Root (ROOT) / 7 Aug 24 / 2024 Q2 Earnings call transcript

Company Profile

Transcript menu

Matthew LaMalva	executive
Alexander Timm	executive
Megan Binkley	executive
Thomas Mcjoynt-Griffith	analyst
Yaron Kinar	analyst
Elyse Greenspan	analyst
Michael Ward	analyst

Operator

Print

Greetings, and welcome to Root, Inc.

Second Quarter 2024 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded. It is now my pleasure to introduce your host, Mr. Matt LaMalva, Head of Investor Relations. Thank you, Mr. LaMalva, you may begin now.

Matthew LaMalva

Thank you for joining us today. Root is hosting this call to discuss its second quarter 2024 earnings results. Participating on today's call are Alex Timm, Co-Founder and Chief Executive Officer; and Megan Binkley, Chief Financial Officer. Earlier today, Root issued a shareholder letter announcing its financial results.

While this call will reflect items discussed within that document, for more complete information about our financial performance, we also encourage you to read our second quarter 2024 Form 10-Q, which was filed with the Securities and Exchange Commission earlier today.

Before we begin, I want to remind you that matters discussed on today's call will include forward-looking statements related to our operating performance, financial goals and business outlook, which are based on management's current beliefs and assumptions. Please note that these forward-looking statements reflect our opinions as of the date of this call, and we undertake no obligation to revise this information as a result of new developments that may occur.

Forward-looking statements are subject to various risks, uncertainties and other factors that could cause our actual results to differ materially from those expected and described today.

In addition, we are subject to a number of risks that may significantly impact our business and financial results.

For a more detailed description of our risk factors, please review our most recent 10-K, 10-Q and shareholder letter. A replay of this conference call will be available on our website under the Investor Relations section. I would also like to remind you that during the call, we will discuss some non-GAAP measures while talking about Root's performance.

You can find reconciliations of those historical measures to the nearest comparable GAAP measures in our financial disclosures, all of which are posted on our website at ir.joinroot.com. I will now turn the call over to Alex Timm, Root's Co-Founder and CEO.

Alexander Timm

Thanks, Matt.

We continue to make strong progress in the quarter.

For the second consecutive quarter, we generated operating income and positive adjusted EBITDA. A testament to our powerful data science and technology, our culture of discipline and the talent and dedication of our team.

We continue to advance our near-term target of achieving profitability. From day 1, we've committed to providing drivers with car insurance that is transparent, easy to understand and at a great price.

Our technology empowers a delightful customer experience, while our proprietary algorithm allows us to offer lower prices to the best drivers.

Our laser-focused mindset on disciplined underwriting and stringent expense management has allowed us to build a strong foundation to significantly grow our business.

Importantly, we are growing smartly and profitably.

We are not chasing growth for the sake of growth. We're doing it while achieving some of the best loss ratios in the industry.

New writings during the quarter primarily came through our direct channel, where we target consumers with a great insurance product at a great price.

Our data science machine constantly monitors the competitive environment. And as we've noted before, during the quarter, we saw elevated competition.

Leveraging our proprietary data science machine, we were able to quickly adapt and deliver new business at our estimated return targets.

We expect to remain opportunistic through the back half of 2024 and growing the direct channel. Should we see an opportunity to grow faster while maintaining our unit economics, we will invest more in marketing to drive profitable growth. We believe there are material opportunities to expand our competitive advantage to additional data-rich channels.

As we do with everything, we will explore these channels in a disciplined, rigorous manner and quickly grow or [indiscernible] these experiments based on results.

Additionally, we continue to make excellent progress within our partnership channel where we meet consumers at contextually relevant times, such as the purchasing of a car.

Our technology provides partners a seamless integration into their existing platforms and creates a simple insurance purchasing experience in as little as 3 clicks. Compared to Q2 last year, we grew new writings in our partnership channel by 120%. With more than a dozen partners in the channel and a robust pipeline of additional opportunities, we believe we are well poised to continue to drive growth in this channel.

We are always working to lower prices for the right customers. We believe that through our machine learning and engineering advantages, we can become the best in the world of pricing and automation.

Our approach allows us to be flexible, fast and sophisticated. We delivered another successful quarter, achieving a gross loss ratio of 61.6%.

As our data sets grow and we continue to retrain our models, we believe we will continue to improve prices and fuel additional growth, [indiscernible] a sustainable competitive advantage.

As we look forward, we are excited to add more partners, expand our footprint nationally and continue to deliver better products at better prices to our customers.

Our team's determination to become the largest and most profitable personal lines carrier in the United States is stronger than ever, and we believe their hard work keeps us squarely on the path to profitability. I'll now turn the call over to Megan to discuss our operating results in more detail.

Megan Binkley

Thanks, Alex. We delivered another strong quarter in large part to our data advantages and disciplined underwriting.

We continue to drive loss ratios that are among the best in the industry.

For the second quarter, our net loss was $8 million, a 79% improvement year-over-year.

For the second consecutive quarter, we generated operating income and positive adjusted EBITDA. Operating income was $4 million and adjusted EBITDA was $12 million, improvements on a year-over-year basis of $29 million and $24 million, respectively.

Our progress continues to be driven primarily by growth in our net earned premium, consistently strong loss ratio performance, our closely managed fixed expense base and responsible deployment of marketing investments.

As we've consistently noted, we do not defer the majority of customer acquisition costs over the life of our customers, which leads to accelerated expense recognition relative to earned premium. We doubled new writing, policies in force, gross written premium and gross earned premiums compared to the second quarter of 2023. We achieved this growth while delivering a gross combined ratio of less than 100%, an 18-point improvement year-over-year. The gross accident period loss ratio was 62%, a 2-point improvement year-over-year, driven by our continued investment in data science and technology. In the second quarter of 2024, we ceded approximately 15% of our gross earned premiums and reduced the difference between our growth and net loss and LAE ratios to 2 points for the quarter, reflecting a reduction of 16 points year-over-year.

Our improvements in reinsurance costs were made possible through our continued improvement in underwriting results. Unencumbered capital as of June 30 stood at $447 million compared to $483 million as of March 31.

Our unencumbered capital consumption during the quarter included $16 million of capital contributions, which were used to fund growth in net written premiums and increased book value in our domestic insurance subsidiaries.

Additionally, as we noted on our prior call, we paid approximately $11 million in tax recoding obligations related to the vesting of equity awards in early April. This is a high-quality cost as it means that our market value has appreciated.

I'm pleased to report operating cash flow was positive for the fourth consecutive quarter, once again driven by our improvements in loss ratio and significantly reducing our net loss over time.

As we proceed through the back half of 2024, we remain focused on growing in a disciplined manner and maintaining our underwriting and expense rigor. We plan to continue to deploy direct marketing investments as long as targeted unit economics are achieved. Overall, we continue to make steady and strong progress towards our top priority of reaching GAAP profitability with our existing capital. We remain excited for the future. Appreciate your time and look forward to your questions.

Operator

Thank you.

We will now be conducting a question-and-answer session. [Operator Instructions] The first question comes from the line of Tommy McJoynt with KBW.

Thomas Mcjoynt-Griffith

You called out seeing competition increase in your various marketing channels. Do you think the competitive landscape is going to get sort of any easier over the coming years? It seems like competition is perhaps only going to intensify as more carriers reach rate adequacy on a market-by-market basis.

So how do you think about your go-to-market strategy given that customer acquisition could remain pretty competitive for an extended period of time here?

Alexander Timm

Thanks, Tommy. This is Alex.

As we said and as we sort of guided last quarter, we did see competition increase in the quarter. And as a result of that, our marketing machine reacted really exactly as design. And we continue to actually hit our target unit economics in the quarter. Quarter-to-date, we've been roughly holding this steady, and we're constantly monitoring the competitive environment. We -- again, we will not be chasing growth for growth's sake, and we are going to continue a rational and disciplined approach to deploying our capital. And if we see pockets of growth or opportunity to continue to deploy marketers, we're going to do that. And if we see competition increase, we'll pull back and continue to drive more towards profitability.

Over the long term, we believe that we actually have material opportunities for growth First and foremost and we have a very robust partnerships pipeline where we're continuing to build differentiated access to customers, scaling existing partners as well as so onboarding new partners, and that channel has continued to grow new writings and grew new rides 120% year-over-year.

Second, we are continuing to invest in state expansion. Right now, we're in 34 states, but we plan to be national. There's no reason our model shouldn't work on a national scale. Those 34 states represent about 75% of the addressable population. And as we add those states, we're going to naturally drive further growth.

And then third, you will see that we're investing in R&D into new marketing channels. And we're still in a very small corner of the marketing universe today when you look at all of the opportunities and all the different channels out there. And many of those channels, we have actually virtually no presence in. And we're going to continue to leverage the technology that we've built in our current performance marketing channels and our rich data-driven approach to really bring that learning machine into these new channels.

And so we think long term, there's ample opportunity for growth. But certainly, in the near term, we're going to monitor the competitive environment and react appropriately. And I think that's exactly that discipline is exactly what you saw from us this quarter, and it's what's pushing us towards profitability in the near term.

Thomas Mcjoynt-Griffith

Got it. I appreciate that. And just to make sure I heard you correctly.

You said that quarter-to-date in the, I guess, it'd be third quarter PIF remained steady and then if you could share some comments maybe anything on what you've seen in terms of like the turnover or sort of inverse, I guess, the retention rates of your book of business, perhaps over in the second quarter and then even quarter date would be helpful, too.

Alexander Timm

Yes. We've continued to grow PIF -- we continue to grow it in the quarter, and that's despite the new writings moderating from the competitive environment. And we continue to see a favorable retention profile in our partnerships channel. And as that grows, that is building a more higher retaining customer base. And again, we've built a model and an underwriting model that can really price business profitably and hit our target returns across all sorts of different retention profiles.

And so we feel good. We feel very good about where we are.

Operator

Next question comes from the line of Yaron Kinar with Jefferies.

Yaron Kinar

I guess my first question, just looking at the G&A and the tech development spend, I guess I thought it may see a little more operating leverage there.

So seeing the ratio of those line items versus direct premiums earned maybe coming down a bit more significantly. Can you maybe talk about that? And Alex, I think you may have mentioned something about some additional tech spend that you're undergoing right now as you're developing new products, but would love to understand that a little bit better.

Megan Binkley

Yaron, it's Megan. Excellent question.

As we entered into the second quarter, I mean, as we've finished second quarter, it really has been another quarter of strong results. And we're pleased with the progress that we've continued to make over the past few years to really rightsize our fixed expense base. And as we mentioned on our prior call, we're also strategically expanding headcount in pivotal areas.

So what you're seeing in terms of tech and dev and G&A increases in the quarter, that's primarily increased due to the modest investment that we've made in our product and in our people.

And this includes headcount investment really in our product delivery teams to make sure that we're continuing to advance our product and to support the tremendous growth that we've seen in the business, particularly on the tech and dev line item, we also saw about $1.5 million of accelerated amortization of certain internally developed software cost assets. That was all recognized in the second quarter.

We don't expect that, that acceleration is going to continue into the future. These were assets that were really unrelated to the core auto product and our technology there. That said, I do believe that our expense base is scalable even as we continue to invest in our people and our tech stack, and you should expect to see continued improvement in our operating expense ratios going forward.

Yaron Kinar

Okay. That's helpful. And then my second question, can you maybe talk about kind of the cadence of the PIF growth over the course of the quarter, namely, did you see the PIF start slowing more meaningfully as the quarter developed? Or was it more kind of a straight line? And maybe following up on Tommy's question, how are you seeing that develop into the third quarter as well?

Alexander Timm

Yes. We saw the typical seasonality, particularly that we see every year, which means you usually get more new writings obviously, in Q1 and really towards the front part of Q2. But really, we have been holding our PIF steady, and we're very happy with the strong growth year-to-date. We know that Q2 had seasonality, lower new writings versus Q1, and so that was anticipated. And we're still monitoring the competitive environment, making sure we're making the right decisions for the company and making sure that we're driving the company towards near-term profit. And again, like quarter-to-date, I wouldn't say there's been any material changes to that. We've really been holding our PIF study.

Yaron Kinar

Got it. If I could sneak one last one in on the marketing costs.

So I know you guys have talked about this repeatedly your expectation that marketing costs would go up as the year progresses and it sounds like they did indeed. That said, one of your large competitors hosted their call yesterday, it was talking about marketing cost or unit cost still being very, very attractive as far as they can see.

So I would be curious to hear your thoughts on kind of where we are in the overall cycle here for marketing unit cost? And is it still relatively attractive? Or do you see yourself needing to maybe pull back more as it becomes even more competitive?

Alexander Timm

I'd say, certainly, we've seen, as you've seen a lot of increase in marketing spend, you've certainly seen the competitive environment increase, which has made the environment more expensive to get a customer today than it was a year ago today when everybody was out of the market.

And so we have seen that. That said, we continue to acquire customers profitably and we continue to hit our expected return targets.

And so we do think there's ample opportunity out there to continue to grow the business and we also believe that there's many other marketing channels again that we aren't even in.

We are in a vast minority of the marketing channels today.

And there's no reason to believe that our competitive advantage we've built in those channels through our technology does not apply to additional channels and so you should see us continue to expand that. If we see as now you've mentioned it. If we see the industry or competitors sort of get too aggressive here and start to put too much money into some of these channels where they aren't sort of generating returns, you will see us pull back.

We will be disciplined, and we believe that the ability to be nimble and measure that in real time is actually one of our key competitive advantages and is a way to actually drive longer-term superior enterprise value. And that's why -- and you're going to see us stay true to that.

Operator

Thank you -- next question comes from the line of Elyse Greenspan with Wells Fargo.

Elyse Greenspan

My first question on the -- looking at the accident period loss ratio, right, in the low 60s in the quarter. How do you guys see that trending from here?

Alexander Timm

I'd say in the second quarter, we did see some storms, particularly, I think Colorado is where we probably had the most weather in there.

And so I think you had probably a couple of points or so of weather in that accident period loss ratio. There's also some storms in Texas. And that's pretty typical for Q2 and Q3, we are watching some of the weather events that's typically more where you would see hurricane exposure.

And so we're watching that and there might be some typical quarter-over-quarter seasonality there. But in general, we're very happy with where our loss ratio is. We're very comfortable with our rate adequacy.

And so we're not anticipating any major rate changes at this point.

Elyse Greenspan

Are you expecting, I guess, staying there for a second, you're not expecting any rate changes? Are you guys expecting declines? Or what do you foresee from the rate perspective from here?

Alexander Timm

Yes.

I think you may see in a handful of states, some moderate declines and decreases or some small changes.

And so we're going to continue to look at that on a market-by-market level.

We are very happy with where our rates are and you may see some declines in some states.

Elyse Greenspan

And then in the Q, right, you guys. There's a sentence that you talk about as our results improve, we can now evaluate our cost of capital and how to optimize our capital structure or maintaining appropriate regulatory capital levels.

So what are you, I guess, you guys considering from a capital perspective when you say that you're continuing to look to optimize the structure.

Megan Binkley

Elyse, it's Megan. I'm really glad you asked that question. I mean, capital efficiency and just looking at our cost of capital overall has been just a critical aspect of our strategy and will be moving forward.

So as we look at our underlying business results, you've seen just material improvement over the past few years. In second quarter, we posted our second consecutive quarter of operating income. And ultimately, we believe that our financing costs are a derivative of our underlying business results.

So we do expect that the improvement in our business results will translate to a lower cost of capital and more specifically, we expect to get better terms on our debt capital in the near future.

The prepayment penalty on our current debt facility expired in July. And as we sit here today, our goal is to materially reduce our financing costs, and we are actively looking at options to reduce our interest expense.

We will provide the market with additional details on what that means for the business as appropriate.

Operator

[Operator Instructions] next question comes from the line of Michael Ward with Citi.

Michael Ward

I was wondering if you could give us a sense of how your mix of coverage compares to maybe the industry in terms of providing comprehensive coverage. We saw some gaps in the quarter, especially in Colorado, where you have some concentration.

So we're trying to see if you're wondering if you saw hail losses or if your customers are not buying comprehensive?

Alexander Timm

We certainly saw hail losses in the quarter and in Colorado and so we did get a couple of points probably of weather. The Colorado hailstorms were actually, I think, the biggest weather event for us.

And so we certainly saw that.

I think in terms of the industry, you've got to basically compare, I would say, our customer base to other direct carriers.

So we are online, we are an online auto.

And so that's really the customer that we target. They tend to be between the age of 25 and 35, so they're a bit younger, more tech savvy, and we look to grow with that customer.

So we think we saw a good mix of coverages, and we did see some weather exposure, but at the same time, we think that it's appropriate for our customer base.

Michael Ward

And then wondering if you had a sense of, I guess, the percentage talking about some of the younger customers. How many of your customers download the root app and I guess, for some in the industry, it's all telematics, right, and others, it's just using the ID card. But curious if you have that data at all.

Alexander Timm

Yes. On our direct business, we have the vast majority of our customers do download the root app and receive some form or share some form of telematics data.

Some customers share a couple of weeks of data.

Some customers might share 2 months of data. And one of the things that's special about our technology and our technology platform is the ability to leverage, whether it's 2 weeks of data, 1 week of data, 2 months of data, the ability to actually ingest that and then predict and use it to create a very high fidelity prediction of what we believe future loss costs are going to be for that customer.

And so we believe we have a very high, particularly in the industry, maybe one of the highest, if not maybe the highest telematics adoption rate, particularly in our direct channel.

And so I would say it's the vast majority.

Operator

Thank you. There are no further questions at this time. This concludes today's teleconference.

You may disconnect your lines at this time. Thank you for your participation.