The Allstate Corporation (NYSE: ALL)

Recommend Buy at 5%| PT: $144.61

September 25th, 2023

CIMG Investment Research

Not All Is Lost: Investment Recommendation

The Committee is recommending a buy of The Allstate Corporation at a 5% weight. Recent inflationary trends plus ALL's delay in raising premiums to match rate with risk present an opportunity to capture a positive repricing trend that will increase net earned premiums through the **reduction of losses relative to premiums**. We anticipate a slow shift to a direct model, use of telematics, and normalizing catastrophe losses, which have been elevated above historical levels in 2022/2023, to drive further upside.

Investment Thesis

Management's Focus on Auto Margins

Back in Q1 of 2022, Allstate developed a comprehensive plan to help restore their auto margins. Since Q2 of 2022, Allstate has reported negative earnings due to increased severity and frequency in their underwriting business. Allstate developed this comprehensive plan to improve their auto insurance profitability by raising rates, reducing expenses, limiting growth, and enhancing claims processes. They have started to implement this plan by increasing rates by 5.8% in 34 locations in Q2 2023 and increasing rates in three underperforming states by 25% since Q1 of 2022. They have said that they will continue to pursue rates throughout the second half of 2023. In their expenses, Allstate has decreased their property-liability underwriting expense ratio by 2.5% in Q2 2023 and have temporarily reduced advertising spend to reduce new business volume. In addition to this, they are expecting to see future cost reductions from digitization, sourcing and distribution of their insurance products. We believe that this comprehensive plan, combined with their Transformative Growth model, should help push Allstate's combined ratio back to their Mid-90s (we project high 90s) level.

Premiums Increases Will Outpace Claims Increases

Since there is a lag in rate increases due to the 6-month policy term, average earned premiums lag average premium per policy. What we saw in 2021 and 2022 was that used cars and car parts saw roughly a 45% year over year increase at its high in June 2021. With elevated inflation, and the lag on premiums earned, Allstate could not increase their rates fast enough to keep up with this inflation (since Auto claims severity is determined by auto prices). This has caused Allstate to continue to pursue rises in their average premium per policy to help combat this inflation. More recently, we have seen year over year change in used cars and trucks prices start to decline and now sits at roughly -6.5% in August of 2023. This, combined will Allstate's telematics pricing model, should help Allstate start to see an increase in their premiums earned relative to losses and expenses incurred in underwriting and operating.

Catastrophe Losses Should Decrease in The Coming Years

In the first half of 2023, Allstate saw their highest catastrophe loss ratio since 2011. The average catastrophe loss ratio between 2018 and 2022 has been 7.86, but now in Q2 2023, it has reached 22.6 and even 14.5 in Q1 of 2023. In the second quarter, there were 42 catastrophe events which impacted 160,000 customers and resulted in a $2.7 billion catastrophe loss. Severe weather, mostly hail, coupled with rising populations in areas prone to violent weather, resulted in this loss. In August, Allstate announced estimated catastrophe losses for the month of $551 million, with approximately half of the losses related to the Maui wildfire. To offset this loss, Allstate implemented rate increases of 13.2% in homeowners' insurance average gross written premiums in August of 2023 compared to the prior year. We are expecting that with continued rate increases, Allstate's catastrophe loss ratio will normalize to 2018-2022 average, which should help their underlying combined ratio.

Financial Committee

Nick Kalra – Committee Head
nkalra@crimson.ua.edu

Abigail Britton – Analyst
abritton@crimson.ua.edu

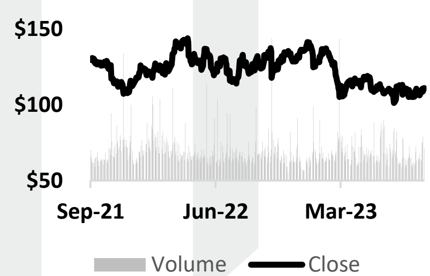
Caroline Long– Analyst
crlong6@crimson.ua.edu

Michael Brophy – Analyst
mjbrophy@crimson.ua.edu

Maddie Blahnik – Analyst
mjblahnik@crimson.ua.edu

Pranav Sundararajan – Analyst
Psundararajan1@crimson.ua.edu

Figure 1: ALL 2 Year Stock Chart



Price	$114.09
PT	$144.61
Dividend Yield	3.14%
Upside	27%
52-Week Range	$100.57 – $142.15
Mkt Cap	$29.66b
LTM EPS	-$9.95
LTM Prices/Sales	0.55x
TTM Revenue	$54.83b
LTM Combined	117.60%

Valuation

We arrive at a $144.61 price target for ALL using a levered DCF valuation as well as a 2-Yr Fwd P/E Multiple approach. The key drivers in the model are the normalization of catastrophe losses (particularly in the Allstate Protection – Homeowners segment), the increase of rates (premiums earned/policies in force, particularly in the Allstate protection – Auto segment), and the continued reduction in the operating expense ratio as management pursues cost rationalization and continues to shift to a direct rather than agent model. Other model assumptions include policies in force decreasing in the near term as ALL slows policy growth at unprofitable prices and limits unprofitable business. For valuation, we first used a levered DCF with two approaches: a long-term growth rate (DR: 10%, LTGR: 1.5%) and a terminal P/E multiple (12x PE, negative implied LTGR). The LTGR approach and terminal multiple approach give us price targets of $156 and $142 respectively. We also used a 2-Year Fwd multiple of 10x applied to our estimate of 2025 earnings to arrive at a target of $136. Blending the three valuation methods, we get a price target of $144.61.

Company Overview

Allstate was founded in 1931 by Sears President Robert Wood and a friend. They started by selling auto insurance through the mail and, over the years, developed into selling home and other property/casualty insurance lines. In 1992, the Allstate Corporation was founded to hold the assets of Allstate Insurance Company. Sears divested a 20% stake in 1993 when Allstate went public and sold off the rest of the shares in Allstate in 1995. Throughout the course of its business, Allstate developed four main segments: Allstate Protection, Protection Services, Allstate Health and Benefits, and Run-off Property-Liability. Allstate Protection, the largest segment, offers private passenger auto, homeowners, other personal lines, and commercial insurance through agents, contact centers, and online. Over the years, Allstate has acquired multiple companies, including National General in 2021, SquareTrade in 2016, and Answer Financial in 2011. This has allowed Allstate to now have over 189.1 million policies in force at the end of 2022 – most of which are auto. Allstate has grown to this by utilizing their Allstate Protection's strategy, which is to increase personal lines market share through Transformative Growth. Allstate's Transformative Growth model is about creating a business model, capabilities, and culture that continually transform to better serve customers by providing affordable, simple, and connected protection through multiple distribution partners.

Industry Overview

Allstate operates in the personal lines insurance industry, where it competes against companies such as State Farm, Progressive, Geico, USAA, and others. Over the years, insurance companies have developed insurance products to meet their clients' needs, including environmentally friendly insurance products, cyber insurance, and home-sharing insurance. The most significant trend in recent years has been insurers investing in online platforms, mobile apps, and digital customer experiences. This trend has streamlined policy purchasing, claims processing, and communication between insurers and policyholders. Recently, the industry has faced profitability challenges as many state regulators have imposed caps on rate increases, leading to difficulties for insurers dealing with increasing severity in insurance claims. Insurers are attempting to raise rates to address this severity increase, but many have not done so fast enough, resulting in significant losses in various segments. Specifically, many insurers have experienced losses in their auto segment as the auto market continues to face problems with limited vehicle supplies and high prices that have persisted since the post-pandemic shutdown era. In the homeowner segment, many customers are more inclined to renovate or expand their current homes rather than purchase new ones due to constrained supplies and high insurance rates. This presents the risk of an insurance mismatch, as policies written pre-renovation may not fully cover the increased value of the home if the homeowner fails to report the renovation to their insurers. We believe that Allstate will enhance their operations and increase rates properly to counteract these problems.