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Allstate (ALL) Earnings Report: Q3 2014 Conference Call Transcript

The following Allstate conference call took place on October 30, 2014, 09:00 AM ET. This is a transcript of that earnings call:

Company Participants

- Pat Macellaro; The Allstate Corporation; Director IR
- Tom Wilson; The Allstate Corporation; Chairman President and CEO
- Steve Shebik; The Allstate Corporation; EVP and CFO
- Don Civgin; The Allstate Corporation; President and CEO Allstate Financial

Other Participants

- Michael Nannizzi; Goldman Sachs; Analyst
- Matt Winter; The Allstate Corporation; President, Allstate Personal Lines
- Bob Glasspiegel; Janney Montgomery Scott;Analyst
- Jay Gelb; Barclays Capital; Analyst
- John Hall; Wells Fargo Securities; Analyst
- Judy Greffin; The Allstate Corporation; Chief Investment Officer
- Amit Kumar; Macquarie Research Equities; Analyst
- Josh Stirling; Sanford C. Bernstein & Company; Analyst
- Vinay Misquith; Evercore; Anaylst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the Allstate third quarter 2014 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, Mr. Pat Macellaro. Please go ahead.

Pat Macellaro (Director IR):

Thanks. Good morning, everyone. Thank you for joining us today for Allstate's third quarter 2014 earnings conference call. To being Tom Wilson, Steve Shebik, and I will provide some color on our results for the quarter and then we answer your questions.

We realize there's other calls this morning, so we've shortened our comments , and ask that you limit yourself to one question.

Yesterday, we issued a news release and investor supplement, filed our 10-Q for the third quarter, and posted the slides we will use this morning. These are all available on our website at AllstateInvestors.com.

Our discussion today may contain forward-looking statements regarding Allstate's operations. Allstate's results may differ materially from these statements, so please refer to our 10-K for 2013, our 10-Q for the third quarter, 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 on our

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website.

We are recording this call and a replay will be available following its conclusion. I'll be available to answer any follow-up questions you may have after the call.

Now I will turn it over to Tom for his thoughts on the quarter.

Tom Wilson (Chairman President and CEO):

Good morning, everybody. We appreciate your interest and investment in Allstate .

I'm going to start by providing an overview of third quarter results -- in particular how they relate to our strategy and our 2014 operating priorities. And then Pat and Steve will provide some context on our results. Then our leadership team will be here to answer your questions.

In the room with us are Matt Winter, who leads Allstate Personal Lines; Don Civgin, who is responsible for Allstate Financial and Esurance; Kathy Mabe, who leads Business-to-Business; Judy Greffin, our Chief Investment Officer; and Sam Pilch, our Corporate Controller. So let's begin with slide 2.

Put simply, Allstate had a really good quarter this time. We continue to proactively take action, which is to enhance our competitive position, execute our strategy, and deliver our current results. And while not everything is where it ultimately needs to be, most of the trends are in line with expectations.

This strategy of focusing on unique value propositions for different customer segments is working. Growth increased as we added almost 800,000 Property-Liability policies in force and increased annual net written premiums by $1.4 billion over the trailing 12 months.

Financial results for the quarter were also excellent. Net income was $750 million for the third quarter, as you can see that is in the table on the bottom, which is significantly higher than last year's third quarter. But you will remember, last year we reported the initial loss estimate on the sale of Lincoln Benefit Life in the 2013 results.

Operating income for the third quarter was $1.39 per share. The property liability business generates good combined ratios in aggregate despite catastrophe losses and investments in growth.

Allstate Financial had good growth in the voluntary workplace benefits business with policies increasing almost 8% in the third quarter compared to the prior-year quarter. Allstate Financial returns were up, which reflects higher investment yields, lower expenses, and a decline in capital rates. We also made progress on our five 2014 operating priorities and delivered strong cash returns to our shareholders.

If you go to slide 3 that breaks out the property liability operating results for the four customer segments. Starting at the top of the slide, Property-Liability policies in force increased 2.4% and net written premiums were 4.9% higher than in the prior-year quarter. Overall profitability was strong with the Property-Liability recorded combined ratio of 93.5, which included 7.1 points of cat losses.

The underlying combined ratio for third quarter was 86.1, which brings that year-to-date total then for the first nine months to 86.4, which is better than the full-year outlook range of 87 to 89 that we provided in February.

The Property-Liability results by customer segment are shown on the bottom half of the page. If you start with the largest segment served by the Allstate agencies that is in the lower left, profitability was good across all products and Matt's team continues to execute a comprehensive, profitable growth plan.

We continue to have broad-based auto policy growth, which is 2.6% higher than the prior year. There is also a modest increase of 0.1% in homeowners and other personal lines policies were 1.7% higher than the prior year.

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Esurance, which is in the lower right, had policy growth of 14% over the prior-year quarter, which is a decline from last year's growth rate, reflecting the profit improvement initiatives. Growth investments continue to have a negative impact on the recorded combined ratio and, as we discussed in prior quarters, Don's team is focused on reducing the underlying loss ratio, which at 75.3 was about 2 points better than the prior year. The lifetime profitability of growth at this loss ratio is above our cost of capital, so we remain committed to increasing market share in this segment.

Encompass, in the upper left, has slowed growth, particularly its package policy offering, as we expand profit improvement initiatives. Encompasses path to growth under Kathy will be first to improve profitability.

Answer Financial, in the upper right, sells non-proprietary policies through the web and call centers. Non-proprietary premiums increased almost 10% over the prior-year quarter.

If you go to slide 4, our five 2014 operating priorities are shown there. Since we just discussed both growth and profit, I will focus on the remaining priorities. We experienced another good quarter of investment returns.

The total portfolio return in the quarter was 0.4%, but it's 4.7% for the first nine months of 2014, reflecting the proactive approach taken by Judy's team. Net investment income, however, was lower than the prior-year quarter as strong limited partnership income was not enough to offset the impact of the $12 billion reduction in the portfolio because of the sale of Lincoln Benefit Life. Modernizing the operating model will improve the customer value proposition by enhancing customer service and lowering costs. This includes simplifying technology applications and using continuous improvement to improve effectiveness and efficiency.

We also are looking to build long-term growth platforms, so to increase growth in our largest customer segment we are building on the existing comprehensive growth plan by helping Allstate agencies become trusted advisors and expanding into more local markets. Our broad product line, household focus, and innovations like Good Hands Roadside and Drivewise further enhance those customer relationships. The Drivewise telematics offering, we have expanded that to include a mobile phone application which is now in 16 states so we can compare the utilization of that method to the devices that are tied to the cars' OBD port.

Esurance's advertising messages of insurance for the modern world and 7.5 minutes, not 15 minutes has further strengthened the brand for self-serve customers. Our broader product line, geographical expansion, and more sophisticated pricing will also support market share gains.

So in summary, Allstate has strong results across a number of fronts in the quarter. This strategy to better meet the unique needs of customers and proactively manage both investments and capital continues to serve our shareholders well. So let me turn it over to Pat.

Pat Macellaro (Director IR):

Thanks, Tom. I will begin by reviewing the Property-Liability highlights on slide 5.

Beginning with the chart on the top of this page, Property-Liability earned premium of $7.3 billion in the quarter. It was 4.8% higher than the third quarter of 2013. Recorded combined ratio of 93.5 increased 3.5 points versus third quarter of 2013, driven by increased catastrophe losses. The underlying combined ratio was 86.1 for the third quarter, bringing the year-to-date result to 86.4.

Net investment income for the Property-Liability segment increased 11.3% from the prior-year quarter, driven primarily by limited partnership income. Probably-Liability operating income in the third quarter was $553 million, 19.3% lower than the third quarter of 2013, which, as you may recall, was a very benign quarter in terms of weather.

During the third quarter, the annual review of discontinued lines and coverage reserve levels led to an increase of $102 million in reserves, most of which pertained to asbestos liabilities. This increased the

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Property-Liability recorded combined ratio by 1.4 points for the third quarter. Reserves were increased by $133 million in the third quarter of 2013 as a result of last year's annual review.

The chart in the lower left shows net written premium and policy in force growth rates for Allstate Protection. The red line shows the continued positive policy growth trend that began in the second quarter of 2013. Policies in force have grown by 2.4% from last year's third quarter and 1.8% from year-end 2013.

The exhibit on the right of this chart highlights Property-Liability recorded and underlining combined ratio trends as well as results by brand. Esurance's underlying loss ratio of 75.3 for the third quarter of 2014 is also shown to isolate the impact of ongoing profit improvement actions from the impact of growth investments.

Moving to page 6, we show the components of premium and policy growth by brand. Focusing on the Allstate brand in the upper-left chart, policies increased by $572,000 in the third quarter, which is 1.9% higher than the third quarter of 2013, driven by both favorable new business and retention trends. The Allstate brand grew net written premium by 4.5% in the third quarter versus the prior-year quarter as average premiums continued to increase.

Total growth in net written premium was driven by a 4.9% increase in the Allstate brand auto and a 2.9% increase in Allstate brand homeowners compared with the third quarter of 2013.

Moving to the chart on the right-hand side, you can see the policy in force growth trends for Allstate brand auto and homeowners going back to 2005. Current results compare favorably to recent history, due to having substantially completed the repositioning of the homeowners business. In this quarter, Allstate brand auto policies rose by 504,000, or 2.6%, from the prior-year quarter. Allstate brand homeowners rose by a modest 5,000 policies from the prior-year quarter, which is indicative of continued progress in leveraging this product as a competitive advantage versus (inaudible) auto carriers.

Allstate brand policy growth is geographically broad-based and reflects both better customer retention and new business sales. There are currently 42 states growing Allstate brand auto policies and 21 states growing Allstate brand homeowner policies versus the prior year.

Esurance's rate of premium and policy growth in the lower left continues to slow due to ongoing pricing and underwriting actions underway to ensure long-term profitable growth as well as Esurance's increasing size. Total Esurance premium grew by 14%. Policies in force grew by 14.1% in the third quarter compared with the third quarter of 2013. Spending on expansion contributed approximately 2 points to the combined ratio in the third quarter.

Encompass policy in force growth highlighted in the lower right also continues to slow, reflecting actions taken to ensure acceptable long-term returns. Net written premium growth of 4.3% in the third quarter compared with third quarter of 2013 includes the impact of higher average premiums that are a result of the profit improvement plan.

Slide 7 highlights Allstate brand auto and homeowner underlying margin trends. The charts on the left show Allstate brand auto and home recorded and underlying combined ratio trends, while the charts on the right show the components of the quarterly underwriting combined -- underlying combined ratio. As you can see in the charts on the left-hand side, while there is volatility in the recorded combined ratio trends from quarter to quarter due to catastrophes, the long-term underlying combined ratio results have been both very good and stable for auto insurance and steadily improving for homeowners.

The Allstate brand auto underlying margin trends in the upper right-hand chart show that earned premium continued to increase in the quarter, up 1.7% from the prior-year quarter. Premium increases have been approved in 35 states so far in 2014, reflecting an organizational focus on maintaining margins by making frequent adjustments based on actual results.

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The underlying losses and expenses per policy increased slightly in the third quarter by 0.1% compared with the third quarter of 2013. This resulted from a lower frequency of claims and expected increase in severity of losses along with the benefit from a lower expense ratio.

We experienced similar results in the third quarter for Allstate brand homeowners. Average underlying losses and expenses per policy were flat to prior-year quarter and average earned premium continued to increase, although at a slowing rate as more states approach rate adequacy. Allstate brand homeowners underlying combined ratio was 60 in the third quarter.

We are continuing to take rate increases and make underwriting and product changes as needed to continue to keep pace with loss trends and maintain the underlying combined ratio in both of these lines.

Now I will turn it over to Steve to cover Allstate Financial, Investments, and capital management.

Steve Shebik (EVP and CFO):

Thanks, Pat.

Turning to slide 8, our strategy is for Allstate Financial to become more strategically integrated with the Allstate brand's customer value proposition. Allstate Life and Retirement has been refocused on the Allstate agents, but the integration of the Allstate brand customer value proposition will require a multiyear effort.

The chart on the bottom of this page highlights operating income by quarter, including -- excluding the impact of the sold Lincoln Benefit Life business. Operating income for the quarter was $125 million, 1.6% lower than in the third quarter of 2013 but higher when excluding LBL results in the prior year. Operating income return on equity has continued to improve given our efforts to focus the business, a lower cost structure, strong investment income over the past four quarters reflecting limited partnership income, and the $1.2 billion return of capital by the Allstate Life Insurance company over the past 12 months.

Select estimated historical results for Lincoln Benefit Life are provided in our third quarter 2014 10-Q and the investor supplement provides you with further context.

On slide 9, in the top left graph, you can see the composition of the investment portfolio and the impact of the sale of Lincoln Benefit Life, which reduced the size of the portfolio by $12 billion. We are taking a measured approach over time to shift the portfolio composition from fixed income assets to equity and other assets where returns are driven primarily by idiosyncratic performance. Our equity and owned portfolio is lower compared to the prior year-end primarily due to the reclassification of tax credit investments to other assets and the sale of approximately $300 million of limited partnership positions.

Our total portfolio return presented at the top right was 0.4% for the third quarter as investment income of 1% was partially offset by lower fixed income and equity valuations. You can see the valuation impact varies from quarter to quarter, while the income yield has remained relatively constant. Total return for the first nine months of 2014 was 4.7%.

The lower half of the slide provides the investment income and yield for the Property-Liability and Allstate Financial portfolios, each of which comprised approximately half of the portfolio. This approximate equal split reflects the strategic decision to deploy capital out of Allstate Financial.

The Property-Liability portfolio in the lower-left graph shows the interest-bearing yield has stabilized after our 2013 rate risk reduction actions. It illustrates the variability income that may result from limited partnership and other equity investments.

The Allstate Financial portfolio in the lower right graph has a more stable yield due to the longer duration of these investments and the limited reinvestment activity. The decline in quarterly income versus the prior year

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is due to the sale of LBL.

Allstate Financial's portfolio has been reduced through a variety of actions that result in a decline of total invested assets from a peak of $78 billion in the first quarter of $2007 to $39 billion in the third quarter of 2014.

Slide 10 provides an overview of how our capital structure has changed over time. On the left-hand side of the page you can see the capital structure at the end of 2012 compared to the third quarter of 2014 and the shift from predominately senior debt to include more hybrid debt and preferred stock, increasing both our strategic and financial flexibility.

With the repayment of $650 million of senior debt in August, the capital restructuring plan we started early last year is complete. That said, we constantly evaluate alternative sources of capital to lower our costs or decrease volatility in order to create additional shareholder value.

Shareholders receive cash returns of over $1 billion in the third quarter as we repurchased $926 million of common stock and paid $122 million in common stock dividends. Through the first nine months of the year total common shareholder cash returns were $2.42 billion including quarterly dividends, the completion of one $750 million accelerated share repurchase program, the initiation of a second $750 million accelerated share repurchase program, and open market purchases.

We have now completed just over 75% of the $2.5 billion share repurchase authorization approved in February in about 40% of the authorized 18-month repurchase period. Book value per common share reached $48.28, increasing 6.6% since year-end and 11% since September 30 of last year.

Operating income return on equity was a strong 13% in the third quarter on a trailing 12-month basis, but lower than the full-year 2013 return of 14.5%, reflecting the impact of higher catastrophe losses in the first nine months of this year and a higher equity base. As I mentioned last quarter, much of the increased equity is a result of the positive impact of the 2013 change to pension and retiree benefits and plan assumption changes.

Now let's open up the call for your questions.

QUESTIONS & ANSWERS

Operator:

(Operator Instructions) Michael Nannizzi, Goldman Sachs .

Michael Nannizzi (Analyst - Goldman Sachs):

Thank you. First question.

Can you -- Tom, could you talk a little bit about the other personal lines business, that roughly $2.5 billion of premium? What were the trends in that line up from a profitably perspective?

Thanks.

Tom Wilson (Chairman President and CEO):

Sure. Let me provide some overall context, and then Matt can give you some specifics by line.

First, as you know in that customer segment, where they want local advice and branded products that is served by the Allstate agency, they want to buy most of their stuff from the same person. The logic is that I don't have to have a relationship with somebody to buy auto insurance and home and boat and PUP policies and renters policies.

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So we tried to offer -- we do offer them a broad range of stuff. And we have -- Matt's team has been working on more of a household focus, which includes those policies, so we have, of course, sold those for years. I think we have about 5 million policies in total in force when you look at them in total. Matt can take you through sort of both the growth trends where we've had some good success with some of it and profitability.

Matt Winter (President, Allstate Personal Lines - The Allstate Corporation):

Thanks, Tom. Good morning, Mike.

Thanks, first off, for asking about the other personal lines. We often get through a call without ever mentioning these. And, as Tom mentioned, we are trying to incorporate all the products a customer might need within the Allstate agency value proposition and so we have had an increased emphasis on the other personal lines products.

As you know, there is a wide group of products grouped within this category and we do do the breakdown in the investor supp on both pages 15 and 30 that gives you some of the net written premium trends and the policy in force trends. What you see on the profit side is we have had a fair amount of margin actions this year in the landlord, manufactured home, and the PUP areas, and so that has suppressed some of our PIF growth because of those margin actions in those lines.

Most of our item in force growth has come from renters and condo, which are where we need them to be from a profitability standpoint. We did have some decline in involuntary auto as more companies are willing to take on more of those drivers. That somewhat dampened our growth, but overall when we look at our other personal lines products, other than the work that we have ongoing in landlord, manufactured home, and PUP, we feel very good about the profitability and very good about the growth prospects in all those individual product areas.

Michael Nannizzi (Analyst - Goldman Sachs):

Great. Could you provide sort of an underlying or just an indication of kind of where that business is running maybe relative to auto and home?

Tom Wilson (Chairman President and CEO):

You can see that on slide 3, Mike. The recorded combined ratio for the personal lines for this quarter was 85. That compares to 81 for home and 93 for auto. And as Matt pointed out, there's a wide range of products so the capital under those products varies significantly, but we like the returns.

Matt Winter (President, Allstate Personal Lines - The Allstate Corporation):

You might also look, Mike, page 23 of the investor supp shows the loss ratio, cat ratio, expense ratio, and combined ratio for that category.

Michael Nannizzi (Analyst - Goldman Sachs):

Got it, great. And then just in terms of the homeowners line, so now that is ticking on the plus side for the first time in a while and the new issued apps seem to be moving in the right direction. Can you kind of talk about what you expect there?

Do you still see opportunities now for PIF growth to move further into positive territory? What are the factors driving that? And how should we think about the interaction between that and auto if you look to get more on the offense there? Thanks.

Tom Wilson (Chairman President and CEO):

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Let me -- I will provide a longer-term perspective and Matt can talk about both his current growth plans and the profit improvement plans. Because while we are happy with the overall combined ratio where it is today, this is a country with 50 states and a couple of territories and so we have to do things differently in each of those. And so they are not all perfect.

But there is -- we put in a slightly longer view. If you really look at homeowners in total, I think it peaked, Mike, about 7.8 million policies and it's a little above 6 million now. It's really been coming down since the 2006 period of time when we started taking pretty drastic action in, at the time, relatively narrowly focused cat areas being Florida and Louisiana and a few places.

Then, as the weather got worse in 2008 and 2009, we expanded that activity by both increasing prices and, as importantly, reunderwriting the book and making sure we liked the individual properties we had taken risk on. And you can see the business kept coming down on an overall items in force level.

That does -- auto does track with it. If you look at our -- the growth rate of those two, they track together. That said, we weren't willing in the depths of getting smaller in the homeowners business to give ourself a complete out for that, because there are of course monoline auto companies to grow and we felt we should be able to grow as well. It's a little harder, though, when you're telling somebody I'm not going to insure your house, please keep your auto with me, than please give me your auto if we don't have it.

So they do trend together, but they are also separate. And so auto has had higher growth rates over the last couple of years than home has. Home has finally ticked positive, but 5,000 on 6 million doesn't count as sustainable growth. So Matt can talk about what they are doing to get sustainable growth out of that business and how it turns into a competitive advantage for us relative to both the local advice and branded Allstate segment.

We won't go there right now, but you also know we are adding this to the Esurance platform as well so that they can compete in that segment.

Matt Winter (President, Allstate Personal Lines - The Allstate Corporation):

Thanks, Tom, and, Mike, thanks for the question. As you noted, this is the first quarter since 2006 that we grew items on a year-over-year basis. And while it is by a small number of policies, it is pretty widespread, widespread geographically and widespread in terms of its drivers being both favorable new business and retention.

As Pat noted in his opening remarks, we now have 21 states that are growing year-over-year. New business is 12% above prior year and we actually have 36 states with higher new business levels than last year.

As we've talked about on previous calls, we've been putting in house and home. House and home growth has been higher than our countrywide average. And, as we have also discussed, house and home gives us some benefits on the profitability side in that it normally goes in rate-adequate when we launch it and, due to its product design, tends to be more stable and tends to require less rate. And so it gives us a competitive advantage in terms of stability in the marketplace.

On the retention side, retention in homeowners continues to improve. We are now up 1.2 percentage points since 2012 and we have 38 states that are above prior-year retention levels.

What is interesting to us is that while we monitor both first and subsequent retention and both are showing favorable trends, we have noticed that subsequent retention has now reached its highest level since 2005. So we feel quite good about the new business growth, we feel quite good about the retention trends, and we feel quite good about the profitability of that business to enable us to maintain that trend line.

So we believe we have more room to go. We did have some benefit of opening up in some P&L areas that

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had previously been closed, where we figured diversification benefit was worth allowing small policy growth there, but by no means do we feel like we have capped out. We think we have geographic areas within the United States that are underpenetrated compared to what our market potential is, and we think we have room to grow as we expand our agency footprint in some of those areas. So we are cautiously optimistic about the future.

Michael Nannizzi (Analyst - Goldman Sachs):

Great, thank you so much.

Operator:

Bob Glasspiegel, Janney Capital.

Bob Glasspiegel (Analyst - Janney Montgomery Scott):

Good morning, Allstate . Question on Allstate Financial. Where is the expense structure relative to where you want to be without LBL? You mentioned expenses I think as bullet four or five as a priority, but what sort of timing should we expect on getting the expenses rightsized to the smaller operation?

Don Civgin (President and CEO Allstate Financial):

Bob, it's Don. Thanks for the question and thanks for noticing that the expenses are down. Sometimes it's thankless work, but I appreciate you pointing it out.

The Allstate Financial strategy, which we have been consistently following for the last four or five years, really results in a business that is smaller and far better aligned with the Allstate customer value proposition. Part of that -- and Steve mentioned how much smaller the invested assets are. A lot of that happened actually over the course of the last four years or so, even though he pointed out a seven-year time frame, and so that has put a lot of pressure on the expense structure.

We are down this year about 22% in Life and Retirement business. I will exclude Allstate Benefits because they are growing, but in the Allstate Life and Retirement business we are down about 22% on expenses from last year's quarter. I expect those numbers to continue coming down some, but we are getting to the point where we are about the right size -- the expense structure is about the right size for the company.

What we really want to do now is make sure that we are focused on supporting the customer, the Allstate customer, through the Allstate agencies and generating some growth for the company. I think that is going to take a bit longer to get through the transition with Lincoln Benefit Life, but the expense piece of it has come down nicely. We still have a little bit more to go.

Bob Glasspiegel (Analyst - Janney Montgomery Scott):

Thank you. The follow-up is on auto. With gas sub $3 in a lot of areas, are you pricing for increased frequency yet or you waiting to see what will happen?

Tom Wilson (Chairman President and CEO):

Bob, I love the follow-up from life to auto, but I love ya anyway. Matt can talk specifically about what we do. Of course, frequency has all kinds of components in it, right? It's got miles driven. It's got who drives the car. It's got -- and that is factored by a lot of things, including gas prices.

The biggest driver historically from our analysis, which is kind of hard to get between that, is really on the economic growth. So if people are working, unemployment rates are down, economic activity is up. People are going to restaurants. They are driving places.

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And so as you look at the -- and of course unemployment and economic activity has trended up for the last three or four years. Matt's team has reflected that into their results and you see we've been able to maintain ratios.

Gas prices may have an impact on mileage or driving, and we track it. It's not as close, because gas prices aren't really that significant a cost that they keep people from driving. So if you're paying $4 a gallon and you suddenly pay $3 a gallon, even if you are getting 10 miles to the gallon, you're saving $0.10 a mile, it's not really a barrier to people going places.

That said, you tend to get more like summer driving, vacations, and stuff like that. I would just say Matt's team has proven their ability to micro-target that stuff and drive it in a way there. So, Matt, if you want to make a comment about frequency and profitability.

Matt Winter (President, Allstate Personal Lines - The Allstate Corporation):

Sure. Thanks, Tom. I don't really have much to add as far as the gas price impact. As Tom said, something we will watch and watch carefully, but we don't expect it to be a core driver.

That being said, our frequency so far has been extremely favorable to prior year. It is within our historical ranges. It is broad geographically, so our frequency trends have been good. We stay on top of them, as Tom says.

This is a national business managed very locally. And so, even if the change in gas prices drives behavior and miles driven in some small geographies, it will be geographically specific. It won't be widespread and so we will manage it that way. We will continue to do what the company has been quite good at doing.

As you see on page 7 of our presentation, we have a pretty long-term history of managing our margins well and keeping an eye on both frequency and severity and reacting accordingly. So it is something to watch, but not something to obsess over.

Bob Glasspiegel (Analyst - Janney Montgomery Scott):

Thank you.

Operator:

Jay Gelb, Barclays.

Jay Gelb (Analyst - Barclays Capital):

Thank you. The first topic I want to cover is on reinsurance costs. Reinsurance costs appear to be coming down pretty dramatically over the course of this year and probably into next year. Could you update us on your reinsurance protection strategy in terms of whether you expect those savings to fall through to the bottom line or perhaps you've used a portion of those savings to buy more coverage?

Tom Wilson (Chairman President and CEO):

Steve, do you want to talk about --? We redid those programs in June, which is -- of this year. (multiple speakers) Yes, even if pricing is lower today than it was in June, we put our plan in place which is a multiyear plan.

Steve Shebik (EVP and CFO):

Jay, this is Steve. As Tom said, we put in place a multiyear plan. The core reinsurance is a three-year plan rolling one-third, one-third, and one-third. And this year, or actually last year and going into this year, we

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started issuing catastrophe bonds again which we had not done for about five or six years. This year in particular we issued over $1 billion and it was excess I think of $2.75 billion, if I remember correctly.

So the core part of the program is really subject to the changing pricing in the reinsurance market, but it would only be -- kick in about one-third at a time each year going forward. And as you know, our pricing is adjusted for reinsurance costs, so that kind of bleeds into the pricing over a period time.

We did take the chance opportunity this year with the lower prices in the core reinsurance market to buy more coverage up top and also at the bottom. So several years we've had a first event $750 million retention. We lowered that to $500 million this year and we increased the amount of coverage on the top side of the program.

So we have the best coverage I believe we have ever had and we have multiple sources on both the traditional reinsurance program and the catastrophe bonds that are four- and five-year maturity type bonds. So we are covered over a longer period time.

Tom Wilson (Chairman President and CEO):

Jay, this is Tom. Let me maybe take it up a level in terms of capital management. We tend to look at reinsurance as just capital at this point and so Steve talked about how we use it to reduce volatility.

We, of course, are trying to be proactive everywhere in the capital structure, so we put a bunch -- as Steve pointed out, we took a bunch of debt out. Put on preferred, put on hybrids, which lowers our cost of capital and puts us in a really strong financial position.

As the market develops I think what you are seeing in reinsurance pricing is really the growth of the increased interest in insurance-related investments and assets. And so we think you will continue to see new forms of alternative capital being developed, which will enable us -- either lower reinsurance costs, take advantage of other things in the capital structure, or find other ways to lower our cost of capital or take volatility out of the business.

Jay Gelb (Analyst - Barclays Capital):

That's helpful. On the capital management front, Tom or Steve, I find it interesting that Allstate appears to be moving towards share buybacks and dividends being in excess of annual operating earnings. There's only a few companies in the property-casualty sector that did that or have done that so far, mostly on the commercial lines side, that Allstate doesn't have the pricing pressure they are facing.

So can you update us a bit in terms of level of magnitude; in terms of what you are thinking on the pace of buybacks and dividends relative to earnings?

Tom Wilson (Chairman President and CEO):

I know some of the banks, Jay, do it that way. They say 80% of their earnings, but we don't do it that way.

We obviously look at it relative to how much capital we have, which is dependent on earnings, but we look at how much --. For example, some of the things we got rid of -- as Steve pointed out, we've reduced the size of the Allstate Life and Retirement balance sheet by about $40 billion, which is equal to some life insurance companies. And so the capital that supported that we either can deploy in growing our property-casualty business or in giving it to shareholders.

Included in that was the sale of Lincoln Benefit, so that has been factored in. We don't forecast where we will go after we get done with this share repurchase program, but Steve has been very aggressive in buying back the current shares because we have plenty of capital and we are feeling good about returns. We don't want to keep that capital and have our ROE go down.

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Jay Gelb (Analyst - Barclays Capital):

Makes sense, thank you.

Operator:

John Hall, Wells Fargo .

John Hall (Analyst - Wells Fargo Securities):

Thank you, good morning. I have a question starting with Allstate Financial. In the quarter, there was a fair amount of difference between the third quarter and the second-quarter operating earnings. I was wondering if we are at a level that we can start to think of building off of the third quarter going forward.

Tom Wilson (Chairman President and CEO):

I will give you my view; Steve and Don may have their own views. I think this quarter looks more like the future than last quarter, John. I think everyone is doing -- no one is saying anything, so I think we all agree.

We are not -- we don't do forecasts by line or by company or something like that, but you had some increased limited partnership returns last quarter, the second quarter of this year, then this year. Now I will point out, I know there's been some questions from people about the volatility about limited partnership returns. And, yes, it is true that limited partnership returns are more volatile, but that is specifically why we break them out for you and it's also specifically why we do it.

And so if you think about that, our investment philosophy is get a good risk adjusted for return, not trying to optimize any given quarter, and then we look for attractive returns. And because these investments are volatile, they tend to get higher returns. It also puts another of the idiosyncratic or the asset-specific concentration on investment results. It puts some diversification into the portfolio rather than just the market, so it's a good reason for that standpoint.

It also -- if you look at our overall volatility, we have reduced volatility investment portfolio because of interest rates. You see that in lower operating income, but if you look at how we have shortened the duration on the Property-Liability portfolio, that has reduced volatility. While this injects a little more volatility, we think it is volatility that is higher return than just keeping interest rates or duration out there. So we thought the trade between the two and the risk return.

Then if you look at the volatility across the company and go up a level, while I know this makes it harder for you all to forecast what that -- the limited partnership returns will be and then, hence, what Allstate Financial's returns will be, if you look at the volatility in the overall company P&L, we have plenty of places. We got plenty of volatility and this is just an uncorrelated piece of volatility. So we have catastrophe volatility, frequency volatility, and limited partnership volatility.

We spike it out so you can get it, but we think overall it is exactly the right thing to be doing with our investments, even though it creates a little bit of confusion as to is your run rate 150 or 125.

John Hall (Analyst - Wells Fargo Securities):

Great, that all makes sense. Thank you, Tom. And you sort of got to my follow-up, which had to do with whether you are making any changes to the investment portfolio allocation towards these types of investments.

Judy Greffin (Chief Investment Officer - The Allstate Corporation):

This is Judy and, yes, we are changing our allocation towards these types of investments. As Tom just said,

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we like this trade-off versus interest rates currently and, frankly, into the future, but we are doing that at a measured pace. There is no denying that the market is pretty fully priced in terms of valuations.

So we are looking at this space; we like this space over the long-term. It's just finding the right investments for us and those idiosyncratic investments that we think will deliver higher returns again over the long-term.

Tom Wilson (Chairman President and CEO):

And, Judy, you are highly diversified in the space you are in, right, so if you --?

Judy Greffin (Chief Investment Officer - The Allstate Corporation):

Yes, within the overall portfolio we are highly diversified and then this part of the portfolio we are highly diversified as well. And you can see that; in the Q we break that out.

John Hall (Analyst - Wells Fargo Securities):

Thanks very much.

Operator:

Amit Kumar, Macquarie.

Amit Kumar (Analyst - Macquarie Research Equities):

Thanks and good morning. Two quick questions. The first question is on loss cost trends. Can you talk about what you might be seeing in personal injury protection or severity trends considering the fact that one of your competitors pointed out to a 17% increase recently?

Tom Wilson (Chairman President and CEO):

Of course you know PIP coverage is in about five states. I'm not sure what their 17% was, if that was one state or across the country. It seems like a pretty -- it would seem high to me if it was across all five states. If it was us, we would be really worried about that. I don't know if they are or not and I don't even know who you're talking about at this point, but I will soon find out.

Matt, do you want to talk --? It's really a relatively highly-focused, but important, question, because those states tend to be pretty large states, being New York, Florida, Michigan. So anyways, Matt, do you --?

Matt Winter (President, Allstate Personal Lines - The Allstate Corporation):

Yes. As Tom said, I'm not sure specifically who you are referring to so I can't comment on what they might have said. Obviously PIP and BI are things that we watch constantly. They tend to be somewhat volatile and they move around and bounce around, and if they are not managed carefully, they can get out of control.

We watch them carefully and we react in a variety of different ways depending upon the geography. In some cases it is pricing action. In other cases it is underwriting actions. In other cases it's managing where we are growing and where we are not. And so we will continue to manage those two coverages fairly aggressively.

We are not seeing anything get out of control from our perspective; I can say that. We are seeing normal volatility that we would expect, but we are not seeing anything out of control.

Tom Wilson (Chairman President and CEO):

A couple things I would look at, too, on the 17%, without trying to diss anybody else. I would first look at their size of the book. If they have a small book, I would also look at what happened the prior year.

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As Matt pointed out, that PIF line can be highly volatile. You get some pretty big cases in there and all of a sudden the quarter over quarter looks really wild, but the absolute level looks okay in the long-term. So I don't know whether somebody has a problem or not.

There's also the claim procedures in the schedules in which you operate and sometimes you can't control that, which is they will put a schedule in to say chiropractors get a certain amount of money. And you have to pay according to that. So it doesn't mean that the company is not well managed, it just means you are doing what you are required to do. The way in which you manage that is exactly what Matt said, which is you keep paying attention to it and either you are controlling your costs and making sure people get the right amount of money or you are changing your pricing.

And as he pointed out, we have -- I think when people look at our business on profitability they tend to take a commercial lines perspective and look at sort of price and loss costs and assume it's all about price. We really have a system and you really have to think about the system, how it works at the granular level which makes adjustments all the time. It's that system that has generated the good combined ratios in auto insurance for a decade and it's managing and leading that system, which we have to do to make sure we get good returns.

Amit Kumar (Analyst - Macquarie Research Equities):

Got it. The only other question I had was going back to the discussion on telematics and I think you mentioned the mobile app is in 15 states. What I was wondering was why not skip the OBD or the app step and work directly with car manufacturers?

We all are talking about the connected car concept. Why -- what would preclude you from working out some sort of arrangement with, let's say, the big three car manufacturers and installing something on those vehicles which allows the customer to get a quote from Allstate ?

Tom Wilson (Chairman President and CEO):

It's a good question and the answer is nothing, but it wouldn't be comprehensive. In part because the average age of the fleet is 11 years and so there's a whole bunch of people out there driving that we would like to offer them the opportunity to get more sophisticated pricing and a better driving experience now as opposed to waiting until they buy a new car. So we are actively in conversations with everybody.

And that range of potential participants and the connected car obviously includes the OEs, the auto manufacturers, but it also includes the -- some of the telcos are interested. Some of the other connected customer technology companies are interested, so we are active in all that fronts. We like to think of this as a tremendous opportunity for our company. It will evolve and so we are trying to put as many oars in the water as we can so that we at least stay with the tide, if not get ahead of it.

Amit Kumar (Analyst - Macquarie Research Equities):

Got it. Thanks for the answers and good luck for the future.

Operator:

Josh Stirling, Sanford Bernstein.

Josh Stirling (Analyst - Sanford C. Bernstein & Company):

Good morning. Thank you for taking the call and congratulations on the quarter. So I thought I would ask a big picture question about Esurance. I'm wondering if you can walk us through how you guys are thinking about the economics of ad spend.

Really rough numbers it kind of looks like you spent $500 million, $600 million in advertising since you've

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bought the business. You've driven a similar amount of new business growth and so I'm curious on how you think about or we should think about what the returns of that investment would be. And, big picture, is this something where you should be advertising more if you could scale up the organization and you could handle the level of growth?

Tom Wilson (Chairman President and CEO):

I will give you a strategic answer and Don can jump into the specifics of -- and we look at it both ways, Josh. Certainly we think it is an important growth element in our plan. To a certain extent, if you go way up, what we have done is we now have a diversified set of growth opportunities with inside the property liability space. We've traded some of that off for diversification and growth opportunities by reducing the size of our life business.

So we used to have -- and we have this opportunity with a highly-focused customer value proposition to go at that self-serve space and really take on Geico and Progressive Direct head on and, our words, out self-serve them. And so that's why we talk about 7.5 minutes, not 15.

We also are good at that. The reason that diversification by customer segment works is because it is something we are really good at, both pricing and settling claims. And all that has turned out to be true and anchor it for us.

I think the business is up about -- it's not quite double yet. We are about 80% bigger than when we bought it. And you're right; we've invested a lot of money in it.

We also think we've enhanced the underlying processes, not all of which you see in the current P&L, because we continue to invest aggressively in rolling out homeowners, motorcycle, renters. I think, Don, that's eaten up a couple of points of profit just last quarter. So we continue to invest in that.

We think it's an opportunity for us to compete more directly and stop them from coming to compete with -- in the multiline customers in the lower left. And so we like the portfolio approach it gives us. So that said, we like the deal. We're glad we paid a lot of money for it and we are even happier that it has turned out to be growing and we are going to make money on it.

As it relates to the individual annual amount, that gives balanced a couple of ways. One is we look at our overall profitability of the company and I like there to be a balance between that.

So while we certainly could spend more money, I don't want to put too much pressure on other parts of the business that also have growth opportunities because we've got lots of places we can grow. Matt is adding agencies. Kathy is growing the benefits business. We've got plenty of places we can grow, so we try to balance it in the overall portfolio of growth opportunities.

And then Don looks specifically at the returns and the efficiency curve, so to speak. So, Don, you might want to talk about how you figure out where the efficiency curve is and then the economics by segment.

Don Civgin (President and CEO Allstate Financial):

Josh, clearly as Tom said, the Esurance acquisition was done to give us a strategic advantage with that particular customer segment, not to make our GAAP results easier to explain. And it has grown -- 14% growth this last quarter on top of 27% last year. It's been growing really nicely, but it forces us to balance between the growth and the profitability.

The way we run the company, the objective function is to grow it as quickly as we can while maintaining the economics so that the returns are above our cost of capital. Now that requires balancing a few things, so if I look at this year's results so far, we have been working hard on the loss ratio. That came down a couple

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points again this quarter. It's down a little bit more than that year-to-date; feel really good about the loss ratio.

The expenses year-to-date are lower if you take out advertising. And then, as Tom mentioned, we've got a couple of points of investment in things like motorcycles, homeowners, renters, other product launches, and so forth. What we are really trying to do then is balance how much we spend on marketing with the acquisition costs that creates so that we can continue to manage our combined ratio on a lifetime basis to be something under 100.

Should we -- if we wanted to strategically we could relax some of those constraints, but as Tom said, we don't want to use more than our share of the resources of the company and they are growing really nicely. The fact that they are up 80%, 85% since we bought them and still running on a sustainable economic basis is good.

So that is the construct under which we are operating. We will continue to balance that kind of quarter by quarter as it relates to marketing, but my suspicion is we will continue to see improvements in loss ratio, because it has been a focus area, which will allow us to spend a little bit more on acquisition and still make the equation work.

Pat Macellaro (Director IR):

Jonathan, this is Pat. We will take one more question.

Operator:

Vinay Misquith, Evercore.

Vinay Misquith (Anaylst - Evercore):

Sure, thanks. Just one question. Management's stated goal has been to maintain the margin and yet you have blown past it and done extremely well for the last couple of quarters. Curious as to whether you intend to keep this margin or do you think that you are overrunning just a tad and would like to maybe just grow some more? Thanks.

Tom Wilson (Chairman President and CEO):

Well, as you point out, we are operating at the bottom end of the range that we provide to everybody in February. We provide that range to give you all a sense for how good we think the underlying economics are in the business and we will do that again in February of the upcoming year.

We put a range out obviously because frequency and severity can bounce around a good point each without actually -- the underlying actual economics being just volatile as opposed to you've done something right or wrong.

So we like where we are operating today. You could hear from Don's comments we are all-in for growth, but it's got to be profitable growth. Sometimes we get growth and it's not profitable and then we shrink it. Other times we get growth and it's profitable, a little more profitable than we think.

We toggle between those at a relatively micro level, but we don't have any desire to reduce our returns in auto or homeowners or our other businesses today to get more growth. We don't think we need to. We think we are accurately priced.

We think the combination of our pricing sophistication, claims skills, distribution, unique value propositions, marketing all that adds up to a customer value where they are prepared to let us earn the economic rents we do. So we are happy with where we are at. We are not looking to sort of say combined ratio is going to go up so we can grow another point. That's not a good trade for shareholders.

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Thank you all. I know you've got an incredible amount of work in the next couple of days, so thank you for listening.

Our strategy is working. It is profit growth, shareholder returns. We are proactive in running the business. We have a number of initiatives underway which will enable us to continue to do those things, so we will talk to you next quarter.

Operator:

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Thank you, ladies and gentlemen, for your participation on today's conference.

This does conclude the program. You may now disconnect.

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