



The Travelers Companies (TRV)

Updated October 24th, 2019 by Josh Arnold

Key Metrics

Current Price:	\$132	5 Year CAGR Estimate:	4.5%	Volatility Percentile:	11.2%
Fair Value Price:	\$107	5 Year Growth Estimate:	6.0%	Momentum Percentile:	41.5%
% Fair Value:	123%	5 Year Valuation Multiple Estimate:	-4.1%	Growth Percentile:	57.4%
Dividend Yield:	2.5%	5 Year Price Target	\$144	Valuation Percentile:	30.5%
Dividend Risk Score:	B	Retirement Suitability Score:	B	Total Return Percentile:	29.5%

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 \$29 billion in annual revenue and a \$34 billion market capitalization. The company offers a wide and deep variety of protection products for auto, home and business customers. 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 Q3 earnings on October 22nd and results showed some measure of deterioration. Net income came to \$1.50 per share, which was down substantially from the \$2.62 Travelers reported in the year-ago period. Core income came to \$1.43 per share, which was also down significantly from last year's Q3 total of \$2.54 per share. The decline was due to a reserve build, which the company attributed to an increasingly challenging tort environment. Net investment gains were also lower than the year-ago period, although this is a small portion of overall income.

In total, net written premiums rose nicely at +7%, and total revenue came in 4% higher year-over-year. However, the company's combined ratio – which is the sum of all costs divided by premiums earned – was 101.5% in Q3. Its underlying combined ratio was better at 94.1%, but both were higher year-over-year. Higher combined ratios mean profitability is declining, and this crimped the company's earnings despite meaningfully higher revenue.

The share count was 2% lower year-over-year, but it wasn't enough to offset the sizable weakness in margins. Adjusted book value was up to \$90 per share at the end of the quarter, a gain year-over-year from last year's Q3 number of \$87.

After the weak Q3 where margins suffered, we're lowering our estimate of earnings-per-share this year from \$10.75 to \$9.75. Insurance businesses are notoriously cyclical, and Travelers is suffering from that today.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	\$6.32	\$6.31	\$3.25	\$6.21	\$9.46	\$10.56	\$10.87	\$10.13	\$7.27	\$8.94	\$9.75	\$13.05
DPS	\$1.26	\$1.44	\$1.64	\$1.79	\$1.96	\$2.15	\$2.38	\$2.68	\$2.83	\$3.03	\$3.28	\$5.05
Shares¹	520	435	393	377	354	322	296	280	271	264	260	235

After strong growth coming out of the Great Recession, Travelers has failed to regain its 2015 high of \$10.87 in earnings-per-share. It appears that value will remain elusive in 2019 as well. In total, we are expecting 6% earnings-per-share growth annually in the coming years, following a much higher rate of growth for 2019.

Travelers can achieve this growth primarily from higher underwritten premiums and the buyback program, although margins should play a part as well, as long as there aren't any large catastrophes. We see low single-digit gains from higher revenue as well as a similar tailwind from the company's 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

¹ Share count in millions

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earnings, but the Travelers story is really about higher premiums, lower catastrophe losses, and a lower share count. Q3 results were negatively impacted by a reserve build. As mentioned, we've lowered estimates for 2019 due to this factor. The dividend has been raised in the mid-single-digit range annually and we expect that will continue for the foreseeable future. Travelers is not a pure income stock any longer given the higher share price, but its 2.5% yield is respectable, and the payout should continue to grow at a quicker pace than earnings.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	7.0	8.2	17.4	10.3	8.8	8.8	9.7	11.2	17.2	14.7	13.6	11.0
Avg. Yld.	2.8%	2.8%	2.9%	2.8%	2.3%	2.3%	2.3%	2.4%	2.3%	2.3%	2.5%	3.5%

Travelers' price-to-earnings multiple has mostly stayed under 10 for the past decade but today, stands at 13.6 on the lowered earnings estimate. We therefore see the stock as overvalued given that our estimate of fair value is 11 times earnings. That implies a meaningful -4.1% headwind to total returns due to the valuation.

The yield is now somewhat higher than it has been in recent years, and we see the significant overvaluation in the shares as driving continued yield growth over time to the mid-3% area.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	19%	22%	48%	28%	21%	20%	22%	25%	38%	34%	34%	39%

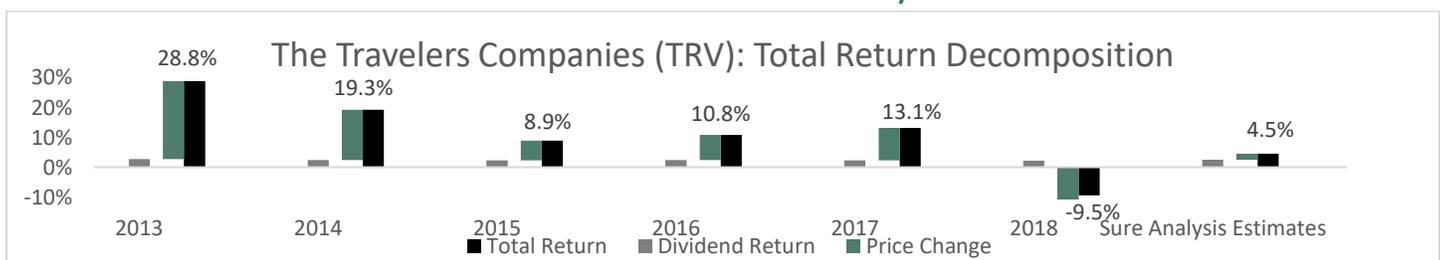
Travelers continues to be conservatively-financed and does not have significant debt coming due in the next three years, so its balance sheet is in good shape and interest coverage remains robust. We believe the payout ratio should remain below 40% given that we are forecasting earnings and the dividend to grow at roughly congruent rates. The dividend is, therefore, very safe and we see many more years of increases on the horizon. Importantly, this continues to allow Travelers to buy back hundreds of millions of dollars of its own shares annually.

Travelers' main competitive advantages are in its immense scale and recognizable brand. Its size allows it to underwrite policies that others would not 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 and again in 2018. This makes Travelers a defensive play should the economy weaken materially, but we reiterate that insurance companies are susceptible to significant and unforeseen shocks, as Travelers has demonstrated in recent quarters.

Final Thoughts & Recommendation

Travelers looks like a safe financial services provider with a decent growth outlook that is trading above fair value. We see total annual return potential of just 4.5% annually in the coming years, consisting of the current 2.5% yield, 6% earnings-per-share growth and a headwind from movement in the valuation. We're reiterating Travelers at a hold rating as the stock is overvalued in our view and its near-term outlook is murky.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	24680	25112	25446	25740	26191	27174	26815	27625	28902	30282
SG&A Exp.	3366	3406	3556	3610	3757	3964	4094	4154	4170	4297
D&A Exp.	797	812	802	827	867	864	818	826	813	803
Net Profit	3622	3216	1426	2473	3673	3692	3439	3014	2056	2523
Net Margin	14.7%	12.8%	5.6%	9.6%	14.0%	13.6%	12.8%	10.9%	7.1%	8.3%
Free Cash Flow	4231	3054	2169	3230	3816	3693	3434	4469	4148	4380
Income Tax	1089	1090	-74	693	1272	1397	1301	1039	674	438

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets (\$B)	109.56	105.66	104.58	104.94	103.81	103.08	100.18	100.25	103.48	104.23
Cash & Equivalents	255	200	214	330	294	374	380	307	344	373
Acc. Receivable	5471	5497	22071	21390	20166	19920	19721	19618	20228	20661
Goodwill & Int.	3953	3867	3798	3746	3985	3915	3852	3848	4293	4282
Total Liabilities	82145	80181	80098	79533	79016	78242	76586	77024	79752	81339
Accounts Payable	546	407	5575	5152	4626	4698	4670	4882	5049	5074
Long-Term Debt	6527	6611	6605	6350	6346	6349	6344	6437	6571	6564
Total Equity	27336	25407	24477	25405	24796	24836	23598	23221	23731	22894
D/E Ratio	0.24	0.26	0.27	0.25	0.26	0.26	0.27	0.28	0.28	0.29

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	3.3%	3.0%	1.4%	2.4%	3.5%	3.6%	3.4%	3.0%	2.0%	2.4%
Return on Equity	13.8%	12.2%	5.7%	9.9%	14.6%	14.9%	14.2%	12.9%	8.8%	10.8%
ROIC	11.1%	9.7%	4.5%	7.9%	11.7%	11.8%	11.3%	10.1%	6.9%	8.4%
Shares Out.	520	435	393	377	354	322	296	280	271	266
Revenue/Share	43.40	52.05	60.51	66.03	69.97	79.34	85.43	94.93	103.74	112.24
FCF/Share	7.44	6.33	5.16	8.29	10.20	10.78	10.94	15.36	14.89	16.23

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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