

## The Hanover

## 4Q23 beat on attritional loss ratio improvement

Reiterate Rating: NEUTRAL | PO: 137.00 USD | Price: 132.01 USD

## The Hanover reports 4Q23 op. EPS of \$3.13

This is a beat vs our forecast of \$2.52 and Consensus of \$2.70. The beat was primarily driven by a better core loss ratio (\$0.65/sh), lower catastrophe losses (\$0.15/sh), and better reserve development (+\$0.10/sh), partly offset by a higher-than-expected tax rate. Premiums written growth of +1% decelerated sharply from +6% in 3Q23 and missed our forecast of +8% as the company ramped up reunderwriting actions to improve margins. Continuing strong rate trends partly offset top line pressure from corrective actions.

## Core loss ratio beats forecast

The core loss ratio of 60.2% beat our forecast of 62.2% and improved 310bps YoY. The Personal lines core loss ratio of 68.0% was better than our expected 70.5%, with both auto and homeowners' contributing. However, the improvement is likely somewhat due to atypically benign weather (4Q has seasonally higher losses from driving in dark, icy conditions). The Specialty underlying loss ratio of 49.5% also beat our forecast of 53.5% and company expectations of "low-50%'" due to favorable marine losses. The Core Commercial attritional loss ratio was essentially in line with our projection. We have modestly reduced our forward core loss ratios following the favorable 4Q23 results.

## First glimpse into 2024E outlook

Following a spate of elevated catastrophe losses, the company has provided a 2024E expected cat load of 7.0% vs original guidance of 5.1% for 2023 (reported 12.2%). We have increased our forward cat losses to better reflect company expectations. The company believes the 2024E cat load will be a "high watermark" as ongoing remedial actions earn into the book over time. We forecast only a modestly better 2025E cat load vs 2024E; we acknowledge upside vs our forecast if improvement is greater than we currently expect. On an ex-cat basis, the company guides to a 2024E combined ratio of 90-91% vs 91.3% for 2023E; we estimate within the range at 90.3% as margin improvement initiatives take hold. We expect top line growth to slow to +4% vs +6% in 2023 as targeted non-renewals continue, particularly early in the year.

## Price objective to \$137

Our EPS forecasts net fall on higher cat losses and lower growth, partly offset by better attritional losses. We increase our PO to \$137 from \$130, reflecting the year-ahead P/E multiple (10.4x vs prior 9.5x) on our 2025E EPS forecast. Peer group multiple expansion offsets the impact of lower EPS. We reiterate Neutral on balanced risk-reward.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	5.53	1.56	10.50	13.15	14.70
GAAP EPS	3.21	0.98	10.50	13.15	14.70
EPS Change (YoY)	-36.7%	-71.8%	573.1%	25.2%	11.8%
Consensus EPS (Bloomberg)			10.81	12.77	NA
DPS	3.06	3.28	3.45	3.65	3.85
Valuation (Dec)					
P/E	23.9x	84.6x	12.6x	10.0x	9.0x
GAAP P/E	41.1x	134.7x	12.6x	10.0x	9.0x
Dividend Yield	2.3%	2.5%	2.6%	2.8%	2.9%

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31 January 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	130.00	137.00
2024E EPS	11.15	10.50
2025E EPS	13.70	13.15
2026E EPS	15.15	14.70

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## Stock Data

Price	132.01 USD
Price Objective	137.00 USD
Date Established	31-Jan-2024
Investment Opinion	B-2-7
52-Week Range	103.83 USD - 148.78 USD
Mkt Val (mn) / Shares Out (mn)	4,721 USD / 35.8
Free Float	98.9%
Average Daily Value (mn)	18.41 USD
BofA Ticker / Exchange	THG / NYS
Bloomberg / Reuters	THG US / THG.N
ROE (2024E)	14.8%
Net Dbt to Eqty (Dec-2023A)	NA
ESGMeter™	High

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

# iQprofile<sup>SM</sup> The Hanover

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premiums	5,252	5,663	5,949	6,261	6,610
Net Investment Income	296	332	371	400	429
<b>Total Revenue</b>	<b>5,575</b>	<b>6,026</b>	<b>6,349</b>	<b>6,690</b>	<b>7,069</b>
Total Cost of Benefits and Claims	(3,623)	(4,135)	(3,960)	(4,106)	(4,320)
S,G & A (Including Commissions)	(1,638)	(1,753)	(1,844)	(1,918)	(2,013)
<b>Total Operating Expenses</b>	<b>(5,324)</b>	<b>(5,955)</b>	<b>(5,868)</b>	<b>(6,088)</b>	<b>(6,398)</b>
<b>Pre-Tax Operating Earnings</b>	<b>251</b>	<b>72</b>	<b>481</b>	<b>602</b>	<b>671</b>
Income Tax Expense	(51)	(15)	(100)	(125)	(140)
<b>Operating Earnings After Tax</b>	<b>200</b>	<b>56</b>	<b>381</b>	<b>476</b>	<b>531</b>
<b>Net Income (Reported)</b>	<b>116</b>	<b>35</b>	<b>381</b>	<b>476</b>	<b>531</b>
Diluted Shares	36	36	36	36	36
Operating Earnings Per Share	5.53	1.56	10.50	13.15	14.70
Net Income (Reported) Per Share	3.21	0.98	10.50	13.15	14.70

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Fixed Income Securities	7,482	7,985	8,502	9,105	9,756
Total Cash and Investments	8,815	9,229	9,827	10,523	11,276
<b>Total Assets</b>	<b>13,997</b>	<b>14,613</b>	<b>15,336</b>	<b>16,163</b>	<b>17,054</b>
Reserves	7,013	7,308	7,704	8,115	8,547
LT Debt	782	783	783	796	796
<b>Total Liabilities</b>	<b>11,672</b>	<b>12,147</b>	<b>12,654</b>	<b>13,215</b>	<b>13,792</b>
<b>Total Equity</b>	<b>2,326</b>	<b>2,466</b>	<b>2,682</b>	<b>2,948</b>	<b>3,261</b>
<b>Total Equity (Ex FAS 115)</b>	<b>2,326</b>	<b>2,466</b>	<b>2,682</b>	<b>2,948</b>	<b>3,261</b>
Book Value per Share (Reported)	65.33	68.87	74.72	82.47	91.51
Book Value per Share (Ex FAS 115)	85.14	83.32	89.12	96.94	106.02

## Ratios (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Expense Ratio	31.2%	31.0%	31.0%	30.6%	30.4%
Loss Ratio	69.0%	73.0%	66.6%	65.6%	65.4%
<b>Combined Ratio</b>	<b>100.2%</b>	<b>104.0%</b>	<b>97.6%</b>	<b>96.2%</b>	<b>95.8%</b>
Avg Assets / Avg Eq (Ex FAS 115) Ratio	5.2x	6.0x	5.8x	5.6x	5.3x

## Growth Rates (YoY) (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Earned Premium	10.1%	7.8%	5.0%	5.2%	5.6%
Net Investment Income	-4.6%	12.1%	11.8%	7.7%	7.5%
Total Revenue	9.2%	8.1%	5.4%	5.4%	5.7%
Operating Earnings per Share	-36.7%	-71.8%	573.1%	25.2%	11.8%
Asset	-1.8%	4.4%	5.0%	5.4%	5.5%
Reported Book Value per Share	-26.3%	5.4%	8.5%	10.4%	11.0%

## Performance Metrics (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Operating ROE	7.6%	2.4%	14.8%	17.0%	17.1%
Operating ROE (Ex FAS 115)	NA	NA	NA	NA	NA
Operating Return on Average Assets	1.4%	0.4%	2.5%	3.0%	3.2%
Operating Margin	3.6%	0.9%	6.0%	7.1%	7.5%
Long Term Debt to Cap Ratio (Ex FAS 115)	25.2%	24.1%	22.6%	21.3%	19.6%
Net Income % Operating Income	100.1%	99.8%	100.0%	100.0%	100.0%
Amtz of DAC % Pretax Profit bef Amtz of DAC	0%	0%	0%	0%	0%

## Company Sector

Insurance - Non-Life

## Company Description

The Hanover is a domestic Property & Casualty (P&C) carrier that offers Core Commercial, Specialty Commercial, and Personal lines coverage. The Core Commercial book focuses on small and mid-sized enterprises. The company's footprint is primarily concentrated in the Midwest, Northeast, and Southeast, although it also has strong commercial presence in the West. The company aims to be the premier carrier in the independent agent space.

## Investment Rationale

While we prefer The Hanover's business mix vs that of the industry broadly, we expect valuation to remain in line with that of the group. The company is currently undergoing remediation efforts across its catastrophe footprint, middle market commercial margins, and personal lines margins, and we believe the stock is unlikely to capture a premium valuation in the midst of these efforts. Relatively limited upside vs our PO translates to a Neutral rating.

## Stock Data

Average Daily Volume 139,430

## Quarterly Earnings Estimates

	2023	2024
Q1	0.13A	2.52E
Q2	-1.91A	2.00E
Q3	0.19A	2.78E
Q4	3.13A	3.20E

## Price objective basis & risk

### The Hanover (THG)

Our price objective of \$137 reflects 100% of the P&C group forward P/E multiple (10.4x) applied to our 2025E EPS forecast. We assign a relative valuation near historical averages. We believe the stock will have difficulty capturing the premium valuation implied by the company's business mix while it executes its margin remediation plan.

Bi-directional risks to our PO are catastrophic losses, reserve development, investment yields, changes in P&C pricing trajectory, evolving loss cost trends, and changes in the competitive environment.

## Analyst Certification

I, Grace Carter, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Aflac	AFL	AFL US	Joshua Shanker
	Allstate Corp.	ALL	ALL US	Joshua Shanker
	American International Group	AIG	AIG US	Joshua Shanker
	Arch Capital	ACGL	ACGL US	Joshua Shanker
	Assurant	AIZ	AIZ US	Grace Carter, CFA
	Axis Capital	AXS	AXS US	Joshua Shanker
	BRP Group, Inc.	BRP	BRP US	Joshua Shanker
	Cincinnati Financial Corporation	CINF	CINF US	Grace Carter, CFA
	Corebridge Financial	CRBG	CRBG US	Joshua Shanker
	Everest Group Ltd	EG	EG US	Joshua Shanker
	Intact Financial	YIFC	IFC CN	Grace Carter, CFA
	Intact Financial	IFCZF	IFCZF US	Grace Carter, CFA
	MetLife	MET	MET US	Joshua Shanker
	Progressive	PGR	PGR US	Joshua Shanker
	RenaissanceRe	RNR	RNR US	Joshua Shanker
	The Hartford	HIG	HIG US	Joshua Shanker
	Voya	VOYA	VOYA US	Joshua Shanker
	W.R. Berkley	WRB	WRB US	Joshua Shanker
<b>NEUTRAL</b>				
	Aon	AON	AON US	Joshua Shanker
	Brown & Brown	BRO	BRO US	Grace Carter, CFA
	CNA Financial	CNA	CNA US	Joshua Shanker
	Lincoln National	LNC	LNC US	Joshua Shanker
	Marsh McLennan	MMC	MMC US	Joshua Shanker
	Principal Financial Group	PFG	PFG US	Joshua Shanker
	Prudential Financial	PRU	PRU US	Joshua Shanker
	The Hanover	THG	THG US	Grace Carter, CFA
	Trupanion	TRUP	TRUP US	Joshua Shanker
	Unum	UNM	UNM US	Joshua Shanker
<b>UNDERPERFORM</b>				
	Arthur J. Gallagher & Co.	AJG	AJG US	Joshua Shanker
	Chubb Ltd	CB	CB US	Joshua Shanker
	Goosehead Insurance Inc.	GSHD	GSHD US	Joshua Shanker
	Selective	SIGI	SIGI US	Grace Carter, CFA



## US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Travelers Cos	TRV	TRV US	Joshua Shanker
	Willis Towers Watson	WTW	WTW US	Joshua Shanker

**iQmethod<sup>SM</sup> Measures Definitions**

Business Performance	Numerator	Denominator
Return On Capital Employed	$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$	$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5 Year CAGR From Latest Actual	N/A
Free Cash Flow	$\text{Cash Flow From Operations} - \text{Total Capex}$	N/A
Quality of Earnings	Numerator	Denominator
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	$\text{Net Debt} = \text{Total Debt} - \text{Cash \& Equivalents}$	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit	Numerator	Denominator
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	$\text{Cash Flow From Operations} - \text{Total Capex}$	$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$
Enterprise Value / Sales	$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$	Sales
EV / EBITDA	Enterprise Value	$\text{Basic EBIT} + \text{Depreciation} + \text{Amortization}$

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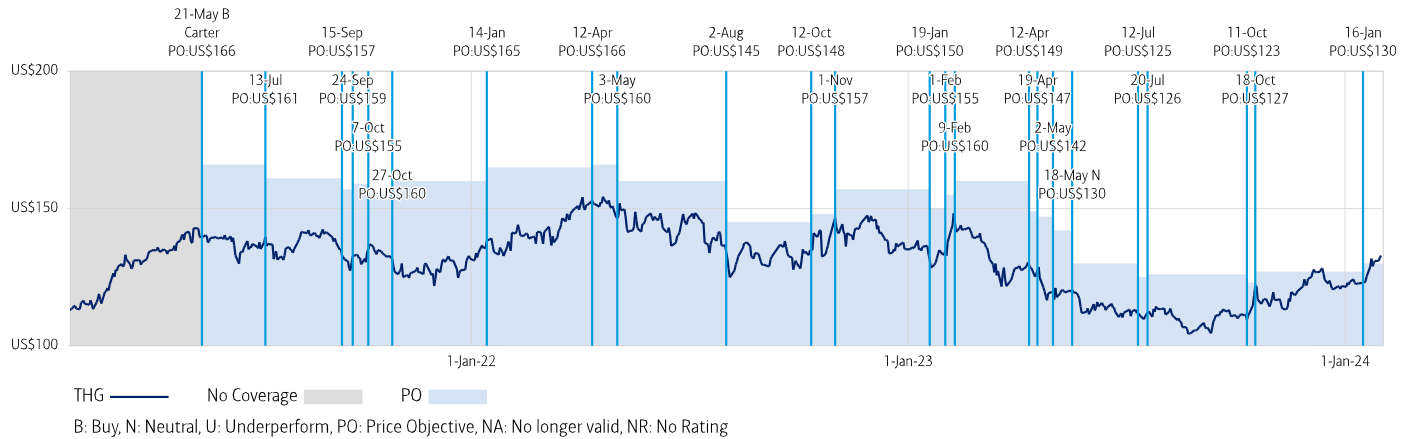
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### Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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