Selective Insurance(SIGI)

$65.19 (As of 01/01/20)

Price Target (6-12 Months): **$68.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 12/30/19) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:C
	Value: B | Growth: C | Momentum: C	

Summary

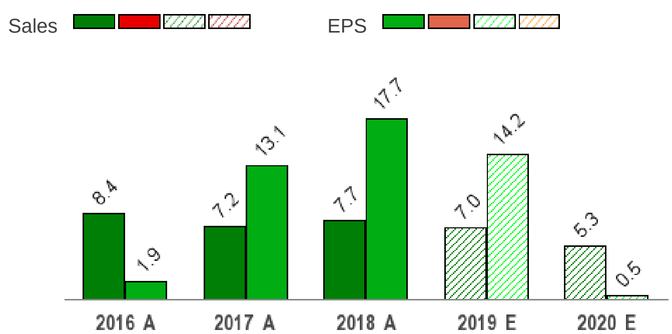
Selective Insurance is poised to witness top-line growth owing to high retention ratio, pure renewal price increase and new business growth. The company reported higher investment income on the back of increase in net proceeds and active portfolio management. Geographic expansion plays a vital role in diversification and growth of the company. A strong capital position enables the company investment in business and improving debt to capital ratio look impressive. However, the company is exposed to catastrophe loss due to natural disasters. Also, weather-related events pose an inherent risk to the property and casualty business, rendering volatility to earnings results. Increased expenses stemming from higher losses and policy acquisition costs tend to exert pressure on operating margin. The stock has underperformed its industry in the past year.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$81.33 - $58.77**
20 Day Average Volume (sh)	**265,159**
Market Cap	**$3.9 B**
YTD Price Change	**7.0%**
Beta	**0.69**
Dividend / Div Yld	**$0.92 / 1.4%**
Industry	**Insurance - Property and Casualty**
Zacks Industry Rank	**Bottom 37% (159 out of 253)**
Last EPS Surprise	**-12.6%**
Last Sales Surprise	**-0.7%**
EPS F1 Est- 4 week change	**0.0%**
Expected Report Date	**01/30/2020**
Earnings ESP	**0.0%**
P/E TTM	**15.4**
P/E F1	**15.6**
PEG F1	**1.5**
P/S TTM	**1.4**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	731 E	740 E	748 E	754 E	2,974 E
2019	686 A	701 A	713 A	723 E	2,825 E
2018	637 A	650 A	667 A	681 A	2,641 A

EPS Estimates

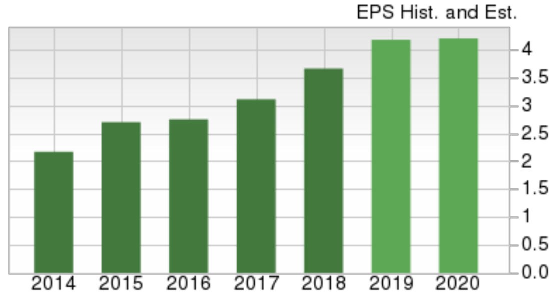
	Q1	Q2	Q3	Q4	Annual*
2020	$0.95 E	$1.04 E	$1.05 E	$1.11 E	$4.20 E
2019	$0.90 A	$1.16 A	$0.97 A	$1.14 E	$4.18 E
2018	$0.46 A	$1.01 A	$0.99 A	$1.20 A	$3.66 A

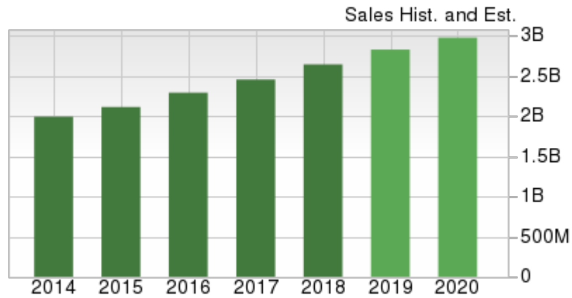
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/01/2020. The reports text is as of 01/02/2020.

Overview

Headquartered in Branchville, NJ, Selective Insurance Group, Inc. was established in 1925. The company operates as a P&C insurer. It offers insurance products and services across the United States. Through its subsidiaries, the P&C insurer provides a wide range of insurance products and services, which includes property, casualty as well as flood insurances. The company caters to a wide set of clients including businesses, non-profit organizations, local government agencies as well as individuals.





Selective Insurance classifies its operations through four segments, namely Standard Commercial Lines, Standard Personal Lines, Excess and Surplus (E&S) Lines plus Investments.

Standard Commercial Lines (74.2% of 2018 Revenue) — This segment offers insurance products and services to commercial enterprises including businesses, non-profit organizations and local government agencies. Presently, the segment represents 78% of the total insurance operations' net premiums written (NPW) and is sold across 25 states and the District of Columbia.

Standard Personal Lines (11.9%)— The segment offers products and services mainly to individuals, who have obtained coverage in the standard marketplace. The unit represents 13% of total insurance operations' NPW and is primarily sold in 13 Eastern and Midwestern states. The company boasts being the fifth largest writer of this coverage through the National Flood Insurance Program (NFIP) and writes flood business across all 50 states and the District of Columbia.

Excess and Surplus Lines (8.5%)— The segment provides insurance products and services to customers with not obtained coverage in the standard marketplace. Currently, the company writes commercial lines E&S coverages with the business forming 9% of the total insurance operations' NPW and sold in all 50 states and the District of Columbia.

Investments (5.4%) — This segment invests premiums collected by the company's insurance operations along with the amount received by virtue of its capital management strategies comprising the issuance of debt and equity securities.

Reasons To Buy:

Geographic expansions, improving premiums, improved rate environment leading to better investment income and solid capital position well poise Selective Insurance for long term growth.

- **Geographic Expansion** — The P&C insurer relies on geographic expansion for growth and diversification. Over the years, the company successfully expanded in New Hampshire along with presence in Southwest region such as Arizona, Colorado, Utah and Mexico. As a result, the company now has a total commercial lines presence in 27 states. It is on track with its geographic expansion strategy, as it added $26 million of new business in 2018.

  As part of the long-term growth strategy, Selective Insurance intends to increase standard commercial lines market held by its Ivy League distribution partners to at least 25% as well as grow its share of business within these distribution partners, which it refers to as "share of wallet," to 12%.

- **Improving Premiums** — Sustained premium growth across segments has helped the company's total premiums witness a five-year CAGR (2014-2018) of 5.6%. The momentum continued through the first nine months of 2019, with the metric improving 6.2% year over year driven by renewal pure price increase and new business premium written. Substantial new business opportunities, high retention ratio as well as pure renewal price increase should continue to aid premiums.

  Steady betterment of premiums has resulted in top-line improvement and over the past five years (2014-2018), total revenues witnessed a CAGR of 4.9%. Revenues increased 9% year over year in the first nine months of 2019.

- **Net Investment Income** — Despite a low interest rate environment in the past, the company managed to deliver impressive investment results. The momentum continued through the first nine months of 2019, with net investment income increasing 17% from the year-ago period level, primarily owing to active portfolio management, stellar operating cash flow and high net proceeds from Senior Note issuance. Given better rate environment, investment results should continue to retain the momentum. For 2019, Selective Insurance projects an after-tax investment income of $180 million, up from the prior guidance of $175 million.

- **Robust Capital Position** — Selective Insurance flaunts a sound capital structure and remains committed toward protecting the interests of its policyholders and shareholders alike while improving its financial strength and underwriting capabilities. The company has been experiencing an improving debt-to-capital ratio with the leverage being lowered 540 basis points over the last five years. The ratio has been trending below the company's long-term target of about 25% over the same time frame.

  Riding on a solid capital position, the company has been hiking dividends, which register a five-year CAGR (2014-2018) of nearly 9%. Such steadfast endeavors buoy confidence among investors, making it an attractive pick for yield-seeking investors. Its dividend yield of 1.4% appears attractive compared with the industry average of 0.4%.

- **Price Performance** — The stock has underperformed its industry's in a year's time, Nevertheless, the company's favorable fundamentals should aid its shares.

Reasons To Sell:

Exposure to catastrophe loss due to natural disasters and weather-related events and elevated expenses continue to remain a concern for the company.

- **Stretched Valuation** — Valuation remains stretched at the current level. Looking at the company's price-to-book ratio, which is the best multiple for valuing insurers, investors might not want to pay any further premium. The company currently has a trailing 12-month P/B ratio of 1.81X, higher than the industry average of 1.42X.

- **Exposure to Catastrophe Loss** — Being a property and casualty (P&C) insurer, Selective Insurance remains exposed to catastrophe loss stemming from natural disasters and weather-related events. Such a massive loss poses an inherent risk to the P&C insurance business inducing volatility to its results. In the first nine months of 2019, the company incurred catastrophe loss of $74.5 million, up 2.2% year over year. For 2019, the company estimates GAAP combined ratio to be around 91% (improvement from the prior guidance of 92%) and 350 basis points impact from catastrophe losses.

- **Rising Expenses to Hurt Margin Expansion** — Selective Insurance has been witnessing rising expenses over the years, primarily due to increasing loss and loss expense incurred and amortization of deferred policy acquisition costs. The metric has witnessed five-year CAGR (2014-2018) of 5.3% and another 3.2% increase in the first nine months of 2019. Increasing expenses can induce net margin contraction. Hence, the company should strive to generate higher revenue growth rate compared with the rise in expenses. Otherwise, expenses will tend to weigh on the operating margin expansion. Expense ratio of 33.6% for the first nine months of 2019 deteriorated 60 basis points, year over year.

Last Earnings Report

Selective Insurance Q3 Earnings Miss, Decline Y/Y

Quarter Ending	09/2019
Report Date	Oct 30, 2019
Sales Surprise	-0.70%
EPS Surprise	-12.61%
Quarterly EPS	0.97
Annual EPS (TTM)	4.23

Selective Insurance Group's third-quarter 2019 operating income of 97 cents missed the Zacks Consensus Estimate by 12.6% due to increased levels of non-catastrophe property losses and employee-related severance costs. Moreover, the bottom line declined 2% from the year-ago period's number.

Behind the Headlines

Total revenues of $713 million were up 6.9% from the year-ago quarter's figure. However, the same missed the Zacks Consensus Estimate by 0.7%.

Net investment income rose 6% year over year to $45.4 million, attributable to solid cash flow from operations and net proceeds from senior notes issuance in the first quarter of 2019.

Net premiums written increased 4% year over year to $676.9 million driven by solid growth in Standard Commercial Lines segment. It was partially offset by lower Standard Personal Lines and Excess and Surplus Lines premiums.

Combined ratio deteriorated 60 basis points (bps) on a year-over-year basis to 95.2% in the quarter under review.

Segmental Results

Standard Commercial Lines net premiums written were up 6% year over year to $532.9 million, attributable to retention, increase in new business generation and solid renewal pure price rise.

Combined ratio improved 30 bps to 94.2% from the prior-year quarter's figure.

Standard Personal Lines net premiums written dipped 4% year over year to $81.6 million due to 22% reduction in new business. Combined ratio also deteriorated 490 bps to 100.8%.

Excess & Surplus Lines net premiums written decreased 3% year over year to $62.4 million, due to a 28% decrease in new business. Combined ratio also deteriorated 320 bps to 96.9%.

Financial Update

Selective Insurance exited the third quarter with total assets of $8.7 billion, which rose 10% above the level at December 2018 end.

As of Sep 30, 2019, book value per share was $35.98, up 18% from the level as of 2018 end.

Annualized operating return on equity was 11.2% in the quarter under review, contracting 260 basis points year over year.

2019 Guidance

The company estimates catastrophe loss of 3.5 points.

The company estimates GAAP combined ratio of 91%, excluding catastrophe losses.

The company projects an after-tax investment income of $180 million, consisting of $14 million of after-tax net investment income from other investments.

An overall effective tax rate of approximately 19%, which includes an effective tax rate of 18.5% for net investment income, reflects a tax rate of 5.25% for tax-advantaged municipal bonds and a tax rate of 21% for all other items

Outstanding weighted average shares are estimated to be 60 million.

Recent News

Selective Insurance Joins S&P SmallCap 600 – Sep 6, 2019

S&P Dow Jones Indices has announced Selective Insurance joins S&P SmallCap 600.

Valuation

Selective Insurance's shares are up 10.2% over the trailing 12-month period. Over the past year, the Zacks sub-industry and the Zacks Finance sector are up 18.6% and 20.3%, respectively. The S&P 500 index is up 30.7% in the past year.

The stock is currently trading at 1.81X trailing 12-month book value, which compares to 1.42X for the Zacks sub-industry, 2.83X for the Zacks sector and 4.41X for the S&P 500 index.

Over the past five years, the stock has traded as high as 2.4X and as low as 1.14X, with a 5-year median of 1.81X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $68 price target reflects 1.88X book value.

The table below shows summary valuation data for SIGI

Valuation Multiples - SIGI

		Stock	Sub-Industry	Sector	S&P 500
P/B TTM	Current	1.81	1.42	2.83	4.41
	5-Year High	2.4	1.67	2.89	4.42
	5-Year Low	1.14	1.26	1.83	2.85
	5-Year Median	1.81	1.47	2.5	3.6
P/S F12M	Current	1.37	1.59	6.56	3.51
	5-Year High	1.62	11.26	6.61	3.51
	5-Year Low	0.71	1.55	5.2	2.54
	5-Year Median	1.32	1.93	6.04	3
P/E F12M	Current	15.61	27.72	15.56	20.3
	5-Year High	19.08	31.55	16.21	20.3
	5-Year Low	10.2	22.77	12.01	15.17
	5-Year Median	15.12	25.57	13.98	17.44

As of 12/31/2019

Industry Analysis **Zacks Industry Rank:** Bottom 37% (159 out of 253)

Top Peers

American Financial Group, Inc. **(AFG)**	Neutral
Hallmark Financial Services, Inc. **(HALL)**	Neutral
National General Holdings Corp **(NGHC)**	Neutral
Everest Re Group, Ltd. **(RE)**	Neutral
RenaissanceRe Holdings Ltd. **(RNR)**	Neutral
Alleghany Corporation **(Y)**	Neutral
Argo Group International Holdings, Ltd. **(ARGO)**	Underperform
Axis Capital Holdings Limited **(AXS)**	Underperform

Industry Comparison Industry: Insurance - Property And Casualty

Industry Peers

	SIGI Neutral	X Industry	S&P 500	AFG Neutral	AXS Underperform	RNR Neutral
VGM Score	C	-	-	B	F	C
Market Cap	3.87 B	1.94 B	23.93 B	9.89 B	4.99 B	8.65 B
# of Analysts	2	2	13	3	3	4
Dividend Yield	1.41%	1.02%	1.78%	1.64%	2.76%	0.69%
Value Score	B	-	-	A	D	C
Cash/Price	0.09	0.17	0.04	0.28	0.24	1.90
EV/EBITDA	14.54	9.34	13.95	9.34	21.45	-18.35
PEG Ratio	1.47	2.07	2.12	2.34	2.47	2.32
Price/Book (P/B)	1.81	1.27	3.33	1.56	1.04	1.63
Price/Cash Flow (P/CF)	14.57	13.54	13.67	10.08	12.09	21.52
P/E (F1)	15.52	15.61	19.66	12.75	20.95	22.02
Price/Sales (P/S)	1.40	1.03	2.69	1.27	0.98	2.37
Earnings Yield	6.41%	6.34%	5.08%	7.84%	4.78%	4.54%
Debt/Equity	0.26	0.21	0.72	0.23	0.33	0.26
Cash Flow ($/share)	4.47	3.05	6.94	10.88	4.91	9.11
Growth Score	C	-	-	C	F	C
Hist. EPS Growth (3-5 yrs)	11.25%	-0.55%	10.56%	13.41%	-23.80%	-4.49%
Proj. EPS Growth (F1/F0)	23.34%	0.00%	0.00%	1.30%	20.71%	24.93%
Curr. Cash Flow Growth	11.17%	9.94%	14.83%	39.71%	-541.78%	-231.59%
Hist. Cash Flow Growth (3-5 yrs)	13.91%	7.23%	9.00%	13.00%	-13.32%	-11.68%
Current Ratio	0.32	0.44	1.23	0.16	0.55	1.58
Debt/Capital	20.49%	17.79%	42.92%	18.38%	22.20%	41.16%
Net Margin	8.53%	5.34%	11.08%	8.43%	2.68%	17.32%
Return on Equity	12.83%	6.81%	17.10%	12.83%	2.02%	8.23%
Sales/Assets	0.33	0.31	0.55	0.12	0.20	0.15
Proj. Sales Growth (F1/F0)	0.00%	0.00%	0.00%	NA	0.00%	0.00%
Momentum Score	C	-	-	D	C	F
Daily Price Chg	0.59%	0.24%	0.33%	0.17%	0.13%	-0.27%
1 Week Price Chg	-2.78%	-0.63%	0.13%	-1.28%	-2.13%	-1.59%
4 Week Price Chg	0.22%	1.60%	3.67%	1.18%	2.39%	5.55%
12 Week Price Chg	-12.21%	0.15%	10.64%	9.08%	-5.52%	4.35%
52 Week Price Chg	6.97%	10.93%	27.46%	21.12%	15.10%	46.61%
20 Day Average Volume	265,159	119,321	1,693,267	302,975	425,524	222,306
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	0.00%	-0.12%	0.00%
(F1) EPS Est 12 week change	-4.02%	-1.85%	0.14%	-0.58%	-43.91%	-38.99%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	C
Momentum Score	C
VGM Score	C

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

Disclosures

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