S&P Capital IQ

CONTENTS

The Allstate Corporation NYSE:ALL

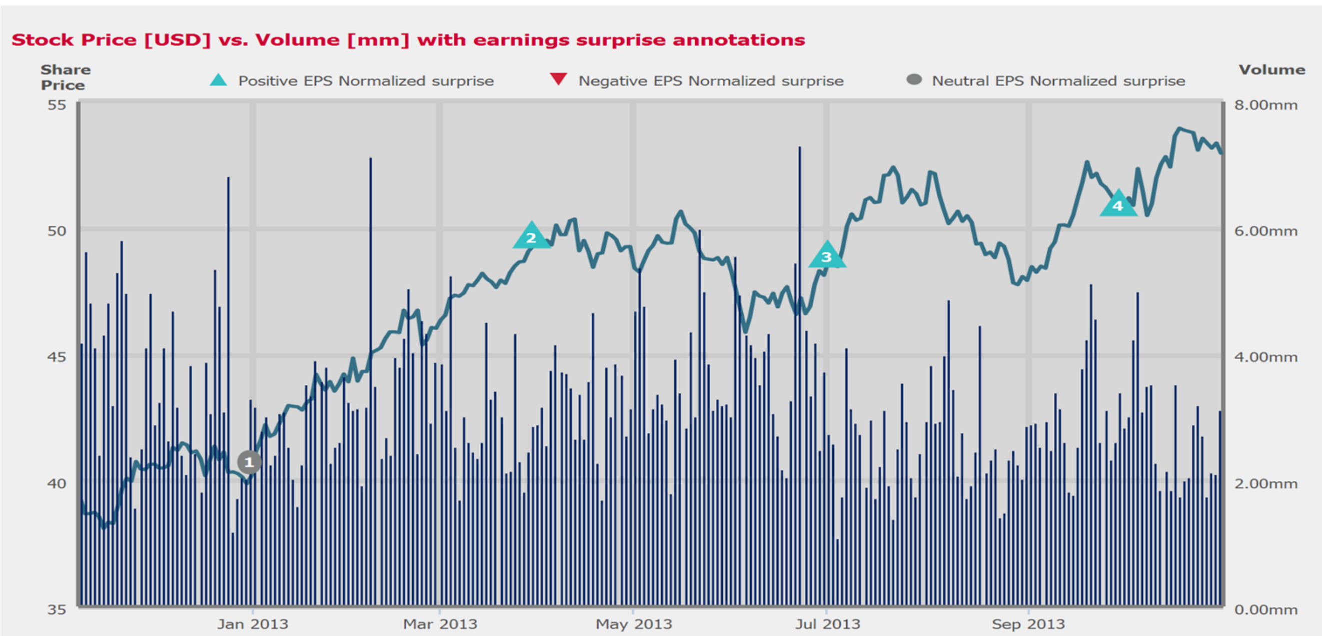
FQ4 2013 Earnings Call Transcripts

Thursday, February 06, 2014 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.37	1.70	▲24.09	1.32	5.36	5.68
Revenue (mm)	6979.67	7014.00	▲0.49	7232.26	27680.79	27618.00

Currency: USD
Consensus as of Feb-06-2014 11:26 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	(0.06)	0.59	NM
FQ1 2013	1.29	1.35	▲4.65 %
FQ2 2013	0.98	1.12	▲14.29 %
FQ3 2013	1.38	1.53	▲10.87 %

Call Participants

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to The Allstate Corporation Fourth Quarter 2013 Earnings Conference Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mr. Steven Shebik, Chief Financial Officer. Sir, you may begin.

Steven E. Shebik
CFO & Executive VP

Thank you, Matt. Good morning, everyone. Thanks for joining us today for Allstate's Fourth Quarter 2013 Earnings Conference Call. After the prepared remarks by Tom Wilson and myself, we will have a question-and-answer session.

Yesterday, following the close of the market, we issued our press release and investor supplement, posted a slide presentation to be used in conjunction with our prepared remarks. These are all available on our website. We plan to file our 2013 Form 10-K on Wednesday, February 19.

As noted on the first slide, our discussion today may contain forward-looking statements regarding Allstate's operations. Allstate's results may differ materially from these statements, so please refer to our 10-K for 2012 and our 10-Q for the third quarter of 2013, the slides and our most recent press release for information on potential risks. Also, this discussion will contain some non-GAAP measures for which there are reconciliations in our press release and on our website.

We're recording this call, and a replay will be available following its conclusion. I, along with our Treasurer, Mario Rizzo; and Pat Macellaro from Investor Relations, will be available to answer any follow-up questions you may have after the call.

Now, let me turn it over to Tom Wilson.

Thomas J. Wilson
Chairman & CEO

Well, good morning. Thank you for investing your time and money in Allstate. I'll start by covering our 2013 results as they relate to our strategy and our operating priorities for both 2013 and 2014. Steve will then go through the business unit results and talk about capital management.

With us today for the Q&A period are Matt Winter, who, of course, leads Allstate Personal Lines; Don Civgin, who's responsible for Allstate Financial and Insurance; Kathy Mabe, who leads Allstate Business To Business Operations; Judy Greffin, our Chief Investment Officer; and Sam Pilch, our Corporate Controller.

So let's begin on Slide 2. Our strong 2013 results demonstrate success in executing what is a broad and comprehensive approach at creating shareholder value. That includes, obviously, strong operating income; a balancing risk and return; aggressive capital management; and you see accelerating growth as well this quarter, which are all resulting from achieving our operating priorities for the year. Overall, 2013 provides a very solid foundation as we continue to aggressively implement our strategy, which is to differentiate the value proposition between customer segments.

Let's start at the top. Revenues increased 3.6% to $34.5 billion in 2013, which reflects 1.5% growth in policies and, of course, with contributions from all the brands. Net income of $2.3 billion declined slightly from 2012, primarily due to the $521 million after-tax loss from the pending sale of Lincoln Benefit Life and the impact from repurchasing debt.

Operating income of $2.7 billion for the year was 24% higher than 2012, primarily due to lower catastrophe losses. Operating income per diluted share increased 30% to $5.68 per share as a result of higher operating income and the impact of the share repurchases. Book value per common share also increased over the prior year, both including and excluding fixed income, unrealized gains and losses. Operating return on equity was 14.5% in the latest 12 months.

If you go to Slide 3, on the top, we show our 5 operating priorities for 2013. On the bottom, we show the 4 distinct consumer segments we serve through our competitively differentiated strategy, along with the respective growth in profitability. The 3 brands where we underwrite risk, Allstate, Encompass and Esurance, all grew net written premium and policies in force in 2013 compared with 2012, and we achieved all 5 of the 2013 operating priorities.

Starting in the lower left, for the Allstate brand that, of course, serves customers who prefer local advice assistance and want a branded experience, our policies grew in 2013 by 0.4% from the prior year, and Allstate brand auto policies in force increased 1.5% versus year ago and 0.6% versus the last quarter, which reflects both improved retention and continued stronger business growth.

This growth is a result of one, the retention, but also we've expanded the Allstate Agency -- exclusive Agency distribution. We have effective marketing and less restrictive risk targets.

We made substantial progress in improving returns in homeowners. As a result, the decline in homeowners policies was down to 2.2% from year-end 2012 and flat versus the third quarter. The continued rollout of our house and home product across the country will support our future multi-policy household focus.

Overall, Allstate brand profitability improved in 2013, with a combined ratio of 89.9 and an underlying combined ratio of 85.8 due to auto profitability, good underlying homeowner margins and lower catastrophe losses.

Esurance brand, which serves the self-directed brand-sensitive customer, is in the lower right, generated significant premium and policy growth in 2013. Premiums written increased by 27.9%, and policies in force increased by 26.7% compared to 2012. The combined ratio finished 2013 at 117.5, reflected continued high levels of marketing spend you'll remember, and that's where we expense all of our advertising right up front, in investments in expanding both geographically and from a product perspective; continued expensing of acquisition intangibles; and the impact of higher loss ratios on new business.

Esurance continues to adjust its pricing and underwriting to ensure the growth we're experiencing generates long-term profitability. These actions caused growth to decelerate a little bit in the third and fourth quarters, and we expect growth to decline somewhat in 2014.

The Encompass brand, in the upper left quadrant, serves customers through independent agents that provide a choice of brands. Our unique package policy represents about 80% of Encompass' total premium. This brand also grew, with policies up 6.5% compared to 2012. The combined ratio for 2013 was 95.9, an improvement of 10.5 points from the prior year, which was driven by a significant decrease in catastrophes and improved underlying performance in the homeowners line. The auto insurance margins in this brand still need to be approved.

Now, let's move to Slide 4. We have a great year. Now it's time to move forward. 2013's operating priorities are compared to the 5 operating priorities for 2014. The highlight -- the evolution we're going through, which is from focusing on strengthening the core business to positioning for sustainable growth. The operating priority in 2014 on growth is in units rather than premium, as the importance of market share growth is now greater than raising average prices on homeowners insurance.

Secondly, we want to maintain the underlying combined ratio in 2014. This combines the second and third priorities from 2013 and reflects the significant improvements made in the underlying margin in homeowners. Proactively managing investment risk and return remains a priority, although the focus will shift. Now that the interest rate risk has been lowered in the Property-Liability portfolio, the investment focus will shift from public fixed income corporate securities to other high-yielding assets, typically in the private market where returns are not as linked to overall market performance.

The 2014 priority to modernize the operating model is a broader and more sustainable approach to the 2013 priority of reducing the cost structure. We'll continue to take a broad look at improving the way we do business, which means -- and that's, of course, starting with the customer, so we're pursuing continuous improvement, simplifying our processes and streamlining our technology to deliver faster, better and more cost-efficient service. This will lead to improved customer satisfaction and fund further investments in growing our business.

To continue increasing shareholder value, focus is being increased in building long-term growth platforms, so we'll continue to look at ways to become an even more integral part of our customers' lives. The evolution, of course, is a connected customer and telematics, and there's a number of structural and technological changes that offer good growth opportunities for us.

Finally, in keeping with our practice to provide you an outlook for our Property-Liability underlying combined ratio for the next year, that's 2014, we set a range of 87 to 89, which is 1 point lower than last year's range.

Now, let me turn it back to Steve.

Steven E. Shebik
CFO & Executive VP

Thanks, Tom. I'll start by reviewing the 2013 financial highlights on Slide 5. Starting at the top, Property-Liability had earned premium of $27.6 billion in 2013, which grew 3.3% from 2012 and a recorded combined ratio of 92. The underlying combined ratio for the year was 87.3, essentially flat to prior year and better than our full year outlook range. Catastrophe losses were $1.25 billion, $1.1 billion below 2012 and our lowest year of catastrophe losses since 2006. Net investment income for the Property-Liability segment grew 3.7% from the prior year, reflecting very strong limited partnership performance. As a result, operating income was $2.47 billion for the year, 35% higher than 2012. The combined ratios on a recorded, underlying basis for each brand are shown on the right-hand side. As discussed by Tom, the Allstate brand continued to generate solid profitability as the positive efforts -- effects of rate changes and low catastrophe losses more than offset modest inflationary increase in loss costs.

The Encompass recorded combined ratio also improved from 2012, due to lower catastrophes and improved homeowners margins. The Esurance combined ratio of 117.5 for 2013 improved 2.4 points from the prior year. However, it remained elevated, as Tom noted earlier. Allstate Financial, on the bottom left, had a 5% increase in premiums and contract charges in 2013, reflecting a 5.5% increase in underwritten products, including a 10% increase at Allstate Benefits.

Operating income of $588 million was an 11.2% improvement over 2012, due primarily to an increase in investment margin, lower expenses, profitable growth at Allstate Benefits, partially offset by a reduction in spread-based business and the lower benefit spread in our car and [ph] life insurance. Net income of $95 million for 2013 was significantly lower than 2012 due to the loss on the pending sale of Lincoln Benefit Life.

On Slide 6, we show net written premium and policies in force in total and by brand. The red line shows that total policies in force began growing in the second quarter of 2013. For Protection in total in the upper left chart, overall policies grew 1.5% from last year and 0.5% from the third quarter. Each brand achieved growth in both net written premium and policies in the fourth quarter and the full year.

Moving to the upper right chart, Allstate brand policies ended the year 0.4% higher than both 2012 and the preceding quarter. The Allstate brand grew net written premium 3% in 2013, driven by higher average premiums and favorable trends in both retention and new business. Allstate brand auto net written premium increased 2.2% from prior year, while policies rose 1.5% from 2012. Allstate brand homeowners net written premium grew 3.8% compared to the 2012, while the unit volume decline continued to slow, with fourth quarter 2013 homeowners policies flat to third quarter 2013.

On the bottom 2 charts, you can see growth trends for Encompass and Esurance, although remember the absolute dollars scales are much smaller than the top 2 graphs. Both brands grew net written premium and policies compared to 2012.

Moving to Slide 7. The chart on the left-hand side show the earned premium and underlying loss trends for Allstate brand auto and home, while the charts on the right show the combined ratio trends. We have continued to maintain overall margins in the Allstate brand. With Allstate brand auto, you can see that earned premium and losses, which are some of them volatile, tend to move in tandem over time as we closely manage rates to keep pace with loss development. In the last 3 quarters, losses per policy have increased faster than earned premiums, leading to a slight deterioration in margin. Essentially, after experiencing very favorable loss results at the end of 2012, in the first quarter of 2013, moderate increase in loss cost has exceeded the increase in the earned rates. Despite these increases, the underlying combined ratio for auto is still within targeted range and generates extremely attractive returns on capital.

For Allstate brand homeowners, shown on the bottom half of the slide, underwriting loss cost per policy is slightly higher in 2013 than 2012, while earned premium per policy continues to rise. This improved the underlying combined ratio by 2.4 points for 2013 to 62.7. The recorded underlying -- the recorded combined ratio for the year was 77.9, 7.1 points better than the prior year, reflecting the improved underlying margin and lower catastrophes. The combined ratio trends are shown in the lower right-hand chart. You can see our underlying 12-month average continues to decline, but at a slower rate as we approach price adequacy.

Our 2013 investment results, depicted on Slide 8, reflect actions we have taken to reduce interest rate risk in the Property-Liability portfolio, maintain alignment with Allstate Financial's changing liability profile and actively managing our equity investments.

As shown in the graph on the top of the slide, investment income before expenses was $1.08 billion in the fourth quarter and the total portfolio yield was 4.8%. Investment income for the quarter was higher than the first 3 quarters of 2013, but was slightly below the fourth quarter of 2012.

We reported lower income from the interest-bearing portfolio due to lower investment yields and a smaller asset base driven by the decline in Allstate Financial's spread-based liabilities. The equity portfolio continued to benefit from strong limited partnership earnings, which increased by $92 million in the quarter compared to the fourth quarter of 2012, and partially offset the income decline in the interest-bearing portfolio. The equity component of our portfolio continues to grow. We expect to earn attractive, but more variable returns over time in this component.

Moving to the total portfolio return in the bottom left, our total return for the fourth quarter was 1.1%. Net investment income was a primary driver. Total return for the year was 1.8%, as higher equity valuations were offset by lower fixed income valuations as treasury rates rose during the year.

The level of unrealized gains in the portfolio fell from $5.5 billion at year-end 2012 to $2.7 billion at year-end 2013, as shown in the lower right. The fixed income valuation decline, resulting from the significant increase in treasury rates, was the primary driver of the $2.9 billion decline in unrealized gains for the year.

Our rate risk reduction actions position the Property-Liability portfolio to be less sensitive to rising interest rates and pull forward future income through realization of gains and the sale of longer-term securities, but lowers future operating income.

Slide 9 depicts the trends in the Property-Liability and Allstate Financial portfolios, each of which comprise of approximately half of the total portfolio. For Property-Liability, on the top left, there's a declining earned yield trend on our interest-bearing portfolio as seen by the gray line, reflecting the interest rate risk reduction activity during the year and reinvestment in lower-yielding, shorter-duration bonds.

The impact of our actions is further illustrated in a scheduled maturity graph at the upper right, where the 2 declining red bars at the longer maturities show that only 10% of our portfolio is due after 7 years versus 32% by the end of last year. While we continue to evaluate our overall investment and portfolio risk exposure, we currently intend to maintain the shorter maturity profile on our Property-Liability portfolio.

At the bottom of the page, you can see that Allstate Financial's net investment income has been more stable. Over the past few years, Allstate Financial's investment cash flows have been used largely to fund liability outflows, so the portfolio yield has not been impacted significantly by the low yields in new investments. Future investment income will decline as liability outflows outpace new business and the sale of Lincoln Benefit Life is completed.

The last column in the table provides a pro forma view of investment results, exclusive of LBL actual results. The interest-bearing portfolio yield remains essentially unchanged, but investment income is $112 million lower, excluding the LBL-related assets. The chart on the bottom right shows the ongoing decline in the Allstate Financial portfolio as we continue to reduce spread-based liabilities.

Slide 10 shows the progress we have made in improving operating income return on equity from an inadequate return of 8.6% in 2010. We communicated in 2011 our focus on 5 key drivers to increase operating income return on equity to 13% by year-end 2014, as shown on top of the page.

The underlying homeowners combined ratio, which represent over 2/3 of the expected improvement opportunity, has improved steadily from 72.9 in 2010 to 62.7 for 2013 and 60.7 for the fourth quarter of 2013. Auto profitability has remained stable at a combined ratio of roughly 95%, continuing to generate very attractive returns.

When we established our goals in mid-2011, the expectation for the investment portfolio yield and the Allstate Financial ROE was that interest rates would rise over time. This obviously hasn't materialized as risk durations today are lower than they were in 2011. We have also proactively reduced rate risk in the Property-Liability portfolio, which has been the right economic decision even though it reduces operating income.

We continue on our track record of proactive managing -- management of capital, providing strong cash returns to shareholders through dividends and share repurchases. Since 2011, Allstate Financial has returned over $1 billion in capital.

The 2013 14.5% return on equity reflects favorable catastrophe losses. However, normalizing catastrophe losses and adjusting for nonrecurring charges, such as the pension settlement charges, discontinued life reserve strengthening and restructuring charges, as well as excluding Esurance results since we did not own Esurance at the time we established the goal, still leaves an operating income ROE above 13%.

Slide 11 shows our capital position at December 31 compared to last year. We are in a stronger capital position, reflecting excellent earnings, the debt refinancing, changes in employee benefits and the replacement of higher-cost debt with capital that is longer term and has more flexibility, such as perpetual preferred stock.

In the fourth quarter, we returned $565 million to shareholders, to bring the total to $2.2 billion for the year. We repurchased 1.8% of our outstanding common stock in the quarter, or 8.4 million shares, bringing the total repurchase for the year to 7.8%. As of year-end, we had $139 million remaining on our share repurchase authorization.

As you know, we typically review our capital plans in the first quarter, following completion of our year-end reporting. We estimate year-end statutory surplus to be a total of $18.2 billion with $15.2 billion estimated for the Property-Liability companies. During 2013, Allstate Financial companies returned $774 million of capital, including $500 million this quarter. Holding company deployable assets were $2.6 billion at year-end. If you scan down this slide, you can see our strong capital position at the beginning of the year is even stronger today.

Overall, in 2013, we made good progress in the execution of our customer-focused strategy and achieved all of our priorities. We are well positioned to aggressively implement our differentiated strategy, while delivering strong returns to our shareholders.
Now let's open up the call for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from Bob Glasspiegel from Janney Montgomery Scott.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

It seems like you have achieved your homeowners goal in the low 60s. Where do you stand on your overall homeowners strategy going forward?

Thomas J. Wilson
Chairman & CEO

Bob, this is Tom. I'll make a comment, then Matt can talk about what he's doing to turn the line on homeowners. And I know you've been after us several times, wanting to declare a victory at homeowners. We feel really good about where it is now. If you look at the underlying combined ratio, it's in a good place. It's taken us 4-plus years to get there, and we're now positioned to be able to leverage in this competitive advantage. Matt can give you some sense of how he's going to do that.

Matthew E. Winter
President and President of Allstate Insurance Company

So I've mentioned previously that we kind of have a 4-pronged approach to the way we're looking at the homeowners business and our strategy going forward. The first was the rate adequacy component which, as you and Tom have been talking about and as you've been mentioning on previous calls, we have made substantial progress on, and we feel really good about our rate adequacy right now, although as things develop and change, we'll develop and change. But that's only one component of our strategy. The second component was to update and upgrade some of our product availability, which we did with House & Home, which you know we've rolled out to a substantial part of the market. We launched it in about 27 states so far, which is about 3/4 of our new business apps, and we'll continue to roll that out into some additional states this year. The third component of the strategy, though, was to reassess our probable maximum loss and do what we call PML optimization, and figure out if there are ways to use that PML capacity in a more optimized way that enables us to grow households and enables us to get benefits of diversification. And so we've done a lot of work with our PML, we've done a lot of work through reinsurance and we've done a lot of work on a very localized basis to ensure that we're able to take on some additional homeowners capacity without really raising our overall risk load. But the fourth component of it, of the strategy, is just general geographic diversification. We know that the more we're able to grow in certain areas of the heartland where we have non-correlated risk to some of the coastal areas, it gives us overall homeowners capacity. And so there's a lot of work underway to increase that geographic diversification, grow in some areas of the country where we have not historically grown and, therefore, enable us to grow additionally in some of the regions where our capacity is constrained. And all 4 of those prongs are enabled by our brokerage strategy, our Ivantage strategy, which allows us not to hurt the customer as we do all those things. So we always ensure we have a homeowners product offering for our customers and for our agency owners to offer to customers while we're changing things, assessing risk, adjusting PML. And so we've done a lot of work with our Ivantage Agency and Northeast Agencies to ensure we have homeowner product availability throughout the country.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Thoughtful answer. Your third prong, in an environment where there's less -- where reinsurance costs are going down, are you taking the savings to the bottom line or using it to grow?

Matthew E. Winter
President and President of Allstate Insurance Company

Yes.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

A little bit of both?

Matthew E. Winter
President and President of Allstate Insurance Company

I don't mean to be flip. But first of all, reinsurance prices change over time. It's hard to rely on what the arbitrage may be over the long term and so you have to be thoughtful and, I think, disciplined in how we choose to use that and how we choose to think about that in either reinvesting it or taking to the bottom line. So I think we're taking a fairly balanced approach. We may be reinvesting some of that savings and using some of it to enable us to enter areas where we haven't been able to enter before.

Thomas J. Wilson
Chairman & CEO

Bob, it's Tom. Remember 2 things as well. So you don't just take change in reinsurance pricing and pop it into the combined ratio, which is we have a stacked program, so it rolls out over 3 years. And we -- reinsurance factors into our pricing, so on a long-term basis, to the extent reinsurance costs went down, we'd be able to offer our customers more value. We would make that up by growing better but -- so it's not sort of just an expense that comes or goes.

Operator

Our next question is from Michael Nannizzi of Goldman Sachs.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Tom, do you guys have an estimate or an idea on what the potential January losses may be for the first quarter?

Thomas J. Wilson
Chairman & CEO

Mike, we do not, no. But, of course, you know, we do provide -- we'll do our normal monthly cat estimate, which is, I'm not sure, third week is it?

Steven E. Shebik
CFO & Executive VP

It'll be third week, Thursday.

Thomas J. Wilson
Chairman & CEO

It's the Thursday of the month. So that'll be coming up.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it, okay. And then one question on -- how much of the increase in the year-over-year expense ratio was due to the incentive comp?

Thomas J. Wilson
Chairman & CEO

On the year-over-year basis, I'd say less than 0.5 point in total, but incentive comp's like everybody, like not just management, agency, bonuses, I mean, there's a lot of people who are incented to drive growth and profitability in a company. There was a little bit of a bump. It was more than that in the fourth quarter, though, because we had some catch-up because there was a pretty good, strong run for the finish line.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it, okay. And I mean, is there any way to control for that piece or -- so we understand? Is there any way to kind of think about what it might have been excluding that piece, just to try and think about what the forward might look like?

Thomas J. Wilson
Chairman & CEO

I think the best way to look at the underlying profitability is just to look at the loss ratio piece. The expense ratio will move around depending how much we're advertising in the quarter and those kinds of things. We do expect the expense ratio to come down over time, though.

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Got it. And then, so, I mean, clearly taking rate in homeowners seems to be slowing. I don't know if that's the right interpretation. Do you expect to see -- do you think you can continue to see the trend's moving in the right direction as you continue to push for rate and maybe see some margin expansion there?

Matthew E. Winter
President and President of Allstate Insurance Company

Mike, I'm sorry. This is Matt. Were you referring just to homeowners there on rates?

Michael Steven Nannizzi
Goldman Sachs Group Inc., Research Division

Yes, most. I mean, if you can comment on auto as well, but I was mostly talking about homeowners, yes.

Matthew E. Winter
President and President of Allstate Insurance Company

Okay. Well, if you look at Page 17 of the supp, you can see that the impact of rate changes on premiums written over the last several quarters broken out by auto and home. And as I said in my earlier comment to Bob, we have neared rate adequacy. Remember, as we roll out House & Home for the vast majority of states, that goes in rate adequate right away, so that has helped us jump to a rate-adequate position early. But we're -- we operate on a localized rate-taking basis. So we watch loss trends as they emerge on a local basis, and we react on a local basis. They -- so looking at it on a system-wide perspective is hard to do and I think a little misleading. When we see issues arising in a loss cost in a region or in a state, we react quickly in a region or in a state, and we'll take rate as needed. We've done a lot of work. We know the importance of customer experience and momentum. And a lot of work was done over the last several years to factor in customer experience and momentum into the decisions we make about when we take rate, how we take rate and how fast we take rate. And so we'll continue to balance that to optimize the overall return, the overall customer experience and our growth capabilities and our ability to retain our existing customers.

Operator

Our next question is from John Hall from Wells Fargo.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

Tom, yes, I was just wondering if you would just talk a little bit about the profit run rate for Esurance, sort of the time line? And then whether that's truly a top line phenomenon, or whether there's an element of overspending that's going on in Esurance? And then, just sort of tail onto that, whether you have any success metrics that you could share around your post-Super Bowl insurance ad.

Thomas J. Wilson
Chairman & CEO

Okay. I'll answer that, and then Don can help me out as well as since he works directly with him. First, impressive report quickly. I mean, fast turnaround. I was like, you must have had that thing all filled out and just dropped the numbers, and I have to say, I was quite impressed. The -- but as it relates to Esurance, let me go up to the strategy. Don can get into sort of the runway on the profitability. But when we bought it, we thought we were a better owner because we could do a number of things. One, we could reposition the brand specifically targeted towards that self-directed customer. We did that. The first phase of that was to not have it be used -- appeal to both segments, which was people when you want them and technology when you don't. That's obviously trying to appeal to both ends of that spectrum, which they needed to do because of their size, and we did not. So we repositioned it, really, around that self-serve customer, and Don can talk about the work they're doing in marketing there. But that was the first thing; reposition the brand. Secondly, to strengthen the brand by endorsing it with Allstate, so, in fact, we've done that by having it be endorsed but not confusing with the Allstate brand. We also thought we were better at claims and preferred pricing. And it was based on those assumptions that we said we could get in and invest more aggressively to drive growth in the business. So we substantially increased the marketing spend, even though that has a negative impact on the overall combined ratio because we can handle it given the size and scope of our company. And the result of that, as you see, we have great top line growth over the last couple of years with that business. Now, of course, all -- good plans always have something that you got to adjust to. And so they have -- we -- the loss ratio is a little higher than we would like. And so Don and Gary Tolman and the team are working to get that and he can give you some insights on both what are we doing with the current marketing program and what are we doing to get loss cost in line. But I'm okay. As long as the loss cost is in line, I'm okay continuing to invest in growth in the business, even if it brings their specific component combined ratio above what we would like on a long-term basis.

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

John, let me maybe just fill in a couple of things on both the profitability trajectory and then the marketing. I mean, as Tom said in the opening comments, you have to look at both the GAAP profitability, and then what we look at, which is economics. Because we direct -- we expense all the marketing expenses upfront, particularly in a business that's growing, and Esurance is obviously growing very rapidly, the GAAP combined ratio is going to be elevated during the points at which you're growing the way we are. We would prefer to not just look at GAAP, but also look at our economics, which is the way we run the business. So we look at the lifetime combined ratio that the business that they're writing today is generating. And I'll talk about the loss ratio in a second. But by and large, we're comfortable that the business that Esurance is writing right now is profitable over its lifetime. You won't see it in the GAAP accounting because it -- because of the expensing of all of the advertising expenses upfront. On the loss ratio, I think Tom's right. We're all a little disappointed with the loss ratio this year. We've been on it, we understand where it's coming from. Where we can, we've worked with Allstate, shared data and make sure that we're on top of it. I think Gary and his team has done a really nice job of working to make sure that through both pricing, which you'll see in the supplement, you will see the rates being taken, and underwriting actions, that, that will come back in line. And we're already beginning to see the loss ratio come back in line. So I would expect to see improvement in the loss ratio in 2014 compared to where we were in '13. But I think so long as the business continues to justify the advertising spend, you will see an elevated combined ratio on a GAAP basis. Just one word of caution: you saw in the third and fourth quarter, the top line slow down a little bit for Esurance as a result of some of the rates that have already been taken, and I expect to see continued pressure in 2014. The way they're taking rate and moving underwriting, 2014 would be difficult to maintain the trajectory on the top line that they had in 2013. Let me move to marketing for a second. After we made the acquisition, I think Gary and his team did a really nice job of fashioning a new campaign that was designed. It was called the Insurance for the Modern World campaign. It was designed to make sure that everybody understood what their customer value proposition was. So, if you go back to our four square, that advertising campaign was designed to make sure people understood that Esurance was in the lower right-hand and not competing against Allstate. That campaign was terrifically productive, extremely strong response rates and you can see from what it did on our top line, it worked extremely well. The Esurance ad after the Super Bowl was a little bit of a shift in that instead of telling people we're in the lower right-hand, we're now going to telling people how good we are at the lower right-hand. And that was the way to kick off that shift in the campaign. We're extremely happy, not only with the impressions we got and the -- I mean, if you read any of the social media reviews, it was extremely effective in generating Twitter activity after the -- not only after Super Bowl, but up until last night when the announcement was made in the Jimmy Kimmel show on the winner. And so I think it's worked extremely well. And what I like in particular is that the credit the team's getting for the campaign is extremely consistent with what the brand stands for, which is clever, modern and doing things different than it's been done in the past, so feeling very good about the marketing campaign. We're investing in it. We'll see how it works, but I think we're delighted with the way the -- as the ad and after the Super Bowl worked for us.

John Arthur Hall
Wells Fargo Securities, LLC, Research Division

Was there an immediate response in terms of call volume?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Yes, there were -- well, you have to separate that from call volume to quote volume, so quote volume was up substantially after the Super Bowl ad. Call volume was off the charts. A lot of that was, obviously, to learn about the contest and so forth. But the response was really good.

Thomas J. Wilson
Chairman & CEO

We spent a lot of money. People should call.

Operator

Your next question is from Mike Zaremski from Crédit Suisse.

Michael Zaremski
Crédit Suisse AG, Research Division

On capital management for 2014, any outlook there? In 2013, you guys, if I do the math on share buybacks and the dividend over operating earnings, you guys returned in excess. How should we think about 2014?

Thomas J. Wilson
Chairman & CEO

Mike, you should think about it as one of our core values for our investors is generating good cash returns for them. So we started to talk about cash returns a little differently this quarter. So we talked about the combination of dividend and share repurchases, and what does that look like as a percentage of one's market capitalization. And the concept behind that is if you owned the entire company at the beginning of the year and you owned the entire company at the end of the year, how much cash would you have gotten in between? And sometimes, I think the share repurchase numbers get lost in the fact that you could choose to maintain your relative ownership interest as a shareholder by selling pro rata into the share repurchase program getting that cash and that cash looked like about 9% last year, and it looked similar to that the prior couple of years. So that is still our goal. As Steve said, we evaluate that in the first quarter. We're not prepared to make an announcement on what we're doing in dividends or share repurchases on this call, but you shouldn't expect a huge change in our philosophy in terms of driving shareholder return and providing cash to them.

Michael Zaremski
Crédit Suisse AG, Research Division

Okay, that's interesting. Next and lastly, a follow-up to one of the previous questions. Now, if we look at Slide 7, auto loss cost seemed to be exceeding earned premium for the last few quarters. I mean, should we be expecting another tough comp in 1Q given what's been going on in January? And maybe if last year -- if 1Q was a tough comp as well and on cat weather?

Thomas J. Wilson
Chairman & CEO

I don't really want to get into quarterly forecasts on it. I can tell you that our general philosophy is one mantra [ph], which is manage it locally, but also there's the be paranoid about it. So the reason you maintain good returns is you stay focused on it. Matt can talk about what they've been doing in the last half of last year to reflect the trends you just mentioned.

Matthew E. Winter
President and President of Allstate Insurance Company

Yes, thanks, Tom. Yes, Mike, I'd rather focus on, as Tom said, how we manage this. And so when you look at Slide 7 and you look at that chart, I'd just remind you that this is a percent year-over-year underlying margin trend. And so what we just saw is a comparison to what was an extremely favorable fourth quarter 2012. That notwithstanding, we do have some clear pressure emerging. And you see slight uptick. We think it's still within our expected norm and our historical norms on the severity side on BI and PD. But it is just kind of volatility that's normal and somewhat expected. That being said, what we see on a system-wide basis is different than what we see on a localized basis. So, if you go back to Slide -- Page 17 of the supp, you'll see the number of states we put rate in during the second half of the year on auto. It's significantly higher than what we took in the first half of the year. We saw some trends emerging in some particular states, and, as such, we took necessary rate to ensure we got out in front of those and caught up quickly and minimized any lag between the earned premium and the increase in loss cost. We also took some underwriting actions and we accelerated some correct class work in the second half of the year that I anticipate will have a positive impact as we begin this year.

Operator

Your next question is from Dan Johnson of Citadel.

Daniel B. Johnson
Citadel LLC

Wanted to talk about a segment that's actually sizable enough to talk about, that's on the other personal lines, the underwriting improvement there was, I'd say, just about as meaningful as it was in the auto business in terms of year-over-year contribution. What's the outlook for that continuing? And now that Don's not there, who's running the business? And I got one other follow-up after that.

Thomas J. Wilson
Chairman & CEO

Okay, Dan. The -- as you point out, yes, we are doing better in what we would call consumer household stuff, which includes a variety of other Property-Liability products. The business is -- profitability has improved. We'd like to see it grow a little faster to be honest. Its growth was moderate. And when we look at the potential market share, the market share we have in those spaces, whether that be motorcycle or RV or boats, and we look at our overall market share in auto and home by state, we have some room to grow there. And we'd like -- so we're working on having a more household focus. Kathy Mabe is the person who runs that part of that business. She -- oh sorry. Sorry, we moved it over to Matt, I'm sorry. I'm saying Kathy and Matt's saying, "Oh no, I got that one." Kathy Mabe took over for Don, so all the Encompass stuff and all the -- we've rearranged some stuff called business-to-business and I'll come back to that in a second. So Don left. Kathy took his role. We re-shifted that role somewhat. We have some fairly large set of businesses that are good at business-to-business, but they weren't really run together as business-to-business. So, for example, we have our worksite business which serves 2.7 million customers through the worksite. We also have a commercial insurance business, small businesses. There's a bunch of things that are really business-to-business, and we felt like we weren't delivering it really seeing a value proposition to those businesses as we could have. So we put those together and reorientated that right as Don was leaving. As part of that, we took the consumer household business and we moved it into Matt's organization, so that it's more integrated on the household focus from both pricing, technology standpoint, a whole bunch of reasons that'll help it grow faster.

Daniel B. Johnson
Citadel LLC

Yes, well, that was actually my next question as to now that we've got it to very respectable profitability, can we grow it? So maybe I just ask it slightly different. Are we sort of at profitability where we hope to be and then the focus needs to be from growth? Or is there still other things on the profitability front that you think can be done? And that's it.

Matthew E. Winter
President and President of Allstate Insurance Company

Dan, it's Matt. So, on the profitability side, again, when you see it, it's rolled up to all the lines together. And we still have some additional work to do on a few of the smaller lines there to ensure that their profitability is sustainable. Remember, some of the profitably improvement we saw in this last quarter was driven primarily by low cats, and so we don't want to declare victory too soon there. The way we're approaching these lines, as we move them over from what was emerging businesses into personal lines, is I consolidated things with wheels with the auto line into the vehicle line management, and I consolidated landlord, renters and condo and manufactured homes into our homeowners business. So they're being managed more holistically by what is now vehicle and home -- or vehicle and property line management. I expect that, over time, as we ensure that we have profitability on each of the subcomponents of those CoHo lines, that we will, consistent with our CVP, begin growing the overall portfolio. Remember, our overall approach with the Allstate Agency now is to say yes more often to customers, have more products available to serve their customers and enable those agency owners to be more holistic risk advisors to their customers and have a variety of products at their disposal. As we continue to embed that CVP into the agency system, we think that the ability to sell some of the consumer household products will improve. Our breadth and depth of customer penetration will improve as a result, and we will get better at packaging them together, porting data between the lines, making it more intuitive for a licensed sales professional to switch from a standard auto sale to a renter or a condo sale and port data over. And so we're excited about the opportunity. We think the integration into the rest of the personal lines business, the auto and home business, will be a long-term strategic benefit to us.

Thomas J. Wilson
Chairman & CEO

Dan, this is Tom. Let me -- I want to add one thing to that because I think you're on an important point from a strategy standpoint. This is really a shift from a product and items in force strategy to a household strategy focus. And our metrics don't quite follow it. We show you items in force by product and that kind of stuff. But -- and it's really in line with a customer focus. So some of our competitors only have one line, right, and we have to compete heads-up with them. But we're more interested in selling everything we can sell to you. So if you thought of this as a retail store, we don't just want to sell shirts. We want to sell shirts, pants, shoes, socks, whatever you need. We want to give to you, because we think that speaks to that customer segment. And Matt talked about it there. We're also doing the same thing in Esurance. So Esurance, we've rolled our renters in 16 states, motorcycle in 3 states and homeowners in 1. So you should expect to see -- we think that gives us a competitive advantage in that space because we'll be able to leverage our relationships and marketing dollars over a broader swath of products and services, have greater retention from people because we sell more things. So it is about shifting to that consumer -- customer focus, and this is, of course, one part of it.

Operator

Your next question is from Josh Stirling from Sanford Bernstein.

Josh Stirling
Sanford C. Bernstein & Co., LLC., Research Division

So I wanted to talk briefly -- so we oftentimes don't talk about your agents. You obviously have a lot of them, they're sort of essential to the story, but I think they get lost a bit. 3 or 4 years ago, you guys made a whole bunch of changes, lots of new blood in the organization, some consolidations, new agency, behavior and management strategies and compensation. You're obviously starting to see some core growth in the channel. And I'm curious if what you learned from the various initiatives you've pulled and if some of the growth that we're seeing is kind of you guys getting some traction from, like for example, the new blood and new hires and things like that? And whether -- or whether this is -- or whether the growth is something that's just a bit more cyclical as opposed to structural that we can look at?

Thomas J. Wilson
Chairman & CEO

Well, Josh, thank you. As you were talking about [indiscernible], this is my eighth year as CEO. The last one was a lot more fun than the first 6, and we've made a lot of progress. I was -- as it relates to our agency owners, they're never lost. They're a key component in that which we do and very vital to us. As we've talked about before, that it -- we did -- when we went through the homeowners refit and we had to refix homeowners, lean a little heavier on auto, we decided to, at the same time, go and strengthen the agency distribution force, do a whole bunch of things, and Matt can talk about what he's doing there. I would say that I am very proud of the work that our team has done to improve the relationships with them, help them be more successful and that is part of what's driving growth. It isn't just about not selling more homeowners -- or about selling more homeowners and not taking as much rate. That is, of course, part of it. But it's also about getting the system position. And so we have that kind of period of time for a couple of years where we have to kind of regroup, build our foundation and they've taken it to a new level. So, Matt, maybe you want to talk about how you feel about agencies, what their investing in and how it's driving growth.

Matthew E. Winter
President and President of Allstate Insurance Company

Thanks for the question, Josh. I love getting questions about agency owner and distribution. It's, I think, one of our core strengths as a company and one of our competitive advantages. We get a lot of work on reengaging the agency system. As you mentioned, we had a tough transitional period. We had to do some hard work as a company to change and improve the productivity and efficiency of the agencies. Some of that involve compensation changes to shift towards more variable compensation, to spur and incent growth and give them a reason to take a leap of faith and invest in their agencies, even though, at that time, they were declining in size. And we had managed, through that new compensation program, to completely bend the line because they did take that leap of faith. They invested in their agencies. They hired licensed sales professionals. They increased their marketing. They invested in technology. They totally reengaged and, as a result, they are now growing items in force and their agencies are more valuable, our system is more valuable and we're thriving together. That brought together a bunch of work. It brought together technology work, marketing work, compensation work, workflow reengineering to make the products more intuitive to sell, a lot of great product work, and that has yielded a couple of tangible results. So I think on the last call, we mentioned that the agency relationships survey, which is a survey that measures their level of satisfaction and confidence in the system, is at an all-time high. If you see on Page 11 of the supp, and you'll see more detail in the 10-K when it's released, we're growing the number of agencies. And that trend was going down for several years and now it's increasing because we're adding points of distribution, and they, in fact, are adding additional licensed sales professionals. Our EA retention is significantly higher. The previous couple of years, we experienced retention rates that were at about 80%. In 2013, our EA retention was 92%. That means fewer of them are leaving the system, there's less disruption to our customers. It builds on itself. So all of these things, the momentum on the growth side, the momentum on new business side and retention, along with what I call sustainability metrics, which are the number of agencies and the productivity and efficiency in those agencies, should all work together to improve the overall growth of the system. So the short answer to your question is I think it's very structural. I don't think it's cyclical, and I don't think it's a short-term thing.

Daniel D. Farrell

Sterne Agee & Leach Inc., Research Division

That's really helpful, Matt. Just one other sort of question. Long-term, if you guys think about sort of 5 years, we're trying to think about what the Allstate of the future looks like, homeowners is -- arguably, maybe that's cyclical, maybe that's structural, it's a much more profitable business today, and you guys have shrunk your footprint by something approaching, gosh, maybe 30% in terms of PIF since 2005. The question is, is if you think bullishly, how big could you get that business in -- over some extended period of time? And then second, Esurance, you're still sort of getting your legs and -- but your investments, thus far, it's been kind of modest in terms of ad spend and, obviously, that's turning the corner. If you look forward 5 years, how material a part of this business do you think it may be?

Matthew E. Winter
President and President of Allstate Insurance Company

How material...

Jay Adam Cohen
BofA Merrill Lynch, Research Division

Would Esurance be as a function of the total Allstate franchise?

Thomas J. Wilson
Chairman & CEO

Well, I'd like them all to grow as fast as they could grow, so I'd take the same percentage in higher growth in total or I'll take higher percentages on either. But I think if you want to go, really, 5 years, I would start to think more about just telematics, connect to customer, the way in which we interact with our customers. We have a different approach to telematics. We're still developing it is. But telematics, of course, is our Drivewise and DriveSense. It does one thing, which is give better pricing, gives you the ability to do better pricing because you have more data about individual customers. Our offering, though, also is trying to enhance the customer value proposition. We haven't sorted out exactly what that means yet. But if you were to look over 5 years, I think you would find that the types of services, information and relationship we have with our customers will be stronger and more valuable to them and should enable us to grow. So I think you're -- really, in the next couple of years, you should see them to grow in what is economical. And as we think we have the skills, capabilities and performance to grow, I don't really want to talk about just homeowners or the other pieces.

Operator

Our next question is from Adam Klauber of William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

Just to follow-up on the auto, the standard auto loss ratio, looked like it did tick up a bit on the fourth quarter, as you mentioned. Is some of that just sort of an accident year true-up, just looking at the trends developed and you saw it and sort of caught up? And number two, you mentioned you're seeing modest pressure and severity. Also, looks like frequency is maybe normalizing. Could you talk about what you're seeing on the frequency side also?

Thomas J. Wilson
Chairman & CEO

Yes. So as I said, the tick-up that you're referring to, we just consider kind of some normal volatility. There is some embedded pressure on the severity side. I think frequency is relatively stable and it's performing well within the historical ranges. So there was a little PD uptick. But remember that 2012 was actually below the historical range. So we look at that, and there's nothing to be worried about. We looked at the new to renewal ratios, because as we're growing, we would expect some pressure on our frequency there. But actually, it hasn't emerged yet. The faster we grow, that becomes somewhat inevitable, but we're monitoring it closely and we'll stay out in front of it. And again, on the severity side, it's slightly elevated. You look at the 2-year average growth, though, on like PD paid severity, and it's fairly moderate. And so I think it's somewhat -- I know what you're trying to do. Everybody's trying to see whether or not a trend is emerging. And so you have to look at like the last 2 quarters or year-over-year. But we have to do that and balance it with what it looks like over a 2-year period, understanding that there's some volatility in there. And again, you're seeing it on a systemic basis, and we're trying to look at it on a very localized basis. We're able, I think, on a very localized basis, to distinguish better between what is just normal volatility and what's an emerging trend. And we jump on anything that looks like it's an emerging trend, and we wait out what looks like normal volatility.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay, that's helpful. And one follow-up. On the overall expense structure, I mean, the business historically ran closer to 25 and clearly, been edging up more in the 26s now. I mean, is the reality -- is it just more of an expensive business today than it was 5, 10 years ago?

Matthew E. Winter
President and President of Allstate Insurance Company

Adam, it's changed. I would say that you're right and you're absolutely correct in the percentages, but there's more money being spent today in marketing than there has been in the past. We are spending less money in certain categories. And in many categories, we cut cost to invest in other things. So if I look at total technology spend, we're spending a lot more money in technology and simplifying cutting expense out, which should lead to both improved customer experience and lower cost in the future. So it bounces around. We're always about, though, trying to reduce cost. This is a relatively thin margin business. It's low involvement business from a customer standpoint, so they don't like to pay for something if they don't have to. So we try to look at everything and say, "Will our customers pay for it?" So I think in terms of -- we don't have like a magic goal. I think the answer is how do you deliver the most value to customers and split your money up? So if we have to spend 0.5 point in expenses and we think that it gives us ability to charge another percent in average price, we'll do that, because -- and so we're not going to manage just the expense ratio as a way to grow the business. It's all about what the customer wants. But it shifts around a little bit. A lot more money in marketing these days. And then the mix changes with Esurance in there and you got to kind of break it out between Esurance -- really the 4 segments should stand on their own as it relates to expenses because that's what you're paying to deliver the service to that specific customer.

Operator

Our next question is from Brian Meredith of UBS.

Brian Robert Meredith
UBS Investment Bank, Research Division

I wondered, could you give us an update on Drivewise and how that's doing? And any plans for '14 to push that product, maybe more ad spend or something?

Thomas J. Wilson
Chairman & CEO

Yes, I will, Brian. And, Matt, I think this is the last call. I didn't realize we're having some -- getting good questions and we went a little over time, so I apologize to those of you who have other things to do. So yes, we have 2 offerings in the marketplace; Drivewise and DriveSense. First is the Allstate brand; the second is the Esurance brand. In the Allstate brand, we're over 300,000 units on the street today, and we stay connected in our offering versus some other offerings, where they take it back. Not everybody does. But there are 3 components to that which we're trying to do. One is, better pricing. It's every bit as powerful, I believe, as credit was when we got started. Second, it will be about enhancing the customer value proposition. And third is how do we use that data to help our customers do even more and pay less? So there's 3 components to it. We're -- we are -- we have what we call V 1.0 out in the marketplace today, which is the product I just mentioned that's in the cars. We are working on some other alternatives this year that we'll be investing a substantial amount of money in this year to test and decide how we want to take and grow that property. We call those affectionately 2.0, 3.0. And so we have a group of -- a team that's working on innovating there. We're connected with all the OEs on -- in terms of what they do. I think we'll probably end up with a different strategy for the OE market than the aftermarket. And, of course, the aftermarket is where most of our customers are. So that will start to roll out and we'll talk about it as we go through the year. But it is important to us, and we're spending lots of money on it.

Brian Robert Meredith
UBS Investment Bank, Research Division

Great. And then one other just quick one. Can you talk about what potential impact the ACA may have on your supplemental health business as we kind of look forward here and voluntary products going to those exchanges?

Thomas J. Wilson
Chairman & CEO

It's a relatively small impact on the business. There are some product things we have to change, but it won't -- it's not a meaningful item for us in that business or obviously, for the whole company.

So thank you, all. Last year, you saw us. We began to shift from improving returns to accelerating our strategy, which is, of course, to grow by providing differentiated value propositions to the 4 customer segments. We really are now positioned for growth. We've got a good, solid strategy. We've got brands, we got the business capabilities, we're executing well. We have the financial resources and, as importantly, we have a great team between our management team here and our agency owners. So we are positioned to both grow and continue to provide cash returns to our shareholders.

Thank you, all. I will talk to you next quarter.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect.