S&P Global
Market Intelligence

Root, Inc. NasdaqGS:ROOT

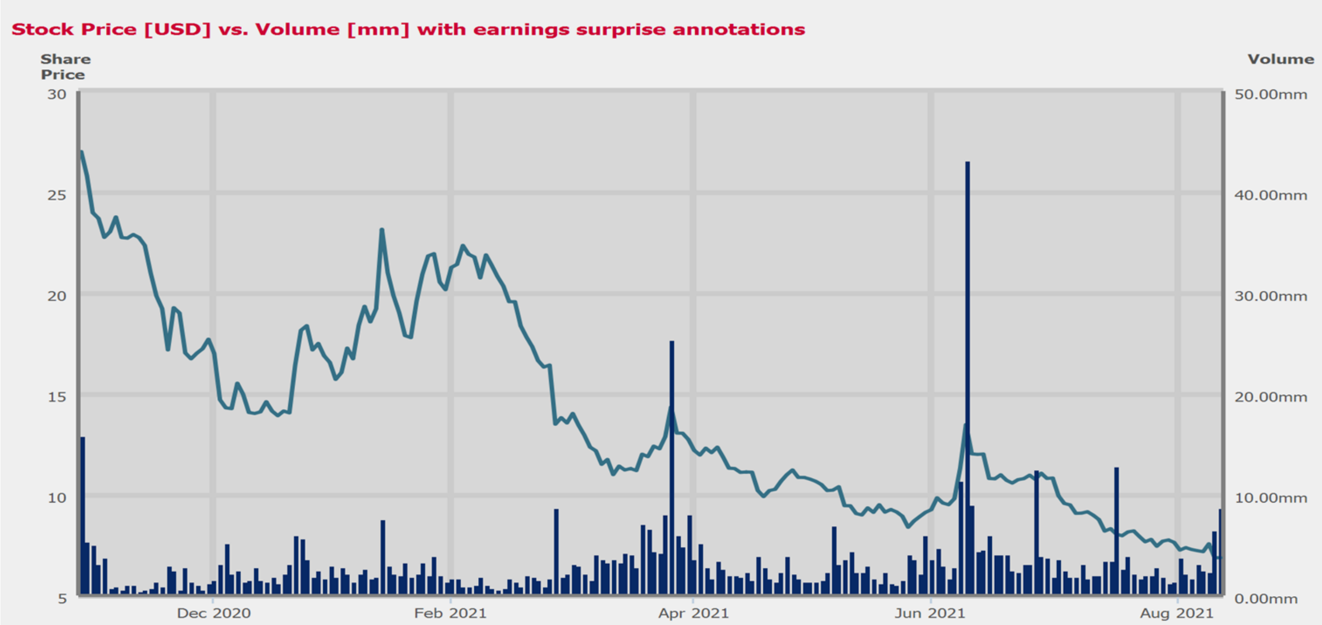
FQ2 2021 Earnings Call Transcripts

Thursday, August 12, 2021 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2021-			-FQ3 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.50)	(0.72)	NM	(0.66)	(2.23)	NA
Revenue (mm)	71.32	89.80	▲25.91	70.70	285.46	NA

Currency: USD
Consensus as of Aug-12-2021 2:52 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2020	(0.33)	(2.20)	NM
FQ4 2020	(0.81)	(0.72)	NM
FQ1 2021	(0.46)	(0.40)	NM
FQ2 2021	(0.50)	(0.72)	NM

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Call Participants

EXECUTIVES

Alexander Edward Timm
Co-Founder, CEO & Director

Christine Patrick

Daniel Harris Rosenthal
CFO & Director

Frank Phillip Palmer
Chief Insurance Officer

Matt Bonakdarpour
Chief Data Science & Analytics Officer

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BofA Securities, Research Division

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

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Truist Securities, Inc., Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

Nicholas Freeman Jones
Citigroup Inc., Research Division

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Autonomous Research LLP

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Barclays Bank PLC, Research Division

Presentation

Operator

Welcome to the Root, Inc. Second Quarter 2021 Earnings Conference Call. My name is John, and I'll be your operator for today's call. [Operator Instructions] Now I'll turn the call over to Christine Patrick. Christine, you may begin.

Christine Patrick

Good morning, and thank you for joining us today.

Root is hosting this call to discuss its second quarter 2021 earnings results. Participating on today's call are Alex Timm, Co-Founder and CEO; and Dan Rosenthal, Chief Financial Officer. During the question-and-answer portion of the call, our presenters will be joined by Matt Bonakdarpour, Chief Data Science and Analytics Officer; and Frank Palmer, Chief Insurance Officer.

Last evening, Root issued a shareholder letter announcing its financial results. While this call will reflect items discussed within that document, for more complete information about our financial performance, we also encourage you to read our 10-Q as well as our 2020 Form 10-K.

Before we begin, I want to remind you that matters discussed on today's call will include forward-looking statements related to our operating performance, financial goals and business outlook, which are based on management's current beliefs and assumptions. Please note that these forward-looking statements reflect our opinions as of the date of this call, and we undertake no obligation to revise this information as a result of new developments that may occur. Forward-looking statements are subject to various risks, uncertainties and other factors that could cause our actual results to differ materially from those expected and described today. In addition, we are subject to a number of risks that may significantly impact our business and financial results.

For a more detailed description of our risk factors, once again, please review our Form 10-K where you will see a discussion of factors that could cause the company's actual results to differ materially from these statements as well as our shareholder letter release today. A replay of this conference call will be available on our website under the Investor Relations section.

I would also like to remind you that during the call, we will discuss some non-GAAP measures in talking about Root's performance. You can find the reconciliation of those historical measures to the nearest comparable GAAP measures in our shareholder letter release today and on our filings with the SEC, each of which will be posted on our website at ir.joinroot.com.

I will now turn the call over to Alex Timm, Root's Co-Founder and CEO.

Alexander Edward Timm
Co-Founder, CEO & Director

Thank you, Christine. Good morning, everyone, and thank you for joining us on our second quarter call.

Today, I will provide a summary of our second quarter business results. Then I'll turn the call over to Dan for a deeper dive into our second quarter financials. Before touching on those topics, I'm extremely excited to share further detail on our exclusive partnership with Carvana that we announced last night. Our partnership has deepened as the 2 companies have gotten to know each other and understand each other's businesses and shared values. Mutual respect has been built as we are 2 companies focused on delivering the best customer experience through technology platforms. And after success with our initial partnership, it made sense to find ways of accelerating this opportunity by expanding our relationship.

This industry-first partnership goes beyond what any other carrier or aggregator has done before, empowering Root to build a fully integrated insurance solution for Carvana customers. As a tech company with a full-stack insurance carrier, Root is best positioned to deliver personalized, bindable quotes embedded into the car ownership experience. Meeting customers where they are at the point of sale creates a natural onboarding experience that is likely to result in meaningful uptake with an attractive customer profile and attractive acquisition costs. Carvana's investment in the company underscores their commitment to the partnership while providing Root with additional capital. We are hard at work bringing the new partnership with Carvana to life, and we'll share our progress along the way.

Now turning to the second quarter. We continue to operate on the 3 key drivers I laid out at the beginning of the year: first, the powerful competitive advantages enabled by our investment in proprietary technology and telematics; second, how these advantages uniquely position us to manage risk as we achieve scale; and third, how our seasoned states will increasingly contribute to our management of the business, deployment of capital and profitability.

A key milestone was the release of our latest underwriting model, UBI 4.0. This brings to market increased predictive power that allows us to give the best drivers rates [they deserve]. The enhancements to the model leverages more than 3x the data of our prior model, allowing us to better identify extreme risks and more accurately predict loss. We now have UBI 4.0 running in 16 states, allowing over half of our current customer quotes to utilize this model, with continued rollout over the coming months.

The advantage of our technology is not just on display when a customer shops and binds with us, it's also apparent in our retention metrics. Through scaling our data sets and improving pricing algorithms, we have been able to better segment our risks, resulting in increasing retention among the best 25% of drivers, while simultaneously decreasing the worst 25% of drivers that renew. This further validates that we're giving customers the policy and pricing commensurate with their risk, a concept that is central to our sense of fairness.

We continued down the path of national expansion, having launched our entry into Wisconsin during the second quarter. We were also able to accelerate our entrance into Washington State following the insurance commissioner's ban on the use of credit score, a bias we believe should be removed from rate-setting altogether. Through our data science capabilities, we were able to move from research to filing in less than 2 months, an effort that takes most competitors in excess of a year. As incumbent carriers in the state struggle to reflect the change, we will be able to enter the disrupted market with a pricing model that reflects the elimination of credit score across all variables. Our flexible platform best positions Root to win in a future where this bias is consistently eliminated nationally.

During the second quarter, our marketing environment proved to be a challenge. Across virtually all of our digital ad channels, we saw placement costs increased substantially, which has since become a documented trend across the entire consumer product landscape. While we were in the process of ramping customer acquisition, the prices we were seeing, particularly later in the quarter, simply got beyond our standards and we began flattening or ramping spend down in certain channels to more acceptable levels. Given the magnitude of the cost increase this quarter, we recognize the value in diversifying our customer acquisition channels through technology and data science, building embedded insurance partnerships and expanding our independent agent product. We see enormous and largely untapped opportunity in creating bespoke insurance offerings for relevant consumer verticals as we expand our network of partners.

As a tech company with a full-stack insurance carrier that owns the end-to-end consumer experience, we are in a unique position to offer a fully integrated digitally native experience. Our exclusive partnership with Carvana is a significant step forward in demonstrating our value in this area. And we look forward to sharing the progress we are making in this channel in the quarters ahead.

To extend our value proposition to more customers, we continue to build out our independent agency product. Nearly 1/3 of customers shop for insurance with an agent. And this number has stayed steady over the past decade, even with the rise of direct channels. We are leveraging our technology to create convenience and transparency for both agents and consumers. And we'll share more on our work in this space in the coming quarters.

Broadening our approach to customer acquisition channels is critical for us to manage your capital over the long term. We are conscious of bringing the right risks onto the book for the right costs and believe using our technology advantage to tap into these enormous opportunities positions us to more efficiently deploy your capital over the long term. We believe we're on the path to truly unique opportunities within these channels, and we can't wait to update you in coming quarters.

I'm thankful for the continued support of our investors, our team and our customers. With that, I'll turn the call over to Dan.

Daniel Harris Rosenthal
CFO & Director

Thanks, Alex, and good morning, everyone.

The second quarter of 2021 reflected the environmental changes that the auto insurance industry experienced. You will find our full GAAP financial results contained in the shareholder letter we published yesterday evening. But we wanted to give a few of the key highlights.

On the top line, we grew direct written premium 24% year-over-year to $177 million. Our direct earned premium increased 19% year-over-year to $181 million. Our direct earned premium from seasoned states increased to 77% of total earned premiums.

Shifting to profitability. Direct accident period loss ratio was 88% for the second quarter, a 22% increase year-over-year against Q2 2020 when compared with the low loss environment in the previous year during the pandemic. More importantly, we recorded a 23-point improvement from Q2 2019, demonstrating how significantly we've improved performance, stripping away the impact of the pandemic. This has been accomplished through the launch of new iteration of our proprietary UBI models and pricing algorithms, further state seasoning and attention to bringing on the right risks at the right cost.

The year-over-year increase in the loss ratio was primarily driven by 16 points of severity and 11 points of frequency, as inflationary pressures increased costs and miles driven rose to above pre-pandemic levels in our book. Direct contribution was a $4 million loss for the quarter. The decline in direct contribution and related margin was driven primarily by direct loss ratio, as I covered above. While the industry, ourselves included, faced headwinds this quarter, we continue to make progress on the business overall. While uncertainty remains around the ongoing impact from loss cost inflation, we believe that the underwriting and planned rate actions, coupled with our ability to update our loss cost model frequently, is allowing Root to react quickly. Additionally, we believe the prior rate increases taken as we saw these trends emerging will continue to earn into the book.

As Alex detailed, we are focusing on diversifying our distribution channels, particularly through our embedded insurance offering and independent agent product. Our partnership with Carvana is the first significant step in unlocking the enormous and largely untapped opportunity that our technology platform brings to the partnership channel. As a whole, our actions this quarter set the stage for Root to drive growth at attractive unit economics and create long-term value for our shareholders. The actions we are taking on both the marketing and partnership fronts not only better position the company for sustained growth, but open channels to more efficiently deploy your capital and strengthen our liquidity position over the long term.

I am also pleased to announce that we have successfully placed a multiyear quota share effective July 1. Reinsurer interest was strong, with oversubscribed demand and the ability to renew at improved terms. We remain excited about the strength of our reinsurance partners as a key component of our capital structure. There is additional stability as all of our treaties are now placed on a multiyear basis.

I echo Alex's excitement about our prospects with Carvana as an embedded insurance partnership. Over time, we expect our relationship to drive a significant competitive advantage. We are laser-focused on efficiency and differentiation in our customer acquisition strategy. We therefore expect to significantly reallocate and reduce our current marketing spend, impacting near-term growth, but positioning us for higher and more efficient growth into the future.

As a result, we are revising our top line and profitability guidance for 2021. We now expect direct written premium growth for Q3 in the low to mid-single digits and a year-over-year decline in Q4. Also, on a year-over-year basis, we expect direct earned premium and GAAP revenues to grow high single to low double-digits in Q3, followed by a decline in Q4.

Looking ahead to 2022, we currently expect declines in top line measures as we lap periods of high growth and significantly higher marketing spend, while we prioritize building out new channels at lower spend. We expect direct contribution to be in a modest loss position in the near term as we make pricing adjustments to match the current industry environment. We expect quarterly operating loss to stay elevated in Q3 2021, then materially decline in Q4 2021 as we focus on our most efficient marketing channels, resulting in a full year operating loss in line to slightly unfavorable to the high end of our initial outlook range of $555 million. Noteworthy is that our updated guidance does not include any impact from the exclusive partnership with Carvana that we announced today.
We are excited about the opportunities before us. I echo Alex's appreciation of your continued support. With that, we look forward to your questions.

Question and Answer

Operator

[Operator Instructions] And our first question is from Matt Carletti from JMP.

Matthew John Carletti
JMP Securities LLC, Research Division

Dan, I just wanted to make sure I'm hearing you right on kind of the reasons behind the changes in the growth outlook and that they are kind of purely customer acquisition costs focused, and that is not related to kind of the near-term pressures that have been on the loss ratio but more just directly related to what happened with cost of marketing through performance channels.

Alexander Edward Timm
Co-Founder, CEO & Director

That's a good question. This is Alex. And I'll let Dan add more detail here. For us, what we saw with the spike in loss ratio quarter-over-quarter from the increase in inflation as well as the increase in costs and marketing channels, we just don't near term see that as an efficient time to actually be deploying capital. And we think it's much better longer term to deploy that capital when we actually -- when we have a better sense for where we want those loss ratios to be and when we have a better sense for that marketing acquisition.

Dan, would you add anything?

Daniel Harris Rosenthal
CFO & Director

Yes. Thanks. Matt, thanks for the question. Look, I'd echo what Alex said, you should not think of this as a massive strategy shift. This is really a prudent use of capital given the current industry environment, having to do more with the marketing channels and the loss ratio both. Across our marketing channels, what you see, Matt, is some things are working, and we're going to keep investing in those channels. Some are not. And what we're saying is we're either going to fix those or stop utilizing those channels. And then we have a couple of new things. We're thrilled about the partnership with Carvana. It's the first of what we hope will be multiple embedded partnerships, embedded insurance partnerships and as well as some of the other new channels that we talked about. And we feel like those channels, combined with the current ones that are working, will help us get right back on the growth trajectory at the right time.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And then just a follow-up, if I could. I heard you talk a little bit about kind of you're working with agents, I think LEFTLANE is the -- what I've seen as kind of the name for it. There was some news. I can't remember if it was announcement for you guys or just industry press about your RootReady during the quarter and kind of your embedded tech within cars and some manufacturers. Can you tell us a little bit about what you're doing there and how we should think about that?

Alexander Edward Timm
Co-Founder, CEO & Director

Absolutely. So RootReady is a program that we've actually been working on for a few years, and we're proud of where we've gotten it. And it really allows us to position the company much better for the future as vehicle technologies continue to improve and as vehicles become increasingly connected. And effectively, what we do is we can -- we have access to databases that, effectively, when a consumer comes to our website or our app and they provide some basic information, we can actually see if they previously had a connected vehicle or currently have a connected vehicle in which we already have driving data.

And in that case, what we will do is we'll actually provide an immediate quote, leveraging telematics data. Now we still want the cellphone data because, obviously, from vehicle data, you don't get texting and driving and other behavioral data. So we will still collect that data over the following 6 months after the consumer binds to incorporate that new data in on renewal. But this really allows us to basically provide an instant quote that has much more -- that is much more data informed than otherwise.

Operator

Our next question is from Elyse Greenspan from Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question, I guess it's just building up on the last topic. I mean you guys mentioned diversifying acquisition channels and bringing on new partner relationships as well as building out your independent agent product. Can you just expand and give us a sense, ultimately, like how big some of these endeavors could be over time?

Alexander Edward Timm
Co-Founder, CEO & Director

Absolutely. So we think that there is going to be a fundamental shift towards embedded insurance, where it makes much more sense for the consumer and is a much better consumer experience to effectively, while they're purchasing a vehicle, to just have insurance included in that vehicle purchase. It makes it much more seamless, much less of a headache. Auto insurance is not necessarily a product consumers love shopping for. And what we have found is that through our technology, having really built an insurance company from scratch over the last 5 years, that we have a very nimble and flexible tech stack that allows us to seamlessly integrate really with a variety of partners. And we think Carvana is obviously a major partner here. We've gotten to know the company very well. We feel very culturally aligned with them, and we think that there's lots of opportunity for them to continue to disrupt the space that they are playing in. And so we think that, that's meaningful.

Now in terms of independent agents, they've weathered the direct market shift very well. They have really shown resilience over the last 10 years. Their market share has been relatively stable at about 30%. And so we do know and we believe that there are many consumers and there will continue to be many consumers that prefer to go to an independent agent.

Now we also believe that those independent agents need better technology from carriers and that allows them to easily quote somebody so that you're not on the phone for 20 or 30 minutes with an agent just to get a simple auto insurance quote. And we found that in our early testing in R&D that we can actually build much better seamless products for the agent that the agent enjoys and then also that allows the agent to get their consumers onto a mobile device and into a mobile setting. And so we've really found that our technology there can extend to serve those customers, too. That's 30-plus-percent of the market, and it's a $270 billion market in total. And so we think that clearly is a very large opportunity.

And in terms of customer acquisition costs, there's a few things I'd say. One, I think all of these channels won't be nearly as exposed to some of the short-term noises that we may be seeing right now in digital marketing channels. And then two, I think they will also be not only much more predictable, but we think they'll be very efficient. And so we will be acquiring the right customer at the right price over the long term.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

That's helpful. Do you have a sense of the relationship with Carvana? I recognize you guys just announced it. But do you have a sense of the TAM there? And just over time, as you guys agreed to enter into this relationship, how much of an opportunity that could be for Root?

Daniel Harris Rosenthal
CFO & Director

Yes. We're really excited about -- Elyse, this is Dan, for the reasons that Alex articulated. This is a transformational partnership for Root, and we believe for consumers of autos and auto insurance. Alex mentioned, we are like-minded companies. We both put digital first. And the good news is we've gotten to know each other. We've worked together now for a year, and we've seen in the early days of our partnership the significant opportunity.

As far as the TAM, I would point you to Carvana's disclosure of having a proven model with some of their other embedded services. For example, as they've disclosed, about 80% of their customers choose to finance with them. They also offer warranty and service embedded. And we think, as Alex has said, consumers today go to buy a car with batteries not included because they don't have the opportunity to purchase insurance at that point of sale. And so the TAM here that we think we can unlock together with Carvana is massive.

Now at the same time, we are making sure that we invest in the right way with them to provide and build a product that works with consumers. And we think that will ultimately lead to better economics as a more vertically integrated player. And we've structured our agreement with Carvana to split those in a way that's fair. At least we're not going to provide any more details at this time. We're going to hunker down, get to work and build an incredible product for consumers.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

That's great. And then one last one. You guys said premium should be down next year, right, recognizing that there's been some strong growth to start 2021? Is that -- like would you expect growth to be down in all 4 quarters? Or is it something where, as you see things today, perhaps given some of these dynamics, are going to impact the second half of this year, that you would return to top line growth in the second half of 2022?

Daniel Harris Rosenthal
CFO & Director

Yes. It's a good question, Elyse. We've -- in the guidance that we've put forward, we've alluded to the first half of the year for the reason that you suggested. We think that we are going to be disciplined in our marketing spend, especially at the tail end of this year and into early next year. And you're exactly right. As you look at lapping the first and second quarter of this year, we are going to make sure that we're focusing our resources on investing in the new channels that Alex talked about as well as some of the existing marketing channels that are working. And our guide is that, that's not going to keep us on the same growth trajectory as we conserve our marketing spend and focus it on the channels that are working. So that is the plan as we move forward. And then as we build out those new channels, we'll be excited to come back and talk to the market about the growth opportunities that we see beyond.

Operator

Our next question is from Josh Siegler from Cantor Fitzgerald.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Can you describe the actual experience that a Carvana customer will have regarding Root? When in the process are they presented with the quote? And will they receive any telematic adjusted rate after a certain amount of time?

Alexander Edward Timm
Co-Founder, CEO & Director

Right now, we really are in the early stage of developing the product and embedding the product in the experience. But we will make it very seamless for consumers. And we're going to test along the way, and we think we're going to learn a lot. In terms of telematics, we will be integrated with the Carvana app. And we do expect that we will be actually even closer to the vehicle through this partnership and even closer to some of the new sources of telematics data at this time. So we'll be excited to share as we develop the product into the future with all of you.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Great. That's helpful. And then speaking on partnerships, can you speak a little bit about the pipeline of additional partnerships right now? Do you expect the future partnerships to kind of look like this exclusive deal with Carvana? Or maybe more like some of your prior partnerships?

Alexander Edward Timm
Co-Founder, CEO & Director

I think really where we are is, we've had partnerships in place for quite a while, both in the auto space but then even more broadly, in financial -- with other financial service companies. And we do think that in intercepting consumers in times that make sense to them is really important, and we have seen various degrees of success with partners. We've tested out lots of partners, some that work really well and some that don't. And what we want to do going forward is really focus and double down on those partners where we think the product makes the best sense for consumers.

And so we see it as we have a very healthy pipeline, and we want to make sure that we're focused. And right now, we think that the focus really is on the Carvana partnership because that's really where we see: one, as Dan alluded to, the most aligned team in terms of technology, in terms of culture and really intimately getting to know one another; but also in terms of the ability to really create a differentiated consumer experience.

Daniel Harris Rosenthal
CFO & Director

And the only thing I would just briefly add is, not only from our perspective does it create a differentiated consumer experience, but does so with a really attractive customer demographic for us. These are not consumers who are going on Google or vertical search to buy car insurance, these are meeting consumers at the point of sale. And we believe that, that will have not only a more efficient customer acquisition cost for us compared to our performance channels, but also, frankly, a longer retaining customer with -- by having met them at the point of sale. So we're really excited. And I echo what Alex said. I think we cannot overestimate the real bond that the teams have had between Root and Carvana, really focused on creating the ultimate consumer experience. And we're very excited about what's to come.

Operator

Our next question is from Nick Jones from Citi.

Nicholas Freeman Jones
Citigroup Inc., Research Division

I guess one on Carvana. Can you maybe describe the nature of the agreement or the exclusivity? And does this mean Carvana can only offer Root? Or are you kind of an exclusive technology partner that, over time, they can embed other auto insurers into the platform? Just maybe a little clarity there. And then can you remind us how many drivers are maybe swapping out used cars or just changing cars also consider changing auto insurance during those transactions?

Daniel Harris Rosenthal
CFO & Director

I can take the first question, Nick, and then turn it over to Alex. The exclusivity in the partnership is something we're really excited about. We are going to build really the first vertically integrated embedded insurance product exclusively for Carvana and working with them on an exclusive basis. Now we recognize that there are some states where we are not yet writing business, and there are perhaps other aspects where the right thing for the consumer is, to your point, a broker in another insurance carrier or what have you. And the North Star for us here is to do the right thing for the consumer. But this is really an exclusive partnership where we are going to be investing a lot of time and energy and people resources in order to build out that really differentiated embedded insurance product partnering with Carvana. Alex?

Alexander Edward Timm
Co-Founder, CEO & Director

Yes. In terms of consumer shopping behavior, this is one of the unique moments of truth. So this is when consumers do change vehicles, as you'd expect, they typically see, one, a change in price to their current insurance. And that does tend to trigger shopping moments. And so we think if you can get in front of a consumer at this moment, that this is easily within the top 3 or 4 sort of triggers for shopping in insurance that's out there. So it's very big.

And I'll also say, even in these triggers and in these moments, you also get access, as Dan was referring to, to consumers that may not otherwise shop for insurance because they're not necessarily going to Google and googling auto insurance to shop frequently or maybe ever. And so it also gets us access to consumers that we may not otherwise see through more traditional marketing funnels.

Operator

Our next question is from Tracy Benguigui from Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

You mentioned that miles driven is rising above pre-pandemic levels for your book, but we're hearing from other auto insurers that miles driven is approaching pre-pandemic levels. Is there something unique to your book that we should consider? Or is there a data set you're using that could help bridge this difference?

Frank Phillip Palmer
Chief Insurance Officer

This is Frank. I can take that one. I've got 2 perspectives on that. First, as I look across the industry and have seen what other folks are reporting, there are some general telematics and traffic data that besides just Root that have said that we're at pre-pandemic levels or higher. And then we might also be looking -- we're looking at very granular data on our customers and being able to see in real time where those miles are going. And so it's not clear that -- and all of the reports that you might be reading, that they're actually looking at like real time in the last month or 2 versus looking at like miles driven compared to the pandemic over the last 6 months or in the quarter 1. So we feel that we actually have really early warning signs and can really more quickly and granularly see what's going on. And it also varies by state, so we can actually tell in certain states where the miles are up versus other states. And so we believe that we've got very granular insights into how that driving happens.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. That's really helpful. And then in response to this loss trend, how would you describe the magnitude of rate increases you may need to get closer to your long-term loss ratio target? And how swiftly do you think you could get through the approval process?

Alexander Edward Timm
Co-Founder, CEO & Director

Sure. A few things on that. First, I'd say that we had seen some signs of increasing trend before the second quarter. And so we have had differentiated maybe in the industry rate increases in first quarter and second quarter, not necessarily as large as what we think we need now, but we've kind of been flowing rate into our book all year long we think faster and sooner than what some of the industry has been seeing.

As we look out over the next 6 months, I think that we will end up being able to do more rate increases than what most of the competitors will be able to do. Some of that is just, again, because of our real-time looking and the fact that we've been able to see this sooner, allows us to start that filing process earlier maybe than some of the industry.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. Maybe just a quick follow-up on that. I mean I think you're right, the last couple of quarters, you had filed some rate increases. And would that limit your ability for more on a regulatory standpoint as others are trying to do it for the first time?

Alexander Edward Timm
Co-Founder, CEO & Director

So there's going to be -- so first, as we filed that, there are some states we haven't filed anything at all. And we will be first into those states probably with rate filed rate increases compared to competitors. In states that we took rate increases in, in the first quarter, most of those or many of those states are ones where you don't have to get regulatory approval. They're filer used. And so we think that we'll be -- and given the fact that we took smaller rate increases in first and second quarter, as we're coming back in, in the third and fourth quarter, we'll also be then looking for smaller rate increases than if we had, had to bunch it up the way our competitors do. So it's much easier to get, say, 2 4s than an 8 approved in a particular state.

Operator

Our next question is from Mark Hughes from Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

I'm curious on the severity and frequency. How much of that do you think is this broader inflation spike? Certainly used cars, you mentioned in your release, the pricing has been up dramatically. But some of those factors may be temporary or maybe not. I'm just curious how you see these losses. How much of it is going to endure? How much might be transitory?

Alexander Edward Timm
Co-Founder, CEO & Director

Sure. So first, we've only had, say, one quarter's worth of data where we've really seen this spike up. So trying to figure out those trends are still opaque, I'd say. We don't really have a clear view, are we seeing a bubble that's going to come down? On the miles driven, when you look at other countries, say, China, we did see China had a big spike right after their pandemic kind of slow down as people move from public transportation to regular transportation or to driving. And then it came back down a little bit on the miles driven as people move back to transportation, but hasn't yet come back down to pre-pandemic levels. So we could see a bubble.

On the severity side, we talked about used car prices. We talked -- you can talk -- you can see general inflation throughout the U.S. economy. I don't see that dropping back down in the next 12 months to zero trend levels. So I see the severity as part of probably more of a 12- to 18-month sustained increase. But again, we've only got 3 to 6 months' worth of data so the trends are pretty hard to tell there.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Yes. And then, Dan, on the reinsurance, renewed multiyear agreement, anything you could tell us around the economics? The -- is the model similar to what you had discussed in earlier periods? I think there's also an element of that where the loss sharing mix shifted over time. Just any updates there on those new agreements.

Daniel Harris Rosenthal
CFO & Director

Yes. Thanks, Mark. All positive on the reinsurance front. As we've talked about before, we manage the business on a direct basis. And then Alex says to my team and me to manage the balance sheet in the appropriate way. And we're really pleased with the renewal of the 7/1 treaty. It is a similar cohort-based multiyear treaty to what we've been doing. Oversubscribed, improved financial terms. And we're very pleased with not only the terms and the size, but the partners who continued and increased as well their allocations. And we can talk more about that in the weeks and months ahead. But nothing to see here. All positive, all consistent with the model, all moving forward.

Operator

Our next question is from Josh Shanker from Bank of America.

Joshua David Shanker
BofA Securities, Research Division

I wanted to follow up on that reinsurance question. In a quarter like 2Q '21 where your direct loss ratio plus LAE is 100%, what are the economics of a quarter like that to the reinsurers? Are they taking also a loss ratio of 100% and they're paying you a ceding commission and they have their own expenses? Can you sort of talk about how their economics work in the contract?

Daniel Harris Rosenthal
CFO & Director

Yes. It's something that we considered as we approached, obviously, the discussions with the different reinsurers. And Josh, I was really pleased the reinsurers took a long-term view and saw the improvements that are happening in our loss ratio through the use of our differentiated technology and some of the work that Frank is doing on segmentation and state management. That's showing up in the actuarial results. So they're committed for the long term through these cohort-based treaties.

The structure is the same as we've talked about in the past. We get paid a ceding commission upfront for securing the business, and then we pay the reinsurers a margin over time. And they ultimately focus on the fact that in a cohort-based treaty, they are benefiting from the lifetime value of the customer. So they're not so much focused on this month's results or that next month's results. It really is a long-term approach looking at the trend of our losses, the improvements that

Frank and his team are making as well as the overall personal auto sector. And reinsurers, as you well know, Josh, want diversification in their risk book, and they're pleased to continue renewing with us. And I was not only pleased with the fact that we were oversubscribed in the treaty, but again, the terms improving as well.

Joshua David Shanker
BofA Securities, Research Division

And on your growth guidance, I know you don't want to talk about the Carvana product yet because it's still in development and whatnot, and so the timing may not be clear. But the growth guidance is ex any possible benefit from the Carvana relationship. Does it include some Carvana in it? How should I think about your outlook for growth in that deal?

Daniel Harris Rosenthal
CFO & Director

It does not include Carvana in it.

Joshua David Shanker
BofA Securities, Research Division

It does not include any Carvana?

Daniel Harris Rosenthal
CFO & Director

Correct.

Joshua David Shanker
BofA Securities, Research Division

And the timing when we could see some contribution, you're not prepared to say just yet?

Daniel Harris Rosenthal
CFO & Director

We've talked about that with our partners at Carvana. And we're -- our message is we're getting in and starting to work. The teams, the product teams, Josh, are tremendously excited by some of the opportunities that are in the works. And stay tuned. We're not prepared to give a specific time line. But again, these are 2 teams that move very fast, that are used to -- that have digital-native approaches. So I would say stay tuned. And we'll come back to the market together when we have more to talk about.

Operator

Our next question is from Phil Stefano from Deutsche Bank.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Yes. Congrats on the Carvana partnership. I feel like there's been a number of questions around the strategy. So maybe just a quick housekeeping item on that. And apologies if I missed it, was there a coupon or a rate that was mentioned on the preferreds? Or is there a way you could help us to think about that?

Daniel Harris Rosenthal
CFO & Director

Yes. We filed our 8-K this morning, Phil, with all of the details. There is no coupon on the convertible preferred.

Philip Michael Stefano
Deutsche Bank AG, Research Division

Okay. Perfect. In the shareholder letter, on the UBI 4.0 section, you noted that there's a belief that it will help in the identification of new segments for expansion. And I was hoping you could just flesh this out a little more. I mean is that a roundabout way of saying the independent agent markets? Or is there different new segments that you're trying to point us to when you talk about this?

Matt Bonakdarpour
Chief Data Science & Analytics Officer

Yes. Thanks for the question. This is Matt. So that's referring to something we're really excited about with UBI 4.0, which is the ability to score drivers with far less data. So historically, we've been very conservative in the criteria we set to make a user eligible to be scored. We wanted to ensure that we had enough data to create a high-fidelity score. Now that we've collected tremendous amount of trip data and [lost it] over time, we've been able to fine-tune our telematics risk score to basically do more with less. So there was a reasonably large population of drivers who don't drive very much, who we were unable to score because of those conservative eligibility rules. And now we're able to confidently score them with a predictive score and really open up that quoted population to getting fair rates through our telematics score.

Philip Michael Stefano
Deutsche Bank AG, Research Division

And is there a way to think about how this will be evidenced? I mean is it more people coming into the funnel? Is it better conversion through the funnel? How do we think about -- as there's more iterations of the UBI technology, how do I think about the right metric to judge the success of this?

Matt Bonakdarpour
Chief Data Science & Analytics Officer

Yes. So in the shareholder letter, you'll look at the good driver proportion over time. We will see a dramatic increase over time because we're able to provide segmentation on this bucket that we were unable to provide segmentation on before. Or said another way, there's a large proportion of good drivers that we were not segmenting before UBI 4.0, and now we're able to provide them adequate rates that reflect their driving experience.

Operator

And our next question is from David Motemaden from Evercore ISI.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

I guess just -- this feels like a big strategy shift here just from the distribution side. And I guess I just wanted to understand sort of the mix of your business and your PIF. And how much of it comes from each channel, whether it be performance marketing, direct partnership? Is there any way you can give us a sense for how big of a shift in your book of business this will be?

Alexander Edward Timm
Co-Founder, CEO & Director

Yes. We really do not view this as a strategy shift. We have been working on our embedded insurance product for actually over 4 years and have been experimenting with various partners. And we've been working with Carvana over the last year, and they really got to know us and our company intimately. We got to know each other on a cultural level intimately as well. And I think that's really where we started to see a potential for the acceleration of our strategy.

And with independent agents and agents, it's always something we wanted to eventually -- we've always believed that we can, through our technology and through telematics, provide a disproportionate value proposition to customers that are coming through that channel as well. And that said, we also still really believe in our direct model. We will grow with our direct model when it makes sense to grow in our direct model and we won't when it doesn't. And in that way, we believe we're going to create the best long-term shareholder value.

And when we look over the long term, we do believe that our marketing channels will continue to invest in the marketing channels that are the most efficient and the distribution channels that are the most efficient. And we would expect there to be a large shift of volume to these new channels that are emerging. And we truly do believe that the future of auto insurance looks much different than what it does today. And we think that it will work better for consumers through partnerships like Carvana and the embedded platform.

Dan, would you add anything?

Daniel Harris Rosenthal

CFO & Director

No. I think that's right. I think that as we move forward, you're going to find that some of these channels are accretive really in multifaceted ways. And I'd echo what Alex said. This is not a massive strategy shift for us. This is about investing capital in the channels that are working and doing the right thing for shareholder value over the long term. And where we see channels that are not working at a time where you can see it in Google and Facebook's earnings, you can see it in what other carriers are doing in terms of vertical search and some of the different channels out there, it doesn't make sense to invest that capital. And we think our investors would prefer that we'd be prudent stewards of that capital and focus on building out the new channels that we're tremendously excited about.

This partnership with Carvana is really transformational for us. We think it's groundbreaking. We think it's going to change the way that consumers buy cars and buy their car insurance. And so it's important for us to prioritize that based upon what we've learned in partnership with them over the last year. So this is only the beginning, and we're excited to move forward and really build out that shareholder value for the long term.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Understood. That's helpful. And then I guess just I wanted to just shift to the debt and capital position. I guess could you just -- I believe there's some debt that's maturing in October. Could you just remind me of your plans for that? And then also, do you have an update just on the capital levels in the Ohio subsidiary, in the Cayman captive? And I guess, your plans for the proceeds from the investment from Carvana, are those -- I guess are those going to be injected into either one of those subsidiaries to support capital levels there?

Daniel Harris Rosenthal
CFO & Director

Yes. David, thanks for the questions. On the first question, we do have a $100 million funded term loan with a group of 8 banks maturing in October. We are in discussions right now with those banks, and we'll come back to the market as we have a further update. As far as the capital levels overall, there are 2 aspects that are important here. One is obviously the investment from the Carvana partnership is important to us on several levels. It's a strategic enabler that really solidifies our already strong financial position and then gives us the flexibility to take full advantage of the opportunity in front of us.

And then second, we're noting throughout our shareholder letter and on the call today that we are going to drive a material reduction in our marketing spend in the coming quarters, that we are going to focus on long-term shareholder value. And when you combine those 2 things, the reduction in our marketing spend and the investment from the Carvana partnership, that will meaningfully extend our capital runway expectations. As we have more on the debt front, reinsurance front or what have you, we'll come back and talk to the market. But we sit here outside of the insurance entities as of June 30 with $825 million of unencumbered capital, and we feel like we're in a good position. When you add that to the Carvana proceeds from their investment and then coupled with the reduction in our marketing spend going forward, we're in good position for years to come.

Operator

Our next question is from Gary Ransom from Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Most of my questions have been answered. But I wanted to understand what you were doing with Carvana before this deal. You said you had been working with them. Were there some sales through the partnership? Was it just more rudimentary type of technology? Could you help us out of what you were doing before versus what you've talked about for the future?

Alexander Edward Timm
Co-Founder, CEO & Director

Absolutely. Before, we were really just displaying Root to a subset of customers, a small subset of customers that were coming through the Carvana experience. And it also was not an embedded experience, it was really just testing to see what those take rates could be and how interested consumers may be in the product.

Gary Kent Ransom
Dowling & Partners Securities, LLC

And one other question on retention. Just overall, I know you talked about retention being better for the better drivers. But even within those better drivers, has there been any change as the frequencies come back and driving has come back? Anything you're seeing there that might be helpful for the outlook?

Daniel Harris Rosenthal
CFO & Director

Yes. We look historically. And compare to seasonal trends, we see that this year's seasonal trend as it pertains to retention mimics the pre-COVID seasonal trend. So the trend is looking the same throughout the year. We have implemented product changes that have shown, through rigorous experimentation, improvements to our retention. And so while the trend is the same, we have seen some shifts in those carriers. As those changes get implemented on top of our entire customer base, we expect to continue to see improvements to those retention numbers.

Operator

Our next question is from Ryan Tunis from Autonomous.

Ryan James Tunis
Autonomous Research LLP

First question, on distribution in Carvana, a couple of pieces to it. First, as you work with independent agents and/or Carvana, are you more willing to move away from kind of the core telematics, drive-first type offering? And then also with Carvana, how does the underwriting work with that? I would think that Carvana would be holding you to some kind of mandatory acceptance rate. So what's your flexibility and your ability to get the pricing, get the mix right underwriting with Carvana?

Alexander Edward Timm
Co-Founder, CEO & Director

Really, our underwriting in our telematics will be deployed really in full force through the Carvana platform as well. And we actually see it as an opportunity to extend our advantage as we get closer to vehicles, which we can then supplement the cell phone data from, whether it's the Carvana or the Root app with vehicle data and data directly off of the vehicle. In addition, there is no mandatory acceptance ratios that we have crafted with Carvana. We will do what's right for the consumer in every situation and make sure that we can address as many consumers as possible and make sure that consumers have a really great experience across 100% of their funnel. But that may or may not mean that those consumers are going to be underwritten directly by a Root insurance entity.

Ryan James Tunis
Autonomous Research LLP

Got it. And then maybe for Dan. The pullback in marketing spend, I would have thought would have maybe benefited the P&L a little bit in the back half of the year. The guide still implies the low end of your previous guidance. So I'm wondering, why is there not more of a benefit there? Is it that advertising will still be relatively elevated? Or is there something else? Is it an expectation for higher loss ratio or more tech investment? Just some color on why you don't expect the quarterly net income run rate to improve materially.

Daniel Harris Rosenthal
CFO & Director

Yes. Thanks, Ryan. It's a combination of losses, which Frank talked about and we obviously talked about in the shareholder letter. And then just the fact that we're sitting here already midway through Q3, and a lot of the marketing spend -- obviously, July is in the past and some of the marketing spend is already committed as we look forward. So as we assessed our channels and really decided to make a move to focus on making sure our capital is being invested in the channels that are working and turning off the ones that are not, it just takes a little bit of transition time to do that. So I think you'll really start to see the impact of that show up in Q4, and so that impacts the operating income guide for the year.

Operator

And our next question is from Christopher Martin from KBW.

Christopher Martin

As kind of a follow-up from the last few questions as -- taking it all in. In like the coupling of moving to an independent agent distribution channel and then also looking at the embedded insurance channels, with all the work you've done to build your technology and your brand differentiation, how does that kind of fit with those types of growth for the future where it's still, hey, here's what Root really stands for, but you're no longer really owning the customer in the same way and then shifting towards more of like a balance sheet and claims organization; as opposed to, I'm getting this from Root, as opposed to I'm getting this from an agent, I'm getting this through Carvana? I was wondering if you had any thoughts around that for the future growth potentials and like the economics of it.

Alexander Edward Timm
Co-Founder, CEO & Director

Absolutely. We do feel that this particularly leverages our engineering and data science work and really is an extension of our value proposition. And so being able to power seamless great experiences for consumers. Whether or not they may see the Root brand or see a Carvana brand, we think it still leverages our core competencies that we've always been about, which is engineering, data science and consumer experience. And everywhere we see the opportunity to build what is best for the consumer, we will do that. We do not believe that, that necessarily precludes us from building a really strong brand. We think there's lots of fintech companies out there that embed their software that still have very strong brands. And so we do not believe that, that moves us away from what we are all about, particularly because what we view we're all about is, quite frankly, just building a better business through technology for the consumer.

We think we can do that also through the independent agent channel as we see lots of technology gaps that exist in independent agency offerings. And by the way, telematics gaps as well. The take rates on telematics and independent agency is historically very, very low. We believe we can change that. And we think that, that's really meaningful for consumers to provide a large host of those consumers with better products at better prices. And that's what we're going to continue to do, and we're going to continue to invest in that. We still, again, believe in our direct channel, and we'll grow that when it makes sense. But we're going to be nimble, and we're going to build a diversified set of really demand generation platforms, and that's going to include the embedded insurance platform and the independent insurance platform -- independent agent.

Operator

Our next question is from Tracy Benguigui from Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

I recognize you've been pretty agile repricing at the 30-day mark when a driver doesn't go through that rehearsal period. And as you enter more affinity relationships like Carvana, do you think you have that same ability to be just as agile? So where I'm getting at is that you have a good thought process behind your churn rate to get to your desired customer mix and rate adequacy, but would an affinity partner be okay with higher churn?

Alexander Edward Timm
Co-Founder, CEO & Director

This is Alex. Really, we view our telematics, as you said, as a way where we can clean up our book. And what that means for some customers is that they take the test drive before they ever are insured with us. And they go through because they want to see what rate they might be able to get. With other folks, we might see that they want a 30-day test driver, to Matt's earlier points, on being able to price people even earlier, it could mean even earlier than that. And so really, we view our telematics platform as something that is very flexible and extensible. And so what we're doing is we are building customized solutions with some of these affiliate partners that can work for their customer set while allowing us to still leverage that data in the best possible way. And over time, what we believe that will do is build the best consumer experiences in the most data-informed way.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. So what you're saying will be nuanced for some of these relationships?

Alexander Edward Timm
Co-Founder, CEO & Director

Absolutely.

Operator

And thank you, ladies and gentlemen. That concludes today's call. Thank you for participating, and you may now disconnect.

Alexander Edward Timm
Co-Founder, CEO & Director
Thank you, everyone.