S&P Capital IQ

CONTENTS



# The Allstate Corporation NYSE:ALL

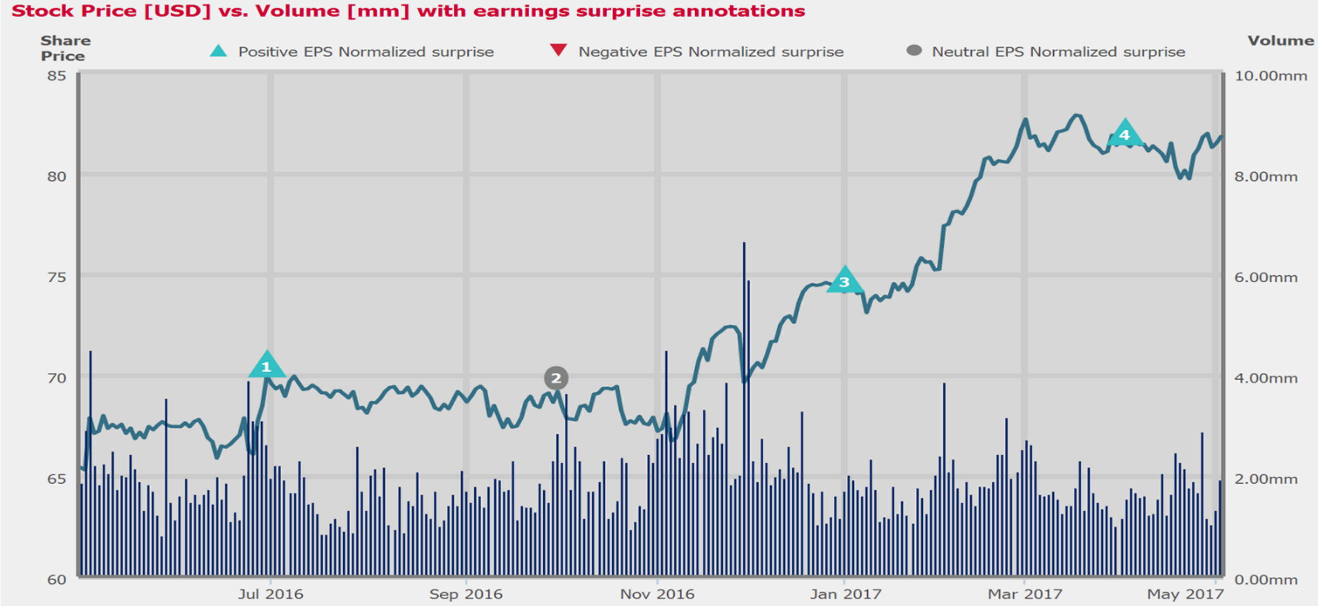
## *FQ2 2017 Earnings Call Transcripts*

Wednesday, August 02, 2017 1:00 PM GMT

## S&P Capital IQ Estimates

| | -FQ2 2017- | | | -FQ3 2017- | -FY 2017- | -FY 2018- |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | CONSENSUS |
| **EPS Normalized** | 0.90 | 1.38 | ▲53.33 | 1.58 | 6.54 | 7.00 |
| **Revenue (mm)** | 7991.80 | 8018.00 | ▲0.33 | 8066.67 | 32129.67 | 33179.67 |

Currency: USD
Consensus as of Aug-02-2017 11:53 AM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ2 2016** | 0.58 | 0.62 | ▲1 6.90 % |
| **FQ3 2016** | 1.26 | 1.26 | 2 0.00 % |
| **FQ4 2016** | 1.61 | 2.17 | ▲3 34.78 % |
| **FQ1 2017** | 1.10 | 1.64 | ▲4 49.09 % |

# Call Participants

## EXECUTIVES

**Don Civgin**
*President of Emerging Businesses - Allstate Insurance Company*

**John Griek**
*Head of Investor Relations*

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

**Steven E. Shebik**
*CFO & Executive VP*

**Thomas J. Wilson**
*Chairman & CEO*

## ANALYSTS

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**Sarah Elizabeth DeWitt**
*JP Morgan Chase & Co, Research Division*

# Presentation

**Operator**

Good day, ladies and gentlemen, and welcome to the Allstate Second Quarter 2017 Earnings Conference Call. [Operator Instructions] As a reminder, today's program is being recorded. I would now like to introduce your host for today's program, Mr. John Griek, Head of Investor Relations. Please go ahead, sir.

**John Griek**
*Head of Investor Relations*

Thank you, Jonathan. Good morning, and welcome, everyone, to Allstate's Second Quarter 2017 Earnings Conference Call. After prepared remarks by our Chairman and CEO, Tom Wilson; Chief Financial Officer, Steve Shebik; and me, we will have a question-and-answer session. Also here are Matt Winter, our President; Don Civgin, the President of Emerging Businesses; John Dugenske, our Chief Investment Officer; Mary Jane Fortin, President of Allstate Financial; and Eric Baron, our Corporate Controller.

Yesterday, following the close of the market, we issued our news release and investor supplement, filed our 10-Q for the second quarter and posted the results presentation we'll use this morning in conjunction with our prepared remarks. These documents are available on our website at allstateinvestors.com.

As noted on the first slide, our discussion today will contain forward-looking statements about Allstate's operations. Allstate's results may differ materially from these statements, so please refer to our 10-K for 2016, the slides and our most recent news release for information on potential risks. Also, this discussion will contain some non-GAAP measures for which there are reconciliations in our news release or our investor supplement. We are recording this call and a replay will be available following its conclusion and as always, I will be available to answer any follow-up questions you may have after the call.

Now I'll turn it over to Tom.

**Thomas J. Wilson**
*Chairman & CEO*

Well, good morning, and thank you, as always for taking your time and investing with us to keep your -- and to understand the progress we're making at Allstate. So let's begin on Slide 2.

Allstate delivered strong financial results in the second quarter. Net income was $550 million or $1.49 per share in the second quarter of 2017, and that is in comparison to $242 million last year, really reflects improved auto insurance margin and strong investment results from our performance-based strategy.

Operating income per share was $1.38 in the quarter. The improvement in auto insurance profitability is a result of rapidly -- of us rapidly reacting to higher loss costs beginning in 2015, and it was aided by declining frequency in the first half of 2017. Investment income on our $81 billion portfolio also increased from the prior year as stable earnings from the quarter, market-based fixed income portfolio was supplemented with higher results from the performance-based portfolio.

Operating income return on equity was 13.5% as you can see at the bottom of the table, a significant improvement over last year.

Let's go to Slide 3, which shows our operating priorities for 2017. We made excellent progress on the 5 operating priorities, but not all of this has yet impacted our reported financial results. The first goal is to better serve customers, and we measure customer satisfaction by Net Promoter Score, and an increase for most of our businesses, although this has not led -- yet led to higher policy retention. We do expect higher customer satisfaction to translate into higher growth, particularly as insurance auto price increases moderate.

Allstate manages shareholder capital to deliver attractive returns, which requires us to achieve target economic returns on capital. As you can see from our results, we are excelling in this priority. Auto insurance margins have improved, reflecting the broad-based profit improvement plans initiated over

2 years ago. Profitability also benefited from lower frequency of accidents, reflecting both our profit improvement plan and overall flattening end market. The recorded auto insurance combined ratio for all brands was 96.6 for the quarter and 95.8 for the Allstate brand. Auto insurance combined ratios for the first 6 months of the year was 94.1 or 6.5 points below the prior year. The difference was the primary driver -- the primary driver of the difference was an increase that led to over $700 million in underwriting profit difference between this quarter -- these first 2 quarters and the first 2 quarters of last year.

Now homeowners insurance line was also profitable in the quarter, led by Allstate brand, which had a combined ratio of 97.2, despite $650 million of catastrophe losses. The Property-Liability was 97.2, and the underlying combined ratio was 85.5 in the second quarter. Through the first half of the year, our underlying combined ratio was 85.1. Assuming current loss trends continue, we expect to end 2017 at or below the low end of our annual outlook range of 87 to 89.

Allstate Financial operating income increased $153 million as a strategy to increase performance-based investments for the Annuity business generated good results.

Long-term value creation also requires growth in the customer base. The acquisition of SquareTrade in January has added over 31 million policies, and Steve will cover our key priorities for SquareTrade in a few minutes.

Allstate Benefits continues its 17-year track record of growth and policies enforced exceed 4 million.

The Allstate brand is now accelerating the Trusted Adviser initiative to raise growth by delivering a better value proposition as a local advice and branded product customer segment.

A large component of operating income is results from investment income, so despite the continuation of historically low interest rates, we've done quite well there as well. The portfolio is proactively managed, and is primarily a high-quality fixed income portfolio, which generates predictable earnings with modest risk. The value of the market-based portfolio has increased this quarter due to reduction in corporate bond yields and higher equity value. The performance-based portfolio had a great quarter with strong growth in private equity and real estate earnings.

We focus on delivering current results while investing for long-term growth. In addition to the Trusted Adviser initiative we have growth plans for Allstate Benefits, SquareTrade, Allstate Roadside and Esurance. We're also investing in building connected car platform at Arity, which has continued to enhance its capabilities in telematics, data, analytics and customer service.

Slide 4 provides an overview of our capital strength and financial flexibility. As you can see from the box at the top, we've delivered excellent returns, increased book value, maintained a conservative financial position while increasing shareholders' ownership in the company by reducing the number of outstanding shares. We returned $903 million to shareholders through the first 6 months of the year. This includes repurchasing 7.9 million shares of our common stock, or 2.1% of those outstanding at the beginning of the year. Yesterday, we authorized a new $2 billion share repurchase program that will begin following the completion of our current $1.5 billion program. Our intention is to fund this new program through a combination of deployable capital, operating cash flow and a potential issuance of preferred shares. Now let me turn it back to John.

**John Griek**
*Head of Investor Relations*

Thanks, Tom. Slide 5 shows Property-Liability results by customer segment and brands. Starting with the table at the top, net written premium was $8.3 billion, which was a 3% increase from the prior year, and the recorded combined ratio of 97.2 was 3.6 points better than the prior year quarter. When we exclude catastrophes in prior year reserve re-estimates, the underlying combined ratio for the second quarter was 85.5, 3.1 points better than the prior year quarter.

The underlying combined ratio for the second quarter includes 0.6 points or $52 million of restructuring expenses, primarily related to the expansion of QuickFoto Claim, our virtual estimating platform. This expansion resulted in improved efficiencies and the closure of a number of claim drive-in offices.

As you know, our strategy is to provide different customer value propositions for the 4 consumer segments of the Property-Liability market. The Allstate brand in the lower left competes with the Local Advice and Branded segment, where the most prominent competitors are State Farm, Nationwide and Farmers. Obviously, GEICO and Progressive target these customers as well, but do not offer the same value proposition provided by our 10,400 Allstate agencies. This segment comprises 90% of our total premiums written.

The underlying combined ratio was 84.4, with a favorable prior year comparison being driven by improving loss trends in auto insurance, which had a 92.8 underlying combined ratio, 5 points below the prior year. Net written premium was 2.3% higher in the second quarter of 2017 compared to the prior year quarter due to a 3.3% increase in auto.

Esurance, in the lower right, serves customers who prefer our branded product, but are comfortable handling their own insurance needs. GEICO and Progressive Direct have a larger share of this segment than their overall market share. We continue to focus on improving the auto loss ratio, raising customer satisfaction and rapidly growing homeowners' policies in force. The combination of these initiatives will support long-term growth.

The underlying combined ratio for auto insurance improved slightly and was below 100 for the second consecutive quarter. The homeowners business continues to grow rapidly with underlying profitability that reflects startup costs. The underlying combined ratio of 125 in the second quarter of 2017 was significantly better than the prior year quarter as homeowners marketing spend was reduced.

Encompass, in the upper left, competes for customers who want local advice, are less concerned about a branded experience and are served by independent agencies. We are making good progress in improving underlying margins but the business has gotten smaller as we exit unprofitable markets and raise prices. As we achieve rate adequacy, we will initiate growth plans on a targeted basis in this segment.

Let's go to Slide 6 to cover the results for Allstate brand auto insurance in more details. Starting with the top left graph, the recorded combined ratio for the second quarter was 95.8, which was 5.4 points below the prior year quarter, and benefited from increased average earned premium, lower frequency and favorable prior year reserve re-estimates primarily related to injury coverages.

The underlying combined ratio of 92.8 in the second quarter of 2017 improved by 5 points compared to the second quarter of 2016, driven by a 5.7-point improvement in the underlying loss ratio. The chart on the top right shows the results of the broad-based profit improvement plan initiated in 2015.

Annualized average premium, shown by the blue line, increased 5.6% to $999 compared to the prior year while underlying loss and expense shown by the red line was nearly flat. This resulted in a favorable gap of $72 per policy compared to the mid-teens in the second quarter of 2015. While we continue to selectively file rate increases to keep pace with loss trends, the overall magnitude of rates taken will moderate if the gap between the red and blue line is maintained.

Gross frequency trends for bodily injury and property damage coverages are shown on the bottom chart. Frequency continued to show improvement across both coverages in the second quarter of 2017, and favorable trends were geographically widespread. The lower frequency in 2017 reflects good weather in the first quarter, the benefits of the auto insurance profit improvement plan and moderating frequency trends across the industry.

Slide 7 shows the underlying drivers of policies in force for Allstate branded auto insurance. As you can see from the graph at the top, overall policy counts have flattened out on a sequential quarter basis. This reflects an increase in new issued applications and a steady renewal ratio. We are beginning to accelerate the components of the Trusted Advisor initiative while expanding Allstate branded distribution with the objective of increasing policies in force. This should be supported by fewer required price increases now that auto margins have improved.

Slide 8 shows similar information for Allstate branded homeowners, which has had consistent profitability and is also being positioned for growth. Now I'll turn it over to Steve.

**Steven E. Shebik**
*CFO & Executive VP*

Thanks, John. Let's go to Slide 9, and our investment results. Overall investment results have been strong this year, reflecting favorable market conditions and the asset allocation decision to increase performance-based investments, which reflects a 10-year history of increasing commitments and building our capabilities. Today, we utilize third-party managers, co-investments, create bistro partnerships and our own direct investing, and have created broad portfolio of diversified investments.

Total return in the upper left graph was 1.8% for the quarter, as our strategic positioning coupled with favorable market conditions drove strong results across our diversified portfolio. Investment income shown in the blue has consistently contributed approximately 1% of return per quarter, with stable earnings through our market-based portfolio, primarily investment-grade fixed income investments.

Total return varies based on the portfolio value at the end of each quarter as reflected by the valuation component shown in gray. As you can see, the value of the portfolio increased in the second quarter, primarily due to lower corporate bond yields and higher equity prices. The Property-Liability bond portfolio, which totals $32 billion, is concentrated in 3- to 5-year maturities. If interest rates rise, bond valuations will be negatively impacted. However, net investment income will increase over time.

Net investment income in total and for the market-based and performance-based portfolios is shown in the upper-right graph. Net investment income for the second quarter was $897 million, $135 million higher than the second quarter of 2016. This increase is driven primarily by performance-based investment income of $263 million.

While performance-based income is variable from quarter-to-quarter, long-term returns for Allstate have been attractive, as shown by the bottom 2 graphs. The quarterly impact of performance-based net income has averaged $155 million over the last 10 quarters, and is largely driven by private equity and real estate investments.

The table beneath the chart on the bottom left shows the increasing carrying value of performance-based portfolio over time. The performance-based portfolio has generated attractive long-term economic returns, as shown in the bottom right. Internal rates of return are generally over 10%. The recent downturn in a 10-year measure reflects high valuations just prior to the global financial crisis of 2008 and 2009.

Turning to Slide 10, Allstate Financial had a substantial increase in profitability as a result of the performance-based investment results. Premiums and contract charges totaled $591 million in the second quarter, an increase of 4.8% compared to the prior year quarter. Operating income of $153 million increased by 27.5% over the prior year quarter. Life insurance net income of $60 million and operating income of $63 million were both $1 million below prior year, as higher contract benefits and expenses were partially offset by higher premium and net investment income.

Allstate Benefits net and operating income were both $25 million in the second quarter of 2017, and operating income, $4 million below the prior year quarter. But higher revenue was more than offset by increased contract benefits and investments in growth. Premiums and contract charges increased 7.2% compared to the prior year quarter primarily related to growth in hospital indemnity, critical illness, short-term disability and accident products.

Annuities operating income of $65 million in the quarter was an increase of $38 million compared to the prior year, reflecting the continued benefit of our performance-based investment strategy. You'll remember, we increased the amount of performance-based assets in this business to match the long duration of liabilities. This should generate increased shareholder value but does require us to utilize more capital in the business and lowers interest income, both of which depress short-term returns on capital.

Slide 11 provides detail on SquareTrade. Last quarter, we indicated additional disclosures, which we provided regarding this recently acquired business. SquareTrade has 3 primary objectives. First, to increase and broaden Allstate's customer relationships. This will be accomplished through the existing model of selling to store-based and online retailers, leveraging Allstate's other market-facing businesses and entering new markets either from a product or geographic perspective. Second, SquareTrade is growing rapidly by utilizing innovative customer service approaches to reinvent a traditional product offering, and will continue to utilize this capability to enhance its competitive position. Third, as all of our businesses need to do, SquareTrade will also earn attractive returns on capital. We evaluate this by looking at long-term cash flows. For high-growth businesses, such as SquareTrade, we use shorter-term measures such as operating profit to ensure we are on pace to meet our long-term objectives, but are willing to continue investing in growth even if it reduces near-term profitability.

Moving to second quarter results, as shown on the bottom half of the page, SquareTrade had solid growth primarily through the U.S. retail channel, with policies in force increasing by $1.4 million from the first quarter to a total of $31.3 million, as shown on the graph in the bottom left. Over the last 12 months, policies in force have grown by 28%. Premiums written in the second quarter of $85 million reflect the magnitude of product sales, while earned premium of $70 million reflects the recognition of that premium over the approximate 3-year average duration of coverage.

Underwriting loss totaled $22 million in the second quarter, reflecting $23 million of amortization of purchased intangible assets related to the acquisition. Operating income, which excludes the amortization of purchased intangible assets, was positive in the second quarter, totaling $1 million. We also included a new non-GAAP measure this quarter, adjusted operating income, to provide a run rate view of the business. This factor excludes purchase accounting adjustments made to recognize the acquired assets and liabilities at their fair value.

During the second quarter, we executed a 100% quota share reinsurance agreement with our largest third-party insurer. As a result, we reduced the premium paid to that third-party insurer, which will increase underwriting income. Additionally, Allstate assumed approximately $200 million in funds, all in trust, for potential future claim payments. Investment income on these funds will be earned by SquareTrade. In conjunction with this agreement, claims and claims expense benefited by a $6 million pretax favorable adjustment for loss experienced.

Slide 12 provides an overview of a new reporting structure we'll expand our financial reporting segments from 4 to 7. We plan to adopt the new reporting structure in the fourth quarter. The restructure will provide enhanced transparency and will offer an evaluation of our businesses group by like attributes.

Allstate Protection will continue to include the traditional Property-Liability businesses that address the 4 segments of the consumer Property-Liability market: Allstate, Esurance, Encompass and Answer Financial.

A new service business segment will include operations that have a larger portion of earnings from services but generally have less underwriting risk. This is likely to include SquareTrade, Arity, Allstate Roadside, Allstate Dealer Services.

Allstate Financial will be split in 3 segments. As you know, we have substantially reduced the breadth and size of Allstate Financial over the last decade. Allstate Life sells life-insurance through Allstate agencies in support of the Trusted Adviser strategy to broaden customer relationships. This business earns a low double-digit return. Allstate Benefits is a high-growth and mid- to high-teens return business. So breaking its results out will highlight its value creation.

Allstate Financial does not sell proprietary annuity given our view on economic returns, so the annuities is really a closed block of business. Returns are low in part reflecting current low interest rates. In addition, as we discussed, the decision to maximize shareholder value by increasing allocation to performance-based investments has had additional negative impact on near-term return on capital. This new segmentation will have an impact on goodwill impairment testing and the aggregation of Allstate Financial reserves for sufficiency testing. More information is available in the Form 10-Q, and we will provide additional detail later this year.
Now I will ask Jonathan to open the line for your questions.

# Question and Answer

**Operator**

[Operator Instructions] Our first question comes from the line of Greg Peters from Raymond James.

**Charles Gregory Peters**
*Raymond James & Associates, Inc., Research Division*

I just wanted to circle back. I've asked this of you before, but now that you've had 2 quarters in a row where your underlying combined ratio is certainly trending better than expected, I'm curious about your view of competitive positioning in the marketplace, especially when, I think, we've seen some anecdotal stories or situations, where some of your peers have started to cut some pricing.

**Thomas J. Wilson**
*Chairman & CEO*

Greg, this is Tom, I'll start. And then Matt can jump in. First, we do think we were out early in taking the price increases that were necessary in auto insurance. And that has put us in a position to not have -- assuming these trends continue, we don't think we'll have to raise prices as much, which obviously helps because price is a large component of that, which we compete on. It's not the only thing we compete on, however, so there's a wide variety of ways in which we compete with other people. The other part is it largely depends on what other companies do, so it's -- and it's hard for -- it's impossible for us to predict what they will do. So some of the large mutuals, which have significant underwriting losses, may choose to stay there, and then it will have -- there really won't be any competitive window for us to grab more share from those specific competitors. Some of our other competitors choose to subsidize various states, run losses there by having lower prices and high -- higher margins in other states. So, I would say, we prefer to be on this end of the equation, having improved our profitability, so we're in a balanced position to grow. But I don't think you can automatically assume that because other people didn't follow us, that they will follow us, or that this is sort of open-to-buy and it is easy to take business away. Matt, you may have some more specifics on that.

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

Thanks, Greg. It's Matt. First, it all varies based upon geography, so we'll start there. On a countrywide basis, as I said last quarter, we feel good that we've essentially caught up from loss trends and are now in a more reactive mode where we're monitoring loss trends and keeping pace with them. But that, of course, has some variabilities state-by-state. There are some states where we still have indications and we'll still need to take some rate. And there are others where we're doing quite well and things have stabilized. Overall, we feel really good about our competitive position. In our business, with our distribution model, one of the most important things for them is stability. And so as we're stable, as we maintain more normalized adjustments to rate and more inflationary rate adjustments, as we're able to build multi-month and multiyear marketing plans and give them predictability, they're more willing to invest, they are able to do long-term business plans and we see increased quota activity and increased closing rates, and as a result, increased new business production. So we actually feel quite good about our competitive position. It's interesting that you point to rate reductions that you've seen. We still see lots of our competitors with very large indications that are not yet taking all of their indications in some states. And in others, they're still taking double-digit rates. So we're seeing it all over the board while we are, for the most part, very stable and taking modest rate increases, which we believe is very good for our business model.

**Charles Gregory Peters**
*Raymond James & Associates, Inc., Research Division*

As a follow-up, with frequency, both BI and property being favorable for you in the last 2 quarters, I believe, is there anything going on in the environment that might lead us to believe that, that's going to continue?

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

Oh boy, if I could predict the future, Greg, I'd be a very happy man, and Tom would be happier, too. What we've seen is a moderation in frequency the first half of this year. As we closed out last year, it was really unclear what frequency would look like. We were, as you know, monitoring miles driven, monitoring the unemployment rate, monitoring gas prices and monitoring all those things that fed into miles driven, which fed into -- in addition to distracted driving, fed into accident frequency. And we've seen some moderation there, which has been good for our business these first 2 quarters. And we have no way really of projecting what it's going to look like for the remainder of the year. We feel, as I said, good of that, the fact that it appears not to be making step-function changes. That is, it appears to be moving in a more normalized basis up and down, normal variability with weather and things like that, which is much easier for us to react to and monitor and take appropriate rates for.

**Operator**

Our next question comes from the line of Sarah DeWitt from JPMorgan.

**Sarah Elizabeth DeWitt**
*JP Morgan Chase & Co, Research Division*

As you begin to transition to growth, should we expect the underlying combined ratio to stay around these levels or should we start to see it rise a bit, given the, I don't know, maybe a new business penalty or less price action?

**Steven E. Shebik**
*CFO & Executive VP*

Sarah, thank you for the question. When we manage overall profitability, we obviously look at the underlying combined ratio, and it's lower than we expected this year, obviously. We also look at the reported combined ratio and factor in CATs and everything else and we kind of like where we're at. Could it drift up? Sure. Frequency and severity typically bounce around by more than 1% a year, so it could move around. But if you said, do we have an objective to further reduce it from here, the answer would be no. Might it go lower? It all depends what happens in the market. But we don't -- we really try to prioritize and balance between maintaining the combined ratio and growth. Obviously, when 2015 frequency and severity went up faster than we had -- faster than to our pricing, we had to prioritize profitability over growth. I would say we're back to a more normal position today. Matt, anything you want to add?

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

Yes. Let me just add. This is Matt. Let me add just 2 items, Sarah. You mentioned the new business penalty and whether or not, as we continue growing, whether or not that could influence the combined ratio. Certainly, the new business penalty is a fact of life, that as you grow fast, the newer business that's not yet tenured does tend to have a higher loss ratio than the more tenured business. One of the things, however, that mitigates against that is that in our reaction to the frequency spike in the last 2 years, we took very segmented rate actions, and we took the segmented rate actions against the -- against those worst-performing segments of the book. As a result, the quality of our book increased that led to more defections from the worst-performing segments. It also led to us adding fewer new customers from those lower-performing segments. So we believe that the new business penalty will be dampened as we add on, assuming that we maintain the same high quality we've been seeing lately. So I don't expect that to be a significant drag. The other thing I'd point out is that, there'd been some commentary about whether or not this will cause us to dramatically increase marketing spend to stimulate growth. And really the marketing spend is not the primary driver on the growth right now as we've discussed many, many times. Retention was actually a bigger influence for us than the new business on our total items in force, and so we are just as focused on trying to improve our retention within those bounds of what we can control, since a lot of it is uncontrollable since it's based upon competitor actions. But for those things that we can influence, such as customer satisfaction and customer engagement and stability of pricing, we're just as focused on the retention component as we are on new business.

**Sarah Elizabeth DeWitt**
*JP Morgan Chase & Co, Research Division*

Great, that was helpful. And then, secondly, I was wondering if you'd talk a little bit about your QuickFoto Claim and other claims initiative. How we should think about the potential for savings there as well as if there should be further restructuring costs. I think your LAE ratio is running around 11 points. Would it be fair to say, maybe over time, you could shave a couple points off of that?

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

Sure. It's Matt again. So let me just start high, first. So we've talked about Integrated Digital Enterprise and emerging technologies, one of those areas that we are deploying it initially and with quite some force is the claims area. We believe it's an area primed for it because there is some inefficiency in the way the model operated. In the past, there was a lot of windshield time. There was a lot of dead time, unproductive time and as adjusters drove around, driving to cars, driving to body shops for both initial estimates and supplements and we looked at that and realized that emerging technologies, data and analytics could rectify that and take some of the inefficiency out of the system. So we began the digitization of the claims process. Last year, we launched a new immediate payment method, which we call QuickCard Pay. QuickCard Pay is the fastest claim payment method in the P&C industry. We make payments directly with debit cards within seconds. We've also been assessing roof damage from hail events utilizing drones, and we've been doing that quite successfully for the last several quarters. In the last quarter, we opened 2 digital operating centers. They handle auto claims on a countrywide basis by estimating through photos. Approximately half right now of all drivable vehicles are currently being inspected through our QuickFoto method of settlement. That has led to the shutdown of many of our drive-in claim centers. And it has also led to a reduced need for field adjusters since we took a lot of that inefficiency out of the system. We now have our adjusters looking at enhanced photos, digital photos in the computers without having to drive to and from the sites. We've also begun utilizing video chat technology to review supplemental damage with auto body shops. It's something we call Virtual Assist. And the combination of all of those things has led to a dramatically more productive and more efficient claims system. We've taken a cycle that used to take 5 to 7 days in order to get eyes on a vehicle and get an estimate out, we've done that now in hours, and we are literally doing that in under 24 hours. So for supplements, instead of having to schedule an adjuster to come back out to a body shop and look at supplemental damage, we now use the video chat technology same day, and we move it along. Everybody's happy. The customer gets their car back sooner, the body shop gets the car off their lift sooner and they take another car in, and we are reducing rental car time and improving customer satisfaction. So we do believe that the combination of these leads to a more efficient system. It leads to obvious cost savings as we take inefficiency out of the system, and it leads to greater customer satisfaction.

**Thomas J. Wilson**
*Chairman & CEO*

Sarah, this is Tom. So I think, you might have to go back and look at the ULAE. Your numbers seem high to me. I'm not sure what -- how you're slicing it out, but you can get that from John or from me. Let me pick up on Matt's Virtual Assist. So this is -- that's really a great technology and we're making it available to other insurance companies. Basically, as Matt mentioned, it's face time that combines with your claims system. And so what it enables you to do is not have somebody drive out to a body shop to do a supplement and you can do it remotely. So we're -- this is -- it's available through Arity so if insurance companies want to use it. This is where we can use our market-leading movement here, because we think we're ahead of other people in doing this. Because you don't have to go out and train a bunch of body shops how to use this technology. We've already trained body shops on how to deploy it so we're making that available to other insurance companies. That is my commercial for Arity.

**Sarah Elizabeth DeWitt**
*JP Morgan Chase & Co, Research Division*

Okay. And can you quantify the savings from these initiatives at all?

**Thomas J. Wilson**
*Chairman & CEO*

Here's what I would say is we're not going to quantify the exact savings. Obviously, when we take a charge of $52 million, not all of it was related to the claims fee. Some was related to restructuring in the legal department. But we obviously expect to earn that back in a relatively short period of time. And so -- and that's not 5 years, that's not 5 days either, but it's pretty substantial savings on an absolute dollar basis. When you look at percentage basis, it's obviously much smaller. When we break all that number, we break out the restructuring fees by component in the Q.

**Operator**

Our next question comes from the line of Jay Gelb from Barclays.

**Jay H. Gelb**
*Barclays PLC, Research Division*

The Allstate brand's underlying combined ratio in auto clearly improved year-over-year although it was higher quarter-over-quarter. I'm just wondering if there's some seasonality that would explain that, or if there's some other costs.

**Thomas J. Wilson**
*Chairman & CEO*

I wouldn't make anything of it, Jay; it bounces around it. You'll remember, the first quarter, January and February were much lower, so it's really better to look at it versus the prior year quarter because of weather impact.

**Jay H. Gelb**
*Barclays PLC, Research Division*

All right. I thought there was some seasonality there, okay. And then on bigger picture. Has Allstate given thought to purchasing increased catastrophe reinsurance protection on sort of working layer catastrophes? It seems that over the past or -- the company's on track over the past 2 years to have around 8 points of catastrophe losses. So as reinsurance rates keep dropping, I'm wondering if there might be an opportunity there for increased risk transfer.

**Thomas J. Wilson**
*Chairman & CEO*

I'll make some general comments and then Steve may want to jump in. So first, we look at reinsurance broadly, continuously, and have helped to actually develop markets, whether that be CAT bonds or larger, longer-term aggregates, where we go out 3-plus years, which were never available before. So we're always active in the market, and that's because we're obviously one of the biggest buyers in the market, so people respond to our requests. But it comes in a couple different flavors. I think what you're suggesting is, have we looked at using reinsurance to moderate the annual impact of what I'll call nonlarge model events, so hail, windstorm, and stuff, so having lower-level protection. We feel we can handle that in the volatility -- that volatility in our P&L. We look over the -- at the homeowners business, each of the rolling last 12 months we've made over $1 billion a year, and it gets expensive when you look there. When you go to the higher end levels, the sort of 1 in a 100-year event, it has, obviously, the benefit of not having to have that volatility if in fact that event happens. But it also is a capital relief tool. So we don't mind paying a little higher price for that because -- except we can earn a higher return on our equity than the reinsurers need to because of their portfolio diversification. And our specific needs, we use it for that purpose. But I would say we're always looking at different ways to do it. We're always trying to moderate the amount of capital we have to put up and maximize the return we get on that capital. Steve, anything you want to add?

**Steven E. Shebik**
*CFO & Executive VP*

I think you did a pretty good job, Tom. The only couple of things that I might add, we do look not only at buying more but how we structure the reinsurance. So we look at it annually, it's kind of an annual buy for Allstate in the early part of the year and for mid-part of the year. And so if you look particularly this year, we did buy a $200 million cover in the Southeast, for the Southeast for auto, which kind of filled in a hole we thought we had in terms of bringing the retention down a bit for that area. So we continue to look, not only highly structured, but if there's holes we think might be if a storm were to hit, we'd focus on that, and as Tom said, really it looks at economics. And generally, what we've seen over the last handful of years, it hasn't been economic for us at that time to buy more or to structure differently. But we're entering into what we consider our normal type period in the fall where we look at it. So we'll look at it again, given that you're correct, reinsurance rates have continued to move down.

**Operator**

Our next question comes from the line of Elyse Greenspan from Wells Fargo.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

As you guys talk about looking to grow in auto and some of your comments you also did mention in home, can you just remind us about the bundling within your book, those that purchase both auto and home purchase coverages, and how you expect, as you look to improve the retention in auto, how you expect that to play out in home?

**Thomas J. Wilson**
*Chairman & CEO*

Matt will answer to the Allstate brand, and then Don will make a comment on Esurance, because I think that one of the analyst writers might be able to comment about Esurance, if that makes sense?

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

Sure. Elyse, it's Matt. So let me talk about the Allstate brand. The last couple of years have hurt our bundling capabilities. We had bundled primarily with auto and another product, auto and home, auto and life, auto and consumer household products and with all the disruption in the auto business, it has influenced and impacted the potential growth of the other businesses. We know that -- we watch the home area, specifically, and we know that home is lagging auto because -- not only because of the 12-month policy in home but the different renewal periods. And as a result, you tend to see a lag in the growth. So when auto ticks up, it tends to be a quarter or 2 before home picks up. So we're still seeing some of the influence from that disruption in home even though auto has begun to stabilize and turn the other way. Our expectation is fully that as this works its way through the system, and I remind you that a lot of rate was taken just over 12 months ago or so, it has now worked its way through the system. As things stabilize and as we hope retention stabilizes and potentially improves, we expect to see our capacity for bundling to improve. We like that, obviously. Number one, we want to serve customers holistically, we think it's 100% consistent with our Trusted Advisor strategy. But it also helps leverage a single acquisition cost across multiple product lines, leading to a more efficient system and a more efficient use of marketing funds. So you should expect to see continued emphasis on the part of the Allstate brand to increase the bundling, increase the number of products sold for household and increasingly meet the needs of our customers. Don, you want to talk about Esurance?

**Don Civgin**
*President of Emerging Businesses - Allstate Insurance Company*

Yes. First, much of what Matt talked about the Allstate brand also applies to the Esurance brand and actually, the other brands as well. As you see across the industry, people -- different companies maybe attempt to bundle for their customers. Recall when we acquired Esurance 6 years ago, it was a monoline company, so they sold only auto insurance. At the time, we knew that there was an opportunity for us to use homeowners to get a different kind of relationship with the customers. In fact, even a different type of customer. Now we have -- and by the way, we obviously know how to do homeowners as a corporation, and so we were able to leverage the skills we had at Allstate as we built out the Esurance capabilities. Esurance now has homeowners in 31 states. Bundling is very important to us for the same reason as Matt talked about for Allstate. Our attach rates are going up dramatically as we roll the product out and make it available to customers. And so it will offer us an opportunity to increase retention, build a different customer relationship and really build the business. Now I want to temper those comments with -- there's only $20 million net written premium here in the second quarter. We have 69,000 policies, a still relatively small percentage of the book, and there is still volatility in that number. So a few large losses will swing that loss ratio up dramatically as it did in the second quarter. But we've done it for strategic reasons. It's delivering everything we expect. And I think it's a big opportunity for us to continue growing Esurance.

**Elyse Beth Greenspan**
*Wells Fargo Securities, LLC, Research Division*

Okay, great. And then in terms of capital return, you mentioned the new $2 billion buyback program and being financed with capital at hand and your earnings, how do you view M&A right now? I mean, I know you just completed the SquareTrade deal, but any kind of high-level thoughts how you think M&A is still part of the equation as you think about capital return here?

**Thomas J. Wilson**
*Chairman & CEO*

Well, of course, the first thing we do is look at managing overall capital as we like to invest in our existing businesses to the extent we can, which is organic growth with that obviously leveraging our skilled capabilities for higher returns. We do look at acquisitions. And as you mentioned, we've bought SquareTrade to broaden our product portfolio, broaden the distribution we have and give us additional products to be able to sell through the Trusted Advisor this year, or through Esurance. And so if you look at -- then what we do after that, is say, okay, if we don't have additional use for the money, we should return it to shareholders and help increase their relative ownership in the company. So in the last 3 years, we bought back 15% of the shares outstanding so that your value should go up by 15% just because we're returning capital to shareholders over 5 years it's been about a little over 25%. So I would expect that same pattern to continue. If we see something interesting, we'll buy it and we paid a lot of money for SquareTrade but we believe we can grow it just as we did Esurance and Allstate Benefits.

**Operator**

Our next question comes from the line of Kai Pan from Morgan Stanley.

**Kai Pan**
*Morgan Stanley, Research Division*

First question to follow up on the digital claims processing technology. I just wonder how do you measure the accuracy using photos to settle an initial loss reserve versus using, like, adjusters in person?

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

It's Matt. It's a good question. Obviously, when you initiate a massive change in a process such as this, the quality is one of the most critical things. So we did a lot of testing along the way. We still have testing and we do both secondary reviews as well as reviews in person. So we do selectively -- have people doing on-site reviews. As I said, it's only about 50% of the drivable cars right now. So we have a baseline to look at and the reality is, the quality has been exceptional. Supplements are slightly higher, but rather an insignificant amount, and the overall quality is quite good. We are continuing to develop our ability to enhance the digital photos and get better visibility into the damage. Obviously, as our adjusters get more familiar, we've had to use these photos and what angles to request, and how to change the lighting on it, we're able to pick up more and more information. We're using some technology to actually help us learn from that and compare photos from similar autos and similar types of accidents to help us baseline. So overall, the quality has been quite good, actually slightly better than we expected and the productivity and efficiency savings have been tremendous.

**Thomas J. Wilson**
*Chairman & CEO*

And Kai, on the reserves, remember, these are relatively short-tail, so within 90 days, you know where the prospects are so it cycles its way through [indiscernible]

**Kai Pan**
*Morgan Stanley, Research Division*

That's great. By the way, how much do you spend on these sort of -- on the investments? Is it part of your expense ratio, right?

**Thomas J. Wilson**
*Chairman & CEO*

Yes. I won't give you a number or percentage. I would just tell you that we always look at these things and to the extent -- we invest heavily in research and development, whether that be the things we talked about here or Arity or other things, and we believe we can handle with the overall P&L. So we do not resource constrain that. We -- capabilities and ability to execute might constrain us, but it is not a money constraint.

**Kai Pan**
*Morgan Stanley, Research Division*

My second question is on your sort of like the change of reporting structure. Is there any change in the underlying operating structure? And how big do you think the service business will be coming, sort of meaningful percentage overall, like a business of the company?

**Thomas J. Wilson**
*Chairman & CEO*

Well, Kai, the operating structure is sort of -- what we did really was try to align the way we allocate capital and the way we think about our businesses and to give you increased transparency. We don't have a specific goal, percentage of revenue or profit we want from any of those various businesses but let me give you an example. If you go to Allstate Financial, the way we -- even though we showed people many of the underlying numbers, when Mary Jane manages that overall business, she doesn't just -- people would look at the overall ROE, and say, oh, it's like 6% or 7% or 8%, depending on the quarter. And the fact is that Allstate Benefits has great ROEs, Allstate Life has good ROEs and it's dragged down by Annuities business. And we felt like we just needed to show people in a different way. And even though some of this information you could parse out and accumulate together by looking at the Q or the K or the investor supplement, this really increases our transparency by bundling it together for you in a way that aligns with the way we think about and manage the business.

**Operator**

Our next question comes from the line of Josh Shanker from Deutsche Bank.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

Between Sarah and Kai's question, I still have trouble understanding the expenses in technology versus what's in the expense ratio and what's not. Can we talk a little bit about why the $52 million maybe shows up in the expense ratio? Typically, you guys have like $10 million-or-so of expenses that are kind of other that show up. How should we think about it going forward? And normally, just to understand, you guys are always investing in the future. Why does this show up in the expense ratio and other stuff and in the past has not?

**Thomas J. Wilson**
*Chairman & CEO*

So it's not just -- let me be clear. It's not about technology expenses, this about the cost for severance, for people who are no longer -- be required, so that's over 500 people. And we have 937 drive-ins. Now a lot of those, over time, we've structured to have month-to-month leases because we knew we were headed here. But we still have some charges to take, on the shut things down, get leasehold improvements out. But that's not really related to the investment in it at all. It's really related to the shutting down of other stuff. Why did this show up in underlying combined ratios is a question Matt and I have harangued Steve with for the last few weeks. And our restructuring charges have always been in there, so I think you should expect to continue to see them in there, even though they perhaps, are not as -- continuing as we would think in terms of underlying. So I don't think you should expect us to take a $52 million charge every quarter. That said, to the extent we need to take the charge or any charge really, as you know, we manage its weights on cash flow and economics assurance and if it rattles through the P&L, it rattles through the P&L.

**Joshua David Shanker**
*Deutsche Bank AG, Research Division*

Okay, that's perfect. I'm on the same page. And then the limited partnerships. I mean, they were -- I'm not going to get a great answer out of it but they were phenomenal this quarter. Were there any specific gains taken that were unusual? Or was it just a great quarter for mark-to-markets? How should we think about this going forward?

**Thomas J. Wilson**
*Chairman & CEO*

John will give you that perspective.

**John Griek**
*Head of Investor Relations*

Thanks, Josh. This is John. It was a combination of factors. One, we have been building up the book of business. You expect that the return on that book of business would get larger. Two, favorable markets did influence it. When you look at our performance-based assets that you have a correlation of about 70% to public market, so that was a factor. And then three, to answer your question specifically, there were a few idiosyncratic properties that performed quite well and credit to the team that sifts through many, many opportunities, narrows them down to the ones that make most sense for the firm and invest in those.

**Operator**

Our final question then comes from the line of Bob Glasspiegel from Janney.

**Robert Ray Glasspiegel**
*Janney Montgomery Scott LLC, Research Division*

One numbers question. On your net investment income page on 51. I'm going in the weeds, I apologize. Your fixed income yields are actually up year-over-year despite the fact you had shortened maturities. How have you been able to keep the yield on fixed incomes going up in a sort of low interest rate world with shorter maturities?

**John Griek**
*Head of Investor Relations*

Yes. This is John again. As you would imagine that the combination of events can cause changes in yields, not only where you're placed on the yield curve, but also what investments you buy in the market. So part of that is in response to increased holdings in securities like high yield and other high-yielding securities.

We also did, and it should be noted well, it was a small move. In the first quarter of this year, we did extend the duration portfolio by about 1/4 of the year, and that impacted yields by about 20 basis points.

**Robert Ray Glasspiegel**
*Janney Montgomery Scott LLC, Research Division*

Got you. And 1 other quickie. On the preferred that you say you're going to issue to help on the buyback, what's the motivation there? What roughly yield in magnitude are we talking?

**Matthew E. Winter**
*President and President of Allstate Insurance Company*

So we are really looking at that as part of the potential funding for our buybacks. So I think currently right now, the market seems fairly attractive. Just kind of goes on cycles. So we will look at that as part of that financial -- obviously we don't have to do it because we have plenty of capital in cash. But, when the opportunities we think our attractive are available, we want to take advantage of them.

**Robert Ray Glasspiegel**
*Janney Montgomery Scott LLC, Research Division*

And rough idea of the size and the yield that you'd be paying, ballpark?

**Thomas J. Wilson**
*Chairman & CEO*

Well, the yield should be as low as possible from our standpoint. But you saw -- and a deal went out earlier this week and a couple of ticks over 5. And when you can issue perpetual equity, that has a guaranteed 5% return, and you can use that to buy back common, we think that's a good trade on behalf of shareholders. And as you know, we've done $1.75 billion of it over the last, I want to say, 2 or 3 years.

**John Griek**
*Head of Investor Relations*

4 years.

**Thomas J. Wilson**
*Chairman & CEO*

Four years. And we like the results of that and so there's more to it. You wouldn't obviously do this for $100 million. It's not worth all the overall effort but -- so we haven't sized it. But there's plenty of opportunities for us to issue given our brand name, our credit capacity and our ability to pay them.

And so let me close by again, thanking you, all, for participating. Overall, we made excellent progress on our 5 operating priorities, most importantly, better serving the customers achieving economic returns on capital and proactively managing our investments. And we also are beginning to focus more on growing the customer base and are always looking at building long-term growth platforms, whether that's investing in Integrated Digital Enterprise or new initiatives like SquareTrade and Arity.

Looking forward, we're just going to stay focused on our 2017 priorities and be precise in the way we execute our business, balancing both short and long-term initiatives. So thank you, all, and we'll see you next quarter.

**Operator**
Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.