.7%**	**0.6%**	**0.7%**	**3.3%**
Delta	**5.3%**	**4.4%**	**4.7%**	**4.7%**	**3.1%**	**2.2%**	**1.3%**	**(0.1)%**	**(0.4)%**	**(0.7)%**	**(1.4)%**	**(1.5)%**	**(1.6)%**	**(1.5)%**	**1.2%**

The combination of weaker premium growth and stable severity trends has led to a plateauing of underwriting results across the sector following a year or so of solid improvement, with most combined ratios now starting to trend upwards.

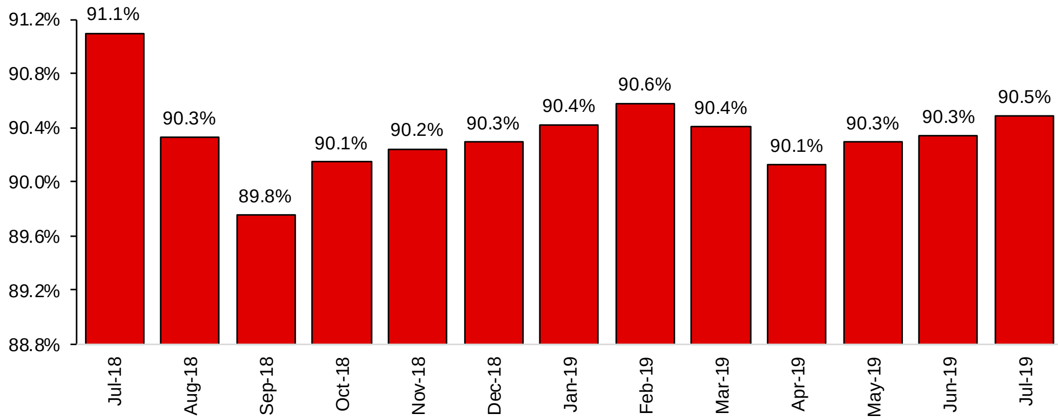
EXHIBIT: PERSONAL AUTO TTM COMBINED RATIO

Source: Company Reports, Inside P&C



Progressive's July results show a continuation of Q2 trends, with margins deteriorating. The 1.7pt increase in the July combined contributed to a 0.2pt increase in the segment's TTM combined to 90.5%. The YoY swing was largely driven by unfavorable accident year development of 0.6 points, a 1.3pt swing from the favorable 0.7pts YoY. The accident year loss ratio was up just 0.1pts. However, a string of 9 adverse development months out of the last ten could speak to some pressure on underlying loss picks.

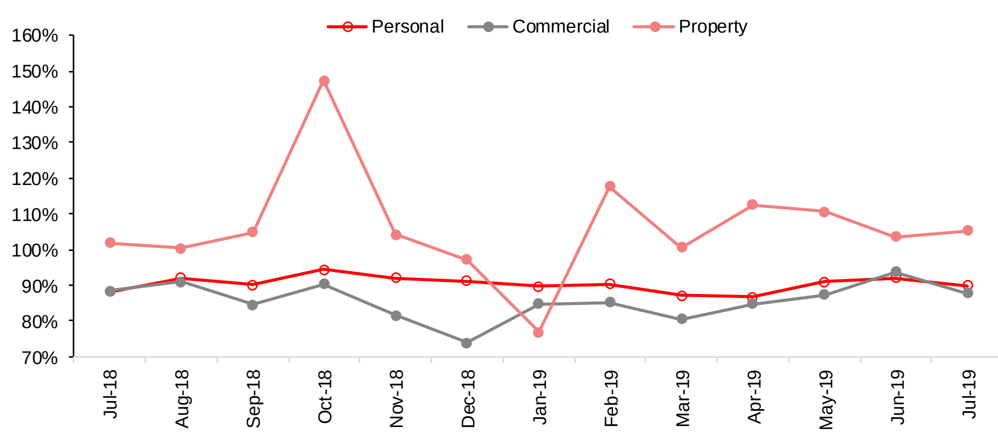
EXHIBIT: PERSONAL AUTO TTM COMBINED RATIO



By segment, combined ratios were relatively flat over that past year.

- **Personal** deteriorated by 1.7pts to 89.9%, driven by 1.9pt deterioration in the firm's loss ratio to 70.5%. Consistent with peers, the firm has previously cited severity trends in H1 as the driving the deterioration.
- **Commercial** improved 0.6pts to 87.8%, driven by 2.7pt improvement in loss ratio to 66.1%. The expense ratio offset the result, up 2.1pts to 21.7%.
- **Property** deteriorated 3.5pts to 105.4%, with the loss ratio up 3.9pts to 72.3%. The segment was impacted by $25.1mn of catastrophes, or 18.8pts.

EXHIBIT: SEQUENTIAL SEGMENT COMBINED RATIOS.



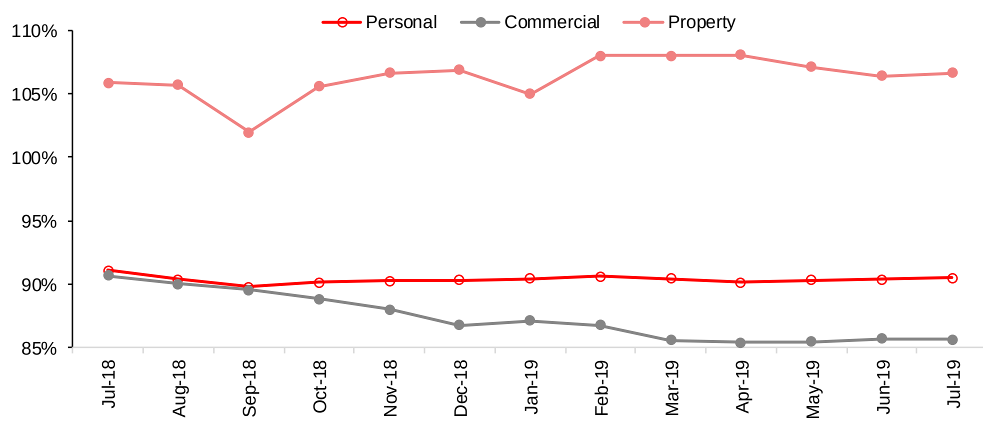
However, we find it more useful to view combined ratios on a TTM basis to smooth out for monthly noise and better illustrate underlying trends.

On that basis, YoY TTM combined ratios were relatively flat excluding commercial.

- **Personal** improved by 0.6pts to 90.5%, driven by 0.9pt improvement in the firm's loss ratio to 70.6%, with benign frequency a factor.
- **Commercial** improved 5pts to 85.6%, driven by 5.1pt improvement in loss ratio to 64.7%. Expense up 0.1pts to 20.9%.
- **Property** deteriorated 0.8pts to 106.7%, with the loss ratio up 2.6pts to 75.1%.

EXHIBIT: PROGRESSIVE SEGMENT TTM COMBINED RATIOS

Source: Company Reports, Inside P&C



We expect margin erosion will be widely seen across the personal lines group. With other trends directionally clear, frequency remains the most likely wildcard to monitor. That said, Progressive has a wide margin of safety, and could likely outlast its peers if further headwinds take shape – and would likely be in a better place to re-accelerate share gains as it did in the last cycle.

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