The Travelers Companies (TRV)

Updated August 6th, 2018 by Josh Arnold

Key Metrics

Current Price:	$130	**5 Year CAGR Estimate:**	5.1%	**Volatility Percentile:**	17.1%
Fair Value Price:	$110	**5 Year Growth Estimate:**	6.0%	**Momentum Percentile:**	31.7%
% Fair Value:	118%	**5 Year Valuation Multiple Estimate:**	-3.3%	**Valuation Percentile:**	34.5%
Dividend Yield:	2.4%	**5 Year Price Target**	$147	**Total Return Percentile:**	30.3%

Overview & Current Events

The Travelers Companies was founded in 1864 in Hartford, CT by two local businessmen. The company began with life and accident insurance but has expanded into various other types of coverage in the 150+ years since then. Today, it enjoys $28 billion in annual revenue and a $35 billion market capitalization. It is also a member of the Dow Jones Industrial Average, making it the only property casualty insurance provider in the prestigious index.

Travelers reported Q2 earnings on 7/19/18 and results were mixed. The company reported earnings-per-share of $1.92, down from $2.11 in the comparable quarter last year. Higher commercial fire insurance losses led to a higher combined ratio, which deteriorated from 96.7% to 98.1%. Net premiums set a Q2 record, up 7% from the prior year quarter as Travelers saw revenue growth in all segments. Travelers also continues to spend heavily on buybacks, purchasing $350 million in Q2. The Q2 report was decent and kept the company on track for our estimate of $10 in 2018 earnings.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$5.24	$6.32	$6.31	$3.25	$6.21	$9.46	$10.56	$10.87	$10.13	$7.27	***$10.00***	***$13.40***
DPS	$1.19	$1.26	$1.44	$1.64	$1.79	$1.96	$2.15	$2.38	$2.68	$2.83	***$3.08***	***$4.30***

After strong growth coming out of the Great Recession, Travelers has failed to regain its 2014 high of $10.56 in earnings-per-share. We estimate $10.00 for 2018 as a strong rebound from 2017 is expected, given that it was a very tough year for catastrophe insurers. The trough earnings of 2017 aren't indicative of Travelers' long-term earnings potential and we expect more normalized performance going forward, as weather-related losses should abate. In total, we are expecting 6% earnings-per-share growth annually in the coming years, following a much higher rate of growth for 2018.

Travelers will achieve this growth primarily from higher underwritten premiums and the buyback, although margins should play a part as well. We see low single digit gains from higher revenue as well as a similar tailwind from the company's famous buyback, which has reduced the float by more than half in just the past decade alone. Recent reductions have been smaller in size given the higher share price, but Travelers is committed to reducing its share count over time. Lower operating expenses should also provide a bit of a boost to earnings, but the Travelers story really is about higher premiums, catastrophe losses, and a lower share count.

The dividend has been raised in the mid-single digit range annually and we expect that will continue for the foreseeable future. Travelers isn't an income stock any longer given the higher share price, but its 2.4% yield is respectable, and the payout will continue to grow at roughly the pace of earnings.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	8.7	7.0	8.2	17.4	10.3	8.8	8.8	9.7	11.2	17.2	***13.0***	***11.0***
Avg. Yld.	2.6%	2.8%	2.8%	2.9%	2.8%	2.3%	2.3%	2.3%	2.4%	2.3%	***2.4%***	***2.9%***

Travelers' price-to-earnings multiple has mostly stayed under 10 for the past decade but today, stands at 13. We therefore see the stock as overvalued given that our estimate of fair value is 11. Should the stock revert to a more normalized valuation, it would see a 3.3% headwind to total returns annually as a result.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

The yield is near its historical lows at 2.4%, but we see the stagnating share price and rising dividend combining to send the yield near 3% in five years. Thus, we believe Travelers will become a strong income stock again.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
UW Mrgn	8.3%	10.2%	6.2%	-6.4%	1.9%	10.2%	10.1%	10.4%	5.7%	2.1%	***5.0%***	***6.5%***
Debt/A	77%	75%	76%	77%	76%	76%	76%	76%	77%	77%	***77%***	***77%***
Int. Cov.	11.0	13.3	12.1	4.5	9.4	14.7	14.8	13.7	12.2	8.4	***12.0***	***15.0***
Payout	23%	19%	22%	48%	28%	21%	20%	22%	25%	38%	***31%***	***32%***
Std. Dev.	33%	31%	14%	27%	14%	13%	15%	17%	17%	13%	***15%***	***19%***

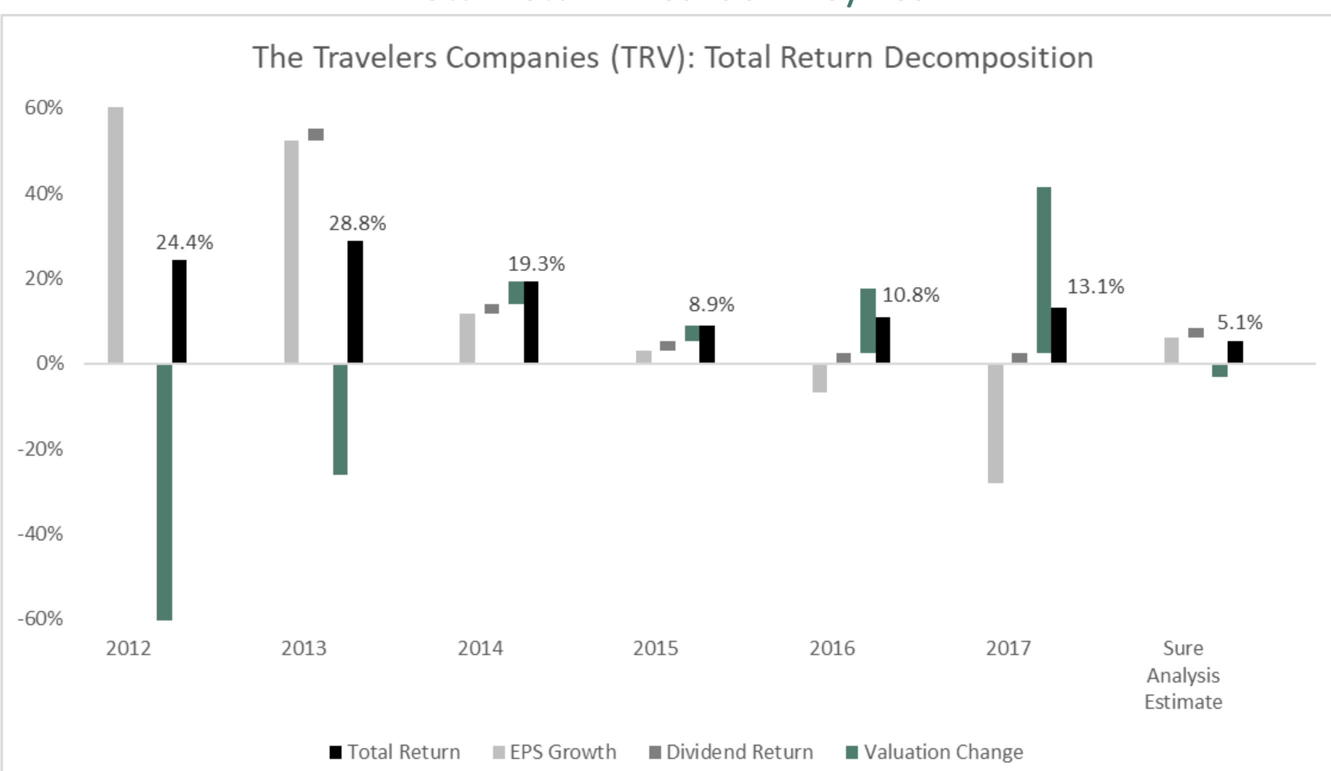
Travelers' quality metrics have oscillated over time along with its insurance losses. Underwriting margin peaked in the low-10% range but hasn't recovered. After hitting what should be a long-term trough last year at 2.1%, we see higher premiums and more normalized losses producing underwriting margins in the 5% to 6% range moving forward. Travelers continues to be conservatively-financed and doesn't have significant debt coming due in the next three years, so its balance sheet is in good shape and interest coverage remains robust. The payout ratio should remain in the low-30% area given that we are forecasting earnings and the dividend to grow at roughly congruent rates.

Travelers' main competitive advantages are in its immense scale and recognizable brand. Its size allows it to underwrite policies that others wouldn't be able to and its brand is well-known from its long history. Travelers is more susceptible to catastrophes than recessions, as we saw in 2017.

Final Thoughts & Recommendation

Travelers looks like a safe financial services provider with a decent growth outlook, but it is also trading meaningfully in excess of fair value. We therefore see total annual returns of just 5.1% annually in the coming years, consisting of the current 2.4% yield, 6% earnings-per-share growth and a 3.3% headwind from a lower valuation. Travelers will likely become an income stock again in the future but those interested in owning it should wait for a better entry price. We rate the stock as a hold given the high valuation.

Total Return Breakdown by Year



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