S&P Capital IQ

CONTENTS

The Allstate Corporation NYSE:ALL

FQ1 2016 Earnings Call Transcripts

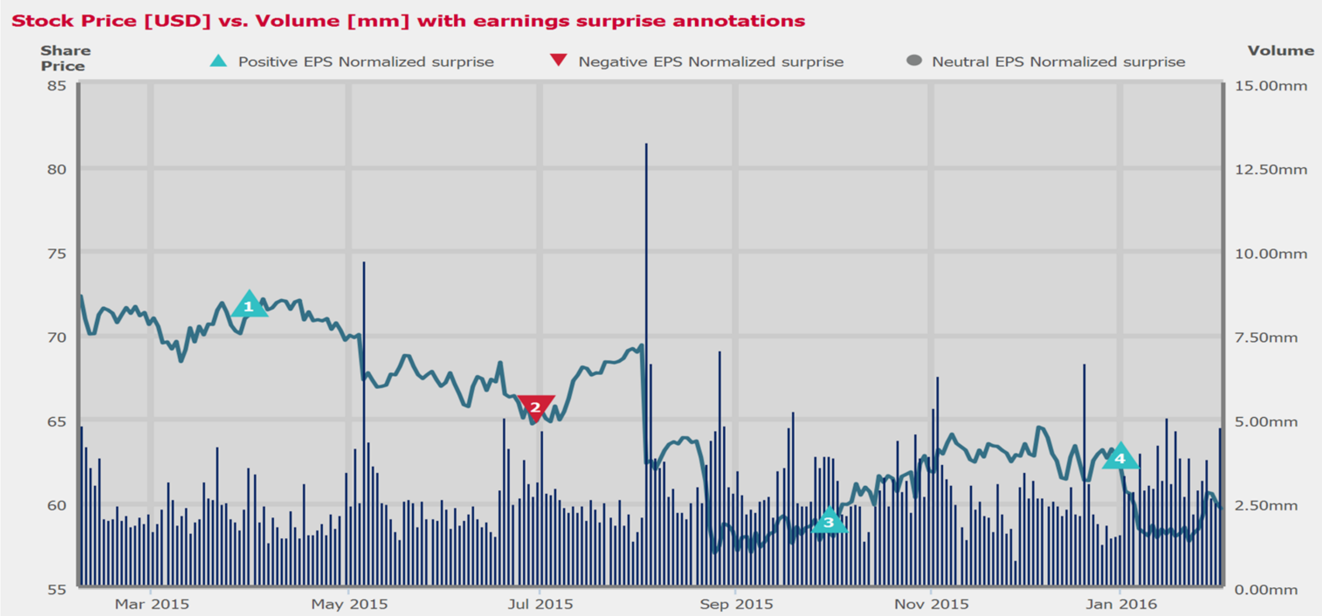
Thursday, May 05, 2016 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2016-			-FQ2 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.67	0.84	▲25.37	1.03	4.80	6.24
Revenue (mm)	7765.30	7723.00	▼(0.54 %)	7841.22	31458.10	32710.50

Currency: USD

Consensus as of May-05-2016 12:31 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2015	1.42	1.46	▲1 2.82 %
FQ2 2015	1.02	0.63	▼2 (38.24 %)
FQ3 2015	1.30	1.52	▲3 16.92 %
FQ4 2015	1.33	1.60	▲4 20.30 %

Call Participants

EXECUTIVES

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Presentation

Operator

Good day, ladies and gentlemen, and welcome to the Allstate First Quarter 2016 Earnings Conference Call. [Operator Instructions] As a reminder, today's program is being recorded. I would now like to introduce your host for today's program, Pat Macellaro, Vice President of Investor Relations. Please go ahead.

Patrick Macellaro

Thank you, Jonathan. Good morning, and thanks, everyone, for joining us today for Allstate's First Quarter 2016 Earnings Conference Call. After prepared remarks by our Chairman and CEO, Tom Wilson; Chief Financial Officer, Steve Shebik; and myself, we'll have a question-and-answer session.

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

As noted on the first slide, our discussion today will 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 2015, the slides and our most recent news release for information on potential risks.

Also, this discussion will contain some non-GAAP measures for which there are reconciliations in our news release and in our investors supplement.

As always, we'll be available to answer any follow-up questions you may have after the call. And now, I'll turn it over to Tom.

Thomas J. Wilson
Chairman & CEO

Well, good morning, We appreciate you taking the time to stay current on Allstate's operating results. This quarter shows, really why we're in business, which is to protect people when disaster strikes. Overall, operating profit is down largely because of 2 significant hailstorms in Texas in March. At the same time, good progress was made in improving the underlying combined ratio for auto insurance. And the homeowners business continued to generate margins that enable us to handle large catastrophe losses like we saw in March and still generated good return for shareholders.

So as you know, a severe weather creates a need for our customers to be protected, so increasing market these days, and Allstate does an excellent job of helping customers when these events happen.

In Texas, we have over 1,100 local agencies, many of whom are close to our customers that are impacted by these hailstorms so that they can help provide initial claim response. We also have about 1,200 specially trained catastrophe adjusters on the ground in Texas with the expertise, technology and relationships that enable our customers to rebuild after these storms.

If we go to Slide 2, I'll begin by reviewing the overall results and priorities and the Pat and Steve will discuss the results in greater detail. As always, Matt Winter, our President is here; as is Don Civgin, who leads the Emerging Businesses; and Sam Pilch, our Corporate Controller.

Net income for the quarter was $217 million and operating income was $322 million or $0.84 per share. The largest driver of the variance from last year's first quarter was catastrophe losses, which increased from -- by $533 million to $827 million. The underlying combined ratio was 87.2 as the auto profitability actions we've put in place for Allstate, Esurance and Encompass, all made progress in the first quarter from where we ended 2015.

Allstate brand homeowners insurance had a recorded combined ratio of 93.4 for the quarter, despite the significant catastrophe losses. The recorded combined ratio was 82.3 for the last 12 months.

From an investment perspective, we had what felt like a whole year of volatility in the first 3 months of the year and ended up with a 2% total return on the portfolio, reflecting 3 components: interest income for the fixed income portfolio; good returns from performance-based investments; and a decline in interest rates over the 3-month period. Total return over the last 12 months was only 1.3%, which reflected the low returns in the fixed income investments in the last 3 quarters of 2015, given the general uptrend in interest rates.

But net investment income declined 14%, as a result of our strategy to create additional shareholder value, by increasing performance-based investments, where risk-adjusted returns are higher or reported accounting income fluctuates in the short-term. 2/3 of the decline in investment income reflects the performance-based annualized yield of 9.4% in the first quarter of 2016 versus an outstanding 17.5% in the first quarter of 2015.

As a result of the underlying strength of Allstate's businesses, the board authorized a new $1.5 billion share repurchase program, which is an addition to the 10% dividend increase that was approved in February.

We also made progress on the 5 operating priorities established for 2016. Customers, of course, were at the heart of our strategy, and better serving them will create additional growth and profit. Our internal measures of overall customer satisfaction did deteriorated slightly as we raised auto insurance prices to reflect the increasing number in costs of auto accidents. That said, we made progress in some of the underlying drivers through expansion of continuous improvement programs and good expense control.

Overall, economic returns on capital improved as the auto profitability plan progresses, homeowners stay strong and we position the investment portfolio to align with our liability structure. While not the same as economic capital, the operating return on book equity was 10% for the last 12 months and it was 8% on a net income basis.

Growing the number of customer relationships also faced headwinds as we adapted to increasing costs of providing auto insurance. Profit liability items, of course, were comparable to a year ago, but were down from where we ended 2015. We did have great growth through Allstate benefits worksite business, which added over 0.5 million policies over the last 12 months. Steve will discuss how we proactively manage the investment portfolio. But progress was also made and expanded in telematics insurance offering, both in terms of customer offerings and the number of customers, and over 1 million active connections were amongst the leaders in the connected car space.

Let's go to Slide 3, which provide an overview of the first quarter operating results for our 4 Property-Liability customer segments. Starting at the top, overall Property-Liability policies, of course, were comparable to a year ago as a result of implementing auto profit improvement plans into all 3 underwritten brands. Net written premium still increased, however, as we raised average prices. The reported combined ratio was 98.4 and underlying combined ratio for the quarter was 87.2. We have not changed our full year guidance for the underlying combined ratio from 88 to 90.

Moving to the lower left for the Allstate brand. This is our largest segment comprising 90% of premiums written, and it serves customers who prefer branded product and value local advice and assistance. Allstate brand total policies in forth growth slowed in the first quarter to 0.4% -- that's from the prior year's quarter -- as a result our targeted actions to improve underlying auto profitability. Auto policies in force grew by 0.5% from the prior-year quarter, impacted by the slowdown in new business and a decline in retention. Auto written premium growth was 4.7% for the quarter, driven by the positive average premium growth of 4.8%, and as said, the impact of the rate increases continues to flow into results.

Homeowner policies grew over the prior year by 0.6%, the personal lines grew by 1.8%. Both slowing sequentially, given the impact of auto actions that had on customers who prefer to bundle their insurance products.

The Allstate brand underlying combined ratio was a strong 86.1 for the fourth quarter, as shown in the highlighted red box at the bottom.

Esurance, in lower right, serves customers that prefer a branded product for the comfortable handling their own insurance needs. A 1% decline in policies in force was more than offset by a 5.2% increase in average auto premium, so that the net written premium increased by 2.5%. As you know, we intentionally slowed the growth of Esurance last year to better position this business for long-term growth, since it was almost double the size it was when we acquired it in 2011.

The underlying loss ratio has come down to 73.1 in the first quarter of 2016, which is improved by 5.1 points compared to the first quarter of 2015. As a result, the underlying combined ratio declined to 105, which includes about 3.4 points of expenses related to a number of expansion efforts. We do expect to launch new advertising campaign for Esurance this year to accelerate growth.

Encompass, in the upper left, competes for customers that want local advice but are less concerned about the choice of insurance company. And they mostly purchase through independent agencies. We took aggressive action to improve profitability in both auto and homeowners insurance in 2015, and consequently, policies in force declined by 9.6% from a year ago. The underlying combined ratio was 88.3 for the first quarter, 2.3 points better than the prior year, but as you can see, the recorded combined ratio was 105.8, and that's because the Encompass' performance was also significantly impacted by catastrophe losses in the quarter.

Answer Financial, in the upper right, serves brand new to customers who are comfortable doing -- serving themselves, and that increased nonproprietary written premiums by 1.3% in the first quarter of 2016 to $151 million.

Pat will now go through the Property-Liability results in more detail.

Thomas J. Wilson
Chairman & CEO

Thanks, Tom. I'll begin with a review of our Property-Liability results on Slide 4. Beginning with the chart on the top of this page, Property-Liability earned premium of $7.7 billion in the first quarter of 2016 was 4% higher than same period of last year. Recorded combined ratio of 98.4 increased 4.7 points versus the first quarter of 2015, driven by the $827 million catastrophe losses Tom mentioned earlier, while the underlying combined ratio of 87.2 improved by 1.8 points.

Net investment income of $302 million for the Property-Lability segment decreased 15.6% from the prior-year quarter, driven by a decline in performance-based investment income, which had strong results in 2015. As a result, Property-Liability operating income in the first quarter was $291 million, which was $264 million lower than the first quarter of last year.

Chart on the lower left-hand side of this page shows Property-Lability net written premium and policy enforced growth rates. The red line represents policy in force growth versus the prior year and shows the policy growth was comparable to the prior-year quarter, given the actions in place across all 3 underwritten brands to improve auto returns. Blue line on this chart shows net written premium grew by 2.9% in the first quarter of 2016, as average premium continued to increase. Bottom right-hand side of this page shows the Property-Liability recorded and underlying combined ratio results.

Let's go first to the red line, which shows the recorded Property-Liability combined ratio in the first quarter of 2016 was 98.4. This was 4.7 points higher than the first quarter of 2015's result of 93.7 but included 6.7 more points in catastrophe losses. The underlying combined ratio was 87.2, shown by the blue bar, was 1.8 points below the first quarter of 2015.

Slide 5 provides an update on our comprehensive auto profit improvement plan, which is comprised of 4 parts. First, we're seeking approval for higher auto prices. In the first quarter, we received approval to increase rates by $335 million annually, which is on top of the $1.1 billion of increases approved last year, as you can see from the bar chart the lower left. The impact of these approvals on average premium for Allstate brand auto is shown on the lower right. Average gross premium per policy increased by 4.8% in the first quarter of 2016 compared to the first quarter of 2015. Average net earned premium per policy, which lags written, increased by 3.8%. Keep in mind, Allstate brand auto rate changes takes 6 months to be fully recognized in average gross written premium, while they take 12 months to full year net.

Secondly, we have tightened the underwriting guidelines in 2015 to reduce new business in underperforming segments. As we achieved target underwriting results, these guidelines were being modified.

Focus on claims operational excellence and precision is always a priority, but Allstate brand auto property damage severity increased 7.5% in the first quarter of 2016, which is the rate of increase we believe to be higher than what can be explained by inflationary increases. Continued stress on the auto repair industry from higher industry frequency, cost of repairing newer, more complex vehicles and higher total loss volume has caused steadily increasing claim severity. Our team is working to address these industry challenges and create a competitive advantage for Allstate.

Property liability expense ratio by 1.7 points in the first quarter of 2016 compared to the first quarter of 2015, reflecting lower marketing costs and expense reductions. Marketing was purposely reduced, given the rate and underlying actions we were implementing, providing the opportunity to enhance our marketing programs. New campaigns for both Allstate and Esurance will be launching later this year.

Slide 6 highlights the benefits of these profit improvement actions for Allstate brand auto and the continued strength of Allstate brand homeowners.

Chart on the top left of this page provides a view of the quarterly recorded and underlying combined ratios for Allstate brand auto. The underlying combined ratio of 95.9 in the first quarter of 2016 was 0.3 point higher than the first quarter a year ago, reflecting continued higher levels of accident frequency and higher severity. While property damage frequency in the first 3 months of 2016 moderated somewhat from prior quarters, still increased on a paid basis by over 2%.

As we've discussed, frequency is evaluated on a gross and paid basis for a variety of reasons, such as managing claims staffing, evaluating cost trends and estimating ultimate losses. To provide additional transparency into how these measures relate, we added a footnote to the investor supplement that isolates the impact that including fixed objects hit by a vehicle head-on gross frequency, which is likely larger than on a paid frequency basis. These types of changes were accounted for in our processes and had no impact on pricing or financial results.

Chart on the top right highlights drivers of Allstate brand auto underlying combined ratio. Annualized average earned premium per policy, shown by the blue line, continued to increase as crude rates result in a 4.7% increase in premiums written in the first quarter of 2016 compared to the first quarter a year ago. Average underlying losses and expenses per policy in the first quarter of 2016 increased by 0.1% compared with the first quarter of 2015, due to high frequency and severity, and was partially offset by lower expenses per policy.

The positive gap between these 2 trends widened in the first quarter, as earned premium growth outpace the increase in loss costs in the quarter. On a sequential basis, the underlying combined ratio improved by 1.7 points compared to fourth quarter of 2015, due mainly to improve loss ratio.

Allstate brand homeowners results are shown on the bottom of this page. On the bottom left, you can see the significant impact catastrophes had in the first quarter of 2016, given the gap between the blue column and the red line. On an underlying basis, continued favorable noncatastrophe frequency and severity and lower expenses resulted in a 59.4 underlying combined ratio in the quarter, which was 5.1 points lower than the prior year quarter. The components of the first quarter homeowners underlying combined ratio are in the chart on the bottom right. Average earned premium per policy increased to $1,091 or 2.2% over the prior year quarter, while underlying loss and expense per policy decreased by 5.8%. On a sequential basis, the underling combined ratio rose by 3.4 points from a very favorable 56 in the fourth quarter of 2015.

Slide 7 provides a view of the financial trends for both Esurance and Encompass. These charts on the top of this page show the component parts of the combined ratios for both brands. Esurance's recorded combined ratio of 106.2 in the first quarter of 2016 was 11.6 points lower than the same period a year ago, reflecting decreased marketing investment, along with a 4.4 point improvement in the loss ratio due to ongoing actions from improved auto returns. Encompass' recorded combined ratio of 105.8 in the first quarter of 2016 was adversely affected by catastrophe losses that were 7 points higher than the prior year quarter. The underlying combined ratio on Encompass of 88.3 was 2.3 points lower than the first quarter a year ago, result of ongoing underwriting and pricing changes to achieve target margins.

Charts on the bottom of this page show how growth is being impacted by profit improvement actions in both brands. In Esurance, policies declined by 1% compared to the first quarter of 2015, while net written premium grew by 2.5% compared to the same quarter a year ago. And Encompass net written premium declined by 6.7% in the first quarter of 2016 compared to the first quarter of 2015, as the 9.6% decline in policies in force more than offset higher average premium from increased rates.

Now I'll turn it over to Steve.

Steven E. Shebik
CFO & Executive VP

Thanks, Pat. Slide 8 provides overview of Allstate Financial's results for the first quarter of 2016. There are 3 main businesses in Allstate Financial with a total of 6 million policies outstanding: a life insurance business that provides products sold to Allstate Agency; Allstate Benefits, which provides life, disability and select health products of worksite; and an annuity business, which is largely close for new business. We began to reposition Allstate Financial in 2006, when we exited the variable annuity business, then accelerated the repositioning post the financial crisis in a low interest rate environment.

The bar chart on the upper left show how this has impacted the balance sheet over the last 4 years, with total reserves declining by $21 million due to exiting the broker-dealer and bank channels for deferred annuities and the sale of Lincoln Benefit Life.

Notice that the gray bar representing immediate annuity reserves has been relatively constant. Although these annuities begin paying out benefits immediately upon issuance, they have extremely long lives.

The current financial results are shown in the upper right. Premiums and contract charges increased 5.4% in the quarter versus the prior year, driven by 9.6% growth of Allstate Benefits and increase in traditional life insurance products. Net investment income declined to $419 million or 13.4%, as we saw long-duration fixed-income bond annuity portfolio in the third quarter of 2015. These sales harvested the gain on these bonds, given the decline in interest rates. The proceeds will be shifted over time to performance-based investments, which are expected to generate higher long-term returns. I will discuss this in more detail on the next slide.

Operating income was $104 million for the first quarter, reflecting the decline in investment income. As you can see from the chart on the bottom, the decline was concentrated in the annuity business.

Moving on to Slide 9, you can see the shift in investing allocation for the Allstate Financial portfolio. We have reduced investment-grade fixed income securities, shown in blue, from 68% to 60%. This increased on holdings of investments for asset-specific performance drives more return, such as limited partnerships and equities.

The shift to public equity and performance-based investments is expected to deliver increased long-term returns over time. The chart on the bottom left is based on historical return data from 1800 to 2015. On average, regardless of the time horizon, equities have historically outperformed fixed income, as you can see from the gray columns. On the right 2 columns in table, the risk is measured by the 99% loss levels, but fixed income is lower than net rate [ph] equities over a 1-year time period. By 10 years, the risk of loss is the same, but the returns are more than double.

As we can hold the investment back in the immediate annuity reserves for a long period of time, performance-based assets are expected to generate additional shareholder value. However, the challenge from a financial reporting perspective is that these returns fluctuate quarterly, impacting reported operating earnings.

The chart at the bottom right shows that while our performance-based long-term earned yield and returns fluctuate from quarter-to-quarter, the 10-year internal rate of written has traded consistently in a range of our long-term return target of above 10%.

On Slide 10, our GAAP total return on investment portfolio, shown at the upper left, was 2% for the first quarter. The investment income component of return has been fairly consistent, and valuations were positive in 2016, as fixed income marks increased on lower interest rates. The unrealized gain on the portfolio increased to about $2 billion, as you can see on the upper right. Overall, investment income of $731 million was 14% lower than the first quarter of 2015, but 2/3 of this decline reflects a good return from performance-based investments; 9.4% on annualized basis versus what was a great quarter a year ago. Investment income and yield by business segment are provided at the bottom of the slide. To the left is Property-Liability. We reduced our interest rate risk in this portfolio in 2013, and yield is now increasing, reflecting our increased allocation by high-yield bonds and performance-based, long-term investment.

As I noted earlier, we took actions last year to reduce interest rate risk in the Allstate Financial portfolio and began to increase performance-based investments backing the immediate annuity portfolio. While we realized capital gains, the shorter duration lowered the interest-bearing yield to 4.5% as shown by the black lines in the chart to the right. We are currently well-positioned to shift to performance-based investment as well as to extend the duration of our fixed income portfolio at the appropriate time.

Slide 11 provides overview of our capital strength and cash returns for the first quarter of 2016. Allstate remains in a position of financial strength and flexibility. We finished the first quarter of 2016 with $20.3 billion of shareholders equity and deployable holding company assets of $2.9 billion. During April 2016, we completed the $3 billion share repurchase authorization that was announced last year, and as Tom mentioned, our Board of Directors authorized a new $1.5 billion program yesterday to be completed no later than November 2017.

Generally, we fund our annual share repurchase activity with net income with any capital we need to retain to grow the business and pay our common dividend. Our repurchase activity has been enhanced over the past few years by a number of proactive capital and mismanagement actions. For example, the actions we undertook to strengthen the balance sheet by issuing hybrid security, deferred stock, enabled us to return capital in excess of net income over the past 3 years.

The sale of Lincoln Benefit Life in 2014 freed up an additional $1.2 billion of capital, which was also used to repurchase common shares. In the last 12 months, we repurchased 9% of outstanding shares, increasing pro rata ownership and earnings per share leverage. Since the beginning of 2010, we repurchased 36% of year-end 2009 outstanding common shares and have paid $2.8 billion in common dividends, representing a total $12.2 billion return of capital to common shareholders.
With that, I'll ask Jonathan to open up the line for your questions.

Question and Answer

Operator

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

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

I appreciate the chart you had in your presentation about the increase in average premium. In the Auto Profitability Measures slide, in your supplement, the loss ratio, it looks like it's stabilized. Nevertheless, I'm wondering when should we expect that to start improving in the context of your rate actions that you've implemented over the last year?

Thomas J. Wilson
Chairman & CEO

Good morning, Greg. This is Tom. As you know, and Pat mentioned that, it takes a while. So when we get a price approved, we obviously have to go through the regulators. And then once we do that, we have to program it in and start to roll that out to our customers, and those policies roll out over 6 months. And then, of course, it takes another 6 months before you get collected off. Matt can talk about the pace of change, but his team has been highly focused on this, and aggressive, making sure we are ahead of where the industry is going in terms of getting our pricing fixed, so that when they catch up with us, we'll have an opportunity to grow again at profitable levels.

Matthew E. Winter
President and President of Allstate Insurance Company

Greg, this is Matt. Thanks for the question. Everything that Tom just said is true, and that would be true if we were in a completely static environment, but we're not. So we're in a still-moving environment. So, we did see auto frequency moderate in the first quarter compared to the last half of 2015. And as a result, as you said, because of the rate taken, average earned have begun outpacing loss cost trends in the quarter. That's a really good thing. But we are questioning whether some of the moderation of frequency may have been due to weather in the first quarter. We don't know. But we're not sure exactly whether or not we've seen the rise -- the end of the rise in auto frequency, a stabilization or just normal fluctuation. So from that perspective, we continue to execute on our profit improvement plan. And we refine that profit improvement plan as time goes on and we get more information, greater clarity on the trend line, and that's true not only on frequency but it's true on severity as well. As you've seen, I'm sure you've looked at fourth quarter Fast Track, it showed a clear acceleration across the industry in PD and collision severity. That's due to total loss was up, higher cost to repair more complex cars, greater of number parts replaced, a whole host of different factors. Allstate has historically outperformed and industry in managing those cost. It looks like in first Quarter, we may have given up some of that advantage due to responding to high catastrophe load and increased frequency, but our goal is to get back to our competitive position there and lead the industry. But the end result of all of that is that we'll continue to execute all 4 components of the profit improvement plan, we'll continue to monitor the emergency of both frequencies and severity trends, and we will ensure that we are keeping pace with loss cost trends because we know that once you fall behind those, it's really hard due to the timing Tom to really have to catch up quickly.

Thomas J. Wilson
Chairman & CEO

Greg, sometimes people are trying to forecast a combine ratio by quarter. You could do that. Obviously, what Matt just said is what he has been executing on, which is we've made -- we're getting good returns in the auto business today, but we've gotten much more attractive return, given our competitive position, and we're headed to do that. You could do the math. You could look at the bottom left-hand chart. You could look at the $1.1 billion or the $300 million. You can forecast about what time you think it will come in. You can -- it's not complete dollars for dollar, but we have pretty high effectiveness on getting that through. And then you could look at just what happened to the frequency and severity. So you could -- what Matt was saying is like we're just at this -- we know we need to make more money in auto insurance, we made great progress, but we're not done yet.

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

Excellent color. Thank you. Just one follow-up. How should we think about the expense ratio over the next several quarters in the context of -- I guess, you've announced new advertising campaign, and it's clear that you've booked substantial improvement in the expense ratio for the last 3 quarters.

Thomas J. Wilson
Chairman & CEO

Well, we have. Obviously, we're always tried to make sure we watch expenses, whether that be our marketing expenses, our technology expenses or our general overhead expenses. And our team has a lot of work going on, on that third category. In market, you're right, it did come down. We took the opportunity. There's really no reason to continue to bang away and drop lots of money on advertising if your underwriting standards are tight and you don't really want to grow. Despite the fact that more people are shopping, one of the reasons we try to get out ahead of it is, with our brand and our marketing, we want to be open for business when other people are raising their rates so we pick up those shoppers. And so I think you should expect to see our expense ratio go up, but we're going to manage it to make sure we still get the combined ratio targets we're trying to get to. We did take this opportunity to refresh some of our programs and we feel good about what we're going to launch. But it's not like we want dark, either. I mean, we've been -- we advertise all the time, we look for folks. We have stuff going on. So it's not like we shut the place down, we just tackle in the back a little bit.

Operator

Our next question comes from the line of Ryan Tunis from Crédit Suisse.

Ryan James Tunis
Crédit Suisse AG, Research Division

Just a question, I guess, on capital management. $1.5 billion buyback, it sounds like over 5 for 6 quarters, with the common dividend, it doesn’t seem like it would quite add up to sort of what the Street's thinking of for overall operating earnings. Just curious if we are at a point now where you think about need to retain some capital to grow, whether it's through M&A or just organic growth. I know in the 10-K you mentioned your strategic priority is not to build and acquire long-term growth platforms, not just to build, so I'm curious if there's any M&A component to that.

Thomas J. Wilson
Chairman & CEO

Ryan, this is Tom. We have plenty of financial firepower to do whatever we need to do. Steve mentioned, our debt-to-capital ratio is lowest it's been, I think, since I've been here. I've been here over 20 years. And we are really in a strong position if we need to do anything. Steve mentioned that the thing that we had done historically -- so the last $3 billion program had over $1 billion in it from Lincoln Benefit Life. So I think what happens is sometimes the confusion is, people get the capital actions in the divestitures mixed up with how much we need to grow in that. And so we think this is the right amount of money, keeps the company really strong, and we have plenty of capacity to either grow our business; B, handle any kind of large catastrophes that might come our way, or, C, if we find something that's attractive to us; externally we would want to add to the portfolio, we can do that. As Steve -- I mean, went through the variance, was there anything else on the variance, how we got to $1.5 billion, you'll here more, Ryan? Or are you okay with that?

Ryan James Tunis
Crédit Suisse AG, Research Division

No, that sounds like it's just largely attributed to the deployment of access. That's fair. And I guess, my follow-up is just Esurance and how we should think about the road to profitability from here. Because for a while, it seemed like the story there was scale to top line and also improved your loss ratio. The loss ratio actually looks pretty good now, down here 73. But it doesn't look like it's growing and we're our like 105 combined. So just, I guess, what's the path to sub-100 combined ratio in Esurance?

Don Civgin
President of Emerging Businesses - Allstate Insurance Company

Ryan, it's Don Civgin. Let me just -- let me give you an overview on that. First, if you recall, we acquired Esurance for strategic reasons so that we could grow in the segment where customers wanted self-service and a branded experience. We have from the very beginning been running Esurance from an economic value basis as opposed to GAAP. So with the difference in accounting between the advertising being expensed to quarter you spend it, if you run it through GAAP combined ratio, it is power to drive it. So we've been looking at economic value. The businesses is twice the size it was roughly that we bought it. The GAAP numbers do matter, because it's going to be an increasing size of the Allstate portfolio. So they have spent the last, roughly, 2 years working to improve the performance of the business on a profitability basis. They've improved the loss ratio, but they've also had some operational catch-up because, while it's a direct business, it isn't all done online. We still have claims adjusters. We still have customers to take care of. We still have call centers. I'm really happy with the progress they have made. The combined ratio is in much better shape than it was a year ago. The number you're looking at, the underlying of 105, includes, as Tom mentioned, 3.4 points of investment in product expansion and geographic expansion that's not currently paying off in the current period. Underneath that, the loss ratio improved by over 4 points over last year, so very happy with where it is. You're right, it's still over 100, but out of that 105, I think you have to look and take that investment of 3.4 points out. And then there is still some room on the expenses for them to bring both advertising and nonadvertising expenses down. So I feel good about where they are. As far as the growth, yeah, they didn't grow this year but -- in the first quarter, but they also spent 36% less in the marketing. Now it's not a direct correlation, but they are running a better more effective business. And as Tom said, we're feeling good about where it is, and it is still our growth vehicle in that segment, but we needed to get some operational things sorted out first.

Operator

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

Joshua David Shanker
Deutsche Bank AG, Research Division

Two questions. One is, can we talk a little about your REIT in auto going forward and maybe touch on REIT need in Texas homeowners on top of that? And my second question relates to mass hitting about 2 or 3 quarters ago, but again well ahead of it. There is always this fourth quarter seasonality in losses that didn't happen at all last 4Q as we start discounting at the end of the year into our thoughts. Was that seasonality just a coincidence?

Matthew E. Winter
President and President of Allstate Insurance Company

Josh, it's Matt. I'll start with your first question about rates in auto going forward. You know that we don't disclose our rate plans for the year. We do disclose the fact that we have every intention of staying ahead of our loss cost trends. And as we wandered with others, we continue to take rate as necessary. We have robust rate plans. We revised, and amend and changed them on an almost ongoing basis as we watch the emergence of loss cost. The only thing I can tell you is that there is some public information about rate that has already been filed and approved so far this quarter. You're free to go and search out publicly available information, but I can't give you anything beyond that.

Joshua David Shanker
Deutsche Bank AG, Research Division

Can I just add onto that specifically, whether it's cat [ph] in Texas is a rate issue or whether it's just a volatility issue?

Matthew E. Winter
President and President of Allstate Insurance Company

Well, I'll answer it this way. As we look, we always have a cat load that we take into account as we're looking at rate need overall. We have to figure out what is normal volatility and normal catastrophe activity and when we are at a new norm. I mean, weather patterns are changing and nonmodeled cats are increasing due to global warming. We will and are continuing to look at that. And if we determine that this is a new norm, we will price appropriately for it. But that's a tough question, and I don't think that we will change something based upon a set of cats that took place over a 10-day period. So it will take more than that. But it's a good point that we have to look at whether or not we are in a new weather environment and in new cat environment. And if so haven't been yet, I guarantee you we will react to ensure that we are in economic risk-adjusted returns in Texas and every other state where we have cat exposure.

Joshua David Shanker
Deutsche Bank AG, Research Division

And seasonality of the loss ratio. Anything behind that? Or is that just a magical thing?

Matthew E. Winter
President and President of Allstate Insurance Company

Everybody has a theory on this one. I personally will tell you that we don't believe that there's any historical trend in seasonality that holds true all the time. There are generalities, but we -- last quarter was one of the warmest first quarters in the last 20 years. Things change and who knows what's going to happen in fourth quarter in terms of weather, in terms of catastrophes. And so I don't put that much credence into kind of seasonality predictions. I think they're informative. They help us plan for things, but there have been more exceptions to the rules lately than the rules.

Thomas J. Wilson
Chairman & CEO

John, let me just add one. So as Matt pointed out, he looks at and our team really focuses on homeowners by state -- in total -- as you saw numbers in total, by state and by territory, right? So it's broken down. What I would say is that severe losses like hail, straight-line winds or tornadoes do come through the pricing models faster then severe losses that are caused by hurricanes or earthquakes because of the longer-term nature of the actuarial science on that.

Operator

Our next question comes from the line of Josh Stirling from Sanford Bernstein.

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

Listen, I wanted to start with sort of, kind of a numbers question since I want to make sure I understand. So you said this quarter the weather appear to be light in auto and home and that's probably driving the frequency benefit. And so the headwind there would be that the future, maybe loss ratios, would sort of bounce back. But the upside from an investor perspective is that you're not going to slow raising price increases because you're not ready to declare victory and frequency yet. So that's sort of my first actuarial question. And my second related point. I am just looking at your BI severity, which has been negative for a couple of quarters, and I'm trying to understand what's driving that, whether it's the claims initiatives that you've been working through or if that's more environmental. And I'm trying to get to, do we actually think -- do we think that those favorable trends persist, and ultimately, if the underlying sort of net trend for auto maybe is going to be challenging from here?

Thomas J. Wilson
Chairman & CEO

Hey, Josh. So Matt will answer your question, but just -- we didn't say that favorable weather impacted first quarter results.

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

Okay. Excuse me, and thank you for correcting.

So I just wanted to clear. I'd like -- that it just did what it is

Matthew E. Winter
President and President of Allstate Insurance Company

Hey, Josh. It's Matt. First, I think your question is really about -- I think you referred to it as actuarial, but I think you were referring to whether or not if we have some uncertainty about some of the causal factors in gross frequency, whether that impacts our ability to price and take grade. Rate indications are out of paid, not out of gross, so -- and they're based upon your net trends and your indication. And we go to the regulators and the insurance departments with a robust actuarial package that shows net trends, current indications. And so most of that "uncertainty" about telling you what we think weather did to gross frequency trends last quarter, it is irrelevant to the pricing packages that we put together, which are based upon much more precise information. As far as the DI severity and why it's down, yes, you are correct. We did -- we have talked to you about our enhanced medical injury handling program. It's -- a part of that is an attempt to get through the DI cases quickly, especially those that have enhanced injuries. And so a lot of the decrease in DI severity that you saw last quarter was a mix issue, because we're paying a lot more current claims. The more current claims tend to be lower severity claims. That's one of the reason you'll see DI frequency up a little this quarter, because we handled a bunch more claims and we went through them. And so you always have that volatility and results in long-tail coverages and there's a lot of complexity in DI. So it's hard to look at DI paid severity on a quarter-by-quarter basis and make any sense out it. You have to look at it on the longer term basis and you have to look at it in conjunction with the frequency to see how much is in debt. Volatility is influenced by mix, and in this last quarter, we think a fair amount was influenced by mix. That being said, we think we're making good progress in managing DI severity appropriately.

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

So that's really helpful color. And I guess -- I mean, I don't want to put words in your mouth, but I think I'm to sort of synthesize what the net take would be from all of this, which is I think you're probably going to continue raising prices at more or less rate should have been because that's what -- because you're going to look through the severity thing as sort of mix-driven, and at the same time, the frequency you're going to rely on the paid data more than the gross.

Matthew E. Winter
President and President of Allstate Insurance Company

Well, that must be a Josh question because both Joshes have tried to get me to predict my rate-taking activity, which I tend to.

Thomas J. Wilson
Chairman & CEO

I think in the -- period after we continue to raise pricing. That's definitely it.

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

If I can ask you one then. So we've been happy to PIF growth has not gone negative in spite of the rate initiatives in sort of the core auto business. Is anything in particular you guys are doing to offset that? Or is this just more a function of the fact that you got such long sort of -- you got such a stickier customer relationships that you sort of have a inelastic book?

Thomas J. Wilson
Chairman & CEO

Well, I would point out, actually, our items imports were down this quarter from where we ended the year. So when you look at it sequentially, [indiscernible] But you could really have to -- we're down. We expect it to be down some. We're growing in other parts of the company, but this does have an impact on growth. We knew it was going to happen. We've managed through it. We've spent a bunch of time talking to our customers about policy changes and price increases. And so when you're doing that, you're not out trying to find new customer. So we're just working our way through it.

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

Jay H. Gelb
Barclays PLC, Research Division

On the Allstate brand homeowners business, the first quarter ex calculated combined ratio was slightly under 60%. That's a pretty big improvement year-over-year, but it was actually up relative to the fourth quarter. I'm trying to get a sense of whether you feel you can keep it at or below that 60% range?

Thomas J. Wilson
Chairman & CEO

When we started this, it really -- and you remember, Jay? I don't remember how many -- 4 or maybe 5, 6 years ago, we said we felt that the business needed to, with catastrophes over time, run in the low 80s. And then you can put in whatever kind of cap load you want. We're running there today. We're comfortable with it. The underlying bounces around we got from quarter to quarter. We did note in the fourth quarter that we thought that was a pretty low level, 56-and-change, because cap loads are typically not that high so that you need to be below 60%. So we're just trying to make sure we're competitive in the marketplace, give our customers a good return, handle the volatility. But because we handle that volatility, our shareholders get a good return, which based on required capital levels, we had initially meant in the lower part of the 80s. That said, because we've improved the profitability, we now need to keep less capital, and so we manage it as -- we manage this stuff dynamically and we're always looking at, what's the right return on capital by state, by territory and we adjust for it. So I think you should expect just to continue to deliver good risk-adjusted returns for our shareholders, given what we're willing to take out the volatility of quarters like this quarter.

Jay H. Gelb
Barclays PLC, Research Division

That's great. And then when I think about scenarios like we have with the Texas floods -- I'm sure if it's disclosable we'll hearing about in a couple of weeks. But in that type of scenario, is there a homeowners risk of loss there during a flood? Or is that really just more focused on auto comprehensive?

Thomas J. Wilson
Chairman & CEO

Well, I mean, obviously there is risk of loss because homeowners will lose stuff when the house floods. The government covers flood insurance. We do not. Are there things that could go along with that? Cars get flooded out, things like that, sure, but we factor all of that into our pricing. So the Texas floods largely would not be one of the big elements we view responsible for.

Jay H. Gelb
Barclays PLC, Research Division

That's what I thought. And then finally on the buyback, the $450 million that was done in the first quarter, I'm just trying to square your comments around that with regard to new authorization, which my sense is typically gets done earlier than it's outlined. But the $450 million, should we view that as a kind of a normalized quarterly run rate? Or is there perhaps some upside to that in terms of size?

Steven E. Shebik

CFO & Executive VP

So this is Steve. The $450 million is probably a little higher than what we were going to have as we go forward. That was based on the prior program. I think I've said before what we do is, we actually have outside parties perform the share buyback for us on the basis of a grid. And if you remember, earlier in the quarter, we were lower -- our stock prices went down a little bit, so we were at a lower part of the grid and we didn't buy back as much stock -- I'm sorry, buy back more stock because our prices went down a little bit, which caused us to do $450 million versus a somewhat lower number, which is why we ended the program in April versus a couple of months later.

Operator

Our next question comes from the line of Amit Kumar from Macquarie.

Amit Kumar
Macquarie Research

Two quick follow-up questions, if I may. The first, I guess, goes back to what Greg was asking about the loss cost trends. On the last call, you talked about competitors and spent more time on the industry. Recently, one of the larger companies had advanced development in their results. Does that sort of news -- did that lead you to maybe take a pause or sort of recalibrate the growth plans for 2016? Or did you just feel that, okay, this is others addressing the issues that we have addressed in the past?

Matthew E. Winter
President and President of Allstate Insurance Company

Amit, it's Matt. It's an interesting question, but let me be clear that we have an Allstate philosophy for both how we reserve, which is very conservatively. Somebody else's prior year development is really not that instructive for us. It's interesting. We look at it. It always provides context and information, but we have fairly precise ways that we approach this and that we ensure that we're reserved appropriately. And as I said when I answered Greg's, I think our level of detailed study as we determine where to take rate, how much rate to take, what the net trends are, what the indications are: number one, the level of thoroughness is shown up in our effectiveness in getting rate improved in each of the states; but two, it allows us to react to our information as opposed to others. Everybody is in a different place. Everybody is in a different place in terms of what their rate is, where their rate is, how much rate they need to take to respond to current trends. We saw at the beginning of last year very few people talking about any frequency or severity issues, and then later on, everybody talking about it. So everybody's timing appears to be different, and we're focused on our own book of business, our own trends and our own map.

Amit Kumar
Macquarie Research

Fair enough. The only other question I had was, going back to the discussion on expenses and the marketing campaign, did I understand this correctly? Is it just going back to the usual normalized level? Or is this sort of a reboot for Allstate and Esurance brands?

Thomas J. Wilson
Chairman & CEO

Well, what we were indicating is we're going to put some new creative out, that is incorporated into our marketing program, which is becoming more and more heavily digital as opposed to mass media. And so, therefore, we're constantly adjusting that one as well. We don't have an established percentage of premium that we say, this is what we want to spend. We do it the way both Don and Matt have mentioned, like, if we think we can write the business economically and it creates shareholder value, then we look at the cost per acquisition and we go out and do it. And we look at that with great precision, whether that comes through online stuff or whether it's through TV ads or radio ads. So what we're just trying to say is, as it relates to expenses, the marketing expenses are down. They were down intentionally, because we didn't really want to grow. And so now as we're coming through profit improvement plan on auto, we will want to go back to growing. It will take us some time to get there. So this is not going to happen in every state, in every market and every medium or every brand at the same pace. So I think you should expect to see our expense ratio increased a little bit as we go forward, but I don't think you should see it to be a dramatic spike.

Operator

Our next question comes from the line of Bob Glasspiegel from Janney.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

I really appreciate the disclosure in the bottom of Slide 8 on Allstate Life decomposition of earnings. And hopefully, we will get that prospectively and retroactively would be even better. As we think about the Allstate Life ROE progression, Matt, when he took over several years ago, the idea was to go into mortality, morbidity and cut back spread products, and that's played out well. And the hope was, even though you had some legacy drains in the annuity block that will run off over time, the higher-profit ROE will take charge to drive it forward. Now you had lower yields and some pressures. But where are we, Tom, on the ROE progression there? Can you take cap pull out of there going forward to help us well?

Thomas J. Wilson
Chairman & CEO

That's a good question, Bob. So as you pointed out, we've been working on improving the returns in that business for some time. We feel like we've made good progress. But the other thing I would say is, we look at ROE, but we really manage for shareholder value. So the items -- when you look at that lower right-hand inside to see what happened to annuities in terms of operating income, that hurt the current ROE. But we're okay with that. It hurt it for 2 reasons. One is, obviously, we harvested -- I think it was over $0.25 billion of gains and basically front-end loaded. What would have come through was operating income into the book value when we sold a bond, and now we're going to put it in longer-term investment, that obviously takes a while to get invested so you earn the -- as Steve pointed out, we like to try to get about 10% on that. So it takes a while to get that invested. And to actually get to 10% because it doesn't have them on day 1. Secondly, it also makes us put up more capital because, under the regulatory schemes, that -- when you're investing in performance-based investments, you put up more capital than you would put that in fixed income. We believe that's a good trade-in in our shareholders' best interest. So we're willing to take an ROE hit if we believe that it generates long-term shareholder value, which in the end is it turns out to be total return-based for that immediate annuity portfolio. So we continue to work hard and we've been taking capital out of Allstate Financial for, I don't know, Steve -- 3 years or something. So to the extent we can do that, to the extent we could use financing techniques in a variety of ways to do it, we continue to work on how do we raise the return on capital particularly as it relates to those annuity businesses. That said, we haven't come up with any, what I would call, synthetic approaches to do it. It's just been, we have got to work the money hard.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

My follow-up is a detour to commercial auto. You had a mild increase in reserves in the quarter. Where are you in that book pricing-wise and what drove the reserve increase?

Matthew E. Winter
President and President of Allstate Insurance Company

Bob, it's Matt. Yes, thanks for noticing. Yes, we did have some reserves strengthening. The vast majority of it was in commercial auto and then a little bit in pop [ph]. And it is the same drivers that existed on -- in all the other underwritten standard auto brands. It was frequency severity trends. And unfortunately, I don't think we were at the proper rate level when those hit, and so catching up takes a little longer, and we have to be more dramatic and you will -- you have seen that and you will continue to see that. So we're going to move aggressively to get that business to the point where it's really serving what I think could be a really unique strategic purpose. But in addition to brined in appropriate risk-adjusted return, this is a great marketplace for Allstate. A small business -- we are in Main Street, USA. We have a lot of our existing standard auto and homeowner customers owned, small businesses. We have natural connections and a national brand affinity. And my goal and our goal, the team's goal is to get the profitability at an appropriate level, get the returns where they should be and then deploy this as a strategic asset as part of our broader trusted adviser strategy to serve the full range of customers with their full range of needs.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

We've seen the commercial auto movie pull forward in the industry over the last several quarters. So the reserve increases have tended not to be cameo appearances, but I have got every confidence you'll get your arms around it.

Operator

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

Kai Pan
Morgan Stanley, Research Division

The first question is on the guidance. It looks like the first quarter 87 is below the 88, 99 full year guidance. And it looks like, maybe, auto book will continue to improve over the coming quarters. So what is holding you back?

Thomas J. Wilson
Chairman & CEO

It's a 12-month forecast, and we're 3 months in.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Okay. So I just wonder, is there any seasonality or maybe the property book is better than what you anticipated.

Thomas J. Wilson
Chairman & CEO

No, we've just always said it's 12-month forecast. We don't hold ourselves accountable for it. If you remember, last year, we were bumped along towards the top end of the range. We got to the third quarter; we thought we might end up outside the range, so we let everybody know that, and we had a great fourth quarter and came in below the range. So it's not and we see no need to update our outlook there.

Kai Pan
Morgan Stanley, Research Division

Okay, that's great. Then a bigger-picture question. You have million cars connected through telematics and we have seen, seemingly, a quickened pace in terms of technology advancements such as active safety as well autonomous driving, as well as the driving behavior like sheer mobility. For the auto industry, they tend to be sort of backward-looking using sort of actual table determining rates and the products. I just wonder how do you actively anticipate this technology changes that position your products and the market position?

Thomas J. Wilson
Chairman & CEO

Well, as you pointed out, we now have, I think it's 1,050,000-or-so people currently connected to us on a daily basis. We pull different kinds of information from them. That enables us to do a couple of things. Your expert ride enables us to price more accurately because when we are determining what would you charge somebody, we have put them into groups and ask really sort that out. In this case, we can basically put them into different groups because we know how you brake, what time you drive, and these variety of things that enable us to give customers more accurate price, and often times that's a lower price, more attractive price. With that we can also provide them the connectivity in the 1-hour a day they spend in their car is where we can add additional value for them. For example, today we have the safer you drive, the more rewards you get. If you can get safe-drive rewards, it gives you discounts and things. Our customers like that, It improves our value proposition from. And so that will develop over time. We have a slightly different model than some of the other people in the business who are doing it mostly for the more accurate pricing. So they can do a onetime shot of people and get a sense that ours is a different model. I am not declaring ours is the right one. I'm just saying, we're taking a slightly longer-term customer value look at that. We still have a lot of work to do to develop that, to build those relationships and figure out how to interact with our customers. So this will be a lot of workforce that has the potential to generate additional value for our shareholders, but we're investing heavily in doing that. Okay, well, first, this is maybe a summary here. This is the kind of quarter that the business is built for. We have to protect people from uncertain things like hail storms that happened to them. At the same time. our shareholders can handle the quarterly earnings volatility, and as a result of that get attractive returns. Secondly, we know how to run a property-casualty business, and that shows up the way we executed this year. Our investment portfolio is thought about on a risk-adjusted return basis. So we try to be thoughtful on both a short-term and long-term basis, and again, factoring in how we want to drive long-term value creation. And then the weather has gotten more volatile, which obviously is a growth opportunity for us, because to the extent people have more disasters, they need more coverage. And we need to get back to growth in our auto and other businesses, but we're having good growth, particularly in our benefits business this quarter.

So thank you for taking the time, and we'll talk to you next quarter.

Operator

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