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Root, Inc. (ROOT)

Q1 2024 Earnings Call

# CORPORATE PARTICIPANTS

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**Andrew Kligerman** 

Analyst, TD Securities (USA) LLC

**Hristian Getsov** 

Analyst, Wells Fargo Securities LLC

Matthew J. Carletti

Analyst, Citizens JMP Securities LLC

## MANAGEMENT DISCUSSION SECTION

**Operator**: Hello and thank you for standing by. My name is Regina, and I will be your conference operator today. At this time, I would like to welcome everyone to the Root, Inc. First Quarter 2024 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions] I would now like to turn the conference over to Matt LaMalva, Head of Investor Relations. Please go ahead.

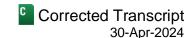
### **Matthew LaMalva**

Head-Investor Relations & Corporate Development, Root, Inc.

Good afternoon and thank you for joining us. Root is hosting this call to discuss its first quarter 2024 earnings results. Participating on today's call are Alex Timm, Co-Founder and Chief Executive Officer; and Megan Binkley, Chief Financial Officer. Root recently 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 first quarter 2024 Form 10-Q.

Before we begin, I want to remind you that matters discussed on this 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 will reflect our opinions as of the date of this call, and we undertake no obligation to revise this information as a result of new developments that may occur. Forward-looking statements are subject to various risks, uncertainties, and other factors that could cause our actual results to differ materially from those expected and described today.

In addition, we are subject to a number of risks that may significantly impact our business and financial results. For a more detailed description of our risk factors, please review our most recent 10-K, 10-Q and Shareholder Letter. A replay of this conference call will be available on our website under the Investor Relations section. I would also like to remind you that during the call, we will discuss some non-GAAP measures while talking about



Root's performance. You can find reconciliations of those historical measures to the nearest comparable GAAP measures in our financial disclosures, all of which are posted on our website at ir.joinroot.com.

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

#### Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

Thanks, Matt. For those new to Root, welcome. I'd love to take a minute to tell you a little bit more about the company before I jump into our results. We believe drivers should have more control and understanding of their insurance. So we built car insurance that is transparent, easy to understand, and offers great prices. We do this through the Root app where customers can see how they are driving, manage their policy and file a claim in seconds. We also do this through our Partnership channel where we meet customers where they are in their moment of need. This includes, for example, embedding our insurance product at the point of vehicle sale. This is all enabled through our data science and technology, which allows us to create seamless, flexible customer experiences at what we believe to be some of the best prices.

With that, I'd like to talk a little bit about the quarter. The first quarter of 2024 was an excellent quarter. For the first time in the company's history, we generated operating income and positive adjusted EBITDA. We did this while doubling gross written premiums and policies in force year-over-year. These results are a testament to our strong product offering, disciplined execution and the power of our technology. While pleased with this performance, we are far from achieving what we believe we can as a company. Over the long term, we believe data science and technology will fundamentally change the way insurance is priced. And in the first quarter, we continued to significantly improve the predictive accuracy of our pricing and underwriting models.

As we grow, our dataset grows, which allows us to retrain our models and deliver better prices to customers. In turn, with better prices, we are able to grow more efficiently, leading to a virtuous cycle. Also core to our strategy is continuing to build differentiated access to customers through our Partnerships channel, offering a three click purchase experience via our partner platform continues to drive differentiated access to customers, and we're pleased to have grown new writings in our Partnership channel 68% year-over-year. The expansion of this channel is foundational to our long-term growth strategy.

Our Direct channel also continued to have impressive growth in the quarter. We leverage advanced machine learning-based algorithms to optimize for our return targets. Our data science machine is constantly looking to see how the competitive environment is evolving. As such, this channel fluctuates due to seasonality and competitive dynamics. And as anticipated, we saw competition increase in the Direct channel this quarter. We continue to optimize for target unit economics and believe being responsive to the changing environment is a smart way to profitably grow this business over the long term, even though it may lead to quarter-over-quarter variabilities.

In the first quarter, the path to GAAP profitability looks stronger than ever. We continue to be excited by the long-term growth potential of the business by adding additional partners, expanding our footprint and continuing to improve our prices and products. I am proud of our entire team for the dedication to driving our success in this quarter.

I'll now turn the call over to Megan to discuss our operating results in more detail.



### **Megan Binkley**

Chief Financial Officer, Root, Inc.

Thanks, Alex. Overall, it was an excellent start to 2024, with further improvements across nearly all of our key financial metrics. For the first quarter, our net loss was \$6 million, an 85% improvement year-over-year. We are pleased to report for the first time a positive quarterly operating income of \$5 million and positive adjusted EBITDA of \$15 million. These metrics improved \$35 million and \$26 million year-over-year, respectively. This strong progress continues to be driven primarily by growth in net earned premium, continued loss ratio performance, a sustained fixed expense base and responsible deployment of marketing investment.

As we've consistently noted, we do not defer the majority of customer acquisition costs over the life of our customer, which leads to accelerated expense recognition relative to earned premiums. We grew new writings fourfold and we more than doubled policies in-force, gross written premium and gross earned premium compared to the first quarter of 2023. We achieved this growth while delivering a gross combined ratio of 99.7%, marking the company's first gross combined ratio less than 100%, and a 23-point improvement year-over-year. The gross accident period loss ratio was 61%, a 4-point improvement year-over-year driven by our continued investment in data science and technology. Note that we benefit from a favorable seasonality trend in Q1 as there are fewer miles driven in the winter months and also higher purchasing power resulting from tax season refunds.

In the first quarter of 2024, we ceded 16% of our gross earned premium and reduced the difference between our gross and net loss and LAE ratios to 2 points for the quarter, reflecting a reduction of 21 points year-over-year. Our improvements in reinsurance costs were made possible through our continued improvement in operating results.

Overall, our results for the first quarter 2024 continue to reflect the sustained momentum towards management's top priority of reaching profitability with our existing capital. The first quarter also marked the third consecutive quarter of positive operating cash flow. This is a result of improved net loss, continued growth in loss ratio performance, even though the first quarter is consistently a high relative cash outflow quarter.

As Alex noted in his remarks, it was a strong start to 2024 as we maintained the disciplined execution of our strategy and continued to build upon the momentum we achieved in 2023. As our market value appreciates, we will incur incremental expenses related to tax liabilities from the vesting of employee equity awards. The second quarter typically encompasses the largest proportion of vesting equity awards per year. As such, we expect to incur approximately \$10.6 million in cash expenses in the second quarter to satisfy this tax liability.

Moving forward, we intend to remain focused on thoughtful and disciplined growth and expect to continue investing in customer acquisition as long as targeted unit economics are achieved. We expect gross written premium levels in the second quarter to decrease relative to the first quarter due to seasonality and changes in the competitive landscape. Achieving GAAP net income profitability with our existing capital continues to be our primary objective. This quarter's results show that we are well on our way.

We are excited for our future, appreciate your time, and look forward to your questions.

# QUESTION AND ANSWER SECTION

**Operator**: [Operator Instructions] We ask that you please limit your questions to one and one follow-up. You may reenter the queue for any additional questions that you might have. Our first question will come from the line of Tommy McJoynt with KBW. Please go ahead.

### **Thomas McJoynt-Griffith**

Analyst, Keefe, Bruyette & Woods, Inc.

Hey. Good afternoon, guys. Thanks for taking my questions. So you've demonstrated some really robust growth here in the policy count over the last few quarters with that growth having started really in the third quarter of 2023. So assuming most of those were six-month policies, can you talk about the retention that you're seeing on those policies that were kind of recently acquired over the past nine months?

#### Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

Yeah. Thanks, Tommy. We're continuing to see retention improve. Big driver of retention is price. And as we've continued, we were very early – thanks to a lot of our technology, we're very early in identifying a changing cost environment which allowed us to take a lot of our rate increases early. So what we've been seeing because of that is as our price has really stabilized over the last year or so, we're continuing to see improvements in retention year-over-year.

#### Thomas McJoynt-Griffith

Analyst, Keefe, Bruyette & Woods, Inc.

Okay. Got it. And given some good visibility into really the broadly improving outlook across both you and your competitors, that certainly suggests that the competitive landscape will be intensifying, as you've noted. So, how do you envision your, your sales and marketing spend trending over the coming quarters, perhaps on an absolute basis would be most helpful.

### Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

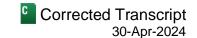
Yeah. Thanks, Tommy. First, I'd say we're very happy with our growth and where we've been year-over-year with doubling the count of customers that we've gotten, doubling our path, as well as revenue. I'd say we are always looking at the competitive environment and monitoring the competitive environment as well as seasonality. And we do know that the first quarter you see more auto insurance shopping and so you should expect that to sort of accelerate sales and marketing spend in the first quarter relative to other quarters.

And then like we said, we've also saw competition come back. And one of the things that we do at Root is we are always looking at profitability and making sure that we are optimizing for profitability. And so, as you see competition return or enter increase, you will see us pull back so that we're constantly and diligently driving the company towards profitability. I think you saw that this quarter and as evidenced by our operating income trends as well.

#### Megan Binkley

Chief Financial Officer, Root, Inc.





Yeah. And Tommy, if I could, I mean, just to reiterate what Alex stated, I mean, Q1 is just another strong proof point that our model is working, right? We delivered the best results in Q1 and company history, right? And when you look year-over-year, we've more than doubled our GWP, our GEP and our PIF count on a year-over-year basis. So we are confident that we can continue to grow, but I want to make sure that it's clear that the growth going forward will moderate if we're not reaching our unit economic profitability returns, right?

Our growth will continue to be very prudent and disciplined. We're not sacrificing our capital position for unprofitable growth. So while we do expect that sales and marketing will be less in subsequent quarters based on seasonality, we'll continue to be opportunistic with respect to direct marketing spend and we're actively focused on optimizing our marketing vetting strategy both within our existing channels and also testing new channels. And we believe that we've got ample growth levers that that we can pull.

Currently, we're only in 34 states. We would like to be national at some point and we're continuing to invest in our differentiated distribution. So our Partnership channel does continue to grow. It's been growing where we're continuing to onboard and launch new partners. So we're consistently focused on gaining profitable market share.

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Analyst, Keefe, Bruyette & Woods, Inc.

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Appreciate the thoughts. Thanks.

### Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

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Thanks, Tommy.

Operator: Our next question will come from the line of Andrew Kligerman with TD Securities. Please go ahead.

### Andrew Kligerman

Analyst, TD Securities (USA) LLC

Hey. Good evening and congrats on another great quarter. I guess my first question is around renewal premium as a percent of gross premium declining to 39%. As that happens and you're writing a lot more new business, should we be thinking – for most of the companies we cover, we think about a new business penalty. So, should we be thinking that terrific gross accident period loss ratio of 61% that could rise up a bit, a few percentage points. And if so, maybe a little guidance, if you could,

#### Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

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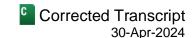
Yeah. I'd say, we absolutely have – we see similar things and there is a new business penalty where loss ratio on new business in that first six-month term is higher than renewal business. We're very pleased with our loss ratio and where it is. And we think we've been very diligent in pricing the business. And so, we feel good about where that loss ratio is. And again, we've been growing now pretty significantly for many quarters. So, a lot of that new business loss ratio penalty that you're already seeing that really in our current quarterly results.

### Andrew Kligerman

Analyst, TD Securities (USA) LLC

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Oh, I see. Thank you for that, Alex. And then, with regard to the competitive environment, as you cited earlier in the call that the last month of the first quarter you saw a little dip in premium growth, and then Megan added later



on that gross written premium sequentially would probably decrease in the second quarter. Could you give us a sense of what you – what we might expect in the second quarter? Any sense of how it's shaped up so far and how it might compare with the first quarter?

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

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Yeah. Thanks, Andrew. Yeah, I think from both seasonality and from a competitive dynamics in these channels, you will see more new writings generally in the first quarter than you will in the second quarter. And that then will lead to a higher written – amount of written premium in our first quarter than in our second quarter. That said, obviously, with the material growth in PIF, you're still going to see very strong earned premium growth and definitely year-over-year growth. And so, we feel good, retention is strong as well. So we feel good with where we are, but you should expect sort of second quarter for there always be some seasonality impacts, I think particularly to where we are now, some competitive returns which will cause in the second quarter that written premium to be lower than it was in the first quarter.

Andrew Kligerman

Analyst, TD Securities (USA) LLC

But it doesn't sound dramatic, though, right, Alex? Is that what I should read into it?

Megan Binkley

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Chief Financial Officer, Root, Inc.

Andrew, we're not putting a quantification at this on it at this point. I mean, we're continuing to be opportunistic in terms of how we deployed direct marketing spend. And look, we're laser focused on profitability and protecting the business long term. So we're not in a position where we're going to write policies for the sake of growth. And we think this is a smart way to grow the business over the long term and not lose focus to really drive quarter-over-quarter fluctuations.

**Andrew Kligerman** 

Analyst, TD Securities (USA) LLC



Makes sense. Thank you.

Operator: Your next question comes from the line of Yaron Kinar with Jefferies. Please go ahead.

Hi, guys. This is [ph] Charlie (17:52) on for Yaron. Congrats on the quarter. I was just curious if you guys were able to achieve \$15 million and positive adjusted EBITDA this quarter. Conceptually, thinking through it, should we anticipate this to be a step change or should we expect the potential for EBITDA to be negative quarter-over-quarter or here and there going forward?

Megan Binkley

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Chief Financial Officer, Root, Inc.

Thanks, Charlie. That's a good question. So, as we sit here today, I mean, Q1 was a really a material milestone for the business for us to print both positive operating income and positive adjusted EBITDA of \$15 million in the quarter. And look, this has really been several years in the making, right? We've had relentless focus on pricing and underwriting, and that's led to material improvements in our loss ratio. Our loss ratio is in a healthy spot and

we're going to continue to focus on driving profitable growth. And as we mentioned earlier, I mean, we remain opportunistic in terms of how we will deploy marketing investment going forward. And as we see opportunities to continue to grow share profitably, we'll continue to do that in a prudent and very disciplined manner.

On the expense side, we've been very diligent in rightsizing that spend. We'll continue to scale on fixed expense. And we are making modest investments in certain areas of the business and in 2024, both to support the growth that we've seen over the last 12 months and to continue advancing our product and driving profitable unit economics.

So, I guess to more directly answer your question, I mean, we remain confident in our path towards GAAP profitability and in the near term. But as we noted in our opening remarks, there are three things that we really want to make sure that you keep in mind for Q2. One, we've already covered, right? We expect growth to be softer in Q2 versus Q1 due to seasonality and due to competitive landscape changes. So that means we are expecting sales and marketing expense to be lower in the second quarter.

Secondly, on the loss ratio, as expected, we do expect that Q2's loss ratio will be elevated compared to Q1. And that's really driven by seasonality. I mean every year we see the loss ratio tick up a bit in Q2 and that's really because people are driving more rate as we get into the spring and summer months. And then lastly, we informed you of a high quality cash expense that we incurred at the beginning of April whereby because of our stock price appreciation, we incurred around \$10.6 million of tax liability related to the vesting of RSUs and PSUs.

So April is the highest vesting month that we have on an annual basis and the bulk of that tax liability around – or 70% of that is going to run through your G&A line item on the P&L and the remaining will hit T&D. So we've included some more information in our 10-Q disclosures to really help the users of the financial statements really understand what the magnitude of what that could be for the remainder of the year, but we do remain confident in our trajectory towards GAAP net income profitability in the near term.

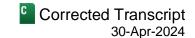
Great. And thanks for breaking that out by line item on the vesting expense there. So, another question, if you guys have had two consecutive quarters now where sessions have been kind of below that 20% watermark, I think 16% and 18%, how should we think about that going forward?

Megan Binkley

Chief Financial Officer, Root, Inc.

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Yeah. Thanks, [ph] Charlie (21:56). Excellent question. We continue to focus on our reinsurance strategy over the long term. I think any time we talk about reinsurance, I think it's important to keep in mind that we do anticipate continuing to purchase the per risk and cat reinsurance covers to really protect the business from volatility. But as we look forward, if we see something opportunistic in the reinsurance markets, we will want to take advantage of that, right. As we sit here today, we don't intend to see more than 25% of our GEP, but we want to make sure that we're giving ourselves optionality, right. We are constantly looking to optimize our capital structure. And as our result have continued to improve. So we've got multiple decision points throughout the year to either increase or decrease our sessions, depending on both our appetite for reinsurance and the external environment. So, our goal is really to maintain flexibility across all of our capital structure options.



Okay. Thanks. And just one last one, if I could sneak it in. So, this is kind of building off of Tommy's question on retention, looks like you guys are seeing improvement year-over -year, but how should we think about that relative to pre-IPO levels?

#### Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

I would say that it's continued to improve actually. So, if you think about the history of the company going back longer term, I would say it's modestly improved since sort of that time period. And the reason for that is when you think about the [ph] era (23:34) that we went through, right, when we saw a lot of inflation occur, we had to take

significant rate that then caused, obviously, retention to come down significantly. And then as again, we've seen more normalized levels, we're seeing that come up, and we are actually shifting our mix towards a higher retaining customer segment that's driven by both improved pricing models and then also our Partnership channel.

So you should expect actually modestly better retention even than pre-IPO.

Great. Thank you, guys.

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

Thanks, [ph] Charlie (24:05).

Operator: Your next question will come from the line of Hristian Getsov with Wells Fargo. Please go ahead.

Analyst, Wells Fargo Securities LLC

**Hristian Getsov** 

Hi. Good afternoon. I had a question on the – so the extra competition in the Direct channel, I guess, does that incentivize you guys to kind of be a little bit more aggressive on the Partnership side, just potentially kind of looking for a few more partners. And I'm guessing kind of like the unit economics just given that there's not really as – I mean, I guess maybe there is some sort of marketing on it, but for the most part, it's kind of just directly through their channel. Does that kind of like incentivize you to kind of like build that channel a little quicker versus kind of like waiting for the Direct channel to kind of clear up from all the competition?

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

I'd say we really like our Partnerships channel, and the way we think about it is that we're going to continue to build that channel. We know through our technology and ability to offer a seamless, embedded quote that we believe that's very differentiated and we have seen that channel grow, writing 68% year-over-year. That's from a smaller base than Direct, so sometimes it's a little harder to see. But that's been very consistent growth and we sort of anticipate that to continue into the future and we really like that channel because of that consistency.

On Direct, we think the most intelligent way to manage that business is to constantly look at any sort of changes in whether that's competitive dynamics, seasonality [ph] what have you (25:34), and constantly making sure that our data science models are never overpaying for a customer, and that we're always paying the right price and making sure that we're always hitting our return targets. And so, I think Direct will continue to grow long term, but it just may be a little bit more exposed to quarterly fluctuations. And we accept those fluctuations because we

think that's the right thing to do for the long term of the business. But make no mistake, we are very passionate about growing both of these channels long term.

**Hristian Getsov** 

Analyst, Wells Fargo Securities LLC

Got you. And then for my second question, I guess the – with the significant kind of growth in the PIF count over the last like two, three quarters, has there been any like dramatic shift in terms of like your demographic builds like within the portfolio has like? I don't know if you have like a little bit more outsized exposure to like certain states or certain age group. Like, has anything shifted over the last couple of quarters just given the huge growth?

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

Yeah, I'd say we've continued to iterate on underwriting and pricing. And so, when you look at the mix shift, it's subtle, but I would say it's probably more towards what would classically be defined as a preferred customer segment, slightly higher retaining, slightly higher credit, sort of as we continue to iterate on our pricing models, we are starting to pick up more and more of that customer segment, but that's really the big changes, I would say, in the demographic mix.

**Hristian Getsov** 

Analyst, Wells Fargo Securities LLC

Got you. And just one more quick clarification one on the – so I understand like the growth will slow in the Q2 versus the Q1, but in terms of PIF count, I'm guessing you guys are still looking for some growth there, maybe not the 20% to 30% we saw in the back half of last year, but you guys are still expecting to see some growth, right?

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

We're really happy with our PIF growth year-to-date. And again, we're going to constantly monitor the environment to look at how that evolves. And if the right thing for the business is to keep PIF flat, that's what we will be doing. We certainly believe that we can grow the business long term and are going to continue to look to do that, but we're not going to be providing sort of quarterly PIF guidance.

**Hristian Getsov** 

Analyst, Wells Fargo Securities LLC

Okay. I appreciate it. Congrats on the quarter.

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

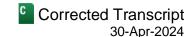
Thanks.

**Operator**: [Operator Instructions] And your next question comes from the line of Matt Carletti with Citizen (sic) [Citizens] (27:55) JMP. Please go ahead.

Matthew J. Carletti

Analyst, Citizens JMP Securities LLC

Hey, thanks. Good afternoon. I just had a question on the fee income line. It's grown really nicely over the past five, six quarters, up multiples. And if you look – even if you look at it on a percentage of premium, it's kind of



done the same, right, becoming a bigger and bigger percentage of premiums. Can you just kind of peel back the onion a little bit and kind of tell us what's happening there and what we might expect going forward?

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

Yeah, sure. Yeah. I'd say when you go back a year or so ago when we started to relook at our forms and you – and look at our filing, we really had – we were off the market in terms of fees. There's lots of fees that we just weren't charging that really the market was. And so, we began to introduce those. And we think that that's really beneficial because as we move more towards fee revenue and out of premium revenue, as we do that, there's a lot of benefits to that. There's lower premium tax, et cetera on that. So, I think we've largely done all of those filings. So I think we're largely at where you're going to see us stay. I don't think there's any other big movements up as a percentage of premium in that line item, but I do think this is roughly at a new normal.

Matthew J. Carletti

Analyst, Citizens JMP Securities LLC

Great. Very helpful. Thank you.

Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

Thanks.

**Operator:** And with that, I'll hand the call back to Alex for any closing remarks.

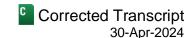
Alexander E. Timm

Co-Founder, Chief Executive Officer & Director, Root, Inc.

Thank you everybody for joining today. We look forward to continue to execute and to continue to talk to you guys about the future of our company. Appreciate it.

**Operator**: That will conclude today's meeting. Thank you all for joining. You may now disconnect.





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