The Hanover Insurance Group, Inc. NYSE:THG

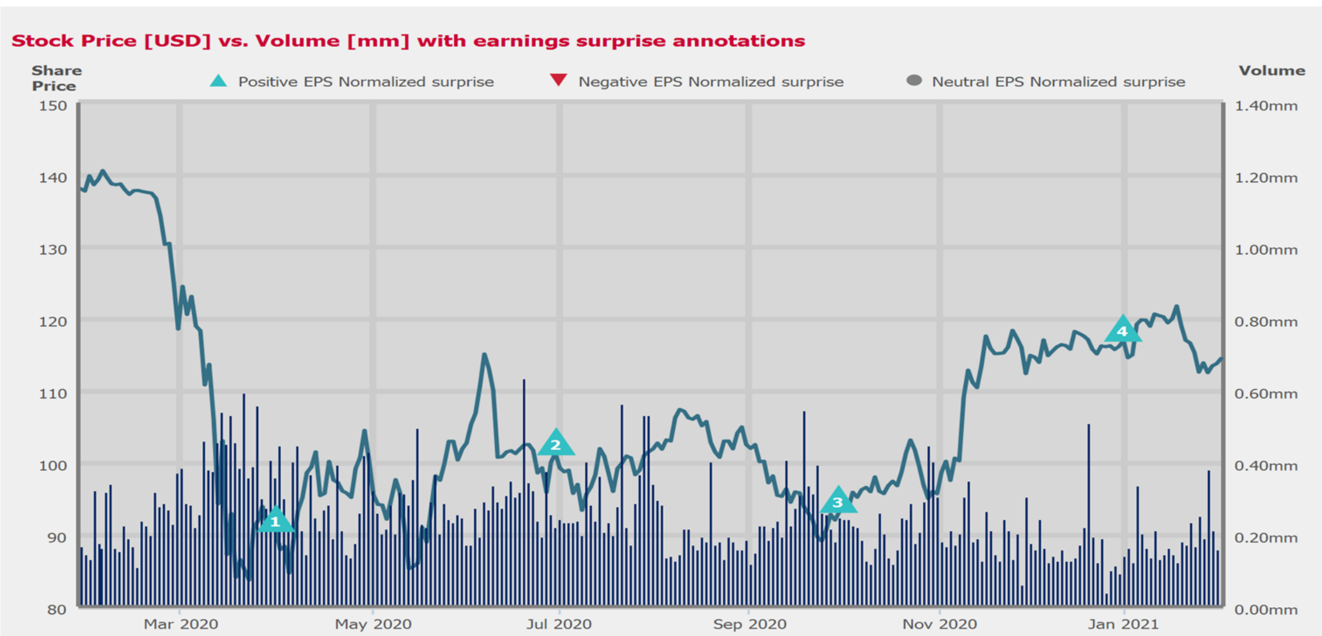
FQ4 2020 Earnings Call Transcripts

Thursday, February 04, 2021 3:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2020-			-FQ1 2021-	-FY 2020-			-FY 2021-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS
EPS Normalized	2.37	3.02	27.43	2.53	8.70	9.32	7.13	9.15
Revenue (mm)	1137.60	1112.10	(2.24 %)	1170.95	4624.00	4598.50	(0.55 %)	4812.35

Currency: USD
Consensus as of Feb-04-2021 3:35 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2020	2.03	2.23	1 9.85 %
FQ2 2020	1.08	1.63	2 50.93 %
FQ3 2020	2.22	2.46	3 10.81 %
FQ4 2020	2.37	3.02	4 27.43 %

Table of Contents

Call Participants

EXECUTIVES

Bryan James Salvatore
Executive VP & President of Specialty

Jeffrey Mark Farber
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Presentation

Operator

Good day, and welcome to the Hanover Insurance Group's Fourth Quarter Earnings Conference call. My name is Sarah, and I'll be your operator for today's call. [Operator Instructions] Please note, this event is being recorded. I would now like to turn the conference over to Oksana Lukasheva. Please go ahead.

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Thank you, operator. Good morning, and thank you for joining us for our quarterly conference call. We will begin today's call with prepared remarks from Jack Roche, our President and Chief Executive Officer; and Jeff Farber, our Chief Financial Officer. Available to answer your questions after our prepared remarks are Bryan Salvatore, President of Specialty Lines; and Dick Lavey President of Agency Markets.

Before I turn the call over to Jack, let me note that our earnings press release, financial supplement and a complete slide presentation for today's call are available in the Investors section of our website at www.hanover.com. After the presentation, we will answer questions in the Q&A session. Our prepared remarks and responses to your questions today, other than statements of historical fact, include forward-looking statements regarding, among other things, our outlook and guidance for 2021, the ongoing impacts of the pandemic, economic conditions, impact of seasonality and other factors impacting our company performance.

There are certain factors that could cause actual results to differ materially from those anticipated. We caution you with respect to reliance on forward-looking statements. And in this respect, refer you to the forward-looking statements section in our press release, the presentation deck and our filings with the SEC, which includes supplemental risk factors related to the COVID-19 pandemic and general economic conditions.

Today's discussion will also reference certain non-GAAP financial measures such as operating income and accident share loss and combined ratios, excluding catastrophes, among others. A reconciliation of these non-GAAP financial measures to the closest GAAP measure on a historical basis can be found in the press release, the slide presentation or the financial supplement, which are posted on our website, as I mentioned earlier. With those comments, I will turn the call over to Jack.

John Conner Roche
President, CEO & Director

Thank you, Oksana. Good morning, everyone, and thank you for joining our call. I will begin with some commentary on our full year financial highlights in the context of the business and economic environment. I will then provide a strategic view of our segments and our 2020 accomplishments. Jeff will review our financial results for the quarter and the year as well as our 2021 outlook, and then we'll be happy to open it up for questions.

We reported outstanding results in the quarter and for the year, delivering strong operating earnings and significant value for our shareholders. In the face of unprecedented challenges, our 4,300 employees and our company rose to the occasion in 2020. We quickly and effectively adapted to the rapidly changing market conditions and customer expectations, while flexing our agile operating model and driving innovation across our organization and the insurance value chain.

In a year defined by the coronavirus pandemic, social unrest, economic disruption and challenging weather, we relied on and even further strengthened our unique, collaborative and nimble culture. And made good on our promises to our agents, customers and communities. And we continue to create value for our shareholders, generating exceptional profitability and high-quality premium growth despite the prevailing economic conditions. Ultimately, thriving in ways we believe position our company for even greater success in 2021 and the years ahead.

For the year, we reported operating earnings per share of $9.32, up 14% from 2019 and a strong operating return on equity of 13.1%, in line with our long-term target. Our performance on the year highlighted the overall effectiveness of our strategy, the resiliency of our business and our ability to drive sustainable, broad-based profitability. In particular, I want to share the following financial observations: First, we managed well in spite of the changing market conditions, continuing to enhance our operating model and invest in our capabilities, positioning the company to deliver strong profitable growth going forward. Despite the many economic challenges related to widespread business limitations and restrictions, we delivered net written premiums of $4.6 billion for the year, up from 2019. After hitting a low mark in the second quarter, we delivered improved growth through the remainder of the year. We expect exposure declines in 2020 will bounce back in 2021, as the economy continues to recover and distribution of the COVID-19 vaccines continues to ramp up.

Our resiliency in 2020 highlights the efficacy of our unique distribution strategy, the strength and commitment of our agent partnerships and our ability to provide a diversified portfolio of products and services to our customers and agents. We are also very encouraged by improvements in the leading growth indicators, ranging from Commercial Lines PIF growth to increased consolidation activity with our top agents, and a gradual pickup in Personal Lines retention. The momentum we have reestablished in our business position us well to accelerate growth as the economy continues to strengthen throughout 2021.

Second, we delivered strong underwriting results with an all-in combined ratio of 94.4% for the year and 88.1%, excluding catastrophes. Our robust underwriting performance in 2020 went beyond the temporary frequency benefits we realized in personal auto. In fact, we delivered returns at or above target in all 3 major business units while continuing to build our earnings consistency.

Though 2020 was an active catastrophe year for the P&C industry overall, the impact of cat on our business was considerably more modest. Our strong performance relative to the industry is a reflection of the many prudent underwriting actions we have taken over several years as well as our continuing discipline with respect to property aggregation. Our ability to outgrow the market, going forward, requires we consistently generate top quartile returns. To that end, once again, we generated excellent returns in 2020, enabling us to take a more aggressive and opportunistic approach to growth in 2021 and beyond as the market provides opportunities.

Third, we continue to be prudent and responsible stewards of our shareholders' capital. 2020 marked the 15th consecutive year, in which the Hanover increased its ordinary dividend. In addition, during the year, we repurchased approximately 2.2 million shares of our company's common stock, deploying $212 million in underscoring the confidence we have in our company's financial earnings and growth prospects. 2020 was a very strong year for us, and we begin 2021 feeling optimistic and confident. We are well capitalized with a very strong balance sheet, a proven business strategy, unique and targeted distribution approach and responsive and innovative products and services. We are intently focused on delivering value and outperforming the industry over the long term.

Turning now to our key strategic accomplishments for the year. We successfully advanced our strategic imperatives and made important progress toward our vision to be the premier P&C franchise in the independent agency channel. A franchise that delivers relevant and innovative risk management solutions while helping our agents transform the way customers experience and value insurance. Our Personal Lines team delivered exceptionally strong earnings during the year, continuing to effectively manage its book of business, finding the right balance between rate and retention on our renewal book and maintaining our commitment to sustainable profitable growth.

As an account writer, we take a disciplined and long-term approach to renewal price across our home and auto policies, so as not to cause excessive disruption for customers and agents. That said, we took pricing actions in the second half of 2020 to protect our profitable renewal book, and we'll continue to do so as market conditions warrant. Those actions started to have a positive impact in the fourth quarter and in January. And we should see retention improving throughout the year, eventually getting back to historical levels.

With respect to aggressive new business price competition, we believe some competitors in the Personal Lines auto sector are being shortsighted. Pandemic related frequency benefits are temporary in nature, and we want to be responsive in our pricing without setting the stage for significant increases in the not-too-distant future. As auto frequency returns to near-normal levels, we want to be positioned for growth and not have to drive outsized increases in recently acquired customers. Additionally, we remain mindful of increased severity in the current environment due to higher intensity incidents and the reemergence of social inflation as the nation transitions out of the pandemic.

Our recent new business indicators are beginning to suggest a return to positive growth momentum. We signed a record number of consolidation agreements with our partners in 2020, which we expect will provide a new business tailwind in 2021. During 2020, we expanded our first lines product offerings with the introduction of Home Business Solutions, a suite of business insurance products for homeowners who manage home-based businesses. In addition, we gained further momentum with our Hanover Prestige offering, which caters to customers with more complex insurance needs. We added more than 7,000 new Hanover Prestige customer accounts during the year and exceeded our full year 2020 new business target, with new business growth nearly 30% higher than in the prior year.

We also expanded our Personal Lines footprint to 20 states in 2020, beginning to write business in Maryland on the heels of adding Vermont and Pennsylvania over the last couple of years. We start 2021 with enormous optimism and believe that our agency relationships, consolidation commitments, customer centricity and expanded footprint will enable us to reestablish our prepandemic growth momentum in Personal lines. We are also very pleased with the performance of our commercial businesses in 2020. Our Commercial Lines team successfully navigated an especially difficult economic environment, while continuing to focus on growth in our most profitable segments. Our diversified industry mix in Core Commercial enabled us to deliver solid growth in the most vibrant and growing industries, such as technology, life sciences, light manufacturing, financial services and educational institutions, while also enabling us to continue to manage profitability in select Property Lines.

In Specialty, we are achieving double-digit growth in management liability and Hanover Specialty property, which are among our most profitable businesses. We continue to expand our products and capabilities, strengthening our offerings for financial institutions, retail E&S and cyber customers. We also advanced our total Hanover strategy, leveraging our specialized capabilities across our Commercial Lines customer base.

Commercial Lines net written premiums were up both for the year and the quarter, as we capitalize on the hardening market to obtain rate, with fourth quarter Core Commercial rate increases of 6.4% and Specialty increases of 8.9%, up sequentially from 5.7% and 7.2% in the third quarter, respectively. At the same time, we are seeing a tightening of new business versus renewal pricing, which indicates further market discipline and solid execution. We believe there is more opportunity ahead to achieve additional rate increases with the continuation of many market catalysts, including low interest rates, ongoing pressure in larger liability account size segments and social inflation.

Across our commercial book, we are seeing rate meaningfully exceed loss trends. Policy exposures and endorsements coming back and our policy counts continuing to grow. These and other factors support our belief that our growth will accelerate throughout the year as the economy continues to recover and through continued market share gains with our agent partners. Our broad industry offering and specialty expertise, combined with deep business insights and agency partnerships, positions us to drive growth in an improving economic climate and in a firm commercial rate environment in 2021.

One of the most profound takeaways for us coming out of 2020 was how quickly things can change. More than ever before, our company flexed its agility and its innovative spirit, giving us even more confidence in our ability to continue to do so going forward. We recognized, as never before, the opportunity that exists in becoming even more customer-centric. Identifying ways to be more efficient and easier to work with in all aspects of customer and agency interaction, including policy acquisition, quoting and underwriting, customer service and claims settlement.

As an organization, we were well prepared to meet the demands of 2020, having invested significantly over the past several years to enhance our major underwriting and quoting platforms. In fact, almost every area of our technology stack had been upgraded or replaced over the last 5 years to enable our business solutions with a more open environment. Our Personal Lines TAP Sales platform now has been deployed in all of our Personal Lines markets, and we have started the rollout of our new small commercial underwriting and agent interface platform. This new Commercial Lines TAP Sales platform will be deployed across the country by the end of 2021.

Additionally, prior upgrades to our major claims and billing systems allowed us to move to a virtual environment overnight, providing our agent partners and customers with a high level of service. We are also bringing our customer and agent connectivity to the forefront of our digital road map. Through multiple agency management systems and InsureTech solutions, we have and are committed to further enhance the overall effectiveness of data sharing between agents, customers and underwriters. In 2020, we expanded customer online inquiry and self-service to commercial lines, while also driving efficiencies with e-billing and e-delivery in Personal Lines. Innovation also is playing a key role in claims, as we increasingly use digitization and technology platforms to virtually complete auto estimates and reinspections using Hanover staff.

The same is true on the property side of the business. Global 360, our downloadable self-service application with virtual interactive inspection capabilities, now processes more than half of the losses that previously would have been adjusted in person. These digital assets make it easier to do business with us today, and they also improve our ability to identify loss trends, enhance operational efficiency, and allow us to fully address the needs and preferences of our customers and agents holistically. The ability to innovate in an agile and thoughtful way is becoming one of the most crucial competitive advantages for insurance companies, and we believe we have what it takes to continue to innovate efficiently. We're proud of the accomplishments we've made to date, but it's our growth mindset and innovative culture that will enable us to embrace the opportunities ahead.

In a year defined by rapid change, economic and social strain and new customer expectations, we elevated our focus in inclusion and diversity and are committed to making ours an even more inclusive and diverse organization. During the year, we made important strides, including the further development of our employee-led business resource groups, continued unconscious bias and inclusive leadership training in the publication of our inaugural inclusion and diversity report, which is available on our website. These important initiatives have been central to our business success over the last few years and will enable us to prosper well into the future.

In parallel, we are advancing our sustainability goals by further incorporating environmental, social and governance factors as we manage our company's investment portfolio, addressing environmental risks and implementing practices that promote and encourage environmentally responsible behavior. These steps are essential in helping us continue to attract and retain outstanding talent, sustain our competitive advantage and maintain top quartile performance in our rapidly changing world.

I am extremely proud of our 2020 performance, which reflects the inherent strength of our company, the effectiveness of our strategy and the versatility of our business model. We begin 2021 in a position of strength, both operationally and financially and look to the year ahead with great optimism. We have a proven and unique business strategy, deep partnerships with the best independent agents in our industry and the talent and drive needed to deliver superior value for all of our stakeholders. With that, I will now turn the call over to Jeff for a review of our financials and 2021 guidance. Jeff?

Jeffrey Mark Farber
Executive VP & CFO

Thank you, Jack. Good morning, everyone. For the quarter, we reported net income of $164.6 million or $4.43 per diluted share compared with $109.8 million or $2.76 per diluted share in 2019. After-tax operating income for the quarter was $112 million, or $3.02 per diluted share compared with $80.2 million or $2.01 per diluted share in the prior year quarter. For the year, net income was $358.7 million or $9.42 per diluted share compared with $425.1 million or $10.46 per diluted share in 2019. Operating income for the year was $355 million or $9.32 per diluted share compared with $331.6 million or $8.16 per diluted share in 2019.

Our fourth quarter earnings reflected a combined ratio of 92.4%, an improvement from 96.2% in the fourth quarter of 2019 due to prior underwriting and rate actions, favorable loss frequency and favorable prior year development. Our combined ratio for the full year improved to 94.4% from 95.6% in 2019, again, reflecting mix improvements and favorable loss frequency, partially offset by higher cats. Fourth quarter 2020 catastrophes totaled $35.1 million or 3% of earned premium, which was below our catastrophe load assumption of 3.6%. Full year catastrophes totaled $286.7 million or 6.3% of earned premium.

While full year cat losses were above our expectations due to a particularly active Q2 and Q3, our overall cat loss experience compared favorably with the industry as a whole. In fact, more than half of our cats above our expectations stem from losses associated with social unrest. This underscores the effectiveness of our prior aggregation management initiatives. Our diversified business mix and prudent risk management practices should continue to serve us well over the long term. That being said and considering changes in weather patterns in certain geographies in the U.S., we believe it is prudent to increase our catastrophe load for 2021 from 4.6% to 4.9%. Even though our PMLs and 10-year averages remain relatively stable. We believe it is thoughtful to assume higher weather-related catastrophe losses going forward, which should appropriately impact our pricing targets and return expectations in cat prone lines.

Excluding catastrophes, we delivered a full year combined ratio of 88.1%, well below our original guidance of 91% to 92%. Our full year 2020 expense ratio of 31.6% was flat with 2019, short of our original expectations due to higher variable agent and employee compensation costs from better-than-expected profits. We expect to achieve a 30 basis point expense ratio improvement for full year 2021, which puts us right on track with our long-term expense ratio savings target of 20 basis points per year. We executed well on our original cost management and efficiency targets for 2020. We also achieved additional savings to address the lower premiums earned during the year due to lack of growth and premium returns. For the most part, these savings are permanent in nature, giving us confidence in our expected 31.3% expense ratio in 2021.

For the year, we recorded favorable prior year reserve development of $15.5 million or 0.3 points of the combined ratio. This was driven primarily by continued favorability in Workers' Comp, partially offset by pressure in auto bodily injury and commercial multi-peril. Our conservative approach to reserves reinforces our commitment to react quickly to trends in order to mitigate the potential for issues down the road. From that standpoint, we concluded 2020 with a very strong balance sheet. This is a direct result of our reserving consistency and discipline. Several years of prudent underwriting and pricing actions in certain specialty lines and in commercial auto, in addition to other initiatives to enhance profitability. We continue to prudently hold COVID reserves, although loss activity has been limited. Our mix of business, specifically not writing travel, trade credit or event cancellations, and our use of ISO based forms has served us well during the pandemic.

Turning to underwriting results in each of our businesses. With the full year now behind us, I will focus my comments on our full year 2020 results, but will mention quarterly movements where relevant. Personal Lines reported a full year combined ratio, excluding catastrophes, of 84%, down from 91.6% in 2019. This improvement was driven primarily by personal auto. Our personal auto ex-cat accident year loss ratio was 61.3% in 2020, an improvement of 10.3 points from the prior year, as a result of the claims frequency benefit associated with the pandemic.

While frequency has declined across our footprint, we benefited less in the second half of the year than in the second quarter, as stay-at-home orders and business restrictions eased to varying degrees. Going forward, we expect frequency will gradually return to historical norms and anticipate ending 2021 with fourth quarter frequency relatively in line with levels before the pandemic. Overall, we expect our Personal Lines loss ratio in 2021 will, of course, increase from 2020, but should remain a little lower than 2019, primarily due to the timing of remaining loss frequency benefits diminishing throughout the year.

In homeowners, our 2020 ex-cat current accident year loss ratio was 49.1%, up 1.2 points from 2019 due to some elevated fire and property losses. We continue to take strong rate of 5% in homeowners, not including the inflation adjustment in the year, and we expect profitability in 2021 to be relatively in line with ex-cat results in 2020. Personal Lines net premiums written declined 0.5% for the full year, including the impact of the premium refunds issued in the second quarter. We believe our customer-centric strategy and high level of engagement with agents will continue to drive growth once the benefit of frequency subsides. During the year, we appointed 170 new agents and achieved record consolidation signings.

Turning to Commercial Lines. Our full year combined ratio, excluding catastrophes, improved 1.2 points to 90.9%, primarily reflecting a decrease in our current accident year loss ratio due to meaningful underlying improvement in other Commercial Lines and temporary frequency benefits in commercial auto. The loss ratio in our commercial auto book improved 5.8 points to 63.8%. We have generally only reacted to the favorable results in the auto property coverages, while maintaining our prudent approach to liability reserving and pricing. Our commercial multi-payroll loss ratio increased 1.5 points to 57.7% due to some elevated large property loss activity in the first and third quarters of 2020 and to a lesser extent, in the fourth quarter. Our review of the portfolio does not suggest any major systemic concerns. However, we continue to actively monitor our business mix and take rate where appropriate.

Our workers' comp loss ratio remained essentially flat at 60.9%. While underlying loss trends remain favorable, we are maintaining our conservative approach to reserves, given the current rate environment and uncertainty about future claims. Other Commercial Lines loss ratio improved 2.9 points to 53.6%, which underscores the success of prior year profit improvement actions in our Specialty property and programs businesses. Our Specialty portfolio is now delivering above target returns and growing the fastest. Commercial lines net premiums written grew 1% in 2020, driven by solid momentum in our Specialty Lines, where rates remained on a strong upward trajectory with sequential increases each quarter of the year.

New business submissions continued their steady upward trend off of their March lows. Core Commercial retention remains at historical highs at 86.2%, while cancellation and endorsement activity moderated. Small commercial submissions and consolidations are trending positively, and we continue to achieve pricing above long-term loss trends. Premium growth in Core Commercial ticked slightly lower in the fourth quarter compared to the third quarter, in part due to exceptionally robust new business performance in the fourth quarter of 2019.

Looking ahead, we expect our underlying commercial lines loss trends to remain relatively stable. Similar to personal auto, we anticipate commercial auto frequency will return to historical norms by the end of 2021. While overall rate will likely exceed loss trend, we remain very prudent with our liability selections, given the continued risk of social inflation and uncertainty around workers' comp profitability, in light of the many years of rate decline in that line. We expect the overall

Commercial Lines loss ratio in 2021 to be fairly consistent with 2020. We believe growth will continue to accelerate in this business going forward, aided by strong rate trends and continued economic recovery.

Turning to our investment performance. We generated net investment income of $70.2 million for the fourth quarter and approximately $265 million for the year. This was ahead of our midyear guidance for 2020 and reflective of better-than-expected investment partnership performance. Lower yields continue to pressure our portfolio, and we expect that trend to continue into 2021. Cash and invested assets at year-end were $9 billion, with fixed income securities and cash representing 85% of the total. Our fixed maturity investment portfolio has a duration of 4.8 years and is 96% investment grade. We have a high-quality, well-laddered and diversified portfolio with a weighted average rating of A+.

Moving on to equity and capital position. We thoughtfully managed our capital throughout 2020, even with the broader market uncertainty and economic volatility. In October, we executed $100 million accelerated share repurchase agreement, which closed last week, underlining our commitment to be responsible and prudent managers of capital. Combined with activity earlier in the year, we returned approximately $212 million to shareholders in 2020 through share repurchases, including the final delivery of all shares. Under the ASR agreement, we repurchased 2.2 million shares or 6% of the outstanding shares since the beginning of 2020.

Underscoring the confidence that we have in our strategy and growth prospects, we paid $99.5 million in dividends to our shareholders throughout the year and increased our recurring dividend payment in December 2020 by 7.7%. With broad-based profitability, expense discipline and an effective capital allocation strategy, we continue to target a return on equity of 13% or higher over the longer term. Our book value per share of $87.96 increased 4.3% during the quarter, and 15.8% from December 31, 2019, driven by operating income and both realized and unrealized gains in our investment portfolio, partially offset by the payment of our regular quarterly dividends.

Overall, I am very pleased with our full year performance, which reflects the clear execution of our strategic goals, financial discipline and commitment to delivering top quartile returns. I'm incredibly confident in the trajectory of our company and our ability to continue building on the strong momentum we have established.

Before opening the line for questions, I will share our guidance for 2021. We expect overall net written premium growth in the mid-single digits, driven by growth in our most profitable businesses. We anticipate acceleration in premium growth throughout the year. However, first quarter 2021 maybe a little lower than full year, impacted by inherent difficulties with a direct comparison to the pre-pandemic first quarter of 2020 and the timing of the economic recovery. While the second quarter comparison will benefit from customer premium returns in the second quarter of 2020.

We expect net investment income to remain flat compared to 2020, as the impact of lower new money yields will be offset by higher operational cash flows. Our expense ratio should decrease by approximately 30 basis points in 2021 to 31.3%. The combined ratio, excluding catastrophes, should be in the range of 90% to 91%. We've set our cat load for the year at 4.9%, as I mentioned earlier. And we expect an effective tax rate to approximate the statutory rate, which is 21%.

Our first quarter cat load is expected to be 4.7%, slightly below our full year ratio.
With that, we will now open the line for questions. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question comes from Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Jack and Jeff, I caught in both your comments. You both mentioned record consolidation agreements with agents in 2020. I was hoping you could just expand there a little bit. And really, what are your thoughts on kind of environmentally, what was driving that? I mean, obviously, some of it had to be Hanover specific, but do you think certain things about the pandemic brought that upon? Was it -- were there competitive environment forces that brought that upon? Just curious kind of -- what you think drove that? And then also if you're continuing to see it or you think that will continue as we move forward?

John Conner Roche
President, CEO & Director

Yes. Thanks, Matt. This is Jack. Listen, first and foremost, we have worked hard over the last several years, building a strategy around accounts and around specialized businesses where agents want to deepen their partnerships with us. At the same time, as you know, the consolidation on the distribution side of the business has kind of aggregated and consolidated more and more of Personal Lines and Small Commercial business in some of the midsized and larger companies across -- agents across the land. So it's just natural that at some point in time, these organizations start thinking about, particularly, Personal Lines and Small Commercial strategically, but also from an operational perspective.

And so we think that -- really, the last 18 months in particular, there has been a real pickup in momentum in the strategic dialogue with agents around these flow businesses, but also their organization and their desire to bring more and more of their best business together into an account environment and with the carriers that they think we'll be able to help them service that business, and frankly, present a level of pricing consistency that allows that business to stay put and be serviced over time. So we were very pleased. Do we think the pandemic added to that momentum? Maybe, maybe as people got the legs underneath them, they start to think about that business in terms of how they focus that with fewer markets, but I think the momentum was well ahead of the pandemic.

Matthew John Carletti
JMP Securities LLC, Research Division

Great. That's really helpful. And then just one other one, if I can. You also mentioned policy exposures and endorsements coming back. I was hoping you might be able to give us a little bit more color there. Are there particular areas of the economy, you are seeing that more than others? Or are there other areas that still struggle a little bit? Or are there particular lines of business, otherwise, you're seeing that more than others?

John Conner Roche
President, CEO & Director

Yes. I'll let Dick and Bryan add on to these comments. In the Commercial Line space, I believe we were one of the most proactive carriers in terms of trying to address mid-term endorsements and exposure changes at renewals for customers that frankly knew they were not going to have payrolls and sales at the levels that they had originally planned for. And our view was, a, that would allow them to address some cash flow needs, but also it would allow us to not go into 2021 with a headwind on return premium audits and having to adjust renewal basis. So we'll see how that plays out over time. But what you saw in the second quarter is we had a low watermark in terms of production, that to some degree was self-inflicted by us being proactive and trying to be responsive to those customers. So I don't know, Dick, do you want to add on that?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Maybe a little color exactly right. In the small commercial segment, we saw -- we're seeing those endorsements coming -- turning positive in the second half of the year, middle market, it's slower to see that turn, although we did see it turn positive in December. To your question of like where? This won't surprise you, right? We're seeing positive activity in the technology sectors, professional services, human services, contractors and the laggards, not surprisingly, our restaurants and hospitality. So nothing all that surprising, but we do see some nice momentum starting to come through.

Jeffrey Mark Farber
Executive VP & CFO

And this is Jeff. I would just add that hospitality and restaurants are roughly 3% of the portfolio. So it's a pretty tiny piece.

Operator

Our next question comes from Mike Zaremski with Crédit Suisse.

Michael David Zaremski
Crédit Suisse AG, Research Division

Maybe sticking -- starting with the outlook. You can maybe kind of offer some color on are you -- which lines of business -- maybe Personal Lines versus Commercial Lines, you feel better or worse about? Or I don't know if that's something you could provide, but it feels like -- are you -- maybe you can give us some color on whether you think kind of Personal Lines profitability tapers off a bit? And in Commercial Lines, is kind of where you feel the comments about rate meaningfully exceeding loss trend, is that more kind of a commercialized focused comment? Any color would be great.

John Conner Roche
President, CEO & Director

Yes. Thanks, Mike. This is Jack again. I'll say a few words about that and then ask my colleagues to chime in. In a lot of ways, I would start with the fact that we are really pleased that we have a broad-based profitability across our portfolio, but we do have different market conditions on the Personal Line side and the Commercial Line side, which is obvious to all. I do think that as we look into 2021, there's a number of dynamics. Obviously, we think that we will see some continued loss frequency benefits, particularly in the first half of 2021, predominantly in Personal Lines. And there is a bit of hyper competition.

We believe that as that wanes, we will see people adjust the dials. It's hard to price new business so competitively for a prolonged period of time without getting way behind more normal loss trends, so history repeats itself. We will see those dials get adjusted by our competitors. And we're trying to be thoughtful about how if we can be positioned when that comes back. Even if loss frequency doesn't come back all the way to what it was, how do we manage those dials so that we maintain our good profitability, but also position ourselves for -- to return back to the growth levels that we once enjoyed.

But to your point, in Commercial Lines, it's hard to deny that the combination of a real firm market, our best profitability we've had in some time and really our focus with our agents during this time, we think the combination of those present a real opportunity for us to at least get our growth back to what it was pre-pandemic, possibly better. And I would say -- maybe I'll turn to Bryan first because in Specialty, as you've seen, our rate trajectory has come up pretty significantly. Our profitability has improved dramatically over the last few years. And really our approach with agents, including the total Hanover approach that we're using is really coming into its own.

Bryan James Salvatore
Executive VP & President of Specialty

Yes. Sure, Jack. Yes. And I'll just add on to that. I'll point back to the comments you made earlier about the increased rate that we've been able to get quarter-over-quarter, right? Ending the year at 8.9% in the fourth quarter, followed by 7.2% in the third quarter, and that continued through December and into January. As did, we were able to achieve growth in Q3 and in Q4, and we feel good about what we're seeing in January as well. So I think that feels good. And when I look at it in terms of just the health, the profitability of our book, the sort of the way we positioned ourselves to grow our most profitable lines. And frankly, if you think about the -- what happened in the middle market space, in the Small Commercial spaces, rates have gone up, right? That's where we focus. And so we're able to now continue to drive that rate and expand our ability to capture more of that middle-market business because it's more favorable due to the price increases. That does, as Jack said, allow us to better penetrate our agents, leverage our total Hanover approach. So I feel pretty enthusiastic about Specialties growth opportunity and our profitability.

Michael David Zaremski
Crédit Suisse AG, Research Division

Okay. Great. Very helpful and comprehensive. I guess my last question, so shifting to capital management a bit. The stock valuation has improved a bit. Maybe you can kind of give us some clues about how you think about payback period in terms of buying back the stock. I guess, if we think about profitability dynamics for next year, it looks like profit levels are trending at very healthy levels and growth still kind of mid-single digits. It's healthy, but maybe -- should we be thinking buybacks can be a material lever, again, if valuations stay at the current levels?

Jeffrey Mark Farber
Executive VP & CFO

So thanks, Mike. This is Jeff. We left the third quarter and talked about it clearly. We had added some capital through debt that we issued. And that created meaningful additional capital in addition to what we already had. We put a plan together at mid-single digits, and you're right. With the earnings where they are, we create a lot of capital in a year. We feel very comfortable on a payback period or valuation perspective where the stock sits today. So we'd love to grow more rapidly and use more of that capital, but I suspect that stock buybacks will end up being a portion of our capital management throughout the year.

Operator

Our next question comes from Paul Newsome with Piper Sandler.

Paul Newsome
Piper Sandler & Co., Research Division

At the end of the day, 2020, was the pandemic net negative or net positive on the underwriting performance for your workers' comp business with the obvious offsets back and forth. How did it ultimately shake out from the year?

John Conner Roche
President, CEO & Director

Okay. Yes, I believe you said worker's comp. I just want to make sure I heard that correctly, Paul?

Paul Newsome
Piper Sandler & Co., Research Division

Yes. Yes, workers' comp.

John Conner Roche
President, CEO & Director

Listen, I think as we've talked about before, I -- having been around the workers' comp business for 3.5 decades, I continue to be amazed at the loss trend trends and not only benign, but negative loss trends over a couple of the years in the last half a dozen. So this year is a little bit -- 2020 was -- we're still trying to understand the underlying loss trend and how that will come back when the economy gets more fully intact. I think to answer your question, though, net-net, it was still a very strong year for us. We're trying to be very thoughtful about our accident year picks. We continue to generate favorable prior year development just based on those amazingly low loss trends in the past that were below our original picks.

The thing that we know is that as the economy picks up, you have to be mindful of people that are coming back to work environment or people getting retrained. So we -- you will see us continue to be thoughtful about our picks. But I'll kind of end with my final thought is around -- I still believe the workers' comp trends into the future are eventual tailwind for our growth that we believe the profitability of our book and the relatively low penetration level we have, particularly in middle market will allow us to become and even more fulsome account writer and more robust workers' comp underwriter as that pendulum swings back and you start to see rates move back into the business. And we did see in 2020, lower discretionary credits on our book and some improvement in the underlying state rates that give me -- that encouraged me about how we can proceed in 2021.

Jeffrey Mark Farber
Executive VP & CFO

Just to amplify those remarks a little bit, if you were to look at the P&L from workers' comp in terms of either prior year development or the current accident year loss ratio, you'd see it as largely the same in 2020 as it was in 2019. However, the frequency underlying that is down very substantially. And as we said in our prepared remarks, we took the opportunity to be really conservative with 2020 loss picks because of the uncertainty around rate. And then also, as Jack mentioned, the uncertainty about what losses are going to be like over time. But I suspect, once the uncertainty resolves itself, we will look back at 2020, fully developed and find that it was quite a profitable year for the firm.

Paul Newsome
Piper Sandler & Co., Research Division

And I want to make sure I've got the simple math right with respect to your guidance on premium next year. You're getting mid single-digit rate. You were flat this year. Hopefully, the economic effects of the pandemic will go away. Am I right to say that essentially, what you're thinking about next year is sort of a stable price environment and same kind of rate increases. But essentially, the exposure declines going away next year and the headwind being coming sort of calm wins, I guess, is that the right way to think about it?

Jeffrey Mark Farber
Executive VP & CFO

So I think over the course of the year, you'll see some changes. So the exposure will start springing back and then we'll continue with more rapidity as you get later in the year. We expect rate to continue and be strong, particularly in the Commercial Lines and even more so in the Specialty businesses where commercial retention should maintain itself, and we're optimistic that personal lines retention will actually increase over the course of the year.

Operator

[Operator Instructions] Our next question comes from Meyer Shields with KBW.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Jeff, you mentioned, I think, in your comments, you expect frequency for personal and commercial auto to get back towards pre-pandemic or to get back to pre-pandemic levels by the fourth quarter. I know there's a thesis bouncing out around out there -- bouncing around out there expecting more people to work from home and therefore, lower frequency than before the pandemic. I was hoping you could talk about your flexibility to quickly adjust rates if that lower frequency scenario plays out?

Jeffrey Mark Farber
Executive VP & CFO

Yes. I think Dick is probably best positioned to cover the flexibility, right?

Richard William Lavey
Executive VP & President of Hanover Agency Markets

Yes, absolutely. So Meyer, we -- the investments we made in our technology really enable us to be quite agile with this -- on this notion. If we -- and we're watching this frequency question, intensely, right? We have -- we've built a towering strength within our organization and claims analytics function where we can watch the trend real time. What kinds of claims are coming through? How are they presenting themselves? What's the duration? So with claims and actuarial and business sort of watching that and then, of course, making a determination of how to act. And we can act very quickly. We've instituted the ability to adjust caps, inflation guards and those don't require a filing, right? So we're not waiting for state filings to come through for approval. And on the new business side, should we decide to do that, we've made some tweaks, adjustments to tiering are very easy for us to make. So it's a matter of putting in place and you start to see the effect 30, 60 days later.

Meyer Shields
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that's very helpful. A second question probably unrelated. But when we look at the business coming through from the various consolidation agreements, does that business typically carry a different combined ratio than other new business that you'd be generating?

John Conner Roche
President, CEO & Director

This is Jack, Meyer. The way we've tried to assess that over the last half a dozen years as we've ramped more and more of our new business in both Personal Lines and Small Commercial and to some degree, in our small specialty business is looking at leading indicators of claim frequency and looking at the mix of the business that comes through kind of market consolidation or pipelining versus the flow or more transactional. There's no doubt that the business that's coming through market consolidation and leveraging our analytics, our agency insight tool has a better mix and has some initial benefits in terms of claims frequency. So we think that's a strong leading indicator that, that business is as good or better. And that is important because, as you know, new business pricing is always a little bit more aggressive than renewals in the marketplace. And if you can have an advantage on the maturation of those loss ratios, that could be hugely helpful to your retention and eventually your profitability. So net-net is, yes, we believe that, that business favorable to mix and favorable to our profit trajectory.

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Sarah, do we have anyone in the queue?

Operator

This will conclude our question-and-answer session. I would like to turn the conference back over to Oksana Lukasheva for any closing remarks.

Oksana Lukasheva
Vice President of Investor Relations & Financial Planning

Thank you, everybody, for participating on our call today, and we're looking forward to talking to you next quarter.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.