S&P Global
Market Intelligence

The Allstate Corporation NYSE:ALL

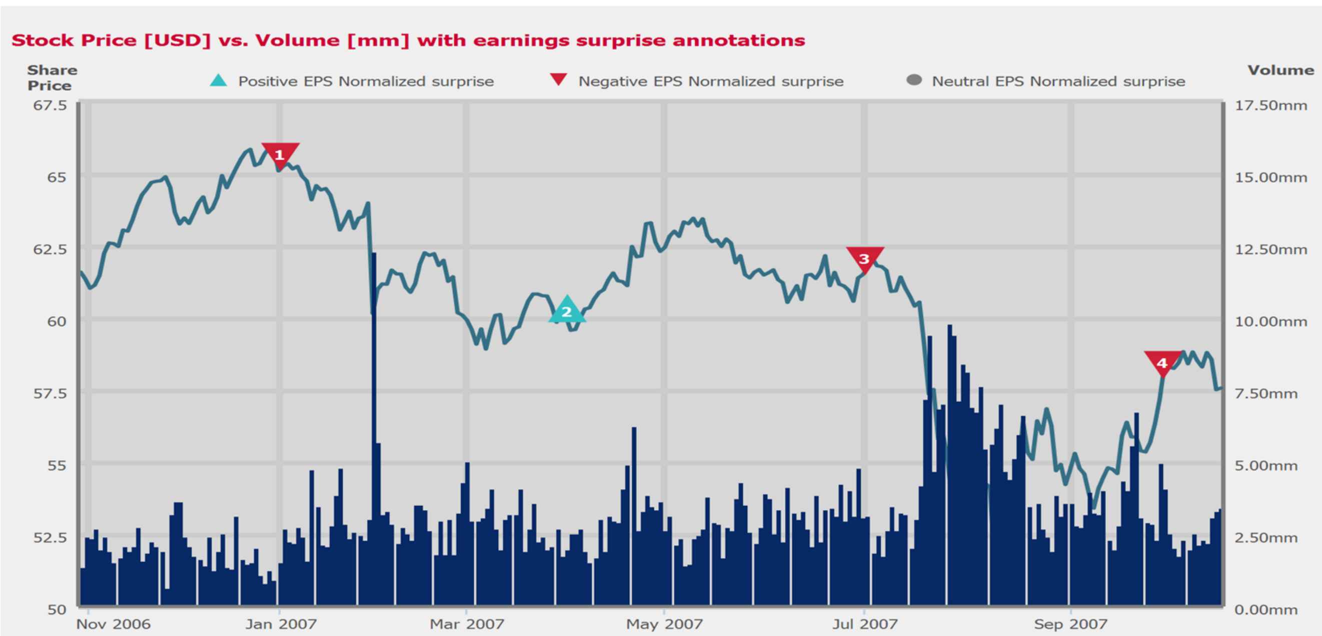
FQ4 2007 Earnings Call Transcripts

Wednesday, January 30, 2008 2:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2007-			-FQ1 2008-	-FY 2007-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.32	1.28	(3.03 %)	1.76	6.57	6.51
Revenue	-	-	(0.62 %)	-	-	-
Revenue (mm)	6828.06	6786.00	-	6782.00	27275.87	27233.00

Currency: USD
Consensus as of Jan-30-2008 12:41 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2006	1.84	1.78	1 (3.26 %)
FQ1 2007	1.86	1.93	2 3.76 %
FQ2 2007	1.80	1.76	3 (2.22 %)
FQ3 2007	1.70	1.54	4 (9.41 %)

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Call Participants

EXECUTIVES

Dan Hale

Eric A. Simonson

George E. Ruebenson

Robert Block

Thomas J. Wilson

ANALYSTS

Brian Meredith
UBS

Charles Gates
Credit Suisse

Daniel Johnson
Citadel

David Lewis
Raymond James & Associates

David Small
Bear, Stearns & Co.

Gary Ransom
Fox-Pitt Cochran Caronia

Jay Cohen
Merrill Lynch & Company

Jay Gelb
Lehman Brothers

Joshua Shanker
Citigroup

Matthew Heimermann
J.P. Morgan

Paul Newsome
Sandler O'Neill & Partners L.P.

Richard Sbaschnig
Oppenheimer & Co.

Robert Glasspiegel
Langen McAlenney

Unidentified Analyst

Presentation

Operator

Good day ladies and gentlemen and welcome to the Allstate Corporation of Fourth Quarter 2007 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session and instructions will be given at that time. [Operator Instructions]. As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference Mr. Robert Block, sir you may begin.

Robert Block

Thank you Matt. Good morning and welcome to Allstate's fourth quarter earnings conference call. As usual, Tom Wilson, Dan Hale and I'll provide commentary on our results for 2007, which were released yesterday. These materials, the press release, investor supplement and updated description of our re-insurance program are available on the IR portion of the Allstate website. After the formal comments, we'll hold a Q&A session. In addition to Tom, Dan and myself, we've George Ruebenson, Head of Allstate Protection; Jim Hohmann, Head of Allstate Financial; and Eric Simonson, Chief Investment Officer available to answer questions.

We expect this call to last about an hour. Please note that the following discussions may contain forward-looking statements regarding Allstate and its operations and actual results could differ materially. For information relating to factors that could cause such differences see our Q3, 10-Q for 2007, our 2006 10-K, and yesterday's press release. Also we may discuss some non-GAAP measures for which you will find reconciliations in the press release and investor supplements. This call is being recorded and your participation will constitute consent to any recording, publication, webcast, broadcast of your name, voice and comments by Allstate. If you don't agree with these terms, please disconnect now. A replay will be available shortly, following the conclusion of this call and our remarks are current only as of the date and time of the call. Finally, once this call has concluded, Investor Relations will be available to handle any further enquiries you may have.

Now I'll turn the call over to Tom Wilson, Tom.

Thomas J. Wilson

Good morning. 2007 was another year of out performance for Allstate, relative to our peers. We successfully executed on our core operating priorities to generate profitable growth that includes continuous focus on operational excellence and disciplined capital management. We also continue to focus on the consumer and on enterprise risk and return. When you look at the entire year, we generated $36.8 billion in revenues, a 2.7% increase. We made over $4.6 billion in net income or $7.77 per diluted share, which is our second highest yearly profit. Our return on equity exceeded 21% and book value per share increased to almost 11% over the prior year. We repurchased 61 million shares at a cost of $3.55 billion and we increased our dividend, as you'll remember for the 13th consecutive year in February of 2007.

We finished 2007 with a strong financial position and a high quality balance sheet. Now, it goes without saying, we did this in a very challenging year. The regulatory and legislative environment remains difficult, particularly in the homeowners' area. Personal lines auto insurance continues to be highly competitive market, though we maintained our pricing discipline. Economic conditions, kind of deteriorated throughout the year, which does impact new business sales, loss cost trends, and our investment portfolio.

Operationally, we did very well in this environment. George's team achieved our combined ratio of guidance that we set out at the beginning of 2007, which was 85.7, which excludes catastrophe losses and reserve reestimates. We maintained our pricing discipline in auto and homeowners. We gained approvals for the Allstate standard auto business in 25 states, averaging 4.4%. For Allstate homeowners, the rate changes were in 33 states, averaging 5.8%. We continue to reinvest protection for consumers with the product rollouts of your choice auto, your choice home, Allstate Blue, and most recently Allstate

Green, and then we have a variety of other service options that are designed to improve the customer experience.

And while we think that we did not experience any major hurricane this year, we did help our customers do 91 separate catastrophe events, including the California wildfires, which are estimated across $318 million. Jim Hohmann, he maintained our pricing discipline and fixed annuities which helped to improve overall returns in Allstate Financial and Eric Simonson in the Investment Group generated over $6.4 billion in net investment income and realized over $1.2 billion in capital gains. And there were clearly some areas of challenges for us in 2007. Our auto bodily injury paid severity increased at a higher rate than we expected last year, but it was somewhat tempered by a reduction in BI's frequency.

Auto physical damage frequencies were higher than 2006, but this was somewhat tempered as our paid severities moderated considerably compared to 2006. All these explained why we have slightly increased prices for auto insurance, last year. We also had to deal with the sub-prime contingent as our investment grade RMBS portfolio suffered a drop in fair value. All of these bonds are current on interest in principle. We expect to fully collect the value of our current portfolio so you will see we only had minor permanent declines in value of net portfolio. And perhaps most important to our shareholders, our total return declined about 17%, a result which is totally disconnected from the excellent financial results we have published during 2007.

Looking forward, we believe 2008 will be another year in which our strategy and operational strength enables us to outperform the competition and generate excellent financial results. This environment plays our strength which is a disciplined approach to profitable growth and leveraging operational excellence. Allstate Protection's combined ratio is expected to be in the range of 87% to 89%, excluding catastrophes and prior year reserve reestimates. This out performance and our focus on reinvesting protection and retirement for the consumer and maintaining a disciplined approach for capital management should drive shareholder value.

Let me turn it over to Bob, who will review you through fourth quarter in more detail.

Robert Block

Thanks Tom. I plan on focusing the majority of my comments on the results for the fourth quarter concentrating on property liability underwriting trends. I will also touch on Allstate financial results. However, I echo Tom's comments, that our results for all of 2007 were strong, reflecting solid execution of our strategy.

Let's begin with total property liability results for the fourth quarter. Net premium written of $6.56 billion was down slightly from the fourth quarter 2006, a trend we saw all year long. Favorable results in Allstate brand standard auto were more than offset with declines in our property line of insurance, as we continue to manage down our exposure to mega-cat. Earned premium followed a similar trend in the quarter. Underwriting income for the quarter of $276 million declined by $702 million from 2006 levels, due to an increase in catastrophe losses of a $193 million, less favorable reserve reestimates of $206 million, and a reduced underlying margin worth $303 million. The recorded combined ratio for the quarter was 95.9%, 10.2 points above the comparable ratio for the fourth quarter of 2006.

Again partitioning this variance, the difference in catastrophe losses accounted for 2.9 points of the variance. Non-cat prior year reserve reestimates made up another three points, so the underlying margin deterioration in the quarter was worth 4.3 points, of which the underwriting expense ratio change contributed 1.2 points, leaving 3.1 points due to increased underlying losses. This equates to about 3% increase in total loss cost trend, certainly a trend we're carefully analyzing and addressing. So our underlying combined ratio for the quarter was 88.6%. For the year 2007, we produced an underlying combined ratio of 85.7% within the outlook range we provided in the beginning of 2007, and reiterated each quarter of the year. That represents an outstanding result in today's competitive marketplace, one that should compare very favorably to the results of our peers.

Over the last five years, we've produced an underlying combined ratio below the 90% level, a direct result of our commitment to generating consistent profitable growth. Looking at the transfer, our major business lines of insurance, our Allstate standard auto business continues to grow, albeit at a slower rate of increase. Net written premium rose 1.5% due primarily to an increase in average premium and to a lesser extent unit growth. We continue to file and receive approval for rate changes with 8 additional states in the quarter, we closed the year with rate changes as Tom said in 25 states for a weighted average of 4.4% as 1.3% on a country wide basis.

Allstate non-standard auto trends have not changed appreciably with the exception of acceleration in new business applications as the introduction of Allstate Blue begins to take hold. It will take until next year for the decline in policies and force to reverse at current trends. This new product is now in 12 states and we expect to expand our reach with this product throughout 2008.

For the quarter Allstate auto loss ratio increased 4.5 points to 68.6% on a reported basis. The underlying loss ratio which excludes cat losses and reserve re-estimates rose 2.4 points from the fourth quarter of 2006 to 69.2%. Shifting to the components of auto loss cost trends for the quarter there was not much change in the direction, in frequency, and severity established during the year.

Frequency continued to increase for property damage and the physical damage coverage's while frequency for the injury coverage's declined. On a paid basis while the injury calendar year paid severity jumped to over 9% above what we would consider acceptable. However when coupled with the declining frequency the loss trend remains manageable. For property damage paid severity increased a very modest 2.2%. Again when combined with the frequency trend it produces a modest increase in loss cost trends. In total the underlying auto pure premium trend is around 3% level for the quarter.

In the quarter we did make some, adjustments to current year severity targets increasing the targets for bodily injury, while lowering the target severities for property damage inclusion in coverage's. The overall P&L effect of these changes was minimal in the quarter. We remained confident in the overall adequacy of our reserve position at the end of 2007.

The trends we experienced in homeowners this quarter does not display any material changes. We continued to decline in premium as we manage our mega-cat exposure. This has resulted in declines in both new business applications and retention. Average premiums before reinsurance increased 2.6% as we continue to file and gain approval for rate increases. For the year we made great changes in 33 states averaging 5.8%, 3.6% on a country wide basis. Homeowner loss trends for the quarter matched the pattern set in prior quarters with ex-cat frequency rising 4.6% and paid severity up 7.9%.

The resulting pure premium increase well in excess of average premium leading to an increase in the underlying combined ratio. For the year homeowner remained profitable at an all combined ratio of 91.5%. However we will continue to reduce our exposure to mega-cat and seek adjustments in our rates in order to generate long-term profitable growth.

Now in anticipation of potential questions let me comment here on Florida. The Florida situation can be summed up very simply. We are still working to find a solution to Florida's broken property insurance market. Unfortunately the economic cost associated with severe hurricanes have yet to be adequately addressed. We are working to help find solutions to fix the market for consumers. In fact we launched a series of public awareness ads today in several Florida newspapers discussing potential solutions to the states property insurance challenges. Some of the public debate has not matched the reality about our property rates in Florida. If you look at the officer rate of insurance regulations website our homeowner rates are about the average and in some cases have the highest competitors.

Changing the focus to Allstate Financial, we continued our focus on improving returns in this business. New business returns increased significantly during the quarter as we maintained discipline in our pricing. Sales through the Allstate Agency System increased 7.2% in the quarter to $884 million. This brought sales for the year to $2.9 billion or an increase of 13.8%. Fixed annuity sales fell significantly as market conditions were not favorable for this type of product and there were no institutional product sales in the quarter. Allstate financial operating income for the fourth quarter hit $158 million, an increase of $16 million over similar quarter in 2006.

For the year we made $615 million showing steady improvement over the last five years. Net income fell in the quarter to $31 million primarily due to higher realized capital losses, of which $95 million were related to investment breakdowns and $120 million to declines in evaluation of derivative instruments. For the year we matched net income for 2006 at $465 million.

Now with that I'll turn it over to Dan for his comments.

Dan Hale

Thanks Rob. I'll like to begin with the brief summary of our investment performance including comments on our sub-prime related holdings, after that I'll recap our catastrophe losses and prior year reserves re-estimates and then following a status update on our re-insurance program for 2008 I'll wrap up with a few additional comments on capital management actions and related balance sheet metrics.

As of year end our investment portfolio totaled $119 billion which was $2.2 billion less than at the end of the third quarter. The decline was related primarily to reduced securities lending activities and to a $656 million reduction on our net unrealized gain position down to $1.9 billion.

$521 million of that unrealized change was a result of sales of equity securities during the quarter which generated realized gains of $351 million. The fixed income portion of our unrealized gain position was down about $150 million from the end of September primarily due to the fact of widening credit spreads more than offset the effects of declining interest rates.

For the year our portfolios had strong overall relative performance exceeding most of our internal benchmarks. While many of our assets groups did, well performance from our equity group and tactical waiting decisions in our portfolio management group combined to drive most of the excess return in the property liability portfolio.

During the quarter our property liability portfolio generated $490 million of net investment income which was 3.8% more than the fourth quarter of '06. Allstate Financial net investment income grew 2.6% to $1.1 billion. Higher net investment income for both businesses was driven primarily by increased income from limited partnerships.

Net realized pre-tax capital gains for the quarter totaled $98 million as $384 million in gains from sales of primarily equity securities more than offset $166 million in net losses related to derivative evaluations and $126 million of investment write downs.

Now for more perspective and more specifics on our sub-prime related investments, at year end on a market value basis we had $3.9 billion of securities where the underlying collateral was backed by sub-prime residential mortgages, with 93% rated AAA or AA. The market value of the sub-prime RMBS portfolio was 89% of amortized cost. That reflects an aggregate unrealized loss position of $502 million or an increase in unrealized losses of $277 million, since the end of the third quarter. As we discussed on previous calls, we value these securities using pricing information plan from independent third party pricing services and brokers and we vest that information along with other factors through our internal evaluation committee. Other factors would include the capital structure, collateral, quality credit enhancements, default rates, loss severities, and credit ratings.

During the fourth quarter, we recorded investment write downs totaling $20 million on our ABS RMBS securities. We also wrote down $62 million of our ABS CDOs and have only $36 million of CDO securities remaining in our portfolio. Write downs were a result of our assessment that [indiscernible] had occurred due to the erosion of collateral positions on certain downgraded securities within the portfolio. We are not currently expecting any additional other than temporary impairments of these securities, although further significant deterioration from today's market conditions could obviously cause us to alter that outlook.

As of now, based on our analysis, and the seniority of our securities claim on that underlying collateral, we currently expect to receive all contractual principal and interest on these securities and we have the intent to hold limit until they are recovering that. Consistent with these expectations, we collected a $166 million of principal payments on our sub-prime RMBS securities in the fourth quarter.

One other investment portfolio topic we would like to comment on is the potential impact on our municipal bond portfolio of insurance from bond insurers. Our practices for acquiring and monitoring municipal bonds focused primarily on the quality of the underlying security and do not rely on insurance which is a rule of thumb and enhances their value by about 1% to 2% of the principle amount.

As of year end, approximately $13 billion, or 51% of our municipal bonds were insured by bond insurers and our current evaluations already reflect a significant decline in the value of the insurance, losing all the guarantees that had no material impact on our shareholders value. And while declines in the value of insurance could temporarily affect the value of this portfolio, we contended out the intent and the ability to hold the bonds and we expect to receive all the contractual cash flows.

Now turning to our catastrophe losses, for the quarter they totaled about $472 million, or about 7% of earned premium and that was $193 million, or 69% more than for the fourth quarter of 2006. The California wildfires, accounted for $318 million, or about two-thirds of the fourth quarter total. Included in those fourth quarter cat losses was $26 million related to prior year's events. Most of that was increased loss reserves for reopened claims arising from litigation filed in conjunction with the Louisiana deadline for filing suits related to Hurricane Katrina. For the year, we experience cat losses of $1.4 billion or 5.2% of earned premium, including $127 million of reserve re-estimates of prior year cat. Including the $26 million, related to prior year catastrophes totaled property liability reserve re-estimates for the quarter, amounted to a $48 million strengthening of reserves. That compared with favorable prior year reserve re-estimates in fourth quarter of '06 of $184 million. In addition to the strengthening for Katrina litigation plans, we had $16 million for discontinued lines and coverage's for potential uncollectible reinsurance receivables.

As was the case last year, during January, we completed the renewal of our catastrophe reinsurance agreements, except for those related to Florida. We expect to place those contracts later this year, once the Florida Hurricane catastrophe plans are known, and then have them effective for hurricane season, beginning June 1st. Our approach this year and going forward is to purchase a reinsurance coverage on a multiyear basis using a combination of one, two, and three year of contracts. This layered approach obviously lessens the amount of reinsurance being placed in the market at any one year. We estimate that the total annualized cost of all reinsurance programs for the 2008 hurricane season would be approximately $660 million per year, or a $165 million for the quarter, including an estimate for reinsurance coverage in Florida. That compares with approximately $900 million per year for our total annualized cost for the 2007 hurricane season. Approximately $240 million decrease is due in part to our reduced exposure in Florida, following our non-renewal activities for the past year. Of course the potential offset and the reinsurance cost reduction is the loss margin on those contracts in the absence of significant catastrophes.

We continue to attempt to capture our reinsurance cost in rate filings and currently we're involved in rate proceedings related to these costs in the states of California, Florida, and Texas. For more detailed information on the specifics of each of our catastrophe reinsurance agreements, including examples of how the programs work on a coordinated basis or hypothetical events some of those that occurred in 2004 and 2005, you can please view our catastrophe reinsurance program document, which we released last evening. It can be accessed from our Investor Relations website.

In the area of capital management actions, during the quarter, we repurchased 10.9 million shares of our stock, for $579 million or $53.11 per share. That brought our total year repurchases to $3.6 billion at an average cost of $58.23. As of yearend, we had $240 million remaining under our current $4 billion repurchase program, which we expect to complete during this quarter. We will be addressing future capital management options, including dividends and share repurchases with our Board of Directors at our February meeting. Our book value at yearend was $38.58 per share, representing an increase of $3.74 or 10.7% over the previous year. Excluding unrealized net gains and fixed income securities increased 14.3%. At our dividend yield approaching 3% and the 3.5 billion of share repurchases, we will get a more complete picture of our overall operating return to our shareholders for 2007.

And finally, as Tom mentioned, based on trends we are seeing, we expect our property liability combined ratio, excluding the effects of catastrophes and prior year reserve re-estimates, we will be within the range of 87% to 89% for 2008 and that level of continued strong underwriting performance should translate into a stock price within our historical valuation range.

Now Bob, I think we are ready for questions.

Robert Block

Hey Mat, if you could start the Q&A session.
Question And Answer

Question and Answer

Operator

Thank you. [Operator Instructions]. Our first question comes from Bob Glasspiegel of Langen McAlenney.

Robert Glasspiegel
Langen McAlenney

Hi, good morning everyone. You indicated Tom yesterday in the interview that you are under 21% ROE in '07 and you are going to be giving some of that back to your customers in '08, what did you mean by that?

Thomas J. Wilson

Good morning Bob. What I meant by that was if you look at our combined ratio guidance, combined ratio drifts up a little bit, that's because we have been holding average prices down some, while you'll see loss cost trends going up a little higher than that. So the combined ratio focus commitments we have made here today are consistent with that yesterday.

Robert Glasspiegel
Langen McAlenney

Okay, so this is somehow tilt towards growth versus profitability as a strategy on the margin?

Thomas J. Wilson

No, not at all. I think, this is... the message is not Bob, we are cutting prices so we can grow, the message you should expect to see more of the same, which is if you look at overall insurance prices in the industry last year, they were essentially flat. You see ours were up some, particularly in those places where we thought we needed to increase price, because our margins weren't good enough. I was simply pointing out that there is a benefit to consumers with this level of profitability and that their insurance costs are not going up at the same rate of inflation as other things that they buy.

Robert Glasspiegel
Langen McAlenney

Got you. One last question then, it looks like you increased your interest rate assumption. If understand the footnote on your pension fund, what drove that?

Thomas J. Wilson

Essentially on that [ph]... keeping with that $158 million, which requires that we have to report the changes and evaluation in funds and that $765 million as a result of applying $158 million towards the year 2007.

Robert Glasspiegel
Langen McAlenney

So interest rate assumption change, or there is both?

Thomas J. Wilson

There is more changes in the assumptions for returns on the assets.

Robert Glasspiegel
Langen McAlenney

Okay, I guess I'll follow-up later with Bob on that. Thank you.

Thomas J. Wilson

Okay, sure.

Operator

Our next question is from Dan Johnson of Citadel. Your question please.

Daniel Johnson
Citadel

Alright. Thank you. Around the auto reserves, can we talk a little bit about what's going on there? We've all gotten so used to having reserves raining out into the P&L, and those have wound down quite a bit. Is this purely, just a function of what's going on with the recent BI trends, or is there something else that we would want to identify, relative to your historically conservative reserve position? Thank you.

Thomas J. Wilson

Well Dan. This is Tom Wilson. We obviously established reserves at the end of every quarter to the exact, the number we think best represents for it and then of course as that estimate changes we rattle it through the P&L. So the first thing you should know is every quarter we try to do it absolutely right Dan, I want to make a quarter, a comment on the fourth quarter, relative to prior year.

Dan Hale

Okay, I think Tom explained it well. As we look at the results for each of the quarters, we establish or we think is appropriate, and then what happens quarter-after-quarter positive or negative flows through the balance sheet. So we have appropriately established our reserves, we feel good about them. They are certainly more than adequate, and again whether or not there is favorable or unfavorable reserve development in the future periods, will depend on what happens in those quarters.

Thomas J. Wilson

Hey Dan. That's about prior year reserves. I think you might... I hope you've heard in Bob's comments. He mentioned we made a small change to the reserve estimates we have for the 2007 year. That we raised our bodily injury targets a little, but we took down our PD targets a little bit, because if you look at the pay trends in BI, it was a little high, and if you look at the paid trends in physical damage, it was lower than we had expected. So we made a little change but that's in 2007. That doesn't show up in the number you are talking about.

Dan Hale

Not material change with current results, current year.

Daniel Johnson
Citadel

Great, and then just the other question was on the expense ratio, obviously it was up in the quarter as you indicated on some enhanced end spending. So the questions there how do you monitor the yield of that and should we be expecting that to result in differential changes in this growth and overall can you observe about what we might be looking at for macro expense ratio trend over the next 12 to 18 months, thanks very much?

Thomas J. Wilson

Okay, I think just three parts there, first Dan we like our marketing, we think its absolutely working, it's particularly strong when you compare the great advertising than its both combined with Your Choice Auto. It raises consideration, it raises willingness to consider, it raises our brand awareness. So all that stuff is working quite well. We measure that at a high level of detail, extremely low level of detail, I guess is a better way to say that, down to like zip code level on some portions of our business. And we feel good about the effectiveness of that. We're continuing to invest in marketing as we started in 2003, and I think you see if you look at the industry the overall industry trends were up a little bit last year, the big ramp ups were... we went up a lot in '03. Geico and Progressive began to follow us in '04 and '05 and it kind of leveled of '06 and '07. And I think you'll see pretty much the same position this year as the industry is trying to find what the right level of advertising is. You should expect to see our advertising stay about the same, you wouldn't see an uptake in PIP from one quarter.

When you look at... in '06, we front loaded January and February because that's when we really kicked off Your Choice Auto. In 07 we didn't put as much in January and February. So the first half of 07 we were down from the first half of 06. But when you look at in total we were up a little bit last year. So you are really just looking at sort of seasonal managing related to how our products go. And what was your third question, I got to...

Daniel Johnson
Citadel

I am sorry... just overall, what are we thinking about in light of growth objectives for the next two years with sort of macro expense ratio?

Thomas J. Wilson

I guess I would put it a couple of ways, we are always looking to reduce expenses whether that be the voluntary termination offer we did a year and half ago or so. The reduction that George and Cathy Brune and their team are putting through in technology as we speak continuing to shift jobs offshore. That's one piece of it, then we always look and say what do we need to invest in and so some of that's investing in marketing which you saw on the fourth quarter. There was a little bit of pick-up in technology spend in the fourth quarter as well. We have also put a little bit more money in to investments technology risk team. So we look at it in two ways one you should always be out reducing your cost but that shouldn't stop you from making investments in your business. I think if you look at the expense ratio in total what you see next year probably ought to be pretty close to what we had this year.

Daniel Johnson
Citadel

Appreciate the thoughts, thanks.

Thomas J. Wilson

May be a little lower but.

Dan Hale

May be little lower.

Thomas J. Wilson

Consistent.

Operator

Our next question comes from David Lewis of Raymond James. Your question please.

David Lewis
Raymond James & Associates

Good morning, thank you. Could you tell a little bit about what your rate filings might be on both auto and homeowners if you give us kind of general trend in 2008 over 2007 and if claims severity and frequency trends hold pretty much in line with what you saw here late in 2007 would you anticipate only a modest increase in the underlying combined ratio in 09?

George E. Ruebenson

This is George Ruebenson. With regard to 09, I don't think we're in a position to give any outlook on 09 but as far as 08 is concerned, 08 will be continuation of what we did in 07. We're constantly monitoring the margin compression that we saw. We took appropriate rates in both auto and homeowners. I think as

Bob mentioned or Tom mentioned in the beginning we've taken rates in 25 states in standard auto this year of about 4.5% in 33 states, about 6% in homeowners. As part of our outlook of 87 to 89 we do think that there will be some drift upward in the combined ratio but it is our intent to take rates whenever we deem it appropriate. So that we don't reduce our profitability.

David Lewis
Raymond James & Associates

And that's why... I am not trying to get an estimate for 2009 but theoretically if you get the rates back on track with the claim inflation trends does that mean that we kind of stabilize that underlying combined ratio just from a high level?

George E. Ruebenson

Yes, the idea is that we will always make sure that our margins are good and if we don't need rates we obviously won't be taking them.

David Lewis
Raymond James & Associates

So your rates in both homeowner's and auto probably will be something similar to what you saw in 2007. Correct?

George E. Ruebenson

Yes.

David Lewis
Raymond James & Associates

Great, thank you.

Operator

Our next question is from Gary Ransom with Fox-Pitt Cochran. Next question please.

Gary Ransom
Fox-Pitt Cochran Caronia

Yes, good morning. I wanted to focus on bodily injury trends, severity trends, and just how... it's apparently accelerating through the year. I just wondered if you could talk about what you see as the causes of that and whether there are any parts of that you think you might be able to control in the future or whether the only option is just to raise rates in response to it?

George E. Ruebenson

Gary this is George, again in the quarter we did have several very large payments that did distort it a little bit. If you adjust for that we don't really see an acceleration of the trend in the fourth quarter. On the other hand we do see it running about 7%, about the same as we had in the third quarter. Part of that is attributed to higher medical inflation, part of it is also attributed to the fact that over the years as we ride lot of high value customers people tend to migrate to higher limits but that's all embedded in our pricing. On the other hand to your real question is there anything operationally that we're doing to address that the answer is yes. There are several things that the claim department is re-instituting and we feel very comfortable that we're going to be able to maintain very competitive position on our bodily injury disposition. But if you look at bodily injury in isolation its really only 24% of the price of the auto product. And then if you look at the rest of its physical damage collusion that's about 60% to 65% and those trends in severity are low single digits. All in all we don't see the need to take any rapid rate increases which would distort the market.

Gary Ransom
Fox-Pitt Cochran Caronia

Is there anything that you're seeing there that I realize it may be hard to measure but there is different components to BI severity one is just the actual medical inflation and another component is just the softer non-economic social inflation that might be there, have you seen anything that suggests that the non-economic portion of BI damages is at a higher rate or different rate what the underlying medical cost might be?

George E. Ruebenson

I think part of the softer stuff is usually driven by the underlying medical costs. As far as loss of wages, payment suffering, that type of thing I don't see anything materially that's happening.

Gary Ransom
Fox-Pitt Cochran Caronia

All right. Thank you. Just one other quick question on the $16 million of uncollectible re-insurance that adjustment and the other operations. Was that a particular re-insurance situation that you were addressing there?

George E. Ruebenson

Yes Gary, it was UK re-insurer situation that we addressed.

David Lewis
Raymond James & Associates

Okay. Thank you very much.

George E. Ruebenson

Okay.

Operator

Your next question is from Josh Shanker of Citi. Your question please.

Joshua Shanker
Citigroup

Good morning.

Thomas J. Wilson

Hi Josh.

Joshua Shanker
Citigroup

Hi there. A quick set of questions. The first one is what if it's possible that you can divide your savings in re-insurance in 2008, the projected savings between cheaper re-insurance pricing, or more competitive pricing and Florida's up public re-insurance opportunity?

Thomas J. Wilson

I don't think we can do that. It's really complicated, because you have, not only you have what we have purchased the prices have changed. Our exposure has changed. The location of our exposure has changed. The relative pricing on that exposure has changed by state with the new air models out where New York has got a lower exposure than it had before. And then the Florida piece you could actually get from public documents as to what they are charging, but it would be really hard to, and you wouldn't get an accurate number. It wouldn't help you any, I guess is the way.

George E. Ruebenson

There are a lot of moving parts Josh and while re-insurance rates generally I think in the industry people will tell you are down to 10% to 20%. You would have to look at that with as Tom indicated the different changes in the agreements and our coverage's, our overall exposure, and then a big chunk would be the reduction exposure in Florida.

Joshua Shanker
Citigroup

Okay, and second question is can you talk about '06 Your Choice, '07 Your Choice in terms of what you are thinking in general penetration rates are in various states to plan how long they have had Your Choice in place?

Thomas J. Wilson

I can't Josh, first Your Choice Auto continues to be a great success. We are now selling over 100,000 policies a month, little over 3.2 million policies. If you do apples-to-apples you would find that the average premium is higher on Your Choice, apples-to-apples would mean adjusting for a IS course who you attract, new pricing methods, and all that kind of stuff. But we like what we see, more people buy ups and down and as we get a little better at selling this, a few more people buy up then buy down. So we are doing a better job of explaining to people the benefits associated with this product. That's Your Choice Auto, on Your Choice Home we've not rolled it out to nearly as many states and we are sort of looking into the headwinds of unintended on catastrophe management. So we have not been as aggressive as advertising that or getting sound up but you see more people buy up when it comes to their home than you do their car. And then of course Allstate Pollute Bob talked about and Allstate Green we launched in couple of states. Allstate Green is our product which is intended to answer the question of the situation if you have to buy auto insurance, you have to drive but you don't have to pollute and if you buy our product we offset the pollution from your car.

Joshua Shanker
Citigroup

In terms of... I was saying the most successful states what percentage of penetration would you think that Your Choice has achieved?

Thomas J. Wilson

Wellfirst, they... we look at, I mean basically everybody should be offered Your Choice Auto so lets start there. In Your Choice Auto there is the standard package which is the same package and same product that everybody else sells. That continues to get a reasonable portion of the volume but its less than half, and we don't give out those specific percentages from a competitive standpoint, we would like those not to be rattling around. But most of the states are pretty close to this thing. There is little bit of variation between how well they execute but the general trends I talked about more people buying platinum and gold than buying value which raises average premiums which is the same just in every state actually.

Joshua Shanker
Citigroup

Okay, just finally quick one. Can you update us on the status of the hiring of someone to manage your re-launch of direct channel sales?

Thomas J. Wilson

We are still working hard on that.

Joshua Shanker
Citigroup

Okay, thank you.

Operator

Our next question is from Jay Gelb of Lehman Brothers, your question please.

Jay Gelb
Lehman Brothers

Thanks and good morning. First on capital management I know that the Board will discuss this in February. In 2007, the or the current $4 billion buyback was roughly complete over two years I believe. Should we think about that size of the buyback again relative to the next up coming one or is... I guess what's going into that decision process?

Thomas J. Wilson

Yeah, I would answer that with you should expect to see more of the same philosophy with the start of capital management our dividend increase at 13 years and I think that were in the top 1% of our companies, only 1% of all companies have actually done that. We are proud of that track record and I think I would like to continue to maintain that track record. When you look at the share re-purchase program it was really an 18 month period I believe and we did that, so we sinked it up with the time which we look at dividends which is in February. And I think you'll see a supply of the same philosophy but I am not prepared to give that number as to what that the board will approve.

Jay Gelb
Lehman Brothers

Okay. And then next question on page 24 of the press release you gave a little bit more disclosure on some topical investment areas, can you talk about your confidence in the money good aspects of the commercial, mortgage backed securities? And then also could you describe what the $2 billion of other CDOs are and also the $2.7 billion of other ABS?

Thomas J. Wilson

In Rick Simonson will deal with first piece and then, you might have to direct them to where you getting the numbers on the second piece.

Eric A. Simonson

Yeah. Hi Jay, it's Rick. We feel quite good about the CMBS exposures that we have. CMBS is in our portfolio primarily as a supplement to our long standing strategy of originating commercial mortgages, home loan commercial mortgages and from time-to-time the economics and risk adjusted returns of from a home loan commercial mortgages are not as attractive. We then supplemented kind of use CMBS as a surge tank. The buying of CMBS has being focused on AAA and AA quality securities. The... that group as well takes conscious degrees of additional risk and you saw in the release what we call commercial real estate CDO exposure and that is a quite different from sub-prime RMBS in terms of the underlying collateral, the quality of the collateral, the diversification of the originators and manufactures of that. And we find that portfolio to be roughly comparably spread from AAA to BBB. So all investment grades for the most part and roughly equally spread across those ratings. And those provide additional risk adjusted return in the context of the overall real estate exposure. Remember our overall commercial real estate exposure includes the home loan commercial mortgages, CMBS securities, and a variety of other real estate exposures, and more equity like instruments, real estate funds, real estate investment trust and the like.

Jay Gelb
Lehman Brothers

Right and then on the... also on page 24 of the press release, there is [Indiscernible] couple of asset backed securities of $8.7 billion. There are two line items there, other collateralized that obligations and other asset backed securities. Can you just remind us what those are?

Eric A. Simonson

Yes, the CDO stuff is generally cash CDOs of corporate nature in terms of the underlying collateral. So consider it a range of high yield mezzanine and some investment grade as well, bank loan type securities, and the underlying of CDO portion of the $2 billion that you see there. Other asset backed securities, we talk about cards, we talk about autos, we talk about student loans. It's a pretty diversified and high quality and short duration mix.

Jay Gelb
Lehman Brothers

And in terms of the fair value on those, is it any discounts at par or do you envision it going that way?

Eric A. Simonson

We can get back to you. Those should be very close to par.

Jay Gelb
Lehman Brothers

All right, then the last one. Just a quick one, on Allstate Financial could you quantify the level of one time benefits in there so you can just get a run rate on the earnings power in the quarter?

Thomas J. Wilson

I am not sure what you are referring to as a one time benefits.

Jay Gelb
Lehman Brothers

There are tax benefits, couple of other things I believe that were mentioned?

Robert Block

All right, this is Bob. I think there are few but there is always a few benefits or the trackers in each and every quarter. I would say that we feel the run rate of operating income for Allstate Financial is probably in the 150 to 155 range. So pretty close to where it actually ended up for the quarter.

Jay Gelb
Lehman Brothers

Great, thanks again.

Operator

: Our next question is from Matthew Heimermann of J.P. Morgan, your question please.

Matthew Heimermann
J.P. Morgan

Hi, good morning everyone. I guess the first question I had was just with respect to as you look at '08 and just kind of some of the pricing actions you want to take can you talk about may be just end market share terms, how many... how much of the industry do you anticipate, raising prices versus keeping prices static?

Thomas J. Wilson

Well I can't you are talking about our competitors, its...

Matthew Heimermann
J.P. Morgan

Just with respect to you?

Thomas J. Wilson

So how much do we expect to raise?

Matthew Heimermann
J.P. Morgan

I am getting to one of the stats you disclosed was you had 20 states where your interest rates on auto I think the change was for and change percent on with respect to the states but country wide it was a 1.3% impact. So obviously that implies, that those states while 20 states, the shares were much lower than average. That's what I am trying to get out is just when you think about how significant rate changes will be just kind of the way where things are going up versus flat?

Thomas J. Wilson

Couple of comments just as general and in general first we are always focused on profitable growth starting with profitable first because we want to make sure we are making money before we grow. So we're always looking at how do we make sure we maintain our margin, so the number that George quoted are in an individual space. And you'll see a lot of those are in the 1% to 3% range, there's not a lot of big price increases, every once in a while. In Illinois we took some pretty big increases this year, our volumes is off a little bit there but it was a necessary action for us. So, we try to balance those things off. Let me take it up a little bit, those who are looking at '08. Our strategy is not just about price, it's about value, it's about reinvesting insurances, it is about Your Choice Auto, it's about great marketing, it is about local agent and so, but we know we have to be competitive in price. So we look at where we get our business from continuously and about half of our businesses comes from what I would say the big large competitors you focus on and about half of our business comes from all other.

There are 1,000 plus companies that were out there competing with on a local basis. When you look at those top five competitors, in the states in which we compete, we have and you look at high life time value customers, medium life time value customers, and low life time value customers. George and his team clearly have a strategy focused on the high and medium life time value customers. And so if you look at our rates, just our prices, and forget all the other things we bring to the strategy, against those five competitors we have lower prices about 80% of the time for high life time value customers. We have lower prices about two-thirds of the time for medium life time value customers and we have lower prices for only about third and only about a third of the states and those competitors, when you multiply that out, when you're looking at low life time value customers. So it's a little more complicated, than just what is the average price. It is required in time that we saw more than that and we have much more segmentation. So we try to be really well priced on the high and medium time life time value customers and we're okay losing the business on low life time value customers and so that is actually part of the market where you've seen a lot more churn going on, as people have been doing more advertisings in our lower lifetime value. So our quotes are up, but our close ratios are down and our overall growth is down a little bit this year.

Matthew Heimermann
J.P. Morgan

If the rest of the market keeps dropping rates, I mean how much per rate increase do you think the market, I guess at what point would you start to get worried from a retention standpoint that some of those relative rate... those rate relativities would start moving enough against you, that it would cause a drop there?

Thomas J. Wilson

Well our retention is off in this quarter and this year, so we're highly focused on trying to get that back up. It's still very high, relative to everybody else but not what we think is right for us. And so we have a variety of things going on that. I would say... I think the price decreases have moderated in third and fourth quarter from the first half of the year. Those people, who were the more aggressive price reduction companies, have seen their combined ratio drift up. I can't speak to what they will do and all I know is what we can do and George's team is highly focused on profitable growth.

Matthew Heimermann

J.P. Morgan

Alright, thanks.

Operator

Next question is from David Small of Bear Stearns. Your question please.

David Small
Bear, Stearns & Co.

Hi guys. Just a few questions. The first is, you have $900 million of ABS Securities which I believe are secondly in mortgages that are backed by using fixed bond insurance. Can you just help us understand who the bond insurers are and what your exposure to each of that piece of, for that $900 million there?

Eric A. Simonson

Sure, this is Eric Simonson. We've got as you say roughly 980 odd book value of largely secondly [ph] sub-prime exposure, backed by modeling insures. They include the names that you are reading about. So FGIC, AMBAC, MBIA, FSA, those are the core that account for over 90% of the back stock. I want to add the point that, just as with our Muni bond, investment strategy, so with respect to this portion of our ABS, RMBS position we are not, we have not gone after these securities because of the presence and the backing of the insurers. I know there are some investors who chose to look through that portion of the market. We have not and consequently the deals come to market, they either do or don't have insurance of back stopping. We underwrite each deal, we underwrite the underlying collateral and so we feel it's a disposable item, but we don't feel it is an important part of the underlying strategy.

David Small
Bear, Stearns & Co.

And so with those, but they are right now if a bond, just to clarify, if one of the bond insurers don't get down rated, would you have to take a mark there, because you would no longer be AAA, if the underlying asset takes the mark?

Eric A. Simonson

Sure, they will follow the AAA in the market enterprising.

David Small
Bear, Stearns & Co.

Okay. My second question is just... back on just pricing for one second. As you mentioned earlier, I think you said 3% was what was cost inflation is going to be. Just how long do you think it will take you get prices to a point where you are offsetting that loss cost inflation. Is this a one year, I mean obviously, if you are one loss contemplation will continue to go up, so a little longer you are not there to catch up. It takes a snowball, so is this an end of your '08, or are we into '09, before you are catching up?

Thomas J. Wilson

I think, I would say, we are always trying to catch up. We don't have a target combined ratio that we publish and give out to the world and set our numbers out. We look at our competitive positions and we set that up so we can make the goals, I think our view is that given the value we offer we can operate at above industry average returns, which means below industry combined ratio. Is that right George.

George E. Ruebenson

Yes, absolutely. Our combined ratio in 07 was better than our major competitors and it is our intent to always make sure that we maintain the margin. On the other hand, I think your point has to do with the inherent lag of lost cost escalations, versus our ability to get rates. That's a reason that we have changed the outlook to 87 to 89 for '08.

David Small

Bear, Stearns & Co.

And just the last question, which is dividend, versus share buybacks. I mean have you guys though at all about, have any thoughts about increasing the amount of capital you view as dividend, compared to share buyback?

Thomas J. Wilson

We look at it all the time. I don't think you would expect to see it turn into a bank 5% dividend paying entity. We liked the flexibility of share repurchases for our shareholders who decide they want to stay with us and others who want to take that out. It doesn't... the fact that when you pay a special dividend, instead of buying stock back it is factored into your total return, which everybody uses to measure performance, is not lost on us, but that's not a reason making an economic choice. We're making the economic choices, based on what we think is right for our shareholders within the company. I don't expect you to... you shouldn't expect to see huge auto pattern increases in dividend payments.

David Small
Bear, Stearns & Co.

Okay, thanks.

Thomas J. Wilson

Could I answer. We have a number of questions left and we don't have much time, and if you still on a call could you just ask one question, so we could make sure we get through the other people.

Operator

: Our next question is from Brian Meredith of UBS, your question.

Brian Meredith
UBS

Thanks, hey Tom.

Thomas J. Wilson

Hi Brian.

Brian Meredith
UBS

I guess, my one question I guess where do you think we are now with respect to the Katrina litigation, this going on has caused some adverse development, when do you think we can expect to kind of see that subside in your results?

Thomas J. Wilson

Well I think you will see the Katrina litigation go on for years, unfortunately on behalf of us and some of our customers, I think there're people who like it to go on. I think you should expect to try to see that. I don't expect you'll see huge changes in the reserve amounts, due to litigation. We think we are adequately reserved, that's about all you can say about, it just kind of keeps going.

Brian Meredith
UBS

Great, thank you.

Operator

: Our next question is from Richard Sbaschnig of Oppenheimer, your question.

Richard Sbaschnig

Oppenheimer & Co.

Hi Good morning. I just I want to clarify a comment made earlier, I guess were you guys saying that the CMBS market is right now more favorable than the whole mortgage loan market and if so, are you seeing any divergence in terms of delinquencies or loan charge offs?

George E. Ruebenson

No, I am not making a comment about today's current conditions. The whole loan commercial mortgage market for those institutional investors who have plentiful cash to invest are probably offering the best conditions and terms as we are seeing over five years. And the CMBS market is yet, as you probably know, is relatively little liquid today, the conduits are largely shut down. So I wasn't trying to make a relative comparability point as of today's condition.

Richard Sbaschnig
Oppenheimer & Co.

Okay, thank you very much.

Operator

Our next question is from Charlie Gates of Credit Suisse. Your question please.

Charles Gates
Credit Suisse

One of you made the comment; I believe that you felt that personal auto insurance pricing decreases had moderated. Could you elaborate on what you see, the industry doing. Seemingly Progressive is raising rates, and seemingly some of your competitors are now in the emergency room such as first acceptance and whatever claims way. So if you could speak to that for a moment?

Thomas J. Wilson

Charlie, this is Tom. I don't really have a whole lot more to add other than what we observed is that the markets are lot smarter than it used to be. There is much more sophistication, a lot more of the market is held by publicly traded companies who are subject to quarterly and annual results. I think you see a little more discipline in pricing today. That doesn't mean that with all the other competitors out there people want you to cut prices but we're seeing it to be less fewer price reductions in the second half of the year than the first half. And the fourth quarter we saw some of the things you saw so we're feeling like the market will look sort of like last year. And we think with our value proposition we have the opportunity to increase prices because consumers are getting value for that and they've proven they'll continue to pay us more. So we're feeling okay but I don't expect to see huge meltdown in the market though.

Operator

Our next question is from Jay Cohen of Merrill Lynch. Your question please.

Jay Cohen
Merrill Lynch & Company

Yeah, I guess a bigger picture question. I mean clearly the economy is getting weaker and there is obvious risk that we're heading into a recession. I'm wondering how you would expect a recession to impact your business and specifically in the claims side what kind of facts and I imagine there are several different moving pieces there but what are some of the important moving pieces that would happen during a recession?

Thomas J. Wilson

Specifically, on the... Jay on the claims side you'll hear people talk about claiming behavior that people are more likely to file claims because they don't have money to pay them. Then it's probably true and really difficult to sort of figure out and doing an analysis as to how much that comes, how much is there.

You'll see a little bit of an up take in fraud and we've a good early warning system on that. So you'll see a little bit of an uptake in fraud in recession. The bigger item for us, economic trends in claims is inflation and making sure that the increase in prices is that rattles to we are properly managing that and making sure we'll get it in our prices. The inflation today really is, I see a lot of inflation in food that doesn't impact. The steel prices start to rattle through on cost... labor cost, seems to be kind of moderate in 3.5% range, used car prices were down in the fourth quarter but so we're not seeing a huge amount of inflation pressure in the cost of fixing cars and as George pointed that's 55% to 60% of the total cost. That would be the bigger economic driver that would cause us to change our pricing position in marketplace.

Jay Cohen
Merrill Lynch & Company

About the number of drivers on the road, if there is... unemployment goes up there are fewer drivers accidents or is that stretching it?

Thomas J. Wilson

No, that's true. I mean obviously there were some of it... which promises to study our gas that has some effect but unemployment has the bigger because people have to drive to work and worked it on drive. And so that has an impact, but the employment numbers while they are softer in terms of the growth you are not seeing big uptakes in unemployment. So really the worry about recession is because of the decline in employment growth as opposed to a rapid rise in unemployment and its that latter piece which would bring frequency down and of course as you know we did not see a lower frequency in 2007.

Jay Cohen
Merrill Lynch & Company

Great. Thanks Tom.

Operator

Our next question from Paul Newsome of Sandler O'Neill. Your question please.

Paul Newsome
Sandler O'Neill & Partners L.P.

I was hoping you could elaborate a little bit more about the reserve development on... stuff related to the reinsurance recoverables?

Thomas J. Wilson

Again that was the $16 million provision and that was for a reinsurance and collectibles as I mentioned earlier for reinsure that financial difficulty in the UK that's all that was one particular incident.

Paul Newsome
Sandler O'Neill & Partners L.P.

One related specific type of reserves.

Thomas J. Wilson

Before, our discontinued lines it was related to those asbestos type reserves.

Paul Newsome
Sandler O'Neill & Partners L.P.

Thank you.

Operator

And our final questions today is from Mike Phillip [ph] with Stifel Nicolaus. Your question please.

Unidentified Analyst

Hey thanks for taking me in, I appreciate the patience. Question on homeowners. How do we think about the impact I guess of decline in home values and insurance to value and how those things would flow through... I guess separately premium volumes and homeowners as compared to lowest cost?

Thomas J. Wilson

That's two pieces. Yes, I guess I will take first. Is home... rising home prices and rising cost of building homes, building materials and all that has stuff has clearly had an impact on our severities over the last 3 or 4 years. If you look back in... the quarter-to-quarter movement severities, it really started in mid 04, George. And so, but it's too early to tell what the slowdown in home building will do to material cost and overhead and profits that you have to allow to builders to fix houses they get that we have paid for. So it is little too early to tell what that will have, the impact on pricing will moderate. We won't be getting automatic increases in PIA that we normally get in homeowners as the values don't grow as much. But that should not impact our profitability and homeowners because hopefully it would offset in that building cost piece that I just mentioned. Does that get to both of your questions Mike.

Unidentified Analyst

Yeah it does. I appreciate it.

Thomas J. Wilson

Okay. Thank you. As always, we value the dialogue. We appreciate the effort you make to follow our company. We are often running in 2008 making sure we focus on those four operating priorities. Our goals are to continue to outperform the industry, to re-invent protection or retirement for the consumer, and if we do those two things we consequently will deliver superior returns for our shareholders and that's our focus for 2008. Thanks again.

Operator

Ladies and gentlemen. Thank you for participating in today's conference. This concludes the program. You may now disconnect. Good day.