Progressive: High cats lead to more 'normal' earnings, direct growth accelerating

Progressive's August results were solid. The firm reported $0.38 in operating EPS, up 11.6% YoY, and recorded a headline combined of 92.6% (down -0.8pts). In any normal environment, these would be great results.

That said, following months of strong margins and excess earnings (stemming from Covid-19's positive impact on auto accident frequency), the results are below recent trend due to higher cat losses in property. As such, the all-in results look almost "normal" with the headline margin in line with Progressive's historic figures.

Unpacking its combined shows that the firm's personal auto segment continues to benefit from Covid-19's positive impact on auto accident frequency, albeit diminishing as the economy strengthens and states ease social-distancing measures. Additionally, our tracking of state databases of auto accidents indicates a worsening (still down YoY but reverting to mean) frequency trend.

While the personal auto segment continued to have strong margins with a combined ratio of 89.6% (down 3.1pts YoY), the firm's property segment recorded a substantial level of catastrophe losses (53pts) from hurricanes Isaias and Laura, which served as an offset. This also led to a recovery on its aggregate reinsurance program (details below), which also protects against further downside from volatility in property for the remainder of the year. Lastly, the commercial lines segment reported margins in line with past results, with notable growth.

Turning to growth, Progressive had a 17.7% rise in its headline NWP to $3.4bn. The firm continues to benefit from an acceleration in its direct personal auto channel, strengthened by secular trends to digital distribution seen across most industries.

Our view has been that Progressive would likely benefit from an accelerated push to online in the Covid-19 economy, but the growth in this channel in spite of an environment of high competition remains something to watch in the coming months. More details below.

Progressive earnings release summary

Source: Company reports, Inside P&C

($mn)	Progressive (PGR) monthly					
Period:	Aug-19	May-20	Jun-20	Jul-20	Aug-20	VAR
Operating EPS.	0.34	0.34	0.61	0.91	0.38	11.6%
NWP	2,921	3,174	3,202	4,109	3,438	17.7%
NII	90	84	77	75	80	(10.5%)
U/W income	184	188	396	624	229	24.4%
LTM ROE	24.4%	30.0%	29.3%	30.9%	32.2%	7.8pts
Cats	0.2%	3.9%	2.0%	0.5%	5.9%	5.7pts
PPD	1.0%	(0.6%)	0.6%	(0.1%)	0.3%	(0.7)pts
AY ex-cat LR	71.7%	51.8%	61.3%	63.9%	65.3%	(6.4)pts
Loss ratio	72.9%	55.1%	63.9%	64.3%	71.5%	(1.4)pts
Expense ratio	20.5%	38.6%	23.0%	19.2%	21.1%	0.6pts
Combined ratio	93.4%	93.7%	86.9%	83.5%	92.6%	(0.8)pts

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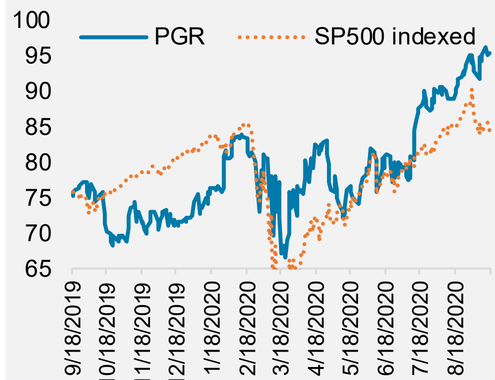
Market cap ($M)	55,659.5
Price	95.4
BVPS	27.62
Tang. BVPS	26.51
Price/Book	3.4 x
Price/Tang. Book	3.6 x
52-week High/Low	96.26 / 66.55
Dividend Yield	0.4%
ROE	46.2%

1YR Price Peformance



Data as of 09 / 17 / 2020

Source: SNL, Inside P&C

Personal auto: Direct growth accelerates and margins ease

Auto margins remained strong in August with a combined of 89.6% – down 3.1pts YoY and below Progressive's "never exceed" target of 96%. That said, the figure is trending back to more "normal" levels as states continue to reopen and consumers pivot back to more traditional social activities.

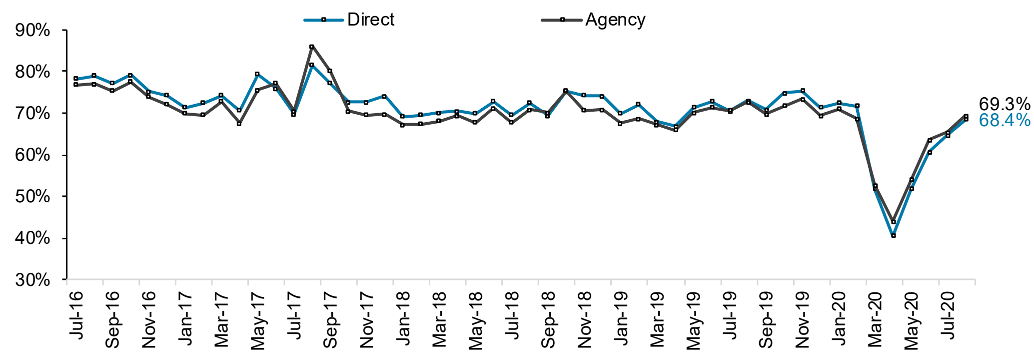
For context, our analysis on auto accident frequency based on state DOTs pointed to a 13% reduction in August auto accidents, compared to 15% in July and a low of 51% in April. Additionally, carrier managements in Q2 calls (similar to Q1) continued to provide clarity on lower accident frequency, which we summed up here.

In August, the personal lines loss ratio came in at 68.9%, down 3.9pts YoY, but up 4pts when compared to July's figure of 64.9%. For context, August is typically around 2.5pts higher than July due to seasonality impacts, making the sequential increase due to fundamentals probably more like ~1.5pts.

The result was driven by both the direct and agency channels, which rose to 68.4% and 69.3% (down 4.6pts and 3.4pts YoY respectively). The YoY declines stem from fewer cars on the road (less so than April/May, when there were strict social distancing measures).

Progressive monthly auto loss ratios

Source: Company reports, Inside P&C

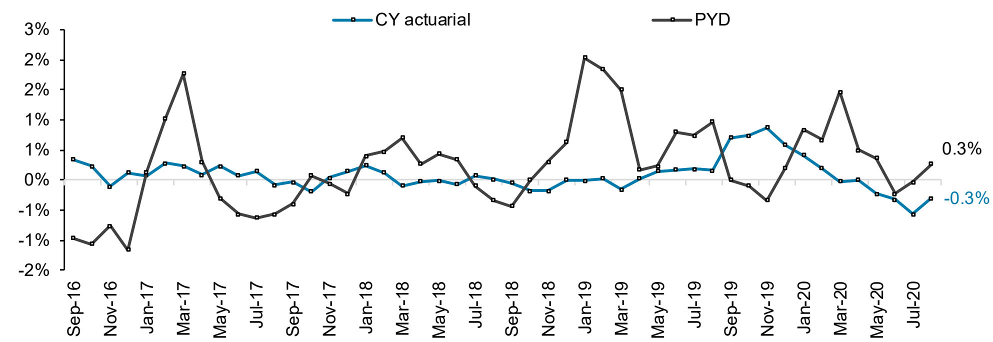


Progressive only provided consumers with two months of premium rebates, but some of that continues to lag into more recent months. In August, the total rebate expense came out to $11.5mn (0.5pts/same as July) for the month, in comparison to $510mn in May. For April/May, rebates only materially impacted the personal lines segment, resulting in an average 18.3pt increase in the direct/agency expense ratios to 41.7% and 39.7% respectively when compared to the month of March.

Additionally, Progressive's results were hit by $4.1mn of unfavorable development related to the current accident year. This offset $3.2mn of favorable prior-year adjustments.

3M average calendar year actuarial pts, PYD pts

Source: Company reports, Inside P&C



On growth, the direct channel continues to accelerate, especially when compared to the agency side of the business. The result is aligned with management commentary during Q1 calls which hinted strength in the direct channel. We attribute this to (1) social distancing pushing shoppers online and (2) low-cost producers having attractive policy options when economic forces drive shopping (though the level of shopping may be offset by lower accidents and price rises).

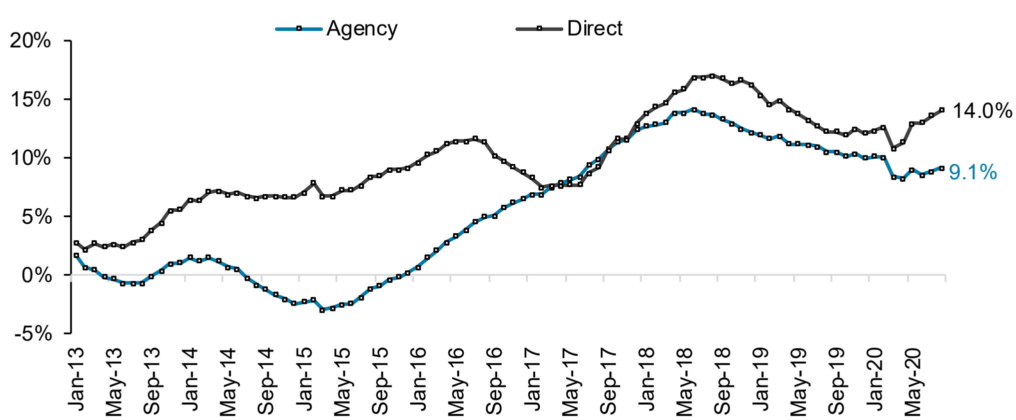
Going back to March, PIF growth in the direct and agency channels recorded a meaningful downtick. Direct was up 0.4% sequentially taking TTM growth to 10.8%, while agency was up 0.2% taking TTM to 8.4% respectively. Since then, the direct channel has rebounded while the agency business's growth has trailed.

In August, the direct channel had a 0.9% sequential growth rate (YoY 14%) and the agency channel recorded 0.7% sequential growth (YoY 9.1%). On a written premium basis, personal lines NWP was up 13.8%.

We have argued that the crisis will likely act as an accelerant and continue the push to direct and away from brick-and-mortar agency plants, in line with trends in broader retail (for background, see our primer on the Omni-Wars).

Progressive monthly personal auto PIF growth

Source: Company reports, Inside P&C



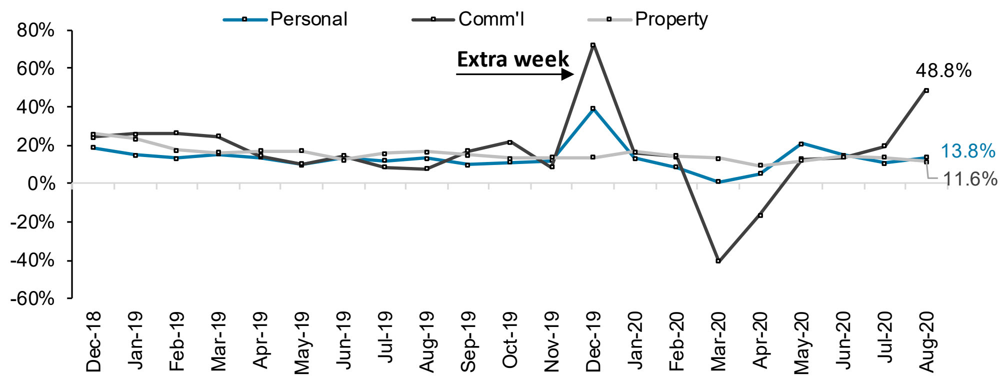
Commercial: Margins back to historical levels, and NWP growth of 48.8%

Progressive's commercial segment registered meaningful NWP growth of 48.8% in August. The figure reflects strong new application growth for its for-hire trucking business policies and the renewal of TNC policies during August (which were written in September during 2019). Management pointed to greater demand for shipping services due to the pandemic.

Back in March/April, the segment had significant declines in premium having to do with a reduction in TNC NWP, reflecting the decrease in actual miles driven and revised estimates of miles to be driven during the remainder of client policy terms.

Progressive segment annual NWP growth

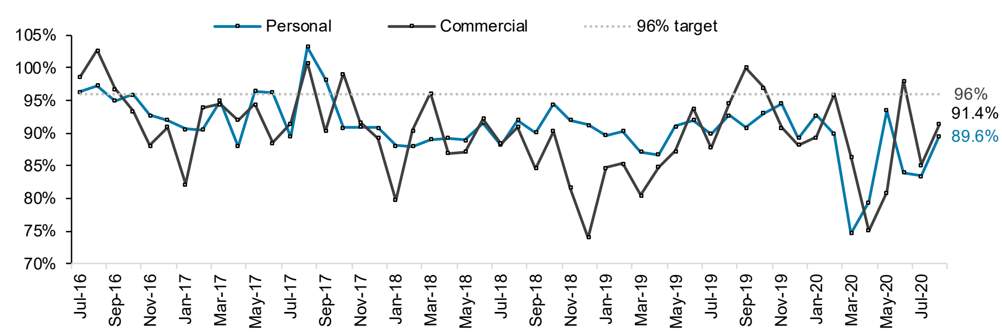
Source: Company reports, Inside P&C



Beyond the high growth, margins for the segment have returned to historic levels with a commercial combined of 91.4% (albeit down 3.1pts YoY). The result stems from a return to its average loss ratio of roughly ~70% at 70.8%

Progressive segment combined ratios

Source: Company reports, Inside P&C



Property: High catastrophe losses are back on the table

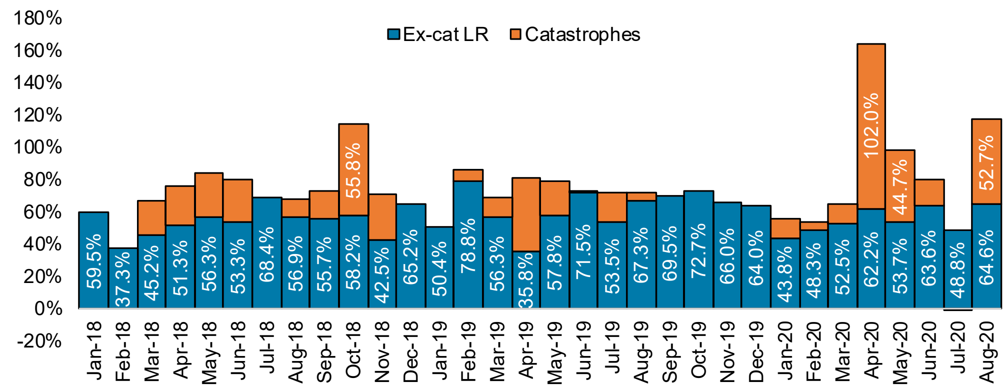
August brought back high levels of catastrophe losses (52.7pts) for Progressive. While not as bad as its April combined of 193.8% (which included 102pts of cats), the segment had a combined of 147.1%. The losses stem from hurricanes Isaias and Laura, and tornadoes and wind events throughout the Midwest.

Progressive recorded a reinsurance recoverable of $70mn under its aggregate excess-of-loss reinsurance program, as 2020 cat losses in the property business now exceed its $375mn retention threshold.

Excluding catastrophes, the loss ratio of 64.6% is down 2.7pts YoY.

Progressive property loss ratio

Source: Company reports, Inside P&C



Looking past the month, we continue to press the level of over-earning at the company in 2020. The firm's all-in combined ratio YTD stands at 87.4%, around 5-7 points below its target range or about $1.3bn-$1.8bn of excess pre-tax profit in eight months. And note, this comes after a 2019 all-in combined ratio well below target levels at 90.9%.

This level of over-earning is unsustainable and will inevitably erode over time – perhaps even rapidly depending on several variables. The key for Progressive going forward will be how quickly and smartly it is able to use its excess earnings buffer into driving market share growth so that its earnings don't get stuck treading water as margins compress. As such, a key risk is a price war and/or increased competition that could poison the well as competitors begin to adapt their models (e.g. Allstate's pivot in direct, acquisition in independent agency). For the industry, Progressive's results continue to suggest that near-term earnings and capital levels will enjoy a benefit that will provide a timely offset to developing Covid-19 exposures that will partially limit industry "stress".

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

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