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The Allstate Corporation (ALL) CEO Tom Wilson on Q3 2019 Results- Earnings Call Transcript

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Q3: 10-29-19 Earnings Summary

Press Release *Slides*

EPS of $2.84 beats by $0.27 | Revenue of $9.09B (5.81% Y/Y) misses by $-49M

Earning Call Audio

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The Allstate Corporation (NYSE:ALL) Q3 2019 Earnings Conference Call October 30, 2019 9:30 AM ET

Company Participants

John Griek - Head of IR

Tom Wilson - Chair, President and CEO

Glenn Shapiro - President of Allstate Personal Lines

Mario Rizzo - EVP and CFO

Steve Shebik - Vice Chair of The Allstate Corporation

Conference Call Participants

Elyse Greenspan - Wells Fargo

Greg Peters - Raymond James

Yaron Kinar - Goldman Sachs

Jay Gelb - Barclays

Mike Zaremski - Credit Suisse

Crystal Lu - Autonomous Research

Josh Shanker - Deutsche Bank

Operator

Ladies and gentlemen, thank you for standing by and welcome to The Allstate Third Quarter 2019 Earnings Conference Call. At this time, all participants are in listen-only mode. After a speaker’s presentation there will be a question and answer session [Operator Instructions] As a reminder, today's program is being recorded.

And now I'd like to introduce your host for today's program, Mr. John Griek, Head of Investor Relations. Please go ahead, sir.

John Griek

Well, thank you, Jonathan. Good morning and welcome everyone to Allstate's third quarter 2019 earnings conference call. After prepared remarks, we will 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 and posted today's presentation on our website at allstateinvestors.com. Our management team is here to provide perspective on these results and discuss the strengths and leading competitive position of Allstate's homeowners insurance business.

As noted on the first slide of the presentation, our discussion will contain non-GAAP measures for which there are reconciliations in the news release and investor supplement and forward-looking statements about Allstate's operations. Allstate's results may differ materially from these statements. So please refer to our 10-K for 2018 and other public documents for information on potential risks.

Beginning in the fourth quarter of 2019, Allstate plans to announce catastrophe losses every month, removing the current $150 million reporting threshold. The enhancements to our catastrophe announcement process increases transparency for analysts and shareholders.

As many of you know, this will be my final earnings call as the leader of our Investor Relations team. As I've transitioned to a new role in our P&C finance area. I'm leaving Investor Relations in the capable hands of Mark Nogal, who will be a great partner for all of you going forward.

I'll now turn it over to Tom.

Tom Wilson

Well, good morning. Thank you for joining us to stay current on Allstate. Let's begin on Slide 2 with Allstate's strategy. So our strategy has two components increase personal property liability market share, and then expand into other protection businesses. Starting with the upper oval that the personal property liability market provides consumers, protection we insure their autos, their homes, motorcycles, boats, personal liability.

We use differentiated products, sophisticated pricing, claims expertise, and a building in integrated digital enterprise to lower costs, which I'm sure will come up later. We're also diversifying our businesses by expanding our protection offerings, and that's highlighted in the bottom oval.

Allstate offers customers a circle of protection. It's a wide range of products from Allstate life, workplace benefits, commercial insurance, roadside services, car warranties, protection plans and identity protection.

These growth platforms have extremely broad distribution, including major retailers, insurance brokers, work sites, auto dealers and manufacturers, telcos, and directly to consumers. They now comprise about 75% of our policies in force, although a much smaller percentage of our overall premiums.

We leverage the Allstate brand, customer base and capabilities, to drive growth in these businesses. Some of these businesses also support the property liability businesses. This strategy creates shareholder value through customer satisfaction, unit growth and attractive returns on capital. It also ensures that we have both sustainable profitability and a diversified business platform.

We move to Slide 3. Allstate strategy is delivering growth and attractive returns. Revenues exceeded $11 billion in the third quarter of 2019; Property Liability earned premium, which grew 5.6%. Strong operating capabilities enabled us to generate net income of $889 million in the quarter. Adjusted net income was $946 million or $2.84 per diluted share, as you can see in the bottom of the slide. Returns were also attracted with an adjusted net income return on equity of 14.2%.

We turn to Slide 4. We also did really well on all of our 2019 operating priorities. And we have five of those, as you know they focus on both near term performance and long-term value creation.

The first three priorities, better serve customers, grow the customer base, and achieve target returns on capital, are all intertwined to ensure profitable long-term growth. Customers were better served, as an - Enterprise Net Promoter Score improved. Property liability policies increased by 664,000 from the prior year quarter to 33.6 million, as the Allstate and Esurance brands grew 1.9% and 5.9% respectively.

Allstate protection plans which of course was formerly SquareTrade were at 89.8 million. Total policies in force now exceed 136 million, an increase of 40.7% compared to the prior year quarter. Returns remained excellent with most individual businesses performing well. The $89 billion investment portfolio had excellent total returns and generated $880 million net investment income in the quarter.

Shareholder value is also being created by building long-term growth platforms. We increased telematics usage in the property liability businesses, and that's supported by having industry leading insurance solutions from Arity.

Allstate protection plan is achieving the acquisition goals we established two years ago. And sales in Europe are growing. Allstate identity protection, which we acquired about a year ago is integrating its products into our customer value propositions.

Mario will now discuss our results by segment in more detail.

Mario Rizzo

Thanks, Tom. Moving to Slide 5, you can see that property liability results continue to reflect strong operating capabilities. Net written premium increased 5.8% in the third quarter, or $1.5 billion for the first nine months. This reflects policy growth in the Allstate and |Esurance brands and higher average premium for auto and homeowners insurance across all three underwritten brands.

As you can see in the middle of the left table, total policies in force, increased 2% to $33.6 million. Underwriting income of $737 million was substantially better than the prior year quarter, due to lower catastrophe losses.

Moving to the bottom of the table, the property liability recorded combined ratio of 91.6 was 2.3 points better than the prior year quarter, reflecting a planned improvement in the expense ratio, offsetting an increase in the non-catastrophe loss ratio. The underlying combined ratio, which excludes catastrophes and prior year reserve re-estimates was 85.0 through the first nine months of 2019.

Moving to the right hand table, Allstate brand auto and homeowners insurance net written premium increased 4.5% and 6.7% respectively, compared to the prior year quarter, due to increase policies in force and a higher average premium.

Esurance, auto insurance policy growth was 5.5%, which combined with average premium increases resulted in total net written premium growth of 8.3%. Encompass written premium increased 2.6% as higher average premium more than offset a small decline in policies in force.

On the bottom of the table, you can see that underlying combined ratios remain strong across our brands. Esurance reflects primarily auto insurance, which has a higher combined ratio than homeowners when catastrophes are excluded, Encompass on the other hand, reflects a 60:40 mix of auto and homeowners insurance premiums.

Let's go to Slide 6, which highlights investment performance which benefited from overall market returns and proactive risk and return management. The portfolio generated a strong 7.8% return over the last 12 months, of which 1.9% was in the third quarter.

Approximately half of this total return came from interest income on the fixed income investment portfolio and returns on the performance based portfolio. The remainder was due to portfolio appreciation, reflecting lower market yields and higher equity values. The chart at the bottom shows net investment income for the third quarter of $880 million, $36 million higher than the third quarter of 2018.

Market based investment income shown in blue, increased to $727 million from $683 million a year ago, reflecting investment at market yields above the portfolio yield. Performance based income, shown in grey, was $202 million in the third quarter. $12 million lower than the prior year quarter,

Slide 7 highlights results for Allstate life, benefits and annuities. Allstate life, shown on the left, generated adjusted net income of $44 million in the third quarter, $31 million lower than the prior year quarter. This is largely due to the write-down of deferred acquisition costs, driven by lower interest rates and model refinements in connection with the annual actuarial assumption review.

Excluding the impact of the non-cash unlock charge in both periods, adjusted net income was $86 million in the third quarter, an increase of $6 million, or 7.5% compared to the prior year quarter.

Allstate benefits adjusted net income was slightly lower than the prior year quarter, as higher premiums were more than offset by increased DAC amortization, driven by lower projected investment returns related to our annual actuarial review of assumptions. Excluding the impact of the noncash unlock charge in both periods adjusted net income was $32 million in the third quarter, an increase of $1 million or 3.2%

Unlock charge in both periods adjusted net income was $32 million in the third quarter, an increase of $1 million, or 3.2%, compared to the prior year quarter, primarily due to higher premiums. All state annuities on the right generated adjusted net income of $16 million in the quarter, which was $4 million lower than the third quarter of 2018, due to higher contract benefits and reduced investment income. Adjusted net income of $43 million for the first nine months was substantially below the prior year, reflecting lower performance based investment income in the first quarter of this year.

Let's turn to Slide 8. Service businesses continue to grow the number of consumers protected with policies in force increasing 67.7% to $95.9 million. This is largely due to Allstate protection plans. Revenues increased 27.1% to $418 million, as you can see from the lower left table, due to growth in Allstate protection plans and Allstate dealer services, as well as the acquisition of Allstate identity protection last year.

Revenues to the first nine months now exceed $1.2 billion. Adjusted net income was $8 million in the quarter shown in the lower right, a $7 million improvement over the prior year quarter, largely due to improved loss experience in Allstate protection plans and Allstate dealer services.

Slide 9, highlights the continued strength of our capital position and financial flexibility. In the third quarter, we issued $1.15 billion of 5.1% fixed rate non-cumulative perpetual preferred stock. The proceeds from this issuance were used to redeem $1.13 billion of fixed rate perpetual preferred stock with an average dividend yield of 6.54%. These actions will lower annual dividend costs by about $16 million.

We continue to deliver excellent returns to shareholders. In the third quarter of 2019, we returned $775 million to common shareholders through a combination of $166 million in common stock dividends and $609 million of share repurchases. We have repurchased 6.7% of common shares outstanding over the last 12 months. Book value per share is up over $9 over the last 12 months.

Now, I'll turn it over to Glenn, who will discuss our special topic of Allstate brand homeowners insurance and how we are positioned to generate industry leading returns while growing market share.

Glenn Shapiro

Thanks, Mario. Homeowner's insurance is a great business for Allstate, as you can see on Slide 10. Allstate is the second largest homeowners insurance in the United States with 6.6 million policies in force. We have written premium, $7.6 billion in the Allstate brand over $400 million in Encompass. And Esurance is also expanding into homeowners insurance, using Allstate's capabilities, and now it's over 100,000 policies in force.

A significant portion of our customers bundle home in auto, which improves retention, and overall economics of both product lines the key message on homeowners insurance as it generate substantial underwriting income and attractive returns on capital. To achieve these results, we target an underlying combined ratio in the low 60s to handle volatility that comes with catastrophe losses.

Since 2012, we've generated over $1 billion of underwriting income on average annually, including catastrophe losses. As a result, returns on economic capital are in the mid to high teens. This profitability also provides diversification to auto insurance profitability.

The graph at the bottom of the page shows homeowners insurance combined ratios for Allstate and the industry since 2012. As you can see, Allstate has consistently outperformed the industry. The results is that we've earned over half of the industry-wide underwriting income in that period.

Turning to Slide 11. Allstate optimizes returns through sophisticated portfolio management. We've improved returns and decreased homeowners insurance volatility through advanced catastrophe modeling, geographic diversification of business and strategic use of reinsurance. Our spread of the business across the country works to our advantage by providing a significant diversification benefit as timing, type and magnitude of weather events differ based on geography.

As you could see on the U.S. map, we have a top three market share in 20 states which are shown in green, but much lower shares in states like California and Florida prone to catastrophes like wildfire, earthquakes and hurricanes.

We take a proactive approach to managing our exposure to different types of risks. We substantially reduced our exposure in California to earthquakes by helping establish the California Earthquake Authority in 1996. And we've decreased our underwritten policies in force there in the last decade.

In Florida, we reduced our market share from about 10% in 2003, to less than 2% today. We also helped shape the Florida hurricane catastrophe fund, which provides reinsurance. And we use a separately capitalized company there, Castle Key and process external reinsurance. The overall objective is to meet customer protection needs while optimizing shareholder risk and return.

We underwrite risk directly where we can achieve target returns. We also broke a nearly $1.4 billion of other insurance property policies. This allows us to meet our customer protection needs, leverage our distribution strength with more customers, bundle additional Allstate products, but not directly right risks outside of our underwriting appetite.

In total, we manage our portfolio of states to target a combined ratio that generates attractive returns. For new competitors in homeowners insurance, the state level – profit dynamic makes it difficult to them to achieve the same level of overall profitability or have the resources to expand.

We shift an extensive amount of catastrophe risk to reinsurance markets which reduces our capital requirements, and protects annual returns. The reinsurance program covers individual large events, utilizing traditional reinsurance and alternative capital. The current nationwide reinsurance program provides over $4.3 billion of limits above a $500 million retention for any single event.

We also use an aggregate cover in case there are multiple events below $500 million. This provides additional protection in case the accumulation of those events throughout the year exceeds $3.5 billion.

Moving to Slide 12. We're not standing still and we're constantly innovating in this space. We're focused on customer value and ease of doing business to accelerate growth. We streamline the homeowner quoting process by using both proprietary and third-party data sources to increase efficiency and accuracy.

Using this information, we've reduced the number of questions asked in the quoting process from over 40 to just three when bundling homeowners and auto insurance together. In many cases, after our quote is complete and we bind coverage, there's an inspection of the home.

Technology, such as aerial imagery and predictive modeling has enhanced the speed and efficiency of those inspections and lowered our expenses. We continue to enhance the design of our homeowner’s product while increasing our pricing sophistication.

Our homeowner’s product house and home is better able to address severe weather risks and unique customer needs. For example, the product includes a graduated roof coverage schedule, though it still provides the ability for customers to – purchase full replacement if they choose.

House and home now represents 90% of our new business and about 45% of our total policies in force. The pricing of house and home is more sophisticated than traditional homeowner’s insurance products with more occupant and residents characteristics.

We've also improved the efficiency and effectiveness of our claims handling through technology and innovation. We leverage our scale, data, and analytics, to rapidly deploying more than 700 full time catastrophe resources to quickly help customers when they need it most, while mitigating damage and managing costs.

We use aerial imagery to improve our efficiency and customer experience. We've expanded virtual claim handling capabilities, including the use of drones, airplanes and satellites, so that now nearly 70% of all wind and hail claims have some aspect of the claim handled virtually compared to less than 10% in 2017.

The bottom line is Allstate has a significant competitive advantage in homeowners insurance. We'll continue to leverage our scale, pricing sophistication risk management, distribution system and claims capabilities to deliver industry leading returns and market share gains.

We'll now open the line for your questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question comes from the line of Elyse Greenspan from Wells Fargo. Your question please?

Elyse Greenspan

My first question, I wanted to spend some time on the expense ratio and property liability. It's been low now for a couple of quarters and I know last quarter, you guys had pointed to a combination of improvement in processes, automation, as well as incentive comp is driving down the second quarter expense ratio.

You could just give us a sense if it's kind of the similar components that drove down the ratio in the third quarter, and just how we should think about modeling through that expense level going forward?

Glenn Shapiro

Yes thanks Elyse, it’s Glenn, We're definitely focused on improving expenses. We've been faster this and going after it hard. I mentioned a few of the examples last quarter where, we've been able to reduce customer inquiry calls, which is a win-win, because it's better customer experience, because we've eliminated the need for those calls on the front end, but it also is more efficient on the back end.

I mentioned in special topic there some of the aerial imagery and data analytics we're using in both claims and to reduce inspection. So we've gone after some real tangible ways we can manage expense. As with any quarter there is a mix of things in there. So similar to last quarter, there is some components to compensation, some components of marketing, some components of sustainable improvements in the baseline of that.

But, we've made some real tangible improvements that we will sustain and we're going after expenses in a real way, because we think it's a path towards growth where we can, maintain margins.

Elyse Greenspan

Can you breakdown give a little bit of color on what might be in a sustainable bucket versus maybe, what was kind of one-time in nature in this quarter and the expense level?

Glenn Shapiro

I don't know that there was a lot of one-time in this. So we've got, where it is sustainable. It says operational improvements, which is, a meaningful chunk of the change that we've got. When you look at some of the compensation components, we've managed, both are, employee compensation and agency compensation over time and you reset every year with a new program.

So there's a little bit of benefit in there from that, that we were short to our growth aspirations in the year but otherwise we've got sustainable, expensive prudence in here.

Tom Wilson

Elyse one place this time, one place, we would like, this quarter was marketing, which we will dial up as we talked about last quarter, we're dialing out there, there's some select markets where we know that we can generate economic growth. That said, that won't change the overall trend line of expensive should be coming down over time. But you know, every quarter is new quarter so.

Elyse Greenspan

And then my second question on, we've seen some of your peers that have seen higher bodily injury severity trends within their auto book of business, or just could you just give us an update on what you're seeing on the BI severity side and just - if you've seen any pockets where trend is pick up in the U.S.?

Tom Wilson

Let me give you, first we can't comment on everybody else's numbers because, as in bodily injury, those are long data claims it takes three, four years to really get them paid out depending, the little ones get closed early, the big ones get closed late. So you always have some bounce of mix in the paid BI that you have to get underneath. That said, we feel good about where overall bodily injury reserves are set and our trends Glenn can talk about the pay trend.

Glenn Shapiro

Yes, so we feel good about where we are in bodily injuries we put in the Q, you know we’re running around medical inflation. As Tom mentioned on the reserving, it's all in the numbers I think would be a headline there because in our reserving actuaries so talented folks, they work very closely with our claims team, our underwriters, our product organization, they all work together to ensure that we have, the right reserves on the book.

And if you look at the trends over time, we've had, a lot more favorable development and unfavorable development through the years, which is, good, bellwether for you to look at in terms of our overall trends.

Operator

Our next question comes from the line of Greg Peters from Raymond James. Your question please.

Greg Peters

My first question, I'd like to revisit of how your guidance is going to look for 2020. John I know you mentioned in your prepared remarks that they're going to start disclosing monthly cat loss numbers. I also remember from a previous presentation that you said you were going to shift from an underlying combine ratio target to a target return sort of guidance. And just wondering if this is a trailing ROE target, do you plan to adjust it for changes in interest rates, et cetera just looking for some color there?

John Griek

Well Greg thanks for the question. We love the fact that you are paying attention to what we say makes real good. The monthly cat numbers it's just a clean up what people are like, is it above 150 what if it's 149 we felt like it was confusing stuff. So we're just put out monthly you can do what you people, everyone is got different things they use it for. So just to make your lives easier and that's more transparent.

As it relates to the return on equity as we're replacing the annual underwriting - underlying combined ratio guidance with longer term ROE goals. ROE is a better measure of the overall business results because it includes first includes our businesses and includes investment incomes and ties directly to reported results which includes catastrophes.

The underlying combined ratio of course, only reflects their property liability businesses, and it excludes catastrophes which bounce around a lot from quarter-to-quarter and year-to-year. But on a long-term basis as a management team we're accountable for making sure that we get a good return on homeowners with catastrophes included it because that's the risk our shareholders take.

So, what we're going to do when we report full year 2019 results is give you what we think a long-term ranges on return on equity and debt management should be held accountable to.

Greg Peters

What do you define as long range and is this adjusted earnings that it's on?

John Griek

Yes, it will be on adjusted earnings just because the accounting - as we move to fair value accounting the book value and reported income bounces around a lot with equity investment. So we feel like adjusted net income return on equity is a better measure of what we want to do. Long-term would be sort of what do you expect to do over two to three years but the goal really is to get people focused and our shareholders focus on what's the overall return we're generating and the capital you have and focus on the overall side of the business, as opposed to just one component.

And while auto insurance and homeowners insurance are extremely important to our business, so we are not the only thing we got going, and that the only thing we should be held accountable to. So ROE is just a much better measure under which you can judge how well you think we're doing as a team.

Greg Peters

Great, thank you for that answer. My second question is, I just a follow-up on the expense. I noted from the Page 9 of your supplement that your agency count was up, year-over-year and sequentially, and your license sales professional account was up, year-over-year and sequentially. And I'm trying to reconcile this with the fact that you're not reporting any restructuring charges, which is unusual, considering the improvement you've realized

And then secondly, on previous call Glenn has mentioned something along the lines of an integrated services platform, and so the numbers are kind of moving contrary to what I think that would be. So maybe you can provide some additional color there?

Tom Wilson

Well let me deal with some components, Glenn can talk about what we're doing with our agency platform to make it more effective and efficient, including things like integrated service and what we're doing in compensation to drive that growth. As it relates to restructuring, we do end up with some little minor restructuring charges that go through there in the Q someplace, but they're not big numbers.

As we move forward, as we move through integrate digital enterprise we just record what we think we have to record under the rules. If it means, we have, headcount go down because we're using integrated digital enterprise and we have to record a charge that we do it. But we don't feel like there is one big bucket that's needed at this point, that we then carve it out and don't come back and hold ourselves accountable for because it's some other charts in place.

Glenn Shapiro

So yes, thanks for the question Greg and as Tom said you’re definitely paying attention to the details in there. So if you look at the agent council start with that, some of that it’s a reflection of, the investment folks are willing to make in the business based on the opportunity, and there's good opportunity with Allstate. And we are, we're growing items and we're profitable and been successful.

So, agents are putting their nickel down, these are small business owners who are opening up a shop and going out and selling product and serving the needs of consumers. In terms of the license sales professional that's reflective of their hiring, they're doing mostly on the sales side of that.

Now that said, I'll mention as Tom said, a compensation component leading into next year, as well as the integrated service that you brought up. From a compensation standpoint, we're leaning more of the compensation towards new business production. We're interested in growing so as we increase marketing, we've improved our expense we'd be more effective and cost effective for customers and we

-- be more effective and cost-effective for customers. And we lean more into new business production in terms of the compensation as we shift that in that direction. We think that's a good system wide approach to go drive growth.

In terms of integrated service, we have talked about it before. It's in the early stages. It's a big system. We have 40,000 people in that agency system, when you take the agents and all of their employees, licensed and unlicensed, sales and service.

So today we do that service in a decentralized way. A lot of the service is done in individual offices, which you're not scaling, is not ultimately going to be as cost effective as you can do it in a more scaled way.

So we built an integrated service model. We're doing that with - we're getting into hundreds of agents, not thousands of agents, at this point. So, from a scale perspective, you wouldn't see it showing up in the numbers that you looked at there at this point.

Tom Wilson

And Greg, just the change in agency compensation, we don't expect to raise overall compensation as a percentage of premiums.

Glenn Shapiro

Correct. Yes, it was a shift.

Operator

Our next question comes from the line of Yaron Kinar from Goldman Sachs. Your question, please?

Yaron Kinar

Can you talk about the increase in property damage frequency and Allstate brand auto this quarter? And are you guys sort of just little surprised to see that given the more recent trends?

Glenn Shapiro

So first of all, I always like to go back to the overall profitability of auto, and we're doing very well. They're 92 combined ratio, some of that is the expenses and I'll come back to sort of some of the intentionality there.

Frequency, first of all, it's hard to predict. You can't predict what is going to happen in the next year, next quarter, but you can understand the trends and where things are moving. So miles driven, we're up. We saw some change in what had been a declining trend to frequency.

That said, it was a little bit mixed. So I'll point you to a few different numbers. Gross frequency was up two points, as you pointed out. But paid frequency, which on a short-term tail line tends to be pretty accurate, was flat. And BI frequency was slightly down.

So I look at the overall frequency picture and say: It's kind of a mixed story in there and something that we're keeping a close eye on.

Now you go a level below that, and at a local level, every state manager is out there looking at their competitiveness, their trends, their frequency, their severity in every state. And we're managing that profitability at that local level. So that's what rolls up into a really favorable return, as we've delivered.

And then lastly on expenses, I want to keep going back to that because part of the reason or the main reason you go after expenses the way we are is actually allows you to let the loss ratio float up and deliver the same return. And that's what it looks like in our ratios when you're giving back more value to the customers.

Yaron Kinar

And then the second question going to homeowners, also saw an increase in severity there. I guess just given the amount of pricing that the companies has pushed through over the last year, I was still surprised to see the deterioration, actually your loss ratio from a pretty weak prior year quarter to begin with, even when that increase in severity.

So can you maybe talk about that dynamic of maybe where the severity has come from and why the price increases we've seen to date have not been sufficient to offset it?

Tom Wilson

Homeowners is one of those businesses where it's really difficult to look at it by quarter, what happens with severity. Because it's obviously impacted by weather, sometimes its cats, sometimes it's not a cat.

And so you have to really look it on kind of a rolling 12-month basis. And when you look at our business, it's got great returns. We feel really good about it. If you look at the average premium, it's way up. And when you go underneath that, and as Glen said, we'd like to segment this down, then we segment it by state, we segment it by coverage.

And in homeowners, depending what kind of loss you have, it changes your paid severity a lot. And again, those tend to be relatively short tail line. But so a fire loss has a much different severity if the house burns, then obviously if somebody runs into the garage door, or hail damage can tend to be much more expensive because it could take out a whole roof than some leaky pipes.

So it really depends. The mix drives a lot of it. Theft is not as big as water damage. So, what I would say is Glenn's comments on this special topic, we feel really good by homeowners. Like, it's a really good business, making really good money, much better.

And I want to just underline what I said. With a 9% share of the market, we've captured half of the overall profits generated in homeowners in the industry. So we feel like that's indicative of good operating expertise and capabilities.

Operator

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

Jay Gelb

My first question was on commercial auto and the ride sharing agreement with the major providers there. One other competitor in that market has had some issues negatively. So just wanted to understand how Allstate is going to position that business?

Steve Shebik

So let me start off and say, that we call it a shared economy business, so it's not just lunch share and car sharing. We look more broadly. And so obviously you've focused on the largest customer we have, but we have a handful of others that we're building an entire team to have knowledge all around that.

Obviously, we are well aware of other competitors in the industry. And the particular competitor you talked about, strengthened their reserves in the 2016 and 2017 year when the industry was kind of early in development.

We started last year, and if you remember, I think in prior calls I've talked about how we triangulated our loss reserves on the basis of the prior history that was provided by the transition network company that we used our own internal, both personal lines and commercial auto experience.

And we've also looked at industry experience and our telematics type of information that we get – we're just at state level. Because remember, we have 15 States we're insuring, not the entire country.

So we're comfortable with where we're sitting. We're still recording essentially at the priced amount for the reserves, primarily because the vast majority of the coverage is the long tail coverages. So it's still early, 19-months since that first month. I think long tail coverages historically take longer than [indiscernible]. It's still coming along through us.

We look at it every quarter. As you may remember, independently, our reserves are reviewed and set by a team that works in claim reserve, looking for Mario and not for me.

So we had different eyes on it from our actual department, from our financial department, obviously in the business too so. [indiscernible]. Does that answer your question?

Jay Gelb

It does, it does. And then on a separate topic, thinking about the underlying combined ratio in the protection business - the underlying loss ratio, excuse me. Having that show an increase year-over-year, my sense is some investors are a little concerned about what's going on in terms of price competition in auto and then also the potential for claims inflation to increase.

So can you just remind us how Allstate is managing that issue to restrain underlying loss ratio deterioration?

Mario Rizzo

Yes, Jay, let me provide some overall context and Glenn can jump in on the relationship between expenses and loss ratio. So, first, as you know, our auto insurance has largest product line.

It comprises about 65% of our total premiums and it's obviously an important lead line as well because it helps us expand into the homeowner's insurance business, which is also highly profitable.

So it's a really important question: Are you going to maintain your profitability on auto insurance so you can keep growing it? But before we go into the specifics on expenses and loss ratios, let me just talk about principles for a minute and a little bit of our history.

So we have some guiding principles on our growth. First, we only want to grow when we get a good return for our shareholders. I mean, it seems simple, but it's not everybody follows that path. And as you know the auto business generates really attractive returns, it's in the low-90s when you add that and homeowner's insurance to the equation that's a big driver of our return on equity, which was 14.2% for last 12-months. But when you adjust out annuities, it's over 17.

So we're getting a really good return on that business. So what we've put in place has been, it's been working. Secondly, we do segment the business by in terms of growth and profitability by business, geography, customer group, and risk, so that we get attractive margins in each segment. And that gives us that solid base from which we can be sustainable in terms of growth.

So if auto margins drop in one state or I want coverage, we had the benefit of good margins than auto insurance in another state or on another coverage or in the homeowners business.

Our third principle is we create shareholder focus, or create shareholder value by focusing on profit and growth at the same time, but we default to profit if necessary. And so, we employ that philosophy across everything we do. So for example, let's go to insurance and you know, when we first bought insurance, it was running a combined ratio well over 100. And we invested heavily in that.

We believe and know now, that their growth created shareholder value because the return on the business we were writing was higher than our cost of capital. The accounting however, required us to write up all the advertising expenses up front, which resulted in an underwriting loss. So after the first year of course, then that advertising expense goes away you capture all the underwriting profit and it's very profitable.

And so, it took a while before that profitable business can offset the negative of first year business think over when you spend $200 million a year on advertising. So as a result that growth reduced underwriting and even though it's positive for shareholder value. So we try to think about are we creating shareholder value. Our first principle we're creating shareholder value when we're doing this.

We can do it and we chose to do it on insurance because we had strong profitability coming from the Allstate brand, auto and homeowners business. And so the concept of portfolio growth, Glenn talked about how it applies at the auto insurance level, it implies for homeowners. It also applies across the whole company. And so now, insurance is two and a half times the size when we bought it.

A similar situation exists for Allstate protection plans. So we acquired square trade, which has been renamed also a protection plans a couple of years ago for 1.4 billion, which is equivalent to about four bucks a share the Allstate share. As you know now their business is over twice its size we got 89 million policies enforce its got great distribution, its growing the European cell phone business and now it has reported profits albeit small, reported profits.

And so valuing that business on an earnings basis, clearly understate shareholder value. So our challenge has been to make sure we give you the information to see value creation, but not get everybody so focused on the 65% of the business, that that's the only thing that matters in terms of creating shareholder value. So it's a really important question, how are you growing that two-thirds of the business to make sure you make money.

But I also wanted to just take this opportunity to say like, don't forget about everything else, because there's a third of the rest of the business that drives shareholder value that when we get so focused on just auto insurance margins, it takes people's eye off the other stuff, which is why we moved to ROE. But obviously, we're very focused on auto insurance profit. We feel really good about it. And we need to make sure we keep doing that.

So Glenn will talk about what Mario mentioned is our intentional strategy to grow the business, offer really good value to our customers by reducing our expenses. And then having the loss ratio drift up, which enables us to maintain margins, and still keep clocking that high teens return on equity from that business.

Glenn Shapiro

Yes, so thanks, Tom, you know as you way out the principles there, clearly we're in an environment in auto that meets those growth principles and so, we want to go after that. But that said, its environment we've chosen to grow in, but it's a competitive environment, we got significant increases in advertising out there. We have an extremely low CPI. So we acknowledge all that in terms of the competition and we're doing things smart as to how we grow as opposed to chasing it.

I think you could call our combined ratio now a little bit of a restructured combined ratio because as you point out Jay, the loss ratio was up, the expense ratio was down. I would argue that it's a lot better than the other way around. That if you think about sustainability, if we were here having this conversation and we were like a point or two up on expenses but we had a huge tailwind because frequency to drop through the floor in the quarter. I think we’re - having a different conversation.

So I look at this as a as a positive, sustainable way for us to go after growth and show that we can do it in a way that's going to continue to provide that, mid high teens return.

Operator

Our next question comes from the line of Mike Zaremski from Credit Suisse. Your question please.

Mike Zaremski

I guess I'm staying on the expense ratio improvement which is enabling you to grow more. There was a media reporter to about shifting certain customer service responsibilities out of the agencies and into call centers which can service customers, potentially more cost effectively. I'm kind of curious if that's part of the reason agent compass is falling and why maybe a permanent decline or just you can correct me if I'm totally off on that?

Tom Wilson

First I may go up for a minute, Mike and say we want to use technology and our people to do a really great job for our customers. And with what you can do in technology today, you can make your people a lot more productive, and make them give a great service and spend less money. So, we've talked multiple times by a quick photo claim with a productivity of a claim adjuster is multiple to what it used to be because they're not driving around from body shop to body shop.

They're sitting in front of a computer, looking at pictures, deciding what should be done with their customers. So that's ripping through our business. We have lots of ways, we're working on doing that and that's what gives us the confidence that we can do a better job for our customers with less expenses. Glenn talked about integrated service, which is the thing you're referring to, and you don't see it in the numbers.

It would be what I would say today. It's not you know, we started with 50 agents this year we're getting the processes down. We're not going to turn this loose on 22 million customers, until such policies until such time as we make sure it works really well. Because the system we have works really well. Our net promoter score was up again this quarter. We like what our agents are doing that said, we think we can do better by leaning into innovation, rather than go.

So you're not seeing anything on integrated service that's the media I think you're referring to. I mean there is so much media out there these days. I don't know whether it's fake news or not, but like – the reality is, as we are doing everything possible to give our customers great service, support our agencies, but do it in a cheaper way. And we're all in on that.

Mike Zaremski

Okay, great that's helpful. And lastly, Glenn, in your prepared remarks, you could I might be a little off. You talked about the state level profit dynamics, making it difficult for competitors to achieve all states homeowner's profitability. Maybe you can elaborate on that. And also, I'm curious if there's any parallels to auto insurance as well? Thanks.

Glenn Shapiro

Yes so, thanks for the question on it. I think the basic premise there is, you know, we have a lot of scale and we've got, breath across states in our blend in our mix across the state is not only a 50 state view and so we've got it everywhere. But we've also been thoughtful and made choices about where we're larger and smaller, given the types of risks we face, which really challenging for the smaller or newer carrier going into it.

It's getting that type of breath across a system where you can offset your highs and lows. It's similar to, what you do with an investment portfolio. You're mixing your investment portfolio in different ways so that when one thing is up another one is down, and you're getting an overall good return, that's really challenging if you're starting out and you're only allowed to buy four stocks.

Tom Wilson

Let me also add to that, so let's just compare homeowners to auto insurance. So homeowner’s is more volatile on an individual location basis than auto insurance. So you should put up more capital for homeowners insurance than you should for auto insurance. In addition, with homeowners insurance, you get very little investment income visits are relatively short tail way as opposed to auto insurance you get a decent amount of investment income off it.

So as a result of that you have to run a combined ratio in homeowners insurance that's below that would you run in auto insurance. So your combined ratio and homeowner should always be below your combine that's not true for everybody but so in total, you got to get there. The problem is it like if there is hail in Dallas one year, and then not for two more years. There is hail in Oklahoma, because it got dumped in Oklahoma before it got to Dallas the next year.

And so, if you're only in Dallas and you got to earn that low combined ratio, and the hail happens to get you in that year, it's pretty hard to then have the money to expand into Oklahoma. So that's what Glenn is talking about. But the businesses, when you look at the homeowners business, and as more people get into it, I think it's worthwhile focusing on what is their actual return on capital in that business, as opposed to just growth.

Operator

Our next question comes from the line of Ryan Tunis from Autonomous Research. Your question please.

Crystal Lu

This is Crystal Lu and for Ryan Tunis. Our first question again on the expense ratio. It seems like the expense ratio has improved a lot, but it doesn't seem to be translating into auto policy growth acceleration yet. And it seems like some of that expense improvement came from advertising, which tends to grow to drive growth. So I'm wondering what actions are being taken right now, where you're investing in growth and going to see that policy growth acceleration in the future?

Tom Wilson

Well, first, if you look at our auto insurance growth, it's about two points, which we think is more than the number of cars and have grown in United States. So we think we're picking up market share, albeit a small amount of market share and we'd like to have more.

So we are investing more in marketing, but that doesn't change the overall trend that Glenn talked about. I mean, we're going to - our overall trend is reduce expenses, be competitive at price, maintain margins at levels that are attractive.

Is it going to be the same level each quarter? It bounces around a lot depending on what frequency happens, but we liked the returns. We're good at getting returns in auto insurance and we have proven that we can grow it and we're going to work on keep producing expenses so we can continue to be competitive.

Crystal Lu

And on the auto rate increases that you guys have been getting this year, it doesn't seem to have slowed very much in the first nine months, despite efforts to pass along more savings to customers and grow the business. So can you kind of describe the auto pricing environment right now and how you're thinking about auto pricing in terms of growing?

Tom Wilson

Yes, thank you Crystal. First of all, we manage all of our pricing and state-by-state basis. And I would say, in terms of the slowing, I would look at it relative to the lost cost trends. And so I would say it's slowed. We've taken over trailing 12 months, 2.2 auto rate that's translated into an average gross premium of 3%. But if you look at the severity trends running five this quarter, in the trailing 12 months, higher than that, we've not had rate that keeps up with that. And as we talked about earlier, we've offset it with lower expenses and that's where you give more value to the customer is not taking rate that has to keep all the way up with those types of inflationary factors.

But, as Tom has said several times, we managed this for profitable growth and we're committed to a strong return. And when we look state-by-state at that, we're looking at our competitiveness, what our price looks like relative to our competitors by different customer cohorts in each market, but also, what our return on all of his cohorts are in each market. And so I think our pricing has trailed the lost trend, which is part of what we're offsetting with the expenses.

Glenn Shapiro

It's hard Crystal to, and I'm not trying to - it's really the level of sophistication of pricing today in auto insurance is so high that, while the numbers overall are important to maintaining looking at the trend in the margins and definitely look at those.

In terms of growth, a lot of it depends what sales you're growing in, what your new business discount is. There's a lot of things we do, and our competitors do to make sure we capture business, which is generates long-term economic growth.

So it's, but - it's a pretty, it's not a robust, we're not seeing people take a bunch of rates right now, you know, state farm's taken some decreases but given where they are in overall price, we think they probably need to take some price decreases because they're pretty high priced. We feel competitive like price right now.

Crystal Lu

That makes sense. And then one more quick one on the auto bodily injury reserve releases this quarter. Could you just give a little bit more detail on what accident years are those are coming from and whether that reflects the level of severity being in line with medical inflation. Is that running at a lower level than you were expecting in those years? Thanks.

Mario Rizzo

So Crystal, this is Mario. I guess the first thing I'd say is just reiterate what Glenn said in terms of - we establish reserves and look at reserves every quarter. We have some pretty robust processes that we follow. We take all relevant facts and circumstances both internal and external trends into account. And then we also take into account any changes in claim handling practice.

So we have a really thorough reserve setting process and we tend to be conservative in how we set those reserves. What you saw this quarter in terms of the releases, we're predominantly in all state brand, auto injury coverages, and we continue to feel good, not only about the severity trends that we're seeing in the current year, but we're seeing favorable development in the prior years that is better than what we expected when we established the reserves. So it's really coming across a number, a number of accident years but we continue to feel really good about our reserve position, and our injury severity trends.

Tom Wilson

And the amount from each prior year wouldn’t really help you. So it's because it's what we picked as opposed to what the trends - the absolute trends are, but when we do the cadence there's obviously the triangles are in there and so.

Operator

Our final question then for today comes from the line of Josh Shanker from Deutsche Bank. Your question please.

Josh Shanker

Yes, thank you. I was looking at the policy count numbers in auto and it seems like there's a slowdown, but I'm wondering if we can sort of break it down to gross policy ads versus a gross policy declines. Are Allstate customers sticking with you and the new customers have slowed. How should we parse that out?

Tom Wilson

That's a pretty detailed level of question, Josh. So first overall retention was flat this quarter basically for statistical reasons, I mean it's kind of down slightly, but it's basically flat. So that means we're keeping in total as many or as a percentage of our customers, as you're correct in assuming that a new business doesn't have its higher retention as people have been with you 10 years. By the time somebody has been with you, actually, people don't wait two, three, four years. They pretty much tend to stay with you really high retention levels.

So growth will drive your retention down despite the fact that we were growing over last couple of years. Our retention has gone up because we're doing a better job on customer service with our net promoter score up. So I don't - I think in terms of our overall growth, you should expect to see more of it come from new business in the future than further increases in retention, if that's helpful.

Josh Shanker

And when I look at the decline ad spend and I guess compensation to agents or maybe right thing that incorrectly, or is that directly tie-able to the amount of new business coming in?

Tom Wilson

You sound like you're looking at a specific number. Maybe what we can do is Glenn can answer for you what the new comp. So we're going to - we'd said we could spend more money in advertising. We're working on that and we expect to still bring our overall expenses down as we do that over time. May not be every quarter, but we're headed down in that direction. And then - but Glenn can talk about what we're doing on compensation.

Glenn Shapiro

And a quick add I'll make to the marketing because this has come up a couple of times. It's during a year-over-year basis the marketing was lower? On a sequential quarter basis, it was up. We're comparing to a quarter last year where there was a new brand launch and you know, so, but we're ramping up and we'll continue to do that with marketing.

From a compensation standpoint, as we talked about earlier, it really is about shifting towards new business production. You ultimately, you compensate agents for the service they provide to customers and for going out and punting and getting new business, and we're within the confines of that amount of money, that compensation system, we're shifting money towards new business production to incentivize that more in the compensation plan going into next year.

Tom Wilson

So, what we're trying to do is, go on a great customer value proposition. We want a good price. We want good service. We're lowering expenses. You should expect to see us continue to lower expenses as we go forward from here and then as loss ratio goes up, that just means you're offering greater value. They're paying less for expenses and more for fixing stuff that got broke.

Josh Shanker

Thank you for the answers and good luck with that.

Tom Wilson

Okay. First, thank you for being on the call. Let me thank John for being both a transparent and direct source to you for a little over three years. He's done a fabulous job. We are excited to see him move on in his career and I know Mark will do a great job. He's worked with John, so it'll be seamless for you and us.

As it relates to Allstate, yes, we made really good progress this year on our strategy, our operating priorities remain focused on profitable growth, and we'll talk to you next quarter. Thank you.

Operator

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