The Hanover Insurance Group, Inc. (THG)

Updated February 3rd, 2023, by Patrick Neuwirth

Key Metrics

Current Price:	$138	**5 Year CAGR Estimate:**	11.2%	**Market Cap:**	$4.8 B
Fair Value Price:	$146	**5 Year Growth Estimate:**	8.0%	**Ex-Dividend Date[1]:**	03/10/23
% Fair Value:	95%	**5 Year Valuation Multiple Estimate:**	1.1%	**Dividend Payment Date[1]:**	03/24/23
Dividend Yield:	2.3%	**5 Year Price Target**	$214	**Years Of Dividend Growth:**	18
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Rating:**	Buy

Overview & Current Events

The Hanover Insurance Group, Inc. (THG) is a holding company whose primary business is offering property and casualty insurance products and services. The company markets itself through independent agents and brokers in the United States. In 2022, Personal Lines accounted for approximately 41% of segmented revenues; Commercial Lines, 36%; Other Property & Casualty, 23%. The company operates an investment portfolio that is primarily exposed to fixed-income securities. The Hanover Insurance Group, Inc. was founded in 1852 and is headquartered in Worcester, Massachusetts.

On February 1st, 2023, Hanover Insurance released its fourth quarter 2022 results for the period ending December 31st, 2022. For this quarter, the company reported a net loss of $11.6 million ($0.33 per diluted share) compared to net income of $163.5 million ($4.53 per diluted share), in the prior-year quarter. The reported net loss in the last quarter was primarily due to the catastrophe losses of $189.6 million, or 13.9 points, including the impact from Winter Storm Elliott (late December) of $165 million. Operating loss was $37.4 million, or $1.05 per diluted share, for the fourth quarter compared to operating income of $122.1 million or $3.38 in the prior-year quarter.

Overall net premiums written for the reported quarter increased by 9.1%, with strong growth from each segment. In particular, the specialty segment showed a strong performance as net premiums written increased by 11.2%. Commercial Lines net premiums written rose 7.2%, driven by rate and exposure increases. Personal Lines net premiums written were $502 million in the fourth quarter of 2022, up 8.7% from the prior-year quarter primarily driven by price increases. Furthermore, net investment income in the last quarter of $73 million, which was below the prior-year quarter of $75.9 million fourth quarter, was helped by higher bond reinvestment rates. Operating income was $199.9 million, or $5.53 per diluted share, in 2022. This compared to operating income of $318.3 million, or $8.73 per diluted share, in the prior year.

The Hanover Insurance Group has a strong outlook for 2023 and presented ambitious financial targets for the next five years outlined during an investor day[2]. The Board of Directors presented a long-term ROE target of ~14% and an EPS growth target of 12% to 13%. Expense leverage from growth is an important driver and the combination of a new software platform and operating model should improve claims cost efficiency. Even given the continued elevated inflation and supply chain disruption, the management is confident to achieve those long-term targets. Net premiums written are expected to show mid-single digit growth in 2023.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS[3]	$5.06	$5.18	$6.26	$4.27	$4.75	$6.79	$8.16	$9.32	$8.73	$5.53	***$9.70***	***$14.25***
DPS	$1.36	$1.52	$1.69	$1.88	$2.04	$2.22	$2.45	$2.65	$2.85	$3.06	***$3.24***	***$4.76***
Shares[4]	44	44	43	42	43	42	38	36	36	35	***35***	***35***

[1] Estimated Date.
[2] Bank of America Securities Insurance Conference, February 16th, 2022
[3] Based on operating income
[4] In millions.

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 Hanover Insurance Group, Inc. (THG)

Updated February 3rd, 2023, by Patrick Neuwirth

The Hanover Insurance Group long-term earnings growth track record shows some instability, with the company's earnings-per-share having dropped in the fiscal years 2016 and 2022. However, in the last five years, the company has been able to grow its earnings-per-share at an 7.4% average annual rate. We expect Hanover Insurance recover from the 2022 EPS dip and grow its earnings-per-share by 8% per year on average over the next five years, mainly driven by premium growth, assisted by optimizing costs, recording greater gains on its fixed-income investment positions and rising yields and interest rates. This growth rate is a bit more conservative compared to the company's expectations for double-digit growth for the next five years. Hanover Insurance has a long history of paying dividends and has 18 consecutive years of annual dividend increases. In December 2022, the board increased the quarterly dividend by 8% from $0.75 to $0.85. Over the last five years, the average annual growth rate is 7.8%.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Avg. P/E	10.1	12.0	12.2	19.4	19.7	17.2	15.4	11.5	13.2	15.7	***14.2***	***15.0***
Avg. Yld.	1.9%	2.4%	2.2%	2.3%	2.2%	1.9%	1.5%	2.5%	2.2%	2.1%	***2.3%***	***2.2%***

The last few years Hanover Insurance's valuation has declined from the peak level (19.7) that it reached during 2017. During COVID, its share price declined to around $83 before climbing back to $150 levels in April 2022. During the past decade shares of Hanover Insurance have traded with an average price-to-earnings ratio of about 15 times earnings and today, it stands at 14.2. We are using 15 times earnings as a fair value baseline, implying the potential for a valuation tailwind.

Safety, Quality, Competitive Advantage, & Recession Resiliency

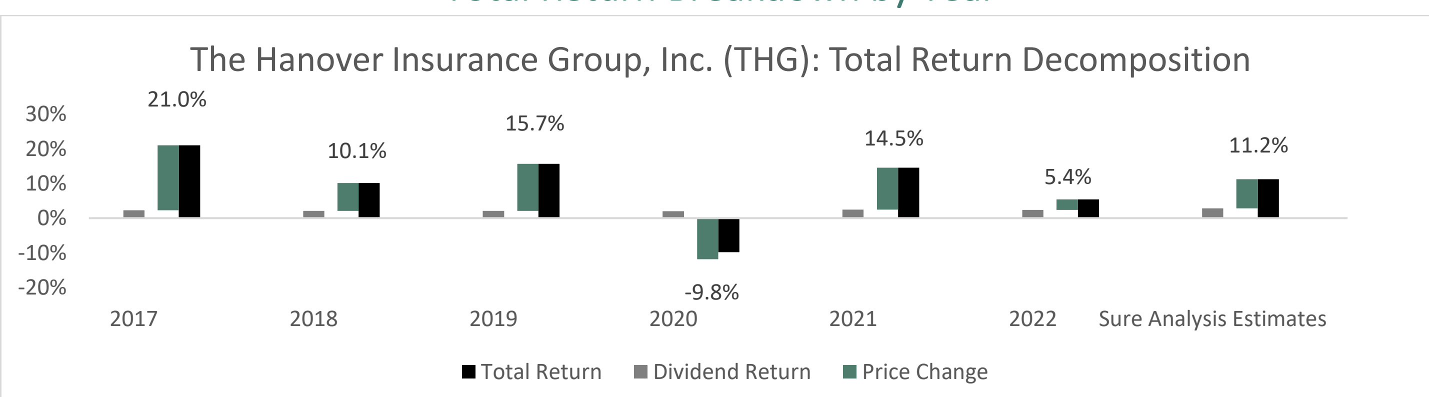
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	27%	29%	27%	44%	43%	33%	30%	28%	33%	55%	***33%***	***33%***

During the past five years the company's dividend payout ratio has averaged around 33%. With the current payout ratio of 33%, THG's dividend payments are well covered by earnings. Given the expected earnings growth, there is still room for the dividend to continue to grow moving forward while maintaining a payout ratio below 30%. The Hanover Insurance Group is a diversified and solid insurer with a differentiated P&C franchise in a fragmented market. With their differentiating strategy, such as specialized products and distinctive agency partnerships, the company can strengthen its competitive advantages. Furthermore, Hanover Insurance has a S&P and AM Best "A"-rating and a stable outlook.

Final Thoughts & Recommendation

The Hanover Insurance Group has a healthy balance sheet and ambitious financial targets for the next five years. The expected total returns for the shares are 11.2% per year, driven by 8% projected earnings growth, a 2.3% dividend yield, and the potential for a valuation tailwind. The company earns a buy rating based on its long-term growth potential.

Total Return Breakdown by Year



Click here to rate and review this research report. Your feedback is important to us.

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 Hanover Insurance Group, Inc. (THG)

Updated February 3rd, 2023, by Patrick Neuwirth

Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	4,591	4,794	5,068	5,034	4,054	4,268	4,494	4,891	4,827	5,228
D&A Exp.	36	35	34	30	31	30	25	22	18	---
Net Profit	56	251	282	332	155	186	391	425	359	419
Net Margin	1.2%	5.2%	5.6%	6.6%	3.8%	4.4%	8.7%	8.7%	7.4%	8.0%
Free Cash Flow	387	361	554	425	728	686	538	590	693	---
Income Tax	(17)	83	96	109	(1)	77	44	93	83	101

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	13,485	13,379	13,760	13,781	14,220	15,470	12,400	12,491	13,444	14,254
Cash & Equivalents	565	486	373	339	283	298	1,021	216	121	231
Acc. Receivable	3,789	3,660	3,629	4,027	4,050	2,721	2,825	3,074	3,214	3,377
Goodwill & Int.	185	185	185	186	185	179	179	179	179	---
Total Liabilities	10,890	10,784	10,916	10,937	11,363	12,472	9,445	9,574	10,242	11,109
Accounts Payable	466	375	227	205	252	52	37	53	48	---
Long-Term Debt	849	904	904	803	786	787	778	653	781	782
Total Equity	2,595	2,595	2,844	2,844	2,858	2,998	2,955	2,916	3,202	3,145
LTD/E Ratio	0.33	0.35	0.32	0.28	0.28	0.26	0.26	0.22	0.24	0.25

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	0.4%	1.9%	2.1%	2.4%	1.1%	1.3%	2.8%	3.4%	2.8%	3.0%
Return on Equity	2.2%	9.7%	10.4%	11.7%	5.4%	6.4%	13.1%	14.5%	11.7%	13.2%
ROIC	1.6%	7.2%	7.8%	9.0%	4.3%	5.0%	10.4%	11.6%	9.5%	10.6%
Shares Out.	44	44	44	43	42	43	42	38	36	36
Revenue/Share	101.34	106.76	112.86	112.37	93.84	99.25	104.52	120.46	126.70	143.62
FCF/Share	8.54	8.04	12.33	9.49	16.84	15.95	12.52	14.52	18.18	---

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