Auto: Carriers win big on frequency benefits

The "empty-street" economy has left auto exposed names in a relatively favorable position, highlighted by a second quarter of strong earnings growth and beats when compared to street estimates. The quarter results include the full impact of premium rebates and further highlights the benefits of pre-existing strong margins combined with significant frequency benefits.

Q2:20 earnings table

Source: company reports, Inside P&C

Firm:	Operating EPS by firm						
Period:	**Q2:19**	**Q3:19**	**Q4:19**	**Q1:20**	**Q2:20**	**VAR**	**Beat/Miss**
Progressive	$ 1.42	$ 1.33	$ 1.31	$ 1.92	$ 1.84	29.6%	5.7%
Allstate	2.18	2.84	3.13	3.54	2.45	12.4%	59.1%
Kemper	1.38	1.93	1.45	2.43	1.20	(13.0%)	16.5%
Mercury General	0.74	0.78	0.21	1.07	1.86	150.4%	138.5%
Horace Mann	0.17	0.64	0.75	0.78	0.67	294.1%	71.8%
Average	-	-	-	-	-	**94.7%**	**58.3%**

Our view remains that Covid-19 will be more than a one-off benefit to auto carriers. Looking past the nearer term impact, crisis often acts as an accelerant that exacerbates pre-existing trends and exposes structural strengths and weaknesses.

Similar to the brutal impact the pandemic is having on brick and mortar retail while benefiting the online and home delivery economy, we expect a benefit to emerge for direct channel carriers like Progressive and Geico. Results can already be seen with strong cumulative PIF growth between the direct carriers which is typically mutually exclusive. This compares to agency channels (excluding aggregators like Gabi) which are likely to struggle with legacy tech and distraction from cash flow issues, a lack of face to face touch points, and a general culture of inertia that leads to more difficulty serving customer needs while working remotely – particularly for new business.

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).

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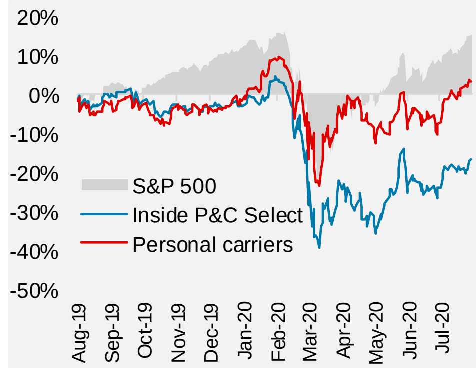
Composite	**YTD px chg.**	**P/B**
Large comm.	**(22.8)%**	**0.8x**
Regional	**(21.2)%**	**1.3x**
Specialty	**(12.1)%**	**1.5x**
Personal	**6.5%**	**1.9x**
Bermuda	**(17.8)%**	**1.1x**
Florida	**(15.0)%**	**1.0x**
Brokers	**1.5%**	**-**
IPC Select	**(14.3)%**	**1.1x**
S&P 500 Fin.	**(18.9)%**	**-**
S&P 500	**4.0%**	**-**

1YR Price Peformance



Auto Q2 wrap: Headline results continue to excel

Q2 results were strong for auto exposed names with earnings exceeding street estimates across the universe. The average beat of 58.3% was driven by Allstate and Mercury General which beat by 59.1% and 138.5% respectively. The lowest beat came from Progressive at 5.7% (which reports monthly so has less opportunity to let expectations diverge from reality).

Taking a step back beyond the consistent EPS growth and beats, the recurring theme for the quarter was low accident frequency, driven by lower miles driven due to Covid-19 shutdowns. Commentary outlining the effects was evident in most calls and press releases throughout the earnings season. One example of frequency declines from Progressive showed that auto frequency was down 39% and 29% for the quarter and YTD respectively.

Q2:20 earnings table

Source: company reports, Inside P&C

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Period:	**Q2:19**	**Q3:19**	**Q4:19**	**Q1:20**	**Q2:20**	**VAR**	**Beat/Miss**
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Allstate	2.18	2.84	3.13	3.54	2.45	12.4%	59.1%
Kemper	1.38	1.93	1.45	2.43	1.20	(13.0%)	16.5%
Mercury General	0.74	0.78	0.21	1.07	1.86	150.4%	138.5%
Horace Mann	0.17	0.64	0.75	0.78	0.67	294.1%	71.8%
Average	-	-	-	-	-	**94.7%**	**58.3%**

Complete earnings press releases for the quarter are linked below:

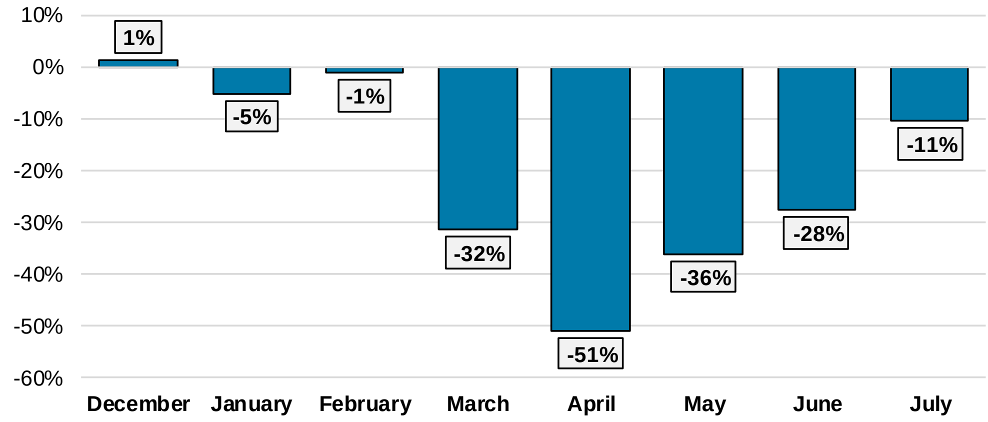
Firm	Progressive	Allstate	Kemper	Mercury General	Horace Mann
Press Release	PR	PR	PR	PR	PR

Margin expansion and earnings growth for the sub-sector was driven by lower accident frequency following social distancing measures put in place to combat Covid-19

Every month we outline our findings on auto accident frequency based on a sample of state level DOTs – knowing the headlined figures is important in understanding results for the quarter. July saw an 11% decline in accidents. This followed 28% in June, 36% in May, and a low of 51% in April. The low accident frequency has materially impacted underwriting ratios within the line of business and is largely in line with commentary provided by carriers throughout the past two quarters.

Estimated monthly auto accident frequency statistics (YoY % change)

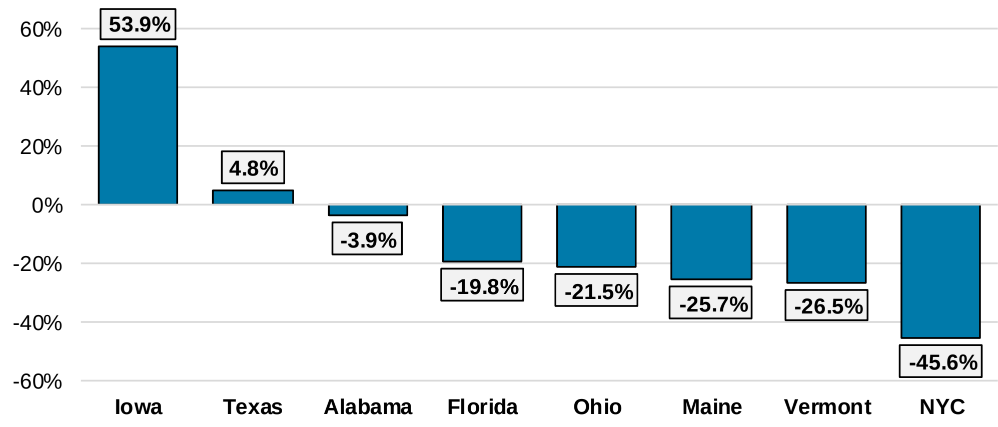
Source: State DOTs, Inside P&C



Results do vary by state, and 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 high (%) volatility.

Estimated July auto accident frequency statistics (YoY % change by state)

Source: State DOTs, Inside P&C



Management earnings calls continued to detail the impacts of Covid on miles driven and auto accident frequency. Notable takeaways from Progressive included a 24% decline in frequency for the month of June albeit there being lots of variability on a state by state basis.

Progressive	*"I won't talk about July, but I will talk about when we think about frequency, I'll state that June was lower than the full quarter at about 24%. So we are seeing them stabilize. We still -- it's very different depending on the state as well. So you can see vehicle miles travel go up."* **CEO Susan Griffith**

On a related note, Progressive reiterated that they are seeing increased shopping, specifically in the direct channel. Comparable to many other industries, social distancing is impacting more than just miles driven and accident frequency. We think that auto carriers are not immune from 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 our Progressive: let the omni-wars begin note. If carriers happen to stick to their channels to please their agents, we 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.

Allstate's President of Personal Lines Glenn Shapiro also noted that frequency is beginning to normalize in some places, however there's a lot of variation on a state by state level unlike what was seen in April and May when Covid first surged. For example, in Montana Allstate saw that frequency is now up slightly on a YoY bases while other areas, specifically heavily concentrated areas with metro, continue to see low frequency figures.

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 – as expected given the large impact already experienced in the first quarter even with only half a month of social distancing policies.

Q2:20 auto frequency statistics

Source: company reports, Inside P&C

Frequency:	Q2:18	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20
Geico (YTD)									
Property	**(2.0)%**	(2.5)%	(3.0)%	(3.0)%	**(3.0)%**	(2.5)%	(3.0)%	(13.0)%	**(38.5)%**
Collision	**(2.0)%**	(2.5)%	(3.0)%	(3.0)%	**(3.0)%**	(2.5)%	(3.0)%	(13.0)%	**(25.0)%**
Personal	**(2.0)%**	(2.5)%	(3.0)%	(3.0)%	**(3.0)%**	(3.0)%	(1.5)%	(10.0)%	**(38.5)%**
Bodily	**(3.0)%**	(2.5)%	(3.0)%	0.0%	**0.0%**	0.0%	0.0%	(7.0)%	**(38.5)%**
Progressive (YTD)									
Personal auto	**(2.0)%**	(2.0)%	(3.0)%	(3.0)%	**(3.0)%**	(3.0)%	(3.0)%	(18.0)%	**(29.0)%**
Bodily injury	**(2%)-(3%)**	(3.0)%	3.0%	(3.0)%	**(3.0)%**	(2.0)%	(3.0)%	(12.0)%	**(28.0)%**
Auto property	**(2%)-(3%)**	(3.0)%	3.0%	(3.0)%	**(4.0)%**	(4.0)%	(4.0)%	(18.0)%	**(30.0)%**
Collision	**(1.0)%**	(2.0)%	3.0%	(4.0)%	**(5.0)%**	(4.0)%	(4.0)%	(23.0)%	**(30.0)%**
PIP	**(2%)-(3%)**	(3.0)%	3.0%	(4.0)%	**(5.0)%**	(6.0)%	(5.0)%	(20.0)%	**(33.0)%**
Allstate (YoY)									
Paid claims (PD)	**(3.0)%**	0.2%	(0.6)%	(3.6)%	**(1.5)%**	0.2%	(4.0)%	(3.8)%	**(37.8)%**
Gross claims (BI)	**(2.7)%**	(0.7)%	(2.5)%	(1.2)%	**(2.1)%**	(0.5)%	(3.2)%	(11.2)%	**(49.2)%**

In addition to Progressive and Allstate, the following commentary from smaller firms like Mercury, Kemper, and Horace Mann all pointed to lower accident frequency and also commented on various competitive dynamics in the market.

Mercury General	*"I will add that we did see an increase in an upward slope and frequency as compared to where -- April and May and June and July. So as Jeff mentioned, we'll just continue to monitor and -- every month, and we'll adjust based on the information that's coming in and severity is rising as well. So offsetting some of the frequency benefits, but no question that there was an upward slope in frequency in the month of June and July as compared to April and May.* **CEO Gabriel Tirador**
Kemper	*"For the most part, in most states, regulators have really clamped down on any rate increases, but there is a smattering of rate decreases, probably ranging from the nominal minus 1%, 2%, all the way up to minus 4% depending on the market. There still seems to be an uptick in rate in the Florida market, in particular, driven by PIP and the BI side."* **EVP Duane Sanders**
Horace Mann	*"For example, P&C earnings increased as average auto frequency dropped substantially for the entire second quarter, but our telematics data shows that people have started taking longer trips. That they are driving at different times of the day and that generally, there is less congestion. This is consistent with anecdotal comments that people are opting to drive for their summer travel this year. Bottom line, mileage is returning to more normal levels, but the miles driven are different than pre-pandemic miles."* **CEO Marita Zuraitis**

All in, the effects of lower accident frequency have manifested in carrier underwriting results. On average the headline auto exposed names saw a 5.9pt improvement in their combined ratios to an average 90.8%. Larger names including Progressive and Allstate saw 2.7pt and 6pt improvements respectively to 87.7% and 89.8%.

Q2:20 headline operating results

Source: company reports, Inside P&C

Firm:	Headlne combined by firm					
Period:	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20	VAR
Progressive	90.3%	91.9%	92.4%	86.9%	87.7%	(2.7)pts
Allstate	95.8%	91.6%	88.7%	84.9%	89.8%	(6.0)pts
Kemper	95.4%	91.7%	94.5%	94.2%	93.0%	(2.3)pts
Mercury General	98.3%	98.6%	103.2%	95.9%	88.2%	(10.1)pts
Horace Mann	103.8%	96.2%	90.3%	88.6%	95.4%	(8.4)pts
Average	96.7%	94.0%	93.8%	90.1%	90.8%	(5.9)pts

More specifically, declines in auto loss ratios drove margin expansion for the quarter. On average, auto loss ratios declined 21.1pts to 51.5%. Large names like Progressive (both direct and agency), Geico and Allstate all saw large declines. Progressive direct dropped 19.8pts to 50.3%, and its agency channel fell 15.7pts to 53.2%. Geico's loss ratio fell 19.9pts to 62.1% and Allstate brand auto saw a 20.7pt decline to 47.7%. Hartford's headline personal lines loss ratio (does not give auto loss ratio) fell to 8.9% due to favorable PYD, however its auto combined ratio fell 14.7pts to 82.5% (in line with peers).

Q2:20 auto underwriting

Source: company reports, Inside P&C

Firm:	Auto loss ratios by firm					
Period:	**Q2:19**	**Q3:19**	**Q4:19**	**Q1:20**	**Q2:20**	**VAR**
Progressive direct	70.1%	71.4%	73.8%	65.7%	50.3%	(19.8)pts
Progressive agency	68.8%	71.0%	71.4%	64.6%	53.2%	(15.7)pts
Geico	82.0%	81.6%	85.4%	74.3%	62.1%	(19.9)pts
Allstate brand auto	68.4%	67.7%	67.4%	61.1%	47.7%	(20.7)pts
Travelers auto	70.1%	70.1%	76.1%	65.9%	57.5%	(12.6)pts
Hartford personal*	71.0%	66.6%	69.0%	59.9%	8.9%	(62.1)pts
Kemper specialty	75.1%	73.8%	75.0%	76.0%	69.8%	(5.3)pts
Mercury General*	73.9%	74.4%	79.8%	70.6%	61.0%	(12.9)pts
Horace Mann auto	73.8%	65.8%	72.0%	65.8%	53.2%	(20.6)pts
Average	72.6%	71.4%	74.4%	67.1%	51.5%	(21.1)pts

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

** Hartford auto combined declined 14.7pts YoY to 82.5%*

On growth, average YoY PIF growth remained positive, however business is moving direct

Both Progressive's direct and agency channel saw the highest PIF growth at 13% and 8.5% respectively, albeit down from 13.2% and 11.1% last year. Geico too saw meaningful growth at 8.3%, up 3.8pts 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 1.4mn policies. This compares to Progressive's PIF growth of 1mn albeit representing a higher (%) growth figure. Other auto exposed names were flat or down with Allstate growing PIF at 0.8% and other carriers losing policies.

Q2:20 YoY auto PIF growth

Source: company reports, Inside P&C

Firm:	Auto PIF growth					
Period:	**Q2:19**	**Q3:19**	**Q4:19**	**Q1:20**	**Q2:20**	**VAR**
Progressive direct	13.2%	12.2%	12.1%	10.8%	13.0%	(0.2)pts
Progressive agency	11.1%	10.5%	10.0%	8.4%	8.5%	(2.6)pts
Geico	4.5%	5.6%	6.4%	6.5%	8.3%	3.8pts
Allstate brand auto	2.5%	2.1%	1.5%	0.9%	0.8%	(1.7)pts
Travelers auto	0.0%	0.2%	0.6%	1.0%	-2.1%	(2.1)pts
Hartford auto	-7.8%	-6.6%	-5.8%	-5.1%	-3.3%	4.5pts
Mercury General auto	1.8%	0.2%	-1.6%	-3.6%	-4.2%	(6.0)pts
Horace Mann auto	-4.9%	-5.4%	-6.5%	-6.6%	-6.7%	(1.8)pts
Average	2.5%	2.4%	2.1%	1.5%	1.8%	(0.8)pts

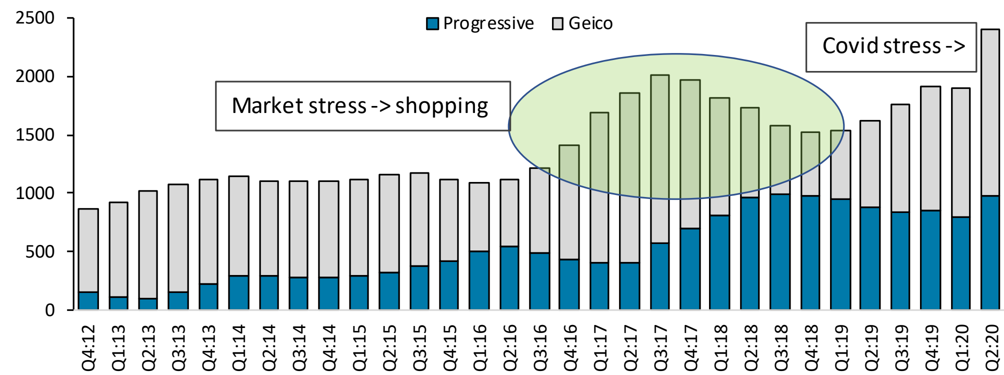
Taking a step back, as mentioned last quarter, we expect the long-term impact of social distancing guidelines to drive policy shopping to direct channels. In addition, financial hardship will likely lead consumers to seek cheaper policies which will benefit lower cost carriers like Progressive and Geico, something typically seen during hard markets. The jump in cumulative PIF for Progressive and Geico appear to show just that with business moving to the lower cost (and also digitally distributed) companies.

If carriers don't shift their models accordingly, we'd expect to see continued market share gains for Progressive and Geico which enjoy somewhat of a duopoly in the channel. However, if carriers begin to adjust in masse, like Allstate and Nationwide have, there is a potential for new entrants to "poison the well" with price competition for the two names which have enjoyed somewhat of a “zero-sum” growth within the channel.

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, and 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.

Progressive and Geico LTM nominal PIF growth (thousands, direct channel)

Source: company reports, Inside P&C



Carriers have not hidden away at their expanding margins and have announced premium rebates largely in the 15% range for three months’ worth of premium. While many carriers originally announced rebates for April/May premium, many extended the credits through June/July. Geico’s plan stood out to us in that they’ve gone further by applying a 15% discount at renewal for the full policy term, and that it also applies to new business during the timeframe. Unlike other carriers that are mostly applying a credit/refund to 2-3 months of premium, Geico’s strategy provides an incentive for customers to collect refunds and then switch over.

Auto carrier refund announcement to date

Source: SNL, Company Reports

Firm	Refund/Credit	2019 Auto DWP
State Farm	25% credit on two months of auto premium	$40.9B
Geico	15% (for 6M policy) credited at renewal, totals $2.5B	34.9B
Progressive	20% credit on two months of auto premium	31.0B
Allstate	15% refund credited to customer, totals $1B	23.6B
USAA	10-20% credit on 4 months of premiums, totals $1.1B	15.2B
Liberty	15% refund on two months of auto premium	11.7B
Farmers	15-25% credit for May / April	10.5B

Nationwide	One-time premium refund of $50 per policy	6.2B
AmFam	10% credit on new/existing policies	5.8B
Travelers	15% refund credited to customers (April / May / June)	4.9B
Kemper	15% credit on two months of auto premium	3.4B
National General	15% credit on April premiums for personal auto policyholders	3.2B
Mercury	10-15% credit on four months of premium	2.8B
Hartford	15% credit on three months of premium	2.0B
Hanover	15% refund on two months of premium	1.2B
Chubb	35% reduction for April/May, "with additional discounts for subsequent months, as the situation warrants"	0.8B
Cincinnati	15% credit on two months of premium	0.63B
Horace Mann	15% credit on two months of premium	0.45B

Even with refunds averaging in at roughly 15% of three months of premium, as discussed above, margins have improved significantly leading to strong earnings growth. The results come even with significant rises in severity (something carrier managements pointed to last quarter).

Allstate (Q1:20)	*"First, the reduction of drivers on the road has increased driving speeds, which can lead to increased severity per claim. We'll also likely incur additional bad debt from some customers who have chosen to take extended payment terms. On a longer-term basis, if the global auto parts supply chain is disrupted or parts prices are raised by auto manufacturers, this could increase repair costs. The pandemic and economic slowdown will also impact growth. If loss costs continue to be below prior year, the lower required rate increases will limit average premium growth."* **President of Personal Lines Glenn Shapiro**

Severity guidance from the previous quarter did materialize with a continued upward trend when compared to Q4:19. YTD Geico saw 10%, 8%, and 11% rises in severity for Property, Collision, and BI. Progressive saw high figures as well ranging 10-20% (albeit flat for Collision). Allstate saw paid claims severity rise by 20.1%.

Q2:20 auto severity statistics

Source: company reports, Inside P&C

Severity:	Q2:18	Q3:18	Q4:18	Q1:19	Q2:19	Q3:19	Q4:19	Q1:20	Q2:20
Geico (YTD)									
Property	**5.0%**	5.0%	5.0%	5.0%	**5.0%**	5.0%	5.0%	8.0%	**10.0%**
Collision	**5.0%**	5.0%	5.0%	5.0%	**5.0%**	5.0%	5.0%	8.0%	**8.0%**
Bodily	**6.0%**	6.0%	6.0%	7.0%	**7.0%**	7.0%	8.0%	5.0%	**11.0%**
Progressive (YTD)									
Total auto	**3.0%**	4.0%	3% - 5%	8.0%	**8.0%**	7.0%	3%-7%	11.0%	**10.0%**
Bodily injury	**2%-3%**	3.0%	4.0%	8.0%	**9.0%**	8.0%	8.0%	9.0%	**10.0%**
Auto property	**2%-3%**	3.0%	4.0%	7.0%	**6.0%**	6.0%	6.0%	14.0%	**14.0%**
Collision	**7.0%**	8.0%	8.0%	7.0%	**7.0%**	6.0%	6.0%	5.0%	**0.0%**
PIP	**(4.0)%**	1.0%	2.0%	8.0%	**6.0%**	7.0%	6.0%	12.0%	**20.0%**
Allstate claims (YoY)									
Paid claims (PD)	**3.7%**	7.7%	7.4%	6.1%	**8.8%**	5.1%	6.0%	7.7%	**20.1%**

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.