Root, Inc. NasdaqGS:ROOT

Earnings Call

Thursday, May 4, 2023 1:00 PM GMT

Call Participants

EXECUTIVES

Alexander Edward Timm
Co-Founder, CEO & Director

Frank Phillip Palmer
Chief Insurance Officer

Jodi Emmert Baker
VP & Secretary

Megan Binkley
Principal Accounting Officer, CFO & Treasurer

ANALYSTS

Charlie Lederer

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Peter H. Phipson
Evercore Inc.

Thomas Patrick McJoynt-Griffith
Keefe, Bruyette, & Woods, Inc., Research Division

Presentation

Operator

Thank you for standing by. My name is Kayla Baker, and I will be your conference operator today. At this time, I would like to welcome everyone to Root, Inc.'s First Quarter 2023 Earnings Conference Call. [Operator Instructions]

I would now like to turn the call over to Vice President and Corporate Secretary, Jodi Baker.

Jodi Emmert Baker
VP & Secretary

Good morning, and thank you for joining us today. Root is hosting this call to discuss its first quarter 2023 earnings results. Participating on today's call are Alex Timm, Co-Founder and Chief Executive Officer; and Megan Binkley, Interim Chief Financial Officer. During the question-and-answer portion of the call, our presenters will be joined by Matt Bonakdarpour, Chief Technology 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 Q1 2023 Form 10-Q, which was filed with the Securities and Exchange Commission last evening.

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, please review our Form 10-K for the year ended December 31, 2022, 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 and Q1 Form 10-Q released last evening. 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 shareholder letter released last evening and our Form 10-Q filed with the SEC, 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 Edward Timm
Co-Founder, CEO & Director

Thank you, Jodi. In Q1 of 2023, we grew total new writings quarter-over-quarter 25% while reducing our accident period loss ratio to 69%. This resulted in improving adjusted EBITDA by 78% on a year-over-year basis, which was driven by the broad work and decisive actions taken in 2022 to reset the foundation of the business. We are now positioned with a loss ratio better than the industry, allowing us to scale new writings on our path to driving profitability. Furthermore, we continue to prove our differentiation in the embedded channel and are excited to announce we finalized a third partnership.

I'd like to take this opportunity to discuss the key elements of our differentiation. Having built our company on a flexible technology stack, allowing customers to get a quote without ever touching a keyboard, we are able to create seamless, real-time, quote-to-bind experiences in the moments that are most relevant to consumers. This drives adoption rates, as shown by an over 3x increase in our attach rates since launching our fully-embedded product.

Second, our platform continues to advance through our API developments, allowing us to rapidly scale and add new partnerships while materially reducing the cost and time to deployment for those partners. Putting these 3 things together, increasing adoption while decreasing costs and increasing speed to market, that's the differentiated value we provide to our partners.

Third, make no mistake, telematics is and has always been a meaningful differentiation for Root. We are actively developing products to incorporate telematics with each of our embedded partners. We see transformational opportunities to create new telematics approaches through the embedded channel. Our state-of-the-art telematics platform allows us to develop unique solutions that work for our partners and their customers.

All of this has been made possible by a continued investment in our data science and technology. These systems allow us to create better experiences for our customers while making better decisions for our business. We believe long term, this will create a leading competitive advantage in pricing and automation. We are building an enduring company and are driving the company to profitability with the capital we have. We are excited to continue our new writings trajectory and are grateful to our customers, employees and investors.

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

Megan Binkley
Principal Accounting Officer, CFO & Treasurer

Thanks, Alex. Results for the first quarter of 2023 reflects strengthened underwriting performance, reduced expenses and increased new writings. Our full GAAP financial results are disclosed in the shareholder letter published yesterday evening.

Gross written premium for the quarter was $135 million, a 28% decline year-over-year. Gross earned premium was $130 million, a 26% decline. The contraction in premium is expected given our stricter underwriting measures, rate we have taken and our current growth strategy. We anticipate an opportunity to return to measured growth within the next year based on the recent success in our direct channel and the potential of our embedded offerings.

The gross accident period loss ratio was 69% for the first quarter, a 13-point improvement versus the first quarter of 2022 as we recognized and responded to loss trends early. We remain committed to lowering the loss ratio and expenses to improve our financial performance and the fiscal foundation of the company.

During Q1, our operating loss was $30 million, a 59% improvement compared to Q1 2022. Adjusted EBITDA, our approximation of operating cash consumption, improved 78% over the prior year. We ended the first quarter of 2023 with $524 million of unencumbered capital compared with $559 million at the end of the fourth quarter.

Turning to our outlook. On a year-over-year basis, we expect to see continued contraction in top line and policy in-force counts through 2023. We continue to prioritize loss ratio improvements and laying the foundation to return to profitable growth. We are closely monitoring emergent trends and will take rate as needed. We remain focused on improving operating results throughout 2023, and believe we are positioning the company to achieve profitability with the capital we have.
With that, we look forward to your questions.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Josh Siegler with Cantor Fitzgerald.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

So with the strategic marketing deployment this quarter, I'm curious, what distribution channels you primarily have been targeting? And do you expect to ramp up marketing in 2Q if it still achieves your profitability targets?

Alexander Edward Timm
Co-Founder, CEO & Director

Yes. Thanks for that . Good to hear from you, Josh. This is Alex. In Q1, we continued to -- and a lot of what you saw in the growth in the direct channel was really us just returning to opening up states and returning to being okay with driving new business, right? When the loss ratio spiked and we said we tightened underwriting and we really pulled back in a lot of state, what really you saw in Q1 was as we saw that loss ratio coming in down really close to our targets in the high 60s, we really began to start to open up more states. And so that allowed us to also, and really a small just handful of our states, begin to deploy some of our marketing dollars, and that was primarily in our search marketing channels and our performance marketing channels.

We've also done some R&D into direct mail and seeing some success there. And we anticipate that we're going to continue to see those -- the success that we see currently in Q1 and Q2 as well. Part of this is also driven by a favorable macro environment, where with our loss ratios in just a superior position to many of our competitors, we are really positioned well to actually drive new writings into market in this period of time while many others aren't.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Understood. That's very helpful color. And then when we're thinking about long-term mix of the company, what percentage of new writings do you expect to generate from embedded versus direct channels over the long term?

Alexander Edward Timm
Co-Founder, CEO & Director

I think over the long term, we're very bullish on the embedded opportunity. We're really excited by the 2 additional partners that we signed already this year and are looking forward to actually launching those products.

We do believe that over the long term, you're going to continue to see a shift into the embedded channel. We believe that it creates better customer experiences in meeting customers in their moments of need and that, that results in superior and better unit economics and business outcomes. And so over the long term, we do expect to see embedded to become the lion's share of the business. But we also know that the Internet is a big place, it's not going to go away overnight, and we're excited to be able to drive profit in our direct channel as well.

Operator

Your next question comes from the line of Tommy McJoynt with KBW.

Thomas Patrick McJoynt-Griffith
Keefe, Bruyette, & Woods, Inc., Research Division

Looking at the cash flow statement, the operating cash outflow jumped a bit in the first quarter, and it looks like it was mostly driven by working capital changes. Is there anything seasonal in 1Q that we should be on the lookout for? And then looking ahead, how do you expect the cash flows to trend throughout the year?

Megan Binkley
Principal Accounting Officer, CFO & Treasurer

Thanks, Tommy. This is Megan. I'm really glad you asked that question because it's important for us to have an opportunity to describe our cash burn, and what you're seeing reflected in the GAAP statement of cash flows is primarily a change in the balance sheet. So that's really reflective of the significant change in our liabilities quarter-over-quarter, and that's really been driven primarily by a reduction in our loss reserves.

And I would say to truly understand our cash burn, a more relevant metric that we focus on is our unencumbered cash. And that balance at the end of Q1 was $524 million, which was compared to $559 million in Q4. So it's a change of $35 million quarter-over-quarter and really reflective of what we consider to be the true cash burn. We do expect that the cash burn is going to be significantly lower in 2023 compared to 2022, and that's really consistent with the material improvement that we're expecting in our operating results.

In terms of run rate and trend, I mean you can expect that the quarterly burn for the rest of 2023 is going to be lower than it was in Q1. But again, we feel very confident in terms of our capital position. And yes, we feel good about where we're at today.

Thomas Patrick McJoynt-Griffith
Keefe, Bruyette, & Woods, Inc., Research Division

And then my second question here, you guys have obviously been taking and getting approval for a lot of rate over the past year or so. Are you guys still actively seeking rate increases in certain geographies? And are those at the same magnitude that you've been incorporating over the past year?

Alexander Edward Timm
Co-Founder, CEO & Director

Yes, not in the same magnitude. So we do see -- still see high single-digit trends. So we are consistently seeking rate increases throughout this year, even in states where we are at target because we are expecting that trend. We did disclose, I think we're about at target in about 80% of our premium. And so we do think that there are still some states that do need more than single-digit trends, but those are fewer than they were last year. So we still expect to take rate but not at the same magnitude that we did last year.

Operator

Your next question comes from the line of Peter Phipson with Evercore.

Peter H. Phipson
Evercore Inc.

My first question is you guys have seen a big benefit from mix helping reduce your frequency, and it looks like renewal as a percentage of new has stabilized now in sort of the high 70s. So I guess, do you have any updated expectation on if you can still see negative frequency as this continues to stabilize?

Alexander Edward Timm
Co-Founder, CEO & Director

Yes. I think, first, I'd say we do tenure adjust the frequencies that we report. So that does take into account the new versus renewal mix, and we believe that a lot of that frequency improvement that we're seeing year-over-year is due to the significant improvements we've made in both underwriting and then as well as segmentation.

So really throughout the last 12 to 18 months, almost all of our rate filings did not just increase base rates. They also were deploying our new segmentation models. And so from those models, we saw a fairly material improvement in our ability to segment risk, which has led to a more preferred profile, particularly with respect to frequency.

Peter H. Phipson
Evercore Inc.

Okay. Great. And I might have misheard, but earlier, I think in the commentary said you anticipate an opportunity to potentially return to growth within the year or within a year. Could you just elaborate on that and maybe what you're expecting? Is this something you're expecting in the first half of '24? And maybe sort of talk about the magnitude of how quickly you turn that growth back on.

Alexander Edward Timm
Co-Founder, CEO & Director

Yes. Thanks, Peter. I think that's a really good question, given where we are. Growing the writings 25% quarter-over-quarter is something that I think we very happy with, especially while showing such material loss ratio reduction, and we're continuing to see a very favorable environment. And as we have continued to see more of our states and a lot of the work we did last year come through actuals and see that loss ratio has improved in many of these states, we're excited to actually continue to deploy marketing dollars just because of the profitability of those dollars. And so we're excited by the new writings trajectory.

We're also equally, if not more excited, by the 2 new embedded partners that we have that we think will provide substantial new writings. Now we want to launch those in the coming months. It will take time to get those products into market, but we have all the faith in the world that those are 2 excellent partners that will provide significant scale for the business.

In terms of our guidance and what we're expecting, we're reiterating what we said in Q4.

Operator

[Operator Instructions] Your next question comes from the line of Charlie Lederer with Citibank.

Charlie Lederer

Great. I guess can you expand on the comments you made about the telematics efforts in the embedded channel. Does that add some friction? Or how do you get around that? And does it differ by the 3 different partners?

Alexander Edward Timm
Co-Founder, CEO & Director

Yes. Thanks for that question, Charlie. It's something that we're really excited by. I think the embedded opportunity is incredibly interesting because what it allows us to do, whether it's through being closer to vehicles or whether it's being embedded in different financial applications, it allows us to actually collect telematics data in really unique ways. That could be well before a consumer ever even considers purchasing car insurance.

And so this allows us to really seamlessly and more effortlessly build in that telematics collection process, which has always been a very difficult part in product experience for many consumers and many companies, in really unique ways. It also allows us to get other insights and data sources. So for example, pulling vehicle data directly versus using smartphone data. We still like smartphone data, but it provides additional opportunities there.

And so we don't think it actually increases friction. We think what it does is it allows us to actually reduce friction in the telematics purchase experience because of the nature of where we're embedding. And it is different for each partner because each partner has a different embedded use case and a different customer base. And the important thing there is that you've got to have a very flexible telematics system and platform that you fully control, which we do, which differentiates Root, and that allows us to really create these custom telematics experiences tailored to each of our embedded partners' customers.

Charlie Lederer

Great. That's helpful. Any color on the reserve development in the quarter? Are you able to break that down by channel?

Frank Phillip Palmer
Chief Insurance Officer

Yes. This is Frank. We are not breaking that down by channel. It's mostly in the damage coverages.

Operator
And there are no further questions at this time. That will conclude today's conference call. You may now disconnect.