S&P Global
Market Intelligence

Kemper Corporation NYSE:KMPR

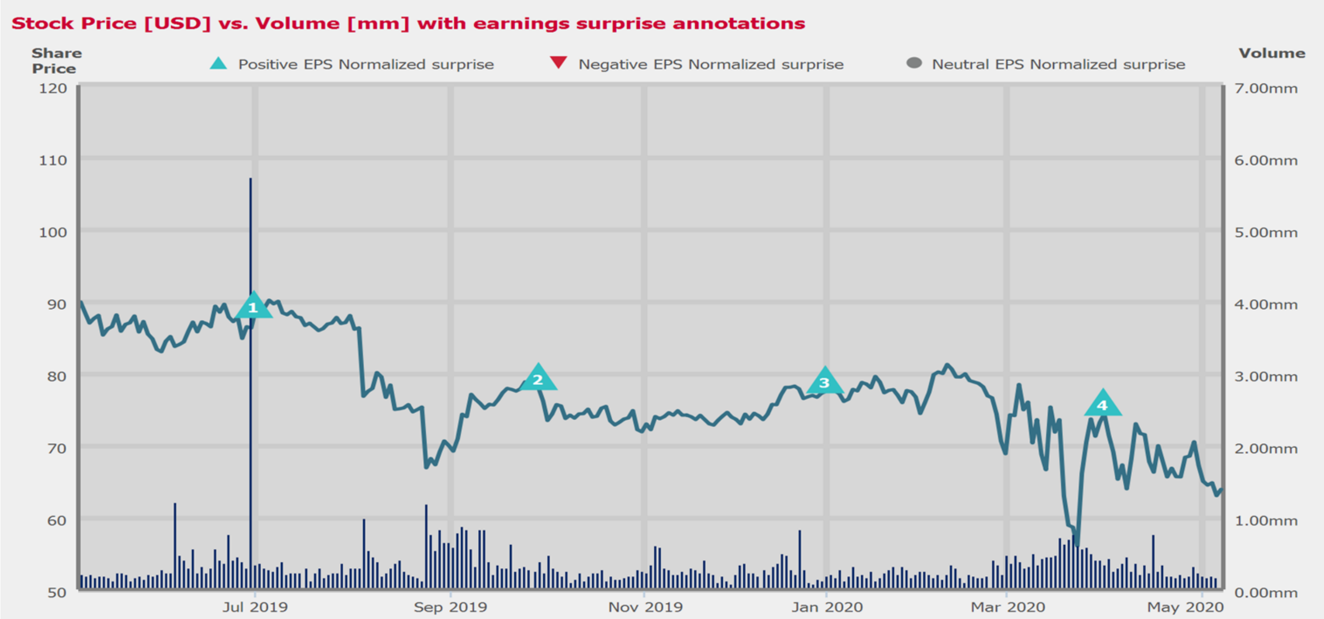
FQ1 2020 Earnings Call Transcripts

Thursday, May 07, 2020 9:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2020-		-FQ2 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	2.37	▲2.53	1.19	6.56	6.27
Revenue (mm)	1291.67	▲3.92	1218.89	5015.26	5188.35

Currency: USD
Consensus as of Apr-27-2020 9:24 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2019	1.33	1.38	▲1 3.76 %
FQ3 2019	1.39	1.93	▲2 38.85 %
FQ4 2019	1.40	1.45	▲3 3.57 %
FQ1 2020	2.37	-	▲4 2.53 %

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Call Participants

EXECUTIVES

Christine Patrick
Vice President of Investor Relations

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

James J. McKinney
Executive VP & CFO

Joseph Patrick Lacher
President, CEO & Director

ANALYSTS

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

Jon Paul Newsome
Piper Sandler & Co., Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

Seth A. Rosenberg
UBS Investment Bank, Research Division

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to Kemper's First Quarter 2020 Earnings Conference Call. [Operator Instructions] As a reminder, the conference is being recorded for replay purposes.

I would now like to introduce your host for today's call, Christine Patrick, Kemper's Vice President of Investor Relations. Mrs. Patrick, you may begin.

Christine Patrick
Vice President of Investor Relations

Thank you, operator. Good afternoon, everyone, and welcome to Kemper's discussion of our first quarter 2020 results. This afternoon, you'll hear from Joe Lacher, Kemper's President and Chief Executive Officer; Jim McKinney, Kemper's Executive Vice President and Chief Financial Officer; and Duane Sanders, Kemper's Executive Vice President and the Property & Casualty Division President.

We'll make a few opening remarks to provide context around our first quarter results and then open up the call for a question-and-answer session. During the interactive portion of the call, our presenters will be joined by John Boschelli, Kemper's Executive Vice President and Chief Investment Officer; and Erich Sternberg, Kemper's Executive Vice President and Life & Health Division President.

After the market closed this afternoon, we issued our earnings release and published our first quarter earnings presentation, financial supplement and Form 10-Q. You can find these documents on the Investors section of our website at kemper.com.

Our discussion today may contain forward-looking statements within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements include, but are not limited to, the company's outlook and its future results of operations and financial condition. These statements may also include the impacts related to the COVID-19 pandemic.

Our actual future results and financial condition may differ materially from these statements. For information on potential risks associated with relying on forward-looking statements, please refer to our 2019 Form 10-K, our first quarter 2020 Form 10-Q as well as our first quarter earnings release.

This afternoon's discussion also includes non-GAAP financial measures we believe are meaningful to investors. One such measure I would like to highlight again is as adjusted for acquisition.

It is clearly important to understand our reported results, including the impact the Infinity acquisition has to Kemper overall.

However, investors have also expressed an interest in understanding the underlying organic performance of the combined businesses. Since our as-reported financials don't include Infinity's historical information prior to the closing of the acquisition and our current results include the impact of purchase accounting, the underlying trends are not easily visible.

In an effort to provide insight into the underlying performance of the combined businesses, we also display our financials as adjusted for acquisition. This view removes the impact of purchase accounting and includes historical Infinity information for periods prior to the closing of the acquisition to more easily provide a meaningful year-over-year comparison.

In our financial supplement, presentation and earnings release, we have defined and reconciled all of the non-GAAP financial measures to GAAP where required in accordance with SEC rules. You can find each of these documents on the Investors section of our website at kemper.com.

All comparative references will be made to the corresponding 2019 period, unless otherwise stated.

Finally, I would like to note that due to the social distancing practices that Kemper enacted in response to the COVID-19 crisis, our call participants are not in the same location. This may cause the question-and-answer section of our call to feel disjointed at times. We apologize in advance and ask for understanding from our listeners.

I will now turn the call over to Joe.

Joseph Patrick Lacher
President, CEO & Director

Thank you, Christine. Good afternoon, everyone, and thanks for joining us today. Before beginning our usual discussion, let's take a few minutes to recognize these unusual times.

I'd first like to acknowledge the human toll this pandemic is taking and express our thoughts and compassion for the individuals and families that have been impacted, whether through illness, death, unemployment or those working on the front lines.

As we continue to move through the dynamic circumstances of the COVID-19 crisis, I want to acknowledge the efforts of our 9,100 employees.

I'm very proud of the way our team has risen to the challenge and focused on supporting the well-being of all of our stakeholders.

On Page 3, I'd like to highlight a few of the ways Kemper is responding to the current situation. Our first priority continues to be the health and safety of our customers, employees and partners as well as their families.

In the early phase of this crisis, the focus is on doing our part to help flatten the curve and protect the health care systems availability for those who might need it. We acted quickly to engage social distancing practices. We have nearly 95% of our employees working remotely, while continuing to meet the needs of our customers at normal service levels. For our employees in the office, we're maintaining appropriate social distancing to keep everyone safe and healthy.

We announced a 15% credit for our auto policyholders towards their April and May premium, and we're extending grace periods for any of our customers experiencing financial strain. We've instituted a commission stabilization program for our Kemper Life employee agent who were forced to temporarily suspend new business sales due to the crisis. We're also providing assistance to enable our communities to meet the urgent needs created by the COVID-19 crisis. The company recently announced a commitment of $1 million to support organizations focused on critical issues, including food and security and supporting frontline medical personnel. These types of organizations are doing extraordinary work.

We're proud to support our customers, employees and communities, at the same time, we maintain a strong focus on effective execution and continue to grow our business to meet the needs of all our stakeholders.

Now let's turn to Page 5 to discuss our quarterly results. This is a unique quarter with January and February continuing the solid top line growth we experienced throughout 2019 before the impact of the COVID-19 crisis started to appear in March. Overall, earned premiums grew 9% in the first quarter, in line with growth rates we experienced in 2019.

First quarter net income was $64 million or $0.95 per share, adjusted consolidated net operating earnings were $163 million or $2.43 per share. We generated a rolling 4-quarter return on tangible equity, excluding unrealized gains of 20%. Our ability to generate that level of return through this environment speaks to the strength and performance of our model through the ups and downs of a business cycle.

Our specialty business saw top line growth of 13%, driven by broad growth across all geographies. Continued geographic expansion and enhanced new business opportunities in Florida resulting from the exit of a competitor. We were able to maintain solid top line growth at attractive margins with an underlying as adjusted combined ratio of 93%.

Operating results from our preferred insurance segment improved this quarter as underwriting actions and the repositioning of our book continued in earnest. Given the modest size of the business and efforts to enhance and refine products we offer, we continue to expect a higher level of volatility in quarterly results. That said, we are pleased with the progress reflected in this quarter's financials.

In our Life & Health segment, we welcome to Erich Sternberg as the division's new President. Erich's breadth and depth of experience within Life & Health will help us continue to thoughtfully grow these businesses.

From a financial standpoint, given the backdrop of the current environment, the segment delivered another quarter of solid earnings and continues to provide diversifying cash flows to the organization.

Now let's turn to Kemper's financial strength. Over the past few years, Kemper has developed into a strong and stable organization that is a source of security for our stakeholders in uncertain times like the one we currently face. We continue to be recognized by rating agencies for our improved performance. I'm pleased that during the quarter, S&P upgraded our key financial strength rating to A and the holding company's senior debt ratings to BBB. This follows the positive rating actions of Fitch and AM Best that I noted on our fourth quarter earnings call.

Our balance sheet is strong with a low debt-to-capital ratio of 17%, no near-term debt maturities, a diversified investment portfolio and significant committed contingent capital by institutions classified as SIFIs.

Through April 1, we repurchased $110 million of Kemper stock. This roughly equates to both the shares issued in conjunction with the redemption of the hybrid notes in 2019 and the after-tax net amount of the CSC judgment, of which we received the remaining balance this quarter.

With that, I'll turn the call over to Jim to discuss our consolidated financial results in more detail.

James J. McKinney
Executive VP & CFO

Thank you, Joe, and good afternoon to everyone on the call. I'd first like to echo Joe's comments acknowledging the human toll this pandemic continues to take and express my sympathy for the many individuals and families that have been affected.

Turning to the results for the quarter on Page 6. Net income was $64 million compared with $155 million in the prior year. Excluding the impact of purchase accounting, adjusted consolidated net income grew to $163 million. Net result this quarter were heavily impacted by the decline in fair value of equity and convertible securities, driven by the global financial market selloff.

On Page 7, we isolate the key sources of volatility, including $89 million we received as satisfaction of the remaining balance of the CSC judgment. Our results in the quarter demonstrate that our business is strong and continues to perform well with solid financial results.

Turning to Page 8. In this challenging time, I'd like to take a moment to remind individuals of our ongoing focus on risk management. Big picture, we strive to maintain capital and liquidity, sufficient to sustain target ratings using the greater of 2 risk test. To be clear, the capital and liquidity levels referenced here are to uphold target credit ratings versus solvency, a much more conservative framework to manage risk.

The first test is an annual stress stimulation to ensure the entity has sufficient capital and liquidity to meet the needs of our operations through a 1 in 200-year event. The second stress simulation is an over the life of the liability assessment that is intended to capture the liquidity and capital needs through a 1 in 50-year event.

Like the Federal Reserve stress test, our 1-in-200 and 1-in-50 events include a broad range of stress events, including market setbacks, operational challenges, regulatory uncertainties and catastrophes. This approach helps ensure we are a strong company through challenging economic periods.

As Joe touched on, our focus on strengthening the Kemper franchise and our risk management capabilities over the past few years have been recognized in recent months through ratings upgrades from S&P and Fitch and an improved outlook from AM Best.

With those reference points, I would like to start by reviewing some of the key financial data points that highlight the strength of our balance sheet. First, we have over $871 million in liquidity, many multiples of our fixed costs. Second, our diversified model is designed to produce positive cash flow through volatile economic periods.

In the quarter, operating cash flow was $62 million.

A final item is our attractive capital stack. It is highlighted by strong capitalization of our insurance entities, a debt-to-capital ratio of 17% and no near-term debt maturities. Our balance sheet is strong with significant financial flexibility.

An important item to note is our recent stock repurchases. Through April 1, we repurchased $110 million of Kemper stock. $101 million of these repurchases occurred during the first quarter. As Joe mentioned in his comments, this amount roughly equates to the after-tax amount of the CSC payment and the shares issued in conjunction with the redemption of the hybrid notes in 2019.

When we issued those shares, we were seeing and expected to continue to see tremendous growth and momentum in our specialty auto business. And there was uncertainty around the timing and amount of the proceeds from the CSC judgment that could help fund this growth.

With the proceeds in hand, we felt the right thing to do for our long-term shareholders was to repurchase these shares. We did so at an 18% discount to issuance price. We have not repurchased any shares since April 1. We have roughly $130 million remaining on our $300 million share repurchase authorization from August 2014. This quarter, the Board expanded this authorization by $200 million, providing roughly $330 million in repurchase capacity. While we do not have near-term plans to repurchase additional shares, if Kemper trades significantly below what we believe the company's intrinsic value is, we have the capacity and capabilities to capture this value for our long-term shareholders.

Turning to Page 9. I, again, want to highlight some of the capital metrics we track closely, including tangible book value per share, tangible return on equity and cash generation, which together, reveal the efficiency of our capital deployment decisions and intrinsic value creation.

In the quarter, tangible book value per share, excluding unrealized gains, was flat compared with the fourth quarter. Solid operating performance was offset by mark-to-market impacts from market volatility. That said, our returns remain strong with an industry-leading 4-quarter rolling return on tangible equity, excluding unrealized gains of 20%.

Turning to Page 10. Net investment income grew slightly over the first quarter of 2019 to $86 million as our investment portfolio continues to grow. In the first quarter, we began including income from our COLI investments in our core portfolio net investment income. This is reflected on a historical basis in the charts on this page. We made this presentation change as a result of the increased allocations we have made to the investment class.

The annualized book yield of the portfolio declined to 4%. The decrease was largely a result of this quarter's global market movements. Similar to many of our peers, given the current market volatility, we believe it would be helpful to expand our discussion to provide additional transparency into our investment portfolio.

Page 11 offers more detail on the fixed income categories of our portfolio that are most exposed to the economic impact of COVID-19. We've identified these areas as retail, energy, transportation and leisure.

As you can see from the slide, our exposure to these sectors is less than 1% of our total investment portfolio. It is well diversified and concentrated in above investment-grade assets.

Turning to Page 12. You can see more detail on our below investment-grade portfolio. It is diversified across different asset types and at 5% of our fixed income investment is a relatively small portion of our overall portfolio.

Page 13 gives more detail on our CLO exposure. The majority of the portfolio is invested in highly rated assets with 83% rated A or higher.

Finally, on Page 14, we break down the largest components of our alternative holdings. The primary focus of our alternative portfolio is current income generation. It is diversified across strategies, focused on private credit, private equity and hedge funds.

Similar to others, roughly 95% of this portfolio has a reporting lag. This means that a portion of this quarter's global market disruption will bleed into next quarter's investment results. In closing, we are well positioned to be a source of strength for our stakeholders through this environment.

And with that, I'll turn the call over to Duane to discuss the results of our P&C segments.

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

Thank you, Jim, and good afternoon, everyone.

Let's begin with the Specialty segment on Page 15. The Specialty segment was highlighted by another quarter of strong growth. Segment income of $60 million was driven by net earned premiums of $823 million, an increase of 13% from the prior year's quarter. Policies in-force increased 10%, excluding the sale of classic car.

As you can see in the chart on the top right of the slide, we continue to experience strong growth across all significant geographies. Our trailing 12-month growth was 6% in California, 23% in Florida and Texas, and 42% in our expansion states.

As previously noted, Florida has been a robust growth market for us. It was further amplified in the quarter by the exit of a competitor. Growth in the first 2 months of the quarter was robust and in line with our recent results. This growth rate slowed in March as stay-at-home orders related to the COVID-19 crisis were implemented.

As part of our response to the crisis, we have provided a 15% credit to our auto customers towards their April and May premiums, totaling roughly $100 million, reflecting fewer miles driven and the resulting decline in frequency. We continue to experience growth at attractive margins with an as adjusted underlying client ratio in the quarter of 93%.

During the quarter, losses in the segment were impacted by 3 items: first, in anticipation of increased volumes of new business, we increased head count with our claim staff to support this planned growth. We expect this to normalize throughout the year. Second, we recognized a loss severity development due to the changing in macroeconomic environment. This includes, among other things, changes in used car values, changes in salvage values and the related impacts around repair cost. Lastly, we recognized a legal item related to Florida PIP.

The long-term growth outlook for the Specialty segment remained strong. The tailwinds we have experienced over the past few quarters are intact, but the COVID-19 situation has created some near-term watch items.

Turning to the preferred insurance segment on Page 16. Segment income was $18 million for the quarter with an underlying combined ratio of 92% compared with the segment income of $3 million with an underlying combined ratio of 96% in the first quarter of 2019. Segment income increased due to a broad array of profit improvement actions taken in our auto and home books that have resulted in lower overall loss activity.

While we continue to make strides towards reaching our preferred insurance segment profitability targets, given the relative size of the book, we expect results to remain volatile for a period of time.

I'll now turn the call back to Joe.

Joseph Patrick Lacher
President, CEO & Director

Thank you, Duane. Turning to our Life & Health results on Page 17. In the first quarter, the segment produced pretax income of $27 million, which reflects pressure in global economic markets impacting net investment income and a couple of onetime items.

In the quarter, there was a $3 million impact from new sales disruption and employee agent commission stabilization as a result of COVID-19. This was offset by a refinement in our CEI estimate.

Earned premiums increased 2%, reflecting our focus on growing the platform as the diversification benefits from the combination of the Life and P&C businesses continue to provide strategic value through enhanced capital efficiency.

Turning to Page 18, I'd like to spend a few minutes walking through key areas of our business that have been impacted by the COVID-19 pandemic. It's still too early to determine how long the crisis will last and the potential outcome. We will learn more in the coming months.

Turning to our Specialty and Preferred segments, the stay-at-home actions put in place towards the end of the first quarter have had an adverse impact on new business written, a shopping behavior significantly decreased in the second half of March. The decrease in miles driven as COVID-19 restrictions were put in place, has resulted in a decrease in auto accident frequency. This has been somewhat offset by an increase in severity. We reflected the drop in frequency with a 15% premium credit for our auto policyholders in April and May.

Given the market dynamics currently in place, it is reasonable to expect modest expense ratio pressure driven by increases in bad debt and lower premium and fee volumes. There's a significant amount of opportunity for Kemper in our specialty auto segment. Growth prospects remain in both existing and expanding geographies where competition is fragmented. We continue to believe this provides a growth tailwind, although current social and economic environment make the near-term timing around this less certain.

Turning to our Life business. We temporarily suspended new business sales in late March with a gradual resumption expected in the second quarter. At this point in the crisis, we have no meaningful information to communicate on COVID-related changes to the mortality and morbidity expectations of our book.

In closing, Kemper is well positioned to perform through this environment with a strong capital and liquidity position. We have a balance sheet highlighted by a low debt-to-capital ratio, no near-term debt maturities and significant committed contingent capital. In addition, the mix of our underwriting businesses provides strong cash flow diversification and added financial flexibility.

I'm proud we have the ability to continue to serve our customers and act as a source of strength for all our stakeholders through the COVID-19 crisis. Insurance is an essential function in crisis situations. We're here to deliver on our promise to our customers when they need it the most.
And now I'll turn the call back to the operator to take your questions.

Question and Answer

Operator

[Operator Instructions] And our first question today comes from Greg Peters with Raymond James.

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

Joe, can we just go back to Slide 18, where you're walking through the COVID considerations. First of all, can you walk us through the mechanics of how the 15% credit are going to flow through the financials? And will it be spread across specialty auto, preferred auto and commercial auto or just specialty auto or give us some further color on that, please?

Joseph Patrick Lacher
President, CEO & Director

Sure. Happy to, Greg. We anticipate accounting for this as a premium credit, and it will go through the lines that it impacts. So the auto lines were appropriate, preferred auto, specialty auto and commercial auto. Now we may get guidance from individual states that they -- we have to file these items. Again, we have filed it as a premium -- return to premium. If we get a particular state that has some objection, that may move the number a little bit, but that is what we expect. And in most cases, the states have acknowledged that was okay.

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

So I guess, another way to look at this is the ordinary acquisition cost or ordinary loss ratios won't change, it's just the numerator that's changing, correct?

Joseph Patrick Lacher
President, CEO & Director

What we expect is it's a return of premium for the month of April and the month of May so the premium that would have been charged in that month, you will still get the losses that we get through. We'll still get the commissions, the expenses. We're not reducing commissions as a result.

So you're correct, the premium number will change, and that will cause the ratios to change.

Greg, if you think about it, we've historically provided kind of information in the past to help you get to normalization. While we certainly haven't teed up all of those items at this age as we continue to kind of firm things out, my guess is that will -- similar to what we did with purchase accounting and other elements try to give you the pieces so that you've got kind of a normalized view and can appropriately assess the business.

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

Got it. You also said in your prepared remarks that you're doing something for your life agents. Can you spend a minute on that?

Joseph Patrick Lacher
President, CEO & Director

Sure. In our life business, we have employee agents. As you can imagine, there's a fairly complex compensation program for those folks. It's a combination of new business and retention measurements, and they are in a business where they're collecting premiums as well. So all of those things go together. There's differences, in some cases, by product and nuances under there. Since we suspended new business sales starting in late March, that causes a significant compensation drop for them from a timing perspective. And we put in some commission stabilization programs. We've done this in the past with smaller groups of agents. We never had to do a countrywide. But if a hurricane came through a geography and we might have that group of agents shut down from a new business perspective for some period of time, we've done it there before and we're sort of running things through that way again.

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

Got it. So let's pivot just to your sales trends. We're hearing across the board that there's pressure on new sales. And maybe you can comment how the current -- or add additional color. I know you did provide some initial comments on it. But provide some additional color on how new business trends are working through April and May and maybe tie that in with retention?

Joseph Patrick Lacher
President, CEO & Director

Sure. We -- I think as virtually everybody in the industry has seen or commented, we saw a slowdown of new business sales starting at the tail end of March. It worked its way into April. Folks were staying at home. They weren't shopping for new cars. They were focused on other things. In many cases, agents may not have been ready to figure out from a service perspective how to deal with those calls. They were dealing with their own issues. As we've gotten through April and into May, we're starting to see the economy start to, in different geographies, pick back up. We're seeing people engage in more miles driven, a little bit more shopping. Agents have adjusted their operational capabilities. So we're starting to see a gradual increase in that shopping. During that time period, we've seen modest changes in retention, but nothing I would have brought to an attention that I thought was worth note around retentions. And again, expect them to largely operate similarly as we look at the second quarter.

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

Got it. All right. My last question will be the last page of your presentation is in Slide 32. And I'm going to focus on the specialty personal auto slide, and the bottom line there, which is the as adjusted underlying combined ratio. Can you walk us through where the trends -- why we're seeing an upward trend in the adjusted? Is that expected to stabilize? What -- give us some color on what's going on there, please?

Joseph Patrick Lacher
President, CEO & Director

Happy to, Greg. What I think is helpful is also to think about this page in relation also to Pages 37 and 38 of the supplement. What you're going to get at or what you're going to see there is about 60 to 70 basis points of it is just related to last quarter -- or last year's quarter had, was favorable purchase accounting and development of 20 basis points when you're looking through there on a combined ratio. And then this quarter, it's minus 0.7. So basically, that 90 basis point change is one element that's rolling through that makes those things a little bit confusing from a service level. The bigger elements that you're seeing is really just a change in a little bit of the development, more onetime in nature and others.

If you look at the quarter, you've got a one point change in the overall underlying combined ratio for the -- versus last year for the private passenger auto businesses coming through and you saw -- where last year, we had some favorable development. This year, you've got a little bit of unfavorable. That unfavorable is primarily driven by 3 things, as Duane had mentioned. We -- with all of the growth that we have been experiencing as well as what we plan would continue to kind of be that way for the remainder of the year, we wanted to get ahead of that growth to make sure that we had our training and other elements. That's resulted in a little bit of A&O pressure that's inside of there that will normalize throughout the year. And again, was related to what we thought would be total new business volumes throughout the year and what would be the best way for us to have our claims department prepared for that and get the best outcome for shareholders.

Again, that item will normalize. I would think about that in totality of kind of being where you're looking at maybe less than 0.5 point-ish going across.

You had some other elements that are out there. One was essentially related to an environmental factor in our picks. As Duane mentioned, on total losses in the salvage value that we saw in conjunction with this environment. You've had a tremendous slowdown, obviously, in the used car market, part demand, other elements from that.

We thought it was prudent at this stage to refine and enhance our estimates in terms of what we thought was the likely recoverability or our assumptions around that. And you saw that roll through this quarter. That was one of the bigger drivers. Then the other item that was going through there that Duane had mentioned as part of his comments was some development as it related to a Florida PIP legal case and a change in interpretation. Again, really a onetime item that would be out there and again, kind of affecting the prior year.

In summary, what you're looking at is that annual pick that you're seeing inside our financials, that 93.1%, that should be a good number. That's how I would think about it. I'd think about us stabilizing around that. Now we'll see what the environment brings. Certainly, don't have anything that would update our numbers from that point.

But again, if I were doing the comparison, I'd be doing the 93.1% over the prior year's 92.1%, and I'd be looking at kind of a 1-point difference in total kind of year-over-year, which we feel pretty good about giving both our growth and other underlying assumptions that are coming through.

Operator

Our next question comes from Matt Carletti with JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

So just 2 questions. One is just a clarification on Greg, just on the first question about the $100 million coming back April and May. So just a -- bottom line is we'll see that come out of both written and earned in the quarter spread across the auto lines? Is that how we'll see it presented in the financials?

Joseph Patrick Lacher
President, CEO & Director

That's how I expect it to be presented in the financials. There are a few areas, Matt, where we're making sure and confirming that from a state perspective and other that it won't be an expense type item. You've seen obviously a diversity of practice in terms of how this has been handled for others. Either way, we'll make sure that it's called out so that you can get to what effectively will be a normalized number so you can tell what's happening from both a rational perspective and other in business. But if I were modeling and if I were starting, I would be starting with the assumption that Joe said that is coming through the premium. We think that's the right place for it, kind of given the research in that, that we've done today. But again, items are still developing. And if there's something that is different, could it come in on expenses? Sure, but we would call it out if that's the case.

James J. McKinney
Executive VP & CFO

And it would go through both written and earned in the quarter.

Matthew John Carletti
JMP Securities LLC, Research Division

Right. Perfect. Wonderful. My other question, I just wanted to go back to, I guess, some of your comments, Joe, on Slide 18, and specifically on the comment about the bad debt expense. I was hoping you could go into that a little bit further and just kind of walk us through kind of the puts and takes and how we should think about insurance commissioner mandates to not cancel anybody for nonpayment. How you guys manage credit in terms of how much premium you might collect upfront? How much cash you might be holding versus particularly in specialty auto versus maybe more preferred, where I'm guessing it might be a little more pay as you go? Anything you can just help us there and how we should think about that?

Joseph Patrick Lacher
President, CEO & Director

Sure. And I'll go in sort of reverse order on those. From a preferred perspective, we have billing plans and processes that are generally consistent with most preferred carriers. While we do typically expect folks to make down payments, there is a greater percentage of folks who are pay as you go. The billing periods often will have -- or the billing process will often allow a grace period to occur there, where somebody might be out of equity. We don't tend to find that to be a large credit risk business. There's some very low level of bad debt that's running through on a regular basis 1% or so. And we would not expect a very large change. We expect some change, but not a very large change inside of that preferred environment, maybe it's 50 basis points or something like that, but not a ton.

Inside of the specialty auto that business is characterized typically by more credit challenged customers or customers who are more price sensitive. As a general rule, we work to not be out of equity inside of that business and try to avoid letting that happen. Because states have required or encouraged carriers to be more responsive to customers if they are having some financial difficulty and allowing grace periods to occur, we are recognizing the difficult economic times in the crisis nature of this pandemic and are responding appropriately. That will cause us to extend more credit than we traditionally would have in our specialty auto business. As a group, that population tends to be less credit worthy, and we would expect more bad debt to run through as a result.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. And then just a follow-on to that question. Whatever the impact on the expense ratio was in the quarter, should we think about that as you guys put up an accrual this quarter for what you think the -- whether it's for the year, some amount of time beyond just the quarter is, and we'll see as we go forward? Or is it more of a that's what you think it is for this quarter, and we -- as long as this goes on, we might have to live with that higher level of provision next quarter or after as things get better, it will come back down to normal?

Joseph Patrick Lacher
President, CEO & Director

Yes. Being good accountants, Matt, we can't actually write-off premium that -- more than the credit we've extended. So all you can do in the quarter is what we have in the quarter. So we did ramp up our provisions for bad debt to some degree, knowing that we were getting out of equity, but it was not the full impact that we would expect to see in the second quarter. And we would expect it to occur only in the quarters where it occurs.

If those grace periods are extended beyond the second quarter, we might see that bad debt go up for some period of time. If we really have a 60-day window or a 90-day window that states are asking for this and we're executing on it, you'll see all the bad debt in that time period and then we'll move back to our normal practice of looking to be in equity and being very time-sensitive and responsive. So long answer there. The short answer is you're going to see a little bit of it in the first quarter, you'll see some bad debt spike in the second. And I would imagine we'll go back to more normal levels in the third and fourth.

Operator

And our next question comes from Paul Newsome with Piper Sandler.

Jon Paul Newsome
Piper Sandler & Co., Research Division

Matt and Greg got most of my questions. But the only one I have left is whether you could talk a little bit about the March frequency differences between nonstandard, the preferred or really standard business and the commercial business, if there was really much difference in your books experience amongst those 3 classes of auto?

Joseph Patrick Lacher
President, CEO & Director

Yes. Through March, we saw frequencies decline in all of the businesses. We saw a greater frequency decline in preferred than we did in nonstandard auto. I think commercial fell somewhere in between those 2. They were significant in all cases, but again, more significant in preferred.

Operator

And our next question comes from Seth Rosenberg from UBS.

Seth A. Rosenberg
UBS Investment Bank, Research Division

And likewise, I think, most of my questions have been answered here. But I guess, one, thinking about you mentioned the benefit from the carrier in Florida and able to pick up that business, do you have a sense for how much of that business you were able to acquire? And kind of looking ahead, is there still more tailwind from that? Or is that kind of behind us now?

Joseph Patrick Lacher
President, CEO & Director

You cut out a tiny bit, Seth. This was the Windhaven question on Florida?

Seth A. Rosenberg
UBS Investment Bank, Research Division

Yes. How much of that business do you think you were able to pick up? And is that sort of now behind us? Or is there still some benefit to see there?

Joseph Patrick Lacher
President, CEO & Director

I think that there's still probably some more kicking around in the marketplace, but the bulk of it would have been behind us just because those folks were nonrenewed and had to go somewhere and move, again, somewhere where they're uninsured.

So we would expect the bulk of it has worked its way through the system. We might see a little bit more running through an April time period, but the bulk of the eggs drew the snake.

And it's hard to tell exactly what it was. We might have had a good shot at telling you if it was sort of a normal quarter. Things got -- just got wacky from a new business volume perspective, and it's a little hard to tell on what its exact impact was in the quarter.

Seth A. Rosenberg
UBS Investment Bank, Research Division

Understandable. I guess, thinking on the top line there, thinking about sort of your geographic expansion strategy, is there an impact? Have you changed sort of your perspective on various states given COVID and maybe just your ability to work with regulators at this point? Is there anything that we kind of should be thinking about there in terms of your expansion?

Joseph Patrick Lacher
President, CEO & Director

Yes. No, we're seeing no impact at all on our view of appetite of geographies. No impact at all on our relationship with regulators or their thought processes. The only impact is it's just a general market environment item where there's just a slowdown in new business and a change in activities. Those states will all -- as I'm sure all of us have read, will restart at slightly different rates and reemerge. So when we get back to sort of a normal health is not clear. But in all of the cases, our core states, California, Florida, Texas and our expansion states were growing in all of them. It's just at a slower rate. We ultimately think the tailwind that we've got behind us in this business is still there. We just think that the entire environment will slow down for a little while.

Seth A. Rosenberg
UBS Investment Bank, Research Division

Got it. Okay. And then shifting to -- so you gave a good context on what's going on with salvage in personal lines, I guess, but you had a lot of favorable development in commercial auto, I think you attributed in the Q to liability trend. Could you help us maybe think about what's going on there? Is that more of a propensity to settle, something we've heard from others? Or I guess, what's the sustainability of what you're seeing there?

James J. McKinney
Executive VP & CFO

No. I mean, Seth, just to give you an idea, the favorable development, we had certain expectations, both from a number of claims and other that would come in. The reality is we've -- if you look at this business line for the last 2 or 3 years, we've overpicked to some degree. There's no real difference here other than we're winding up in a favorable position there. But there's not -- yes, there's been some frequency improvement that, but I think that's more driven just by our overall underwriting practices, other things than it really being a market trend per se that's flowing through the book.

Joseph Patrick Lacher
President, CEO & Director

Yes. When you look at commercial vehicle, it's a smaller book of business. So when you try to just pick the reserves and the development on those, it just gets a tiny bit more volatile from that perspective. We've had time periods where there's been a little pressure. We've seen some favorable development there. As most of us knows -- know, actuaries are generally quick to spot trouble and react quickly, and they're a little hesitant to see favorability come through because they really want to prove it. So that just works its way out a little slower. And again, we're always making our best estimate, but anybody who spent any time working on claims knows they're more likely to get worse than they are to get better. So that just slows itself a little bit. So it's just the normal ordinary course stuff.

Seth A. Rosenberg
UBS Investment Bank, Research Division

Sure. Got it. Make sense. And just last -- quickly, last one. Jim, I think you mentioned in your remarks, you guys report probably also on the lag and there's still some to roll through next quarter. Any kind of size you can give to us as how we should be thinking about that for 2Q?

James J. McKinney
Executive VP & CFO

It's a little bit hard to fully pick that. It's going to end up being some combination of kind of equity market performance. If you look at the equities, you might think a little bit about a Russell 2000 and use that as a proxy. For the private credit, high-yield debt markets, I think you can use that as a proxy. And that will give you a range. It's a little hard to tell. I think we're in a favorable potential position relative to other alternative equities in certain cases. In others, we may see some unusual economic conditions. So it's a little hard that we actually have the data to be more specific to that. I don't mean to be wishy-washy on that. I just -- I think we're going to have very much industry-like performance going through there. And I think it's going to be pretty close to those indexes. But until I actually see the data come in, I hesitate to give you a specific answer, given sometimes there's a disconnect between those things.

Operator

[Operator Instructions] And this will conclude our question-and-answer session. I'd like to turn the conference back over to Christine Patrick for any closing remarks.

Joseph Patrick Lacher
President, CEO & Director

Again, this is Joe Lacher. Thank you all for your time and attention today. We appreciate it, and stay healthy. Thanks.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.