Root, Inc. NasdaqGS:ROOT

FQ3 2021 Earnings Call Transcripts

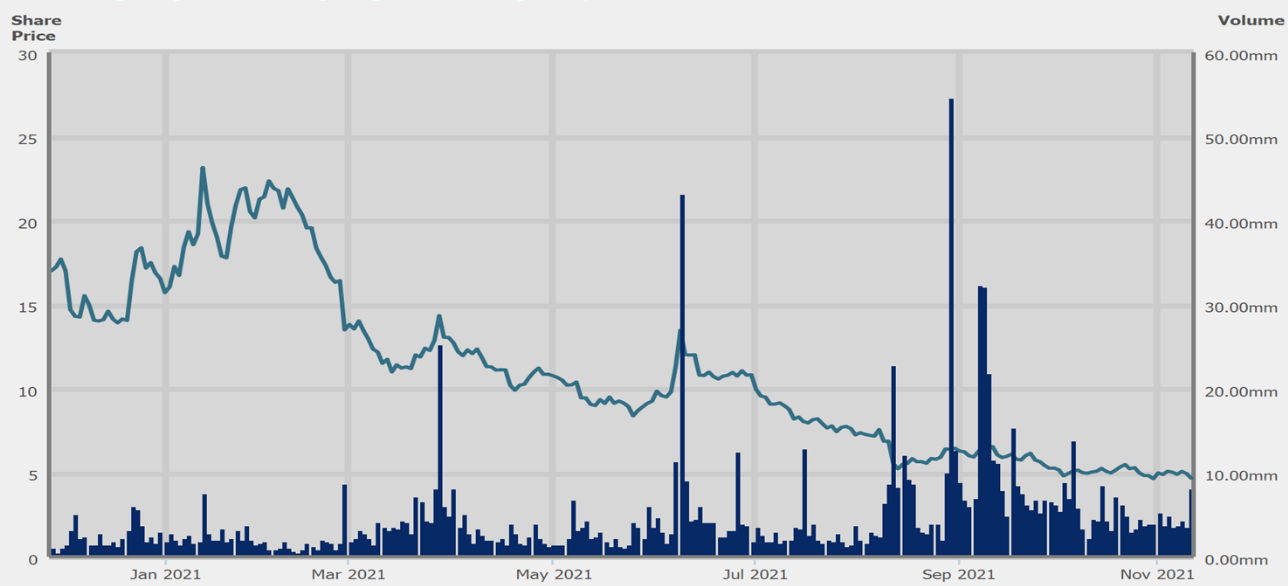
Thursday, November 11, 2021 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ3 2021-			-FQ4 2021-	-FY 2021-	-FY 2022-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.66)	(0.53)	NM	(0.47)	(2.24)	NA
Revenue (mm)	60.90	93.80	▲54.02	46.70	268.18	NA

Currency: USD
Consensus as of Nov-11-2021 7:05 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2020	(0.81)	(0.72)	NM
FQ1 2021	(0.46)	(0.40)	NM
FQ2 2021	(0.50)	(0.72)	NM
FQ3 2021	(0.66)	(0.53)	NM

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EXECUTIVES

Alexander Edward Timm
Co-Founder, CEO & Director

Christine Patrick
Vice President of Investor Relations

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Frank Phillip Palmer
Chief Insurance Officer

Matt Bonakdarpour
Chief Data Science & Analytics Officer

ANALYSTS

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Crédit Suisse AG, Research Division

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David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Matthew John Carletti
JMP Securities LLC, Research Division

Michael Wayne Phillips
Morgan Stanley, Research Division

Nicholas Freeman Jones
Citigroup Inc., Research Division

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Barclays Bank PLC, Research Division

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Truist Securities, Inc., Research Division

Presentation

Operator

Good day, and thank you for standing by. Welcome to the Root Third Quarter 2021 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Christine Patrick, Vice President of Investor Relations. Please go ahead.

Christine Patrick
Vice President of Investor Relations

Good morning, and thank you for joining us today. Root is hosting this call to discuss its third quarter 2021 earnings results. Participating on today's call are Alex Timm, Co-Founder and Chief Executive Officer; and Dan Rosenthal, Chief Operating Officer, Chief Revenue Officer and Chief Financial Officer. During the question-and-answer portion of this 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 released last evening. A replay of this conference call will be available on our website under the Investor Relations section.

I would like to also remind you that during the call, we are discussing some non-GAAP measures in talking about Root's performance. You can find the reconciliation of those historic measures to the nearest comparable GAAP measures in our shareholder letter released last evening and 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 Founder and CEO.

Alexander Edward Timm
Co-Founder, CEO & Director

Thank you, Christine. Good morning, everyone, and thank you for joining us on our third quarter call. During the quarter, we made progress on many of our key initiatives and deepened our founding commitment to building world-class technology that addresses the long-standing inefficiencies and unfairness in the auto insurance industry.

We're seeing the movement towards fairness grow as evidenced by some of the largest incumbents following our lead in questioning the use of credit scores and pricing. We're excited to be leading this charge in the industry and bringing others along with us. This quarter, we placed the Chief Revenue and Chief Operating Officer responsibilities under Dan Rosenthal. In his new role, Dan oversees 3 critical areas of Root: marketing, insurance and business growth development. This gives him the ability to drive profitable top line growth and streamline operations. With Dan's history of entrepreneurial success, I think he is the perfect person to lead this charge for our organization.

I'd now like to walk you through highlights of the third quarter. We made progress toward diversifying our distribution channels, an initiative we detailed on last quarter's call. Root's technology enables us to offer a quote in under a minute, providing meaningful opportunities to build differentiated access to customers and broaden our distribution. By embedding our product offering in moments that meet consumers when they need us most opens up a sizable and largely untapped opportunity in adjacent industries. This also creates a vastly superior customer experience. To bring this to life, we focused on building an embedded product that powers our exclusive partnership with Carvana. Since announcing our partnership in mid-August, cross-functional Root and Carvana teams have been hard at work developing a fully integrated point-of-sale offering. We are currently testing the first iteration in 12 states. Early signs are positive, and we look forward to providing additional detail and results in the months ahead.

We have made investments to bring the speed and ease of use powered by our technology to the independent agency channel, giving Root access to a larger demographic of consumers. We have developed a quote and buying process that takes a fraction of the time required compared to other carriers' platforms. It increases productivity for our agency partners. We're currently testing this product in 5 states with largely positive feedback to date. While investing in the diversification of our distribution channels, we have significantly dialed back our spend in performance marketing, reducing sales and marketing spend by 40%. This move has greatly reduced our customer acquisition costs, which can be seen in a $45 million improvement to our operating loss compared to the second quarter of this year.

This is a prudent use of capital, particularly given the current inflationary loss environment we find ourselves in. We believe the diversified channel approach will enable us to further lower customer acquisition costs, attract customers with higher lifetime values and provide additional levers to deliver strong, profitable top line growth.

We have substantially improved our pricing and underwriting models. We continued the rollout of UBI 4.0, our latest and greatest telematics model; and McModel 4.1, our national pricing model. UBI 4.0 is currently active in 20 of our 31 states, representing roughly 70% of our addressable market. This model enables a precise telematics quote, improves overall segmentation and does more with less data. Since the rollout of this model, we have been able to extend quotes to an additional 10% of users. We are also in the process of rolling out McModel 4.1, which leverages Root's growing data set to expand modeled coverages, improve segmentation and better predict the lifetime value of a customer. As I've stated previously, by growing the data set, we can accelerate the momentum of our flywheel. As our pricing algorithms improve, we bring down the cost of insurance for good drivers, which allows us to attract and retain a more profitable mix of business.

In addition to these segmentation improvements driven by model enhancements, we're also tightening our underwriting by refining contracts and endorsements and leaning on our state management group to unlock state-level efficiencies. We will see the results of these improvements in the quarters to come. The actions we've taken this quarter demonstrate our awareness of deploying your capital thoughtfully and balancing growth and profitability. We still have work to do, but we know what we need to do to positively impact our bottom line. This is an ongoing process, and we will continue to find ways to drive toward profitability. I'm thankful for the continued support and trust of our customers, team members and investors.

With that, I'll turn the call over to Dan.

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Thanks, Alex. Our results for the third quarter of 2021 reflected a decrease in our marketing spend and continued pressure from the loss environment. You'll 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 gross written premium 24% year-over-year to $205 million. Our gross earned premium increased 23% year-over-year to $189 million. Our gross earned premium from seasoned states increased to 76% of total earned premiums. The top line's outperformance was driven by the tail effect from performance marketing dollars previously committed. Overall, for the quarter, sales and marketing expense declined 40% as we took action to reduce cash burn, especially in the face of the surge in performance marketing costs and the current inflationary environment. We continue to expect gross written premium to reflect year-over-year declines in the fourth quarter and first half of 2022 as we take active steps to reposition our marketing investments, pursue more cost-efficient distribution channels and otherwise reduce our customer acquisition costs and operating loss.

Shifting to profitability. Gross accident period loss ratio was 91% for the third quarter, a 12 point increase year-over-year against Q3 2020 when compared with the low loss environment last year. More importantly, we recorded a 9 point improvement from Q3 2019, demonstrating improved performance when stripping away the impact of the pandemic, which is partially offset by the current loss cost environment. The year-over-year increase in the loss ratio was primarily driven by 8 points of severity and 9 points of frequency as inflationary pressures increased costs and miles driven remain above pre-pandemic levels in our book. Leveraging our technology, rating engine and data architecture has allowed us to respond faster than industry norms with 13 rate increases taken during the third quarter and more planned in the coming months.

Direct contribution was a $10 million loss for the quarter. The decline in direct contribution and related margin was driven primarily by direct loss ratio, as I covered above. Operating loss was $127 million, a $45 million improvement when compared with the second quarter, driven by the aforementioned reduction in performance marketing spend. Following quarter close, we repaid both our Term Loan A and Term Loan B. We have signed an exclusive term sheet with BlackRock Financial Management Inc. on behalf of funds and accounts under its management to put in place a larger term loan facility with a longer maturity than our previous structure. We expect to work in good faith with BlackRock to close the facility before year-end, subject to negotiation and documentation of final terms and the terms and conditions contained in the definitive documentation.

Turning to our outlook. We remain on the path we laid out last quarter. We have reined in customer acquisition costs in an inflationary environment and are actively laying the foundation for profitable growth. The work we are doing around cost management is a critical step forward to create the flexibility necessary to invest in and grow our business over the long term. These actions have also given us a more optimistic view of full year operating income. We now expect to close the year on the favorable side of the midpoint of our original guidance of a loss of $555 million to $505 million.

I would like to echo Alex' statement that we have taken a handful of actions that demonstrate our thoughtfulness around deploying capital. It is something we take very seriously, and the effort to improve our bottom line is ongoing. In my new role as Chief Revenue and Chief Operating Officer, I am tasked with aligning our customer experience, products and market opportunities to drive profitable growth, giving further focus to these key drivers of our customer-centric business. I am excited to continue the work around securing our future. We're excited about the opportunities before us and appreciate your continued support.
With that, Alex, Frank, Matt and I look forward to your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from Michael Phillips with Morgan Stanley.

Michael Wayne Phillips
Morgan Stanley, Research Division

Have you seen any change in the auto loss trend environment from last quarter? It looks like maybe your severity numbers came be down a bit. I wonder if that's true, kind of what's driving that and just overall thoughts there.

Frank Phillip Palmer
Chief Insurance Officer

Sure. This is Frank. Your question was on the loss trends. I'd say that we're seeing a number of -- yes. So we're seeing a number of factors there. First is we see higher miles driven, which translates into increased frequency. We've seen that in a number of different reports across the industry. So we believe that that's an industry thing, not just a Root thing. And then as we've seen, there's inflation across the United States, which increases overall costs, but in particular, in the cost of used cars, used car parts, which is causing a super normal increase in severity, especially on the [phys dam side]. So these 2 things together have increased losses dramatically over a very short amount of time. Historically, there have been trend turns in the past, but this is probably one of the most severe trend turns that I've seen in 20, 25 years.

Michael Wayne Phillips
Morgan Stanley, Research Division

I guess, Frank, I think your wording was severity was 8 points this quarter and last quarter was 16. So that seems to be down, but maybe I'm reading that wrong. So anything there that looks like it might be improving there?

Frank Phillip Palmer
Chief Insurance Officer

So -- yes. So I think we saw a big step function from quarter 1 to quarter 2. We are still seeing increased trends, but we're not seeing the same amount of step increase from quarter 2 to quarter 3. So there are still loss trends. We're still seeing inflation. We see that in the news. But I would say we're not seeing as much of an acceleration away in quarter 3 as we did in quarter 2, but it's still -- the inflationary pressures are still high.

Michael Wayne Phillips
Morgan Stanley, Research Division

You had guided to -- last couple of calls, you talked about a delay of one of your reinsurance treaties, how that would affect your seeded ratio. It was still down this quarter. I don't think I understand that. I thought it was -- your prior wording was that's going to tick back up to around 70% in the back half of this year, but it stays at 55%. So is there something else going on? Or was it -- is it going to stay this way until 4Q? Just trying to think about how -- why was it down and then what we could expect that to be in 4Q and going forward?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Yes. Thanks, Mike. This is Dan. You're right, our third quarter cession level remained roughly flat at 55%. And that's really a function of the way that our cohort-based treaties work, where, just as a refresher, they are multiyear treaties, where the first 12 months, we take in new business, and then the reinsurance treaty follows that cohort of new business into additional years. And really just a function of the 2 treaties we've executed this year on 4/1 and 7/1 depend upon levels of new business. And so given the fact that the pullback on the marketing spend, the lower levels of new business that we've talked about, that did lead to the cession level staying flat in the third quarter. I'd expect that to roughly continue in the fourth quarter. You'll see a little bit higher cession rates as we put in place our 10/1 treaty, which is oversubscribed at this point. So that's where we stand in terms of cession levels going forward.

Michael Wayne Phillips
Morgan Stanley, Research Division

Okay. I guess maybe one more here for now and then we'll see. When you talk about further reduction in customer acquisition costs, I assume you mean relative to kind of what you saw in 2Q and the kind of the current environment there from what was happening in your direct channel. Or do you mean further reductions from, I guess, prior to the spike that occurred in 2Q?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Yes. No, we mean effectively further reductions in terms of sales and marketing spend on a quarter-over-quarter basis. So you'll note that in the third quarter, we said what we talked about on the Q2 call, we pulled back marketing by 40% on the sales and marketing side, focused on really utilizing the most efficient performance marketing channels. I think some of that level in the third quarter was that we were talking to you in early August, and we had some dollars that were already committed as the third quarter started. And so now we're being able effectively to pull that back even further as we enter the fourth quarter.

Operator

Our next question comes from Matt Carletti with JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

I wanted to ask first question around UBI 4.0, and you talked about how, I think, in the past and also in the letter enables, it you to offer a quote with less data. I was hoping you could peel the onion a little bit in what have you seen in terms of the impact that that's had on test drive periods as well as the implications that might have for churn?

Matt Bonakdarpour
Chief Data Science & Analytics Officer

Yes. Thanks for the question. This is Matt Bonakdarpour. Historically, when we first released our telematics scoring model, we were conservative in the way we defined our eligibility rules, which is how much data we need before we can produce a score to price with. As you've collected more data, we've been able to test different models that require less data to see if that degrades predictive power. UBI 4.0 allowed us to really dig deep into that question and do more with less. So users are becoming eligible much sooner in the test drive, and as a result, we can issue a telematics inspired quote much sooner. We're seeing that does translate into better conversion levels. People are getting more telematics-inspired quotes, and we'll continue to work on pushing down that test drive period in the models to come.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay. Great. And then kind of along those lines, just hoping you could kind of process flow, just somebody who comes through the app and does a test drive, you have a history of knowing how that works. When we think about Carvana or think about your independent agent channel that is growing, how might that work differently and differently when it comes to an agent? Do they then have to do a test drive after downloading the app or do they get a quote that gets adjusted over time? Kind of how does that work differently than kind of the direct-to-consumer process?

Alexander Edward Timm
Co-Founder, CEO & Director

Yes. Right now -- this is Alex, and thank you for that question. Right now, what we are -- in the independent agency channel, it's still very new, and we are continuing to experiment with different product flows and where we can introduce telematics. We have a very flexible telematics platform, which allows us to both collect telematics data upfront before a quote, after a quote as we also have in our direct model or even more of a traditional policy over a 6-month period and incorporate that telematics data where we see it to be the most beneficial for us and our customer. And so we're still exploring in the independent agency channel where we are actually introducing that telematics rate. In the Carvana channel, right now, and we're very excited about that, that is an instant quote basically with the vehicle purchase. And so it allows the consumer to really just get insurance connected to that vehicle. And right now, we are not collecting telematics data through that flow, but we do have plans to incorporate telematics in future product iterations.

Operator

Our next question comes from Josh Siegler with Cantor Fitzgerald.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Have your telematic capabilities and segmentation allow you to better weather the increased severity and frequency in the market, for example, by identifying higher speed drivers or drivers responsible for more miles? Or do you find that these macro trends are impacting a wide array of drivers on your platform?

Frank Phillip Palmer
Chief Insurance Officer

Sure, this is Frank. Great question. I think first, it gives us greater granularity and greater insight into the trends that are happening. So either before frequencies started to go up, we could see that miles driven was going up and we could start to prepare rate actions in anticipation to the frequency going up. So we have really great granular data to explain and help us understand what was going on as we started to see frequency going up, other criterias may have been paused, and been like, is this a one time thing? is this a catastrophe thing? We could actually tell it was driving patterns that were causing the increases in frequency and so could respond much faster than the industry. So not as much at the granular customer level although of course our score of eccentric customers maybe speeding more because there's less on the road and we capture that on our score of regular rate time.

The big benefit, I think, has been the actual like granular insights into what's going on with trends that has allowed us to respond fast.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Got it. I appreciate the color there. And then just continuing down this road, you mentioned you took 13 rate increases during 3Q. Were these rate increases incremental in nature or perhaps larger step-ups to reflect the loss environment? And how has the market reacted to them, albeit I understand it's early stage still?

Frank Phillip Palmer
Chief Insurance Officer

Sure. I'd start also with we had some rate increases even early -- or late, sorry, in Q1. So based on that telemetics data and the increase in driving and frequency, we actually started around the rate increases in quarter 1, followed that up more with quarter 2 and then had the bunch in quarter 3. We still intend to take more in quarter 4 and quarter 1. Some of them are base rate increases. But as we mentioned, we're also rolling out our new McModel 4, which we think will also give us greater segmentation power as well as helping us kind of capture more rate.

Operator

We have a question from Elyse Greenspan with Wells Fargo.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

My first question just goes back to the guidance you guys provided for gross premiums. Did you expect premiums to decline in the fourth quarter given that we still saw good growth in the third quarter? I'm assuming you guys expect a significant decline in your policy count, given that you're getting -- as you alluded to, you're getting good levels of rate increases across your book. So can you give us a sense of the expected decline in PIF that you expect sequentially in Q4 as well as just the level of churn you're expecting across your book embedded within that guidance?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Yes. I think -- look, Elyse, thank for you the question. Given the actions we've taken on sales and marketing, that's why we wanted to continue to provide the color both for the fourth quarter and the first half of next year, consistent with what we shared on the Q2 call. And I think the way you should model it and think about it is that premiums will loosely follow the policy count. We're not guiding to any specific levels of retention. I think Frank just articulated extremely well what we're doing in the context of the macro environment. So we're not providing any specific guidance with respect to renewals, but you can expect that as we continue to reduce that sales and marketing spend level, there will be an impact on PIF.

Elyse Beth Greenspan
Wells Fargo Securities, LLC, Research Division

Okay. And then as we think about kind of working through like the frequency and severity issues and kind of your changing marketing spend, should we assume that the issues persist right beyond the first half of next year that you guys will consider to kind of continue to reign in the marketing spend, I guess, as kind of getting through the loss issues impact when you guys kind of return to increasing marketing and looking to pursue greater growth?

Alexander Edward Timm
Co-Founder, CEO & Director

This is Alex. I think when we think about our marketing spend and really our growth drivers over the long term of the company, we're really excited, and we're seeing really strong results already in our embedded product. And we believe that meeting consumers where they are in that moment is really going to drive long-term differentiated access to customers and growth. And really, what we're doing now is we're making sure that we are preserving that capital, particularly given the inflationary environment that we are in so that we can continue to develop that product and continue to develop more diversified sources of demand. In terms of timing, I'll turn it over to Frank, who can talk about when we may see our pricing sort of get to the levels that we want to see as a correction for the inflationary environment.

Frank Phillip Palmer
Chief Insurance Officer

Sure. And as we think about kind of returning to growth, there's 2 parts there when you think about a rate increase. When you raise rates today, your new business kind of has the full impact of those rate changes, but it takes time for your renewals to earn in. So as we raise rates and take these rate actions, we expect the new business to return to target profitability faster than what our calendar year or total renewal book might be. So we might expect our ability to kind of turn marketing back on to be faster than what we might actually see in the kind of a calendar year loss ratio period.

Now as that, we do have some pretty advanced marketing models that the data science group has come up with that take a look at a state-by-state and customer-by-customer segment-level profitability. And so I think starting in first quarter, it's likely that we'll be able to turn on either entire states or various segments on marketing and start to grow the new business again.

Operator

Our next question comes from Nick Jones with Citi.

Nicholas Freeman Jones
Citigroup Inc., Research Division

I guess, one, I guess, on the broader auto environment, we've heard that people are actually starting to delay purchases due to how high used car pricing is, and we -- there's still this chip challenge for new cars. So is that potentially a headwind heading into next year in terms of kind of triggering people to think about auto insurance changes? And the second question -- go ahead, and then I have a follow-up.

Alexander Edward Timm
Co-Founder, CEO & Director

We don't see that as a headwind going into next year. We think right now actually demand, particularly for cars, is still very high. Although some of the inflationary pressures that we are seeing our supply chain and chip related, we are also seeing a material amount of it being demand related as well. So if anything, we're pretty excited that there is more interest there than historic levels.

Nicholas Freeman Jones
Citigroup Inc., Research Division

Great. And then on the Carvana partnership, I know it's still kind of early days, but is there any kind of early indication of what kind of attach rate Root is seeing on the outlook?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Thanks, Nick. This is Dan. And Alex touched a little bit on this. We are really excited about the fact there's really no more opportune moment to connect with the consumer in auto insurance than at the moment they purchase their vehicle. And there's no better partner, no more technology forward and customer-centric auto retailer than Carvana. Their enthusiasm and commitment to the success of the partnership have really been shown by the exclusive relationship, their investment in Root, which we closed on the 1st of October. And just to provide some more color, in fact, we had more than a dozen Carvana team members in Columbus this very week. And I commend people like Andy Lesko and Chloe Johnston and Josh Brown and Rachel Nelson and all of their teams for all the hard work that has us already live testing the first iteration in 12 states.

So we were excited about the partnership back in August, and our expectations have really been exceeded. Now it's time to deliver a seamless experience and a fair price to consumers. I don't want to get into specific levels on the task quite yet, Nick, but I would tell you we're off to a great start. We're going to come back in 2022. We'll talk to you about milestones timing and growth at the right time.

Operator

Our next question comes from Tracy Benguigui with Barclays.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

My first question, this is more of a philosophical question. You said your long-term loss ratio target of 60% to 65% when loss cost trends were more benign owed to the pandemic. So I'm wondering if you may be revisiting that 60% to 65% target since I noticed even your renewed business is well north of that range in the last 2 quarters within your seasoned states.

Frank Phillip Palmer
Chief Insurance Officer

Yes. So this is Frank. Great question. I don't know that the pricing philosophy has changed a lot. We still want to price to lifetime profitability on a cohort of customers. So as we think about new business coming in, we still would like that cohort of new business to have a 65% target loss ratio based upon anticipated long-term expenses and so on. Now that was somewhat balanced by what the in-force book that we have currently. And so for both new and renewals, we do want to bring that loss ratio down given the current environment.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Okay. Okay. I also have a question on your marketing efficiencies. You discussed your work with independent agency channel. And I'm wondering if the idea is that maybe at least in the short term, CAC is lower for agency distribution? And if so, how meaningful do you think this revenue source could be in your mix?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Thanks, Tracy. Yes, I think we're not going to get into specific CAC levels by channels. I think the key for us and the discussion we had over the last several quarters is diversifying our distribution channels. And so for us, obviously, we were too concentrated in the performance marketing channels in the first half of this year. That's the conversation that we had following the Q2 call. We are executing on that with Carvana on the embedded insurance product. We are executing on that with what we are exploring on the independent agent product. So we're focused on testing and iterating, focused on diversification, focused on return on capital across the investments, which obviously has to do with CAC, but also the lifetime value of the customers that come through those channels. And we'll come back and talk specifically on each of those channels as that testing develops and we execute further.

Frank Phillip Palmer
Chief Insurance Officer

This is Frank. I'll also add there, as we think about the independent agency channel, it plays in both being an expansion into new consumer segments, it also plays to our strength in UBI. UBI is generally not as developed in the independent agency channel. There are a lot of carriers there that still do not have UBI, and there are agency groups that are concerned with that they're getting cherrypicked by a lot of the direct carriers. And so we do see some demand in that independent agency channel, both for our technology and the ability to write a customer in under a minute or 2 compared to 20 minutes with some of their other carriers as well as being able to deliver them a lower rate for good drivers we are at telematics. So we think that there's good pricing competitive abilities there, too.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

That's interesting because we've actually done some work and reached out some of the agents that you're, I guess, testing the waters with and one thought that I heard is that they're looking for consistency for their customers. So does that limit how agile you could be in pricing [indiscernible]?

Alexander Edward Timm
Co-Founder, CEO & Director

So one of the things we're doing right now with independent agents, and I think we referenced this a little bit earlier, is to actually make sure that the telematics program works for an independent agent. And so it will look different than the direct model. Where we may be pricing -- repricing midterm, we may be using now telematics data at renewal. We also have developed a product that allows consumers to really opt into telematics, and we think that using that consumer experience both works well for an agent as well as works well for that agent's customer. And that's really where we're starting to iterate on our product and develop a product that really does work for that channel.

Tracy Dolin-Benguigui
Barclays Bank PLC, Research Division

Very helpful context. And congrats, Dan, on your new role.

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Thanks, Tracy.

Operator

Our next question comes from David Motemaden with Evercore ISI.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

I had just other question on the outlook. And so I understand the gross premiums written are expected to be down in the fourth quarter and then in the first half of '22. So I just wanted to make sure I'm thinking about this right. You guys obviously had a strong third quarter this year, the $205 million of gross premiums written. Is that -- I guess, when we think about third quarter '22, is that sort of the timing when you guys think you can start to grow gross premiums written again?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Thanks, David, for the question. This is Dan. I feel like I touched on this a little bit earlier with Elyse. We wanted to provide color on where we are through the fourth quarter of this year and the first half of 2022. Given the line of sight that we have to those quarters and given what we've shared on both the Q2 call and today about our sales and marketing timing, the development of the Carvana product and the like, we have a lot we're going to come back and talk to the market about following Q4 on our thoughts for full year 2022. But I'd rather not get into the specifics for specific timing quarter-by-quarter next year quite yet.

As Carvana further develops in the testing, as we develop the diversification of channels that Alex just touched on, we'll come back and talk to you. But right now, we are focused on execution, we are focused on what we call internally, one play this play, and the play is really focused on a lot of what Frank's been talking to you about on this call, our differentiated technology and how it impacts our ability to get ahead of the loss cost environment. That's our focus right now. We'll come back and talk to you in February about 2022.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Okay. Great. That's helpful. And then I guess, maybe, I guess, this is also somewhat of an outlook question on the '22 operating loss. It sounds like that is going to really be driven by just rationalize sales and marketing spend. But I was wondering if you could just touch on thoughts of -- on the loss ratio over that time frame as well, not necessarily quarter-by-quarter, but just sort of thoughts in terms of how you expect that to trend over the next year?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Thanks, David. This is Dan again. Maybe I'll start and then turn it over to Frank on the loss ratio. On operating loss overall, we were pleased to report this quarter that we're expecting to close the year on the favorable side of the midpoint of our original operating loss guidance. And that is a function of the execution that we've been undertaking and the dip in performance marketing spend that we highlighted during the quarter. And I think it's fair to say that we expect to deliver a meaningful improvement in full year operating loss in 2022 versus the 2021 levels as we continue with that strategy and continue with that focused and disciplined execution. As for the loss ratio, I'll turn it over to Frank to speak to trends he's seeing next year.

Frank Phillip Palmer
Chief Insurance Officer

Sure. As mentioned earlier, as Alex mentioned, we have a number of opportunities to improve the loss ratio. So we started early with rate increases. We've got our new McModel coming in. We're looking at improving our underwriting in our contracts. And so we expect meaningful improvement in the loss ratio in 2022. The timing on that is probably less clear. Certainly, as we put in these actions, it takes time for them to earn in, but we're still trying to understand what the macroeconomic trends are. We have -- as mentioned earlier, we've got a little indication that it's not further accelerating in quarter 3 over quarter 2, but there's still only been a few months to actually see those trends. So we'll have to wait and see exactly how much loss ratio improvement we'll see as we understand how these trends develop.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Okay. Great. And maybe I can just sneak one more in, just on the Carvana partnership. Good to hear about some of the early success in some of the 12 states you're testing in. Do you have a sense for, I guess, when that will be rolled out on a broader basis?

Alexander Edward Timm
Co-Founder, CEO & Director

We're going to continue to develop that product. And as we do the rollout, we'll continue to accelerate as the product becomes more and more mature and we continue to get those consumer learnings. We're really excited about this. We think that this is absolutely how insurance should be purchased in the future, meeting consumers where they are in a really seamless experience. We think it's a clearly superior product experience, and we're really excited by it, and we're going to continue to work hard and focus.

Operator

Our next question comes from Mark Hughes with Truist.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

What should we think about in terms of average rate hike? It looks like your premium per policy was up about 6% in the quarter. Is that a good proxy for what you're putting in place, say, Q4, Q1?

Frank Phillip Palmer
Chief Insurance Officer

Yes. I'd go back to the actions that we're taking, right? So we do have rate increases, we've got new model segmentations and we've got improved underwriting. So as I think about that, part of the loss ratio improvement is going to come from just kind of flat rate increases. We also expect that to not necessarily be totally flat given that we expect up through first quarter, maybe 12 to 15 different states picking up our McModel -- our new McModel version. And so the actual increase in premiums will vary greatly by customer segment. And so I don't know that we've got kind of a target like this is how much the average premium is going to change as much as we've got an idea as to we think we'll get meaningful improvements in the loss ratio.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

Okay. And then when you think about the independent agent -- yes, go ahead.

Alexander Edward Timm
Co-Founder, CEO & Director

No, please continue.

David Kenneth Motemaden
Evercore ISI Institutional Equities, Research Division

Okay. All right. When you think about the independent agency channel, how quickly can you roll that out? Are there bigger chunks of maybe agency associations or groups that you can target to speed up your penetration of that market?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Yes. Thanks. This is Dan, and I appreciate the question. I think we are focused right now on testing and iterating the channel. Again, this is about diversification. This is about testing. This is about driving towards the path to profitability. So we'll have a better answer to that as we continue testing with the select group of agents that we're focused on right now. Absolutely, we believe that there are opportunities, as Frank touched on, to take our product and leverage it with the broader agency market. But we're going to focus right now on testing, iterating and executing and then come back and talk about specifics around growth and timing.

Mark Douglas Hughes
Truist Securities, Inc., Research Division

And then one more, if I might. The repayment of the loans and the setting the term sheet with BlackRock, can you talk about the rationale for that and what benefits you think that will bring?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Yes. I think for us, there are sort of 2 parts to that. The first is we're really excited about the partnership with BlackRock. We talk about in the letter that it's a facility that we think will work really well for us, and we'll come back to the market as we have a fully executed deal in place and provide more specifics. For us, it's about just thoughtful and prudent management of our balance sheet and thinking through our capital overall, and that's what we took into account in terms of maturity level -- or maturity timing of the prior facilities as well as the partnership with an entity like BlackRock.

Operator

Our next question comes from Andrew Kligerman with Credit Suisse.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Just a follow-up on some of the earlier questions. Just on the sales and marketing area, after the sharp drop-off in sales and marketing costs from $112 million to $65 million in the third quarter Q-over-Q, you talked about dialing that down. Do you kind of -- kind of prior to the fourth quarter of last year, do you kind of get into that range of, say, $15 million to $35 million? Is that kind of the range that you're thinking about dialing down to for the near to the immediate term?

Daniel Harris Rosenthal

CFO, Chief Revenue & Operating Officer and Director

Yes. Thanks for the question, Andrew. I think the way I would touch on that is to really focus on how seasonality impacts some of this. So the fourth quarter, we've talked about is both traditionally the most expensive quarter from the marketing channels that we have been in as it's a retail-focused quarter approaching the holidays. And then it's a quarter when just, frankly, consumers focus a little bit less on things like car insurance and are focused more on their other purchases approaching those holidays. So for us, seasonally, we would already approach performance marketing in the fourth quarter differently than in prior quarters. And then that is highlighted this year by the fact that we are pulling back in some of those more concentrated marketing channels and focusing on the most efficient channels. So you can expect the level to come down materially in the fourth quarter, and we're focused on really investing our dollars in the right channels and taking it from there.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Okay. So no numbers around that?

Daniel Harris Rosenthal
CFO, Chief Revenue & Operating Officer and Director

Sorry, no numbers.

Andrew Scott Kligerman
Crédit Suisse AG, Research Division

Okay. All right. And then on the last question with regard to independent agency. And again, you're not going to focus exactly on the numbers you said, and you're also looking at testing and iterating here. But as you think about that channel, the independent agency channel, is it going to be sharply less expensive than the digital? Is it a situation where you can go into a large brokerage firm and maybe add a wholesaler or 2 and you could get up and running pretty quickly? I just want to get the sense of the magnitude of the potential upcoming spend, is it materially less than what you need for your other channels?

Alexander Edward Timm
Co-Founder, CEO & Director

This is Alex. In terms of the cost relative to the direct channel, I think what we see is it's just different. It's not necessarily less or more. In the independent agency channel, we will be paying a commission. So instead of a flat fee to get a customer, as you see in the direct channels, we will be paying a commission based on the premium that comes through the channel. And so we like that. We think it's very cash flow efficient because you do not pay all of the customer acquisition costs upfront, but rather you get to really pay that over the life of that customer. We also know that there is very high retaining customer segments that still go to independent agency channels, and we've seen that really persist.

A decade ago, the independent agency channel had 1/3 of all volume. Today, it's got roughly 1/3 of all volume. And so we believe that using our platform that allows us to deliver a quote in under a minute to those customers is really valuable for the productivity of agents, and we think that it will have favorable unit economics as well, both in terms of retention and then, again, that favorable cash flow profile to customer acquisition costs.

Operator

Our next question comes from Mike Zaremski with Wolfe Research.

Unknown Analyst

This is Charlie on for Mike. Wondering if you can provide some color on accident frequency and miles driven levels you're seeing. Has that relationship changed at all versus pre-pandemic levels? Is it consistent across the states or does it vary? And did it vary across the months of the quarter? Any views or themes you could share there would be helpful.

Matt Bonakdarpour
Chief Data Science & Analytics Officer

Sure. Talking about -- this is Matt. Thanks for the question. Talking about this year, we did see an uptick in accident frequency going into April. Since then, it's been a pretty consistent trend month-over-month until now. We looked at day of -- time of day frequency. We have seen, as we've come out of the pandemic, an increased frequency, both from vehicle mileage and accident frequency in the weekday mornings from, say, 6 a.m. to 10 a.m. These are in line with pre-pandemic levels. In terms of accident frequency within Root, because of underwriting and pricing model changes, we have seen a decrease in frequency as our population has mix shifted into lower-frequency customers. That's driven by not only underwriting, but telematics and other pricing model changes. So overall, we're seeing a lower frequency average on our book. But within this year, we are seeing the uptick going into April and beyond.

Unknown Analyst

That's helpful. And then for my second question, can you guys -- you talked earlier in the year about raising rates in Georgia. Can you talk about what you're seeing there? It looks like it didn't slow your growth. Is Georgia a seasoned state now?

Frank Phillip Palmer
Chief Insurance Officer

In Georgia, we did have a rate increase there. We are rolling out a new program. It's not fully in market yet. So we haven't fully turned Georgia back on. We do expect to in the fourth quarter.

Operator

Our next question comes from Chris Martin with KBW.

Christopher Martin

Congrats on the growth in the quarter. I just had follow-up questions on the Carvana piece. And the first one is -- and it's really admirable the work you've done around kind of bringing out the credit score from pricing. But if you are not going to be using the telematics piece in the Carvana side, is that going to be back to kind of a traditional pricing model? Or have we built something else a little bit different to go about that relationship kind of the immediate close?

Alexander Edward Timm
Co-Founder, CEO & Director

We think that there's actually a big feature and a differentiation in the pricing model for Carvana, and it's not just traditional underwriting models. One of the things that's a very interesting opportunity that we are exploring is when these vehicles are sold to consumers, they're actually in the possession of Carvana first. And that gives us actually an opportunity to get closer to that vehicle and closer to the technology inside of that vehicle. And so as we continue to really expand this partnership and continue to do more product development, we fully expect to bring in more data science capabilities and more unique data sources, both from mobile phones and consumers and then also from the vehicles themselves.

Christopher Martin

Yes, that makes sense. And just with like all of the chatter, I may have missed this. But on the independent agent side, will getting your quote from Carvana trigger anything to then be placed as an independent agent if you're in the right place? Or will that be a fully direct business on that...

Alexander Edward Timm
Co-Founder, CEO & Director

That will be fully direct business.

Operator

And we have a question from Ryan Tunis with Autonomous Research.

Ryan James Tunis
Autonomous Research LLP

Following up on some of the independent agency questions. My understanding has always been that table stakes for writing in that channel is like an A- financial strength rating from AM Best or S&P. You can maybe get away with

Demotech if you're a coastal company. Could you remind us who's giving you your financial strength rating now? And if you don't have an A- from AM Best or S&P, have you thought about trying to go out and get one?

Alexander Edward Timm
Co-Founder, CEO & Director

We are not rated right now. We have not found a strong demand from any of our agency partners actually that we have spoken to I think primarily because it is personal auto. And so typically, that's not something that consumers themselves also are really demanding. And so we do not have a financial rating from AM Best or Demotech at this point, and we have not seen that at all be a blocker to our partnership with agents.

Ryan James Tunis
Autonomous Research LLP

Got it. And then my one follow-up was, I guess, just maybe looking for some color. I get what you guys are doing with the performance marketing pullback, which makes sense. But are you seeing that some of the advertising -- like are ad dollars becoming arguably a little bit more efficient given the pullback of a lot of carriers? Are you actually, I mean, theoretically seeing that if you did want to spend, you could maybe do it cheaper if you wanted to at this point, what you're seeing there?

Matt Bonakdarpour
Chief Data Science & Analytics Officer

Yes. Thanks for the question. This is Matt Bonakdarpour. We are definitely seeing improvement in efficiency on back of the pullback of marketing spend. And it's not just a pullback, but also more sophisticated segmentation and targeting to ensure that we are allocating our marketing budget in segments that are providing profitable lifetime value. And so at the new levels of marketing spend, we certainly are seeing return on that spend and more efficient spend as a result.

Operator

And we have a question from Youssef Squali with Truist Securities.

Youssef Houssaini Squali
Truist Securities, Inc., Research Division

Just want to follow up on a couple of questions my colleague, Mark, asked earlier. But just kind of maybe at a higher level, Alex, stepping back, a few years ago, you guys were one of the very, very few companies kind of tied in telematics and all the virtues of it. It seems like on the one hand, more and more people -- or more companies are talking about it. Yesterday, we saw a deal to eliminate Metromile to kind of double click on this. Your Carvana with its instant quote seems to kind of move away a little bit from it, even at least at a first glance. Can you just maybe kind of describe how you feel the industry is evolving around telematics and just the importance of it today versus how you thought about it maybe 3 years ago or 2 years ago? And second, maybe just give us an update on your campaign to drop the credit score and pricing and any kind of traction there?

Alexander Edward Timm
Co-Founder, CEO & Director

Absolutely. Thank you for that question. What we're seeing is that telematics is -- as consumers become more and more comfortable sharing data, that telematics' becoming more of a wave of the future. And I think we have seen several points of validation across the industry. That being said, we also know that we are at the forefront, and we know that for a few reasons. One, we are entirely focused and committed on disrupting new data science methods to disrupt the United States personal auto market, which is a $260 billion market. We have all of our resources, all of our investments and really have for the last 6 years entirely dedicated and focused to building the best technology in that space, and we've seen it.

The Carvana, we believe, actually is just the next evolution of the technology. And so we believe that as we've developed this technology that is highly differentiated, that now allows us to embed into other vehicles and to actually ingest even more unique data sources. We do not believe that the evolution of data science and insurance stops at the smartphone. We think the smartphone is a pivotal piece of the puzzle, but we don't believe that's where it stops. And we think we've demonstrated that. We are now in more states really than any of our insurtech peers, and we are also multiples the size of most of them. So we believe that we are out at the forefront. We think telematics is the wave of the future, and we're excited to be leading that wave and to really have differentiated technology based on rich behavioral mobile data there.

In terms of drop the score and drop the credit score, we also know that when we look at the industry that consumers aren't getting a fair shake, particularly those consumers that we believe need it the most. And we think that there's lots of discriminatory factors that do go into car insurance pricing today. And so we have decided to launch a campaign to really challenge the industry. And again, we're out in the forefront here to drop the credit score. And we're really excited that actually a major incumbent has followed us into this movement and is following our lead, and we are incredibly happy with that. We have -- and we've also now started to see progress at even the National Association of Insurance Commissioner level where they are now considering laws and model laws for how to handle discrimination in car insurance. And those were things that did not exist 3 years ago. And so the industry is changing, it is moving, and we really know that we're at the forefront.

Operator
That's all the time we have for questions. This concludes today's conference call. Thank you for participating. You may now disconnect. Everyone, have a great day.