Porter & Co.

THE BIG SECRET ON WALL STREET

PROPERTY & CASUALTY

INSURANCE VALUATION

FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

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P&C Valuation

As you'll learn in detail in our **Property & Casualty Insurance Guidebook**, P&C insurance offers a way to compound money, year after year, with unyielding efficiency and with very little risk. However, all property & casualty stocks are not created equal. In order to make the most effective purchasing decisions, you'll need a working knowledge of **valuation**.

Valuation measures tell us whether a stock is trading "cheaply" or "expensively" relative to a certain benchmark.

We measure valuation for property & casualty companies by comparing the market cap of the company to one of the metrics below, and seeing whether the stock is trading at a *premium* to the metric (more expensive), or a *discount* to the metric (less expensive).

Here are the two main valuation metrics we examine in property & casualty stocks:

- **Price-to-book value (P/BV)…** stock price per share divided by dollars of equity per share.
- **Price-to-earnings (P/E)** … stock price per share divided by projected earnings per share.

Price-to-book-value (P/BV) is the valuation technique we prefer for *commercial lines insurers* like **Chubb**. P/BV provides a measure of the price of the company relative to its net asset value based on its current balance sheet (the sum of all assets, net of liabilities). We prefer this measure for commercial insurers, instead of valuing the company based on earnings, because earnings are often needlessly skewed due to one-time, outsized loss events (like hurricanes and other natural disasters).

However, we think it is more appropriate to value *personal lines insurers* like **PGR** on a **price-to-earnings (P/E)** basis, since their businesses have relatively consistent earnings. Personal lines companies typically don't deal with huge natural disasters that skew their results, so the stocks move much more closely in line with their income over time.

- **Note:** The charts we'll examine below are primarily concerned with large commercial insurers, so you'll see the P/BV metric used.

For those investors that follow comments from Warren Buffett (whose Berkshire Hathaway is the parent of multiple insurance companies), we have also included another valuation metric that he likes to quote: **float + book value.** (Recall that we discussed float in our P&C insurance industry report, **here**). This valuation metric tracks closely with the other two metrics – not surprising, since the gems in the industry are companies that produce consistent long-term industry-beating margins and growth.

In addition to P/BV, P/E, and float + book value, we also examine several metrics that shed light on a company's profitability. These numbers help us see whether an "expensive" stock is really worth the extra premium... or whether a "cheap" one might be discounted for a reason.

Our profitability metrics for P&C stocks include:

- **Return on equity (ROE***)*. A measure of how effectively a company generates earnings for its shareholders, calculated as net income divided by shareholders' equity.
- **Combined ratio**. A measure of underwriting profitability. This metric is calculated by taking the claims paid by the insurance company and dividing them by insurance premium revenue. 100% is breakeven. Less than 100% is underwriting profitability.

Most P&C stocks are currently trading at premiums relative to their 10-year averages, and a few of the most consistent underwriting outperformers are also trading trading at their highest P/BV ratios of the last 10 years. Top underwriters like PGR, RLI, AFG, and WRB have translated that underwriting success into better ROE's and, thus, higher valuations.

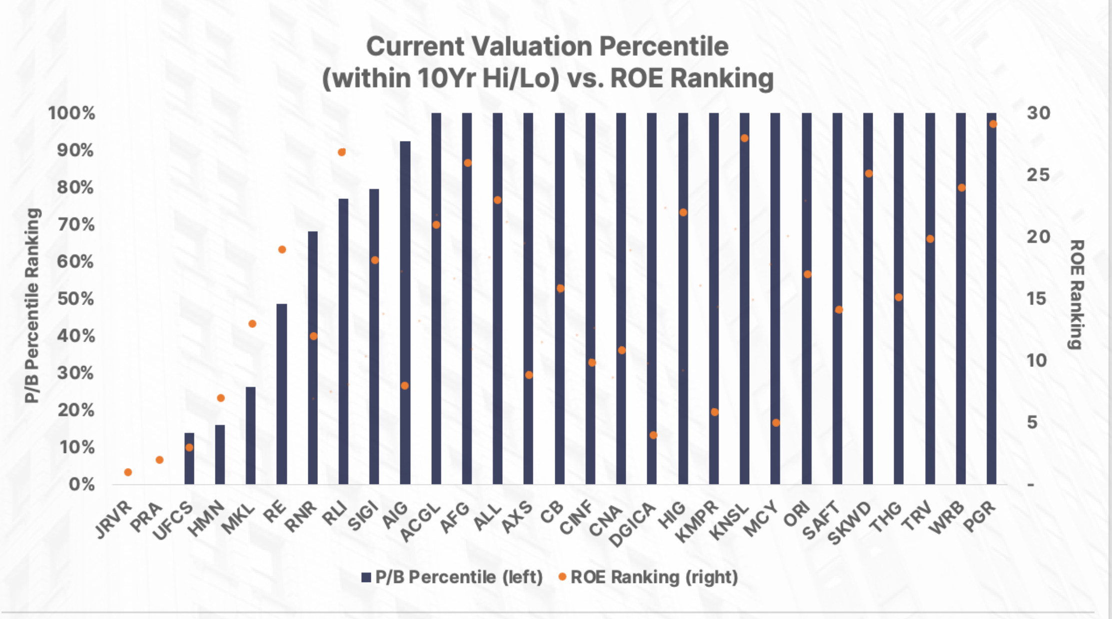
Most P&C stocks with higher relative valuations also have consistent double-digit ROEs. There are a few exceptions like AIG, which has been recovering from the brink of insolvency for the past decade and whose valuation remains weighted down.

For the most part, P&C insurance stocks that have a proven long-term track record of profitability (as measured by long-term combined ratio and ROE) will trade at a premium to their peers. But sometimes the stock market provides opportunities... either to enter a position at a reasonable price, or to exit a position.

How We Find Great P&C Stocks That Aren't "Too Expensive"

Of course, finding the right balance between profitability and valuation brings the best stocks to the top of the list. With the right metrics, we want to find stocks that are cheap by their own historical standards and that rank high in their relative profitability. Finding the right "overall score," defined below, is what we're after.

This chart shows a helpful breakdown of P&C stocks generally trading just above long-term averages. A more detailed list can be found in the table at the end of this report.



The chart graphs two key items:

A. It first graphs the current valuation (P/BV) on a percentile basis, so as to put each company on the same relative scale (blue bars, left axis).

- 100% = currently trading at a 10-year high; 0% = currently trading at a 10- year low; 50% = currently trading at the 10-year average, etc.
- So, for example, PGR is currently trading at the ~100th percentile of its long term range. That means PGR is currently trading near the top end of its historic valuation range, etc.

B. Then it incorporates each stock's long-term ROE ranking (orange dot, right axis).

- 29 = best (PGR)
- 1 = worst (JRVR)

So what we want to avoid is a stock with the combination of high (A), that is, relatively expensive, but low (B), that is, poor ranking on long-term ROE ranking (for example, MCY stands out here).

What we'd like to see is just the opposite... low (A), that is, relatively cheap by its own historical trading levels, but high (B), that is, great ranking on long-term ROE ranking. For example, Everest Group (EG), which is trading below its 50th percentile, but has the 11th best ROE ranking number 19 out of 29.

Ultimately, we combined each stock's current P/BV percentile with its ROE ranking to derive an "overall score."

Stocks with a low P/BV percentile are currently trading cheaply, relative to their own long-term average... generally a good thing. If that same stock scores well on the ROE ranking, then it will rank high on our overall score.

Stocks that rank low on our overall score are those that have a high current P/BV percentile (are relatively expensive compared to their own long-term average) but also a low long-term ROE profile.

We note that each stock in the top two of our overall score – Everest Group (EG) and RLI Corporation (RLI) share the following characteristics:

- Relatively inexpensive. Each is trading at or below the 77th percentile of their respective long-term average P/BV.
- High long-term ROE profile. Each has a top-tier ROE, greater than the overall group average of 10%. We note that of the 29 stocks in this report, only 14 have a long-term ROE greater than 10%. Of those 14, only our top two are trading below their 80th percentile P/BV.

We highlight these two stocks in our next table.

In addition, we've added the 10-year average growth of float and market value for each company. For the most part, high float growth translates to greater stock returns. Kinsale, one of our top insurance recommendations, has grown float by an average 35% per year while the stock's returned 44% per year. The top 5 performers in the Insurance Valuation Monitor averaged annual 28.6% return and float grew by 21.8% per year. The general trend can be a good valuation metric to track insurance companies but, it is important to note that there are few exceptions to this trend like W.R. Berkley and Selective.

P&C Insurance Valuation Monitor

		(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
Company	Ticker	Insurance Type / Focus	Market Cap ($m)	Current Price	Current P/B	10 Yr Averages			10 Yr Historical P/B			Current P/BV Premium (Discount)	Percentile Ranking	Overall Score	Float + Book Value ($M)	Current Premium (Discount) to Float	10 Yr CAGR of Float	10 Yr CAGR Market Cap Growth
						C/R	ROE	ROE Rank	Min	Avg	High							
Arch Capital Grp	ACGL	3,4	$41,752	$110.26	2.09x	85.2%	12.1%	21	1.19x	1.55x	2.09x	54%	100%	22	$39,817	5%	10%	20%
American Financial Grp	AFG	3	$11,225	$133.79	2.38x	90.4%	16.1%	26	0.77x	1.46x	2.38x	92%	100%	17	$14,446	-22%	8%	8%
American International Grp	AIG	2	$46,796	$72.67	1.06x	104.1%	6.8%	8	0.51x	0.83x	1.11x	24%	92%	20	$49,308	-5%	-1%	-5%
Allstate	ALL	1	$49,534	$187.60	2.86x	87.4%	12.5%	23	1.12x	1.65x	2.86x	121%	100%	21	$61,603	-20%	4%	6%
Axis Capital	AXS	3,4	$6,534	$77.67	1.31x	100.0%	6.8%	9	0.76x	0.91x	1.31x	40%	100%	28	$17,094	-62%	3%	3%
Chubb	CB	2	$116,684	$288.87	1.68x	89.9%	10.4%	16	1.02x	1.19x	1.68x	49%	100%	23	$138,397	-16%	11%	13%
Cincinnati Financial	CINF	1, 2	$21,221	$135.82	1.59x	94.8%	7.4%	10	1.19x	1.27x	1.59x	32%	100%	26	$26,602	-20%	7%	10%
CNA Financial	CNA	2	$13,604	$50.23	1.10x	96.0%	7.7%	11	0.41x	0.81x	1.10x	29%	100%	24	$43,111	-68%	0%	3%
Donegal Grp	DGICA	1, 2	$503	$15.35	1.06x	101.7%	4.2%	4	0.63x	0.79x	1.06x	27%	100%	29	$1,357	-63%	9%	0%
The Hartford	HIG	1, 2	$33,802	$115.36	1.87x	97.2%	12.4%	22	0.82x	1.21x	1.87x	66%	100%	11	$53,115	-36%	9%	7%
Horace Mann	HMN	1,2	$1,385	$33.98	0.94x	103.4%	6.5%	7	0.88x	1.04x	1.21x	-10%	16%	10	$5,635	-75%	3%	1%
James River Grp	JRVR	3	$258	$6.81	0.38x	102.3%	-1.5%	1	0.38x	1.20x	1.77x	-82%	0%	17	$1,869	-86%	8%	-10%
Kemper Corp	KMPR	1	$3,866	$60.01	2.21x	100.8%	5.8%	6	0.92x	1.68x	2.21x	53%	100%	26	$8,414	-54%	14%	8%
Kinsale Corp.	KNSL	3	$10,817	$464.53	8.60x	81.4%	20.5%	28	3.91x	6.66x	8.60x	195%	100%	5	$3,466	212%	35%	44%
Mercury General	MCY	1	$3,234	$58.41	1.96x	100.7%	5.5%	5	0.95x	1.30x	1.96x	66%	100%	25	$5,503	-41%	10%	2%
Markel Grp	MKL	2, 4	$20,163	$1,557.58	1.30x	95.0%	8.1%	13	1.16x	1.42x	1.67x	-12%	26%	7	$31,501	-36%	6%	8%
Old Republic Corp	ORI	3	$9,060	$35.05	1.49x	93.8%	11.0%	17	0.65x	0.91x	1.49x	57%	100%	13	$16,809	-46%	4%	10%
Progressive	PGR	1	$ 149,648	$255.56	6.41x	91.0%	22.9%	29	2.10x	4.40x	6.41x	201%	100%	15	$61,971	141%	17%	26%
ProAssurance Corp	PRA	3	$665	$13.00	0.59x	104.5%	1.5%	2	0.59x	1.03x	1.70x	-44%	0%	13	$4,168	-84%	5%	-12%
Everest Re Grp	EG	2, 4	$16,563	$382.75	1.17x	95.7%	11.5%	19	0.86x	1.06x	1.50x	11%	49%	2	$38,194	-57%	11%	9%
RLI Corp	RLI	3	$6,936	$151.63	4.38x	88.7%	20.1%	27	2.52x	3.50x	4.94x	88%	77%	1	$3,909	77%	9%	14%
RenaissanceRe Holdings	RNR	4	$13,483	$258.51	1.33x	91.6%	7.9%	12	0.98x	1.17x	1.49x	16%	68%	9	$25,108	-46%	26%	15%
Safety Insurance Grp	SAFT	1	$1,227	$82.67	1.51x	98.0%	8.7%	14	0.91x	1.28x	1.51x	23%	100%	17	$1,744	-30%	3%	2%
Selective	SIGI	2	$5,533	$90.95	1.89x	95.4%	11.1%	18	1.22x	1.68x	2.07x	22%	80%	6	$8,463	-35%	6%	15%
Skyward Specialty	SKWD	3	$1,559	$38.88	2.24x	91.6%	15.7%	25	2.12x	2.18x	2.24x	6%	100%	4	$1,731	-10%	21%	37%
The Hanover Grp	THG	1, 2	$5,307	$147.48	2.06x	98.0%	9.4%	15	0.94x	1.46x	2.06x	60%	100%	11	$8,573	-38%	2%	6%
The Travelers Companies	TRV	1, 2	$55,011	$241.35	2.18x	94.3%	12.0%	20	1.12x	1.43x	2.18x	75%	100%	7	$90,394	-39%	4%	6%
United Fire Grp	UFCS	2	$525	$20.71	0.71x	103.9%	2.5%	3	0.62x	0.88x	1.33x	-16%	14%	15	$2,111	-75%	5%	-4%
W.R. Berkley Corp	WRB	3	$22,403	$58.84	2.85x	92.7%	14.2%	24	1.22x	1.92x	2.85x	94%	100%	3	$25,716	-13%	7%	14%
Average							10.0%					46%	80%		$27,246	-0.2x	9%	9%

Footnotes:

(3) The type of insurance the company generally focuses on.
1: Personal; 2: Commercial; 3: Specialty; 4: Reinsurance

(5) Stock current price

(6) Stock current valuation, as measured by price/book value

(7) 10-year average combined ratio (see glossary of terms in the write-up)

(8) 10-year average return on equity (ROE; see glossary of terms in the write-up)

(9) ROE ranking, from 1 (worst) to 29 (best)

(10) 10-year low P/B

(11) 10-year average P/B

(12) 10-year high P/B

(13) = (2) - (7). Current valuation relative to historical average.

(14) = [(6) - (10)] / [(12) - (10)]. Current P/B percentile ranking within its high and low range

(15) Overall score (1 best; 29 worst) based on ROE rank and P/B percentile rank

(16) Book value plus "insurance float", succinctly defined as premiums held on books until claim payments are made

(18) Compound annual growth rate of float over the last 10-years or since IPO

(19) Compound annual growth rate of market cap over the last 10-years or since IPO

The rich valuations do not concern us right now. Book value for insurance companies is highly correlated to interest rates, which means it can rise or fall regardless of the strength of the companies themselves.

In most cases, assets of a P&C insurance company consists of about 70% to 75% invested assets – for which they derive investment income from the float. Of that, the majority is in fixed-income products. Over the past two to three years, as interest rates have surged, we have seen a corresponding decline in the value of the invested assets, pushing book value down (recall that book value is the denominator in the valuation metric that we use: P/BV).

However, at the same time that the denominator declined due to the fall in book value, the numerator, most insurance stock prices, actually rose through 2022 and 2024. As a result, the stock values in this group are trading above the 10-year average, with many trading at or near their highest valuations of the last decade.

Today's elevated valuations on a price-to-book basis are mostly a function of the denominator - book values - remaining depressed due to still-high levels of interest rates. On a price-to-earnings basis, many of these stocks trade at much more attractive valuations, given the current record earnings for insurance companies across the board. Meanwhile, with the Fed now entering a rate cutting cycle, this will boost the value of the bond holdings held on insurance company balance sheets. This will cause book values to increase, and make the valuations more attractive as the denominator in the price-to-book ratio rises.

We will continue to monitor these stocks in our own **portfolio** and add others as they reach attractive prices. Of course, valuation is far from the only factor we examine when researching property & casualty stocks – see our **Guidebook** for a fuller list of our criteria – but it's an important piece of the puzzle.