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Horace Mann Educators Corp. (HMN)

Q4 2016 Earnings Call

CORPORATE PARTICIPANTS

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Bret A. Conklin
Acting Chief Financial Officer, Chief Accounting Officer, Senior Vice President & Controller, Horace Mann Educators Corp.

Matthew P. Sharpe
Executive Vice President, Life and Retirement Division, Horace Mann Educators Corp.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

OTHER PARTICIPANTS

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Matthew J. Carletti
Analyst, JMP Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Horace Mann's Fourth Quarter and Full Year 2016 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Mr. Ryan Greenier, Vice President of Investor Relations. Thank you, you may begin.

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you, Donna, and good morning, everyone. Welcome to Horace Mann's discussion of our fourth quarter and full year 2016 results. Yesterday, we issued our earnings release and investor financial supplement and copies are available on the Investor's page of our website.

Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Senior Vice President and acting Chief Financial Officer. Bill Caldwell, Executive Vice President of Property & Casualty; and Matt Sharpe, Executive Vice President of Life and Retirement are also available for the question-and-answer session that follows our prepared comments.

Before turning it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not guarantees of future performance. These forward-looking statements are based on management's current expectations, and we assume no obligation to update them. Actual results may differ materially due to a variety of factors, which are described in our press release and SEC filings.

In our prepared remarks, we may use some non-GAAP financial measures. Reconciliations of these measures to the most comparable GAAP measures are available in the supplemental sections of our press release.

And now, I'll turn the call over to Marita Zuraitis.

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Thanks, Ryan, good morning, everyone, and welcome to our call. As many of you know, Dwayne Hallman, our Chief Financial Officer, passed away last week. Dwayne was an inspiring leader and a true partner in establishing and executing Horace Mann's mission to serve educators. His contributions to our success at Horace Mann are significant and he left an indelible mark on his co-workers and this company. In his absence Bret Conklin, our Senior Vice President and Chief Accounting Officer has assumed acting CFO responsibilities and has prepared remarks this morning.

Turning to our business results. After yesterday's market close, Horace Mann reported fourth quarter operating earnings of $0.52 per share, which brings the full year operating earnings to $1.97 per share. These were solid results considering the impact of weather, elevated industry auto loss trends and a challenging interest rate environment. And these results continue to highlight the benefits of our multiline business model.

2016 was a year of significant strategic investments and advancements for Horace Mann. Our product offerings continue to evolve, addressing issues educators face every day. We enhanced our Horace Mann General Agency offerings to include more property options for coastal exposures, and expanded our brokered life insurance solutions for specialty cases. In addition to these enhancements, we also introduced student loan solutions, which helps educators reduce the burden of student loan debt. To-date we have helped refinance millions of dollars in student loans, and redirect their monthly savings to retirement account.

From an infrastructure standpoint, we are making good progress, modernizing our Life and Retirement systems and are in Phase I of a multi-year effort to modernize the full suite of our P&C systems. In addition, we've made it easier for customers and agents to do business with us with improved digital tools, like a mobile app to submit damage photos and other claim documentation, and an easy-to-use online self-enrolment for our Retirement Advantage products.

From a distribution standpoint, we continue to build complementary distribution channels to allow customers to access us on their terms, essentially increasing the number of ways to introduce Horace Mann to educators. Because we know that their financial needs become more complex, they will seek the advice of a trusted advisor at the point of sale.

For example, in 2016, we enhanced our online auto quoting tool, providing more options and reducing the amount of time it takes to deliver a quote to a customer. By streamlining the user experience and improving our digital presence, we are seeing meaningful increases in the number of customers that begin their Horace Mann relationship using this channel.

And we continue to invest in the agency channel, a key differentiator for Horace Mann in the marketplace. Our captive agent force is a key component to our unique value proposition and an integral part of the education ecosystem, solving for the issues educators and school districts face on a daily basis.

Our Exclusive Agents are the face of Horace Mann and schools across the country, helping educators protect what they have today and prepare for a successful tomorrow. In 2016, our agency force conducted 3,500 workshops in schools on financial literacy, retirement readiness and student loan assistance. In addition, they helped school districts secure over $66 million in crowd funding grants with the assistance of DonorsChoose.

I am pleased to report that agency productivity continues to improve and the proof is in our sales volumes. P&C sales increased 6%. Retirement sales were strong and we clearly have life back in our Life business. Sales increased over 40% to $15.6 million. Adequate life insurance protection is an essential part of a holistic financial plan, and many educators do not have or do not have enough life insurance coverage. We are helping solve for this gap, educating consumers on the importance of life insurance and helping them find dollars to pay for it.

Our customer base is growing. We continue to add new educator households while keeping our current customers. Life and Retirement persistency rates continue to be in the mid-90s, and despite a challenging P&C environment and aggressive rate actions to improve profitability, our industry leading P&C retention ratios continue to be in the mid- to high-80s. These achievements are a lot to be proud of, but we have more work to do to achieve our goal of increasing market share in the educator market and improving profitability to move us closer to a low-double digit ROE.

2016 was clearly a challenging year for the P&C industry. Weather and auto loss trends impacted everyone and we are not immune. Our combined ratio of 101.5% increased 4.5 points largely due to increases in catastrophe, but also due to higher auto loss trends.

From a catastrophe perspective, we had 9.7 points of losses, a level not seen since 2011 when devastating tornados created significant damage across the Midwest and Southeast. This year, we saw a significant increase in convective storm activity with grapefruit-sized hail in Texas, battering winds and torrential flooding in Louisiana, and fourth quarter results included the impact of Hurricane Matthew, which caused significant damage in one of our larger markets, The Carolinas. All said, the nature of these storms impacted not only property, but auto as well. 2016 auto catastrophe losses were historic, $10 million or 2.5 points on the auto combined ratio, a level never seen at Horace Mann.

And the macro industry trends in auto are concerning. The industry is battling an unprecedented increase in auto frequencies. And despite all the safety enhancements in modern vehicles, fatalities and accident severities are on the rise. Drivers today are more distracted than ever and it's not just mobile phones. The sophistication and complexity of new vehicle technology and increases in the number of connected vehicles are clearly contributing to the rise in accident frequency as well as accident severities. We, like many in the industry, are seeing this on our claims data. We are seeing higher accident counts and more severe damage. And when you have a collision at a higher rate of speed, you typically have more bodily injury claims.

Our educators tend to be better, more responsible drivers. And therefore, they are somewhat insulated from these trends, but they are not completely immune from the environment around them. We began seeing an uptick in auto losses in mid-2015, and we reacted quickly in response to these trends. We began tightening underwriting, increasing rates and implementing claim enhancements, with a goal of improving profitability. These actions, combined with the fact that the majority of our policies are on a six month billing cycle, resulted in higher earned rate increase in 2016.

Unfortunately, despite our aggressive actions, the rate we took was not sufficient to cover rising loss cost trends. As a result, we continue to take rate, and in 2016 exceeded our original plan by 50 basis points ending the year at 6.5%. Our initial outlook for 2017 indicates an 8% rate plan, but we will adjust accordingly as we see changes in the auto loss trend. We will provide more specifics on 2017 guidance later in the call. But from where we stand today, we would expect to see modest improvement in the underlying auto loss ratio in 2017.

Despite the weather impacts of 2016, our underlying property book continues to perform extremely well and is an important contributor to the profitability of our P&C line. The majority of our P&C customers bundle auto and property and this combination results in strong retentions, but also higher lifetime profitability. We continue to promote bundling, not only for the profitability benefits, but also to ensure we are providing a complete insured solution for the household.

Turning to the Retirement business, 2016 was a solid year. Ex-DAC operating earnings increased 11% on strong net investment income as well as solid sales and deposit activity. At the end of 2016, retirement assets under management were nearly $6.5 billion, an increase of over 7% compared to the prior year.

We know that our 403(b) and retirement offerings are, in many cases, the first product in educator purchases from us. Therefore, it is important to ensure the customer experience is consistent and aligned with our solution orientation. We have spent the past few years building enhanced online enrolment capabilities, a scalable infrastructure and most importantly an innovative product offering that is integrated and aligned with our solution orientation.

We have built and plan to launch an educational tool administered by our agents during the sales process and annual review, which will help analyze the customers' financial and household information. The output of this tool is personalized education to help customers achieve their retirement goals, but also to provide recommendation on appropriate homeowners and auto insurance, as well as life insurance options for protection and wealth accumulation.

In short, this proprietary tool provides a holistic, goal-based approach to assist our customers with all of their household financial needs. At the center of the savings component of this model is our new employer-based and individual Retirement Advantage products. These offerings feature transparent fees as a percentage of assets under management, flexibility to move between products with no surrender charges, and a best-of-breed selection of third-party mutual funds and sub-accounts with a continued focus on increasing client value and reducing overall cost.

These Retirement Advantage products will replace our current 403(b) and IRA offerings, with a targeted second quarter release. This product shift is designed to harmonize compensation of our agents across all tax types, and ensure a consistent customer experience across all new retirement sales.

We believe our harmonized approach, combined with our innovative new products, will capitalize on the disruption in the retirement space, and we're poised to take advantage of our first mover position.

To reach more educators and ensure we capitalize on this innovative new product offering, we have expanded our institutional sales team led by Bruce Corcoran. As you may recall, Bruce joined the organization in the second quarter of 2016 and leads our newly created Institutional Retirement Solutions team. We have expanded this team hiring seasoned 403(b) institutional sales talent with proven track records of success. This team of experienced business-to-business marketers will improve our competitiveness in medium to large school district market. We expect this to result in accelerated 403(b) growth.

We already have an active pipeline of RFP opportunities, and we're excited to introduce our innovative Retirement Advantage product to more school districts. We are confident the combination of our new educational tool, our innovative new retirement product platform and the growth of the experienced institutional team will result in an acceleration of growth in retirement assets under management over time.

Let me turn the call over to Bret for a discussion of fourth quarter and full year 2016 results. Then, after Bret's comments, I'll provide our operating earnings and key driver guidance for 2017. Bret?

Bret A. Conklin

Acting Chief Financial Officer, Chief Accounting Officer, Senior Vice President & Controller, Horace Mann Educators Corp.

Thanks, Marita, and good morning, everyone. Fourth quarter operating income was $0.52 per diluted share, $0.09 higher than the prior year. Stronger net investment income results across all segments accounted for $0.07 of the increase. In addition, we had modestly favorable DAC unlocking this quarter compared to negative DAC unlocking in the prior period which accounted for $0.04. And if you recall, we refinanced our debt in the fourth quarter of last year and incurred $0.05 of costs related to the debt issuance. Offsetting these favorable variances was $0.06 of higher cat losses in the current quarter.

P&C after-tax income of $9.6 million was $1.7 million higher than the prior year quarter. This included $11.6 million pre-tax or 7.3 points of cat losses which was $4 million higher than the prior year. Hurricane Matthew accounted for the vast majority of cat losses and the impact related to this event was within the range we preannounced on our third quarter earnings call. In addition to Matthew, the relatively warm weather in the fourth quarter resulted in a higher than normal level of wind and thunderstorm activity across the Southeast.

Auto results for the quarter were impacted by accident frequency and physical damage severity that remain at an elevated level. As a result, the underlying combined ratio for the quarter was 108.2%, a 1.4 point improvement compared to with the prior year. So much of the improvement was related to a lower expense ratio, we are encouraged that the auto loss trends appear to be stabilizing although like the broader industry they remain at an elevated level.

Given the uncertainty around elevated auto loss trends, we have been prudent in our reserving action, and this is the first quarter in 2016 where we have seen favorable emergence in auto reserves. During the quarter, we had $1.4 million or 1.3 points of favorable prior year reserve development in the quarter, largely related to liability related coverage's for accident years 2014 and earlier. Underlying property results continue to be strong and the combined ratio on this basis improved 3.3 points to 64.3%.

Operating income excluding DAC unlocking in the Retirement segment was $10.8 million in the quarter, $600,000 lower than the prior year. A higher level of operating expenses related to strategic investments and infrastructure modernization were the primary drivers of the increase. Partially offsetting the increase was a $3.8 million increase in net investment income, driven by strong alternative returns and prepayment activity in the fixed income portfolio.

In the Life segment, ex-DAC operating earnings declined $1.1 million due to slightly higher income tax expenses, as well as the first year expense and reserve impacts of accelerating volumes of single-premium new business. On a full year basis, consolidated operating earnings were $1.97 per share, $0.03 lower than the prior year.

Weather and auto loss trends pressured P&C results in 2016, yet our Retirement and Life segment, ex-DAC operating earnings, increased 11% and 9% respectively. This year's operating performance demonstrates power of the true multiline model. P&C had a challenging auto and cat year, yet Retirement and Life earnings continued to grow resulting in a relatively stable earnings profile.

Full year P&C operating income was $25.6 million, a $14.4 million decline compared to the prior year. The combined ratio of 101.5% was 3.5 points worse than the prior year, with the majority of the increase reflecting a higher level of cat activity and lower prior year development.

During 2016, we experienced $60 million pre-tax or 9.7 points of cat losses. This was significantly higher than our loss experienced over the past four years, and exceeded our average annual modeled losses by nearly 4 points. On an underlying basis, the combined ratio of 92.9% was 1.2 points worse than the prior year. While underlying property results remained strong, auto loss trends were challenging in 2016 underscoring the importance of a bundled P&C product offering.

Ex-DAC operating earnings in the Retirement segment increased nearly $5 million to $50.5 million. Strong investment returns and strong growth and assets under management more than offset nearly $8 million in additional operating expenses.

We continue to invest in the future of our businesses, and as Marita mentioned, we are building the infrastructure and distribution to support significantly larger sales volume in the years ahead.

In the Life segment, full year ex-DAC operating earnings of $16.3 million increased $1.3 million. Much of the increase was related to a lower level of mortality cost in 2016, as death benefits were in line with expectations versus an elevated level in the prior year. In addition, we continued to invest in improving Life infrastructure and had a modestly higher level of operating expenses in 2016.

Consolidated net investment income was $361 million for the year, nearly $30 million higher than the prior year. Alternative investment income increased over $11 million and we experienced nearly $9 million in prepayment activity in the fixed income portfolio over the course of the year. The remainder of the increase in income was a result of higher asset balances in the Retirement segment.

Despite the challenging interest rate environment, our annualized net investment yield increased 15 basis points compared to the prior year to 5.21%. We continue to be successful in sourcing opportunities to put money at work at attractive risk-adjusted returns, without going down in credit quality or extending duration. We achieved a new money rate of nearly 4% over the course of 2016 and maintained a neutral [ph] duration (20:57) position compared to our liabilities.

Turning to the balance sheet, we generated about $75 million of statutory operating income in 2016 and while our RBC ratios aren't final, we estimate P&C is around 570%, with a premium to surplus ratio of about 1.35; and the Life company RBC is around 450%. We have a healthy cushion of excess capital, which we plan to use to fund continued organic growth.

And now, let me turn the call back over to Marita for our 2017 outlook.

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Thanks, Bret. We have spent the past few years building a solid foundation that celebrates our unique value proposition and supports scalable growth. And looking ahead to 2017, I'm confident we have the right products, distribution and infrastructure in place to accelerate profitable growth.

Our operating income guidance for 2017 is $1.95 to $2.15 per share. This estimate includes nearly $0.10 of strategic investments in our Retirement business that we expect will accelerate our growth momentum. Excluding these one-time investments, the midpoint of our earnings guidance represents a 9% earnings growth over 2016.

Within P&C, we expect the underlying combined ratio to increase about one point compared to 2016 levels. The increase is driven by the expectation of a more normalized non-cat weather experienced in property, somewhat offset by a one point improvement in the auto loss ratio.

Getting our auto book to targeted returns is a multi-year journey, but we expect to make progress in 2017. Aggressive rate actions in late 2015 and 2016 are earning in, and our rate plan is 8% for 2017. We expect this along with the disciplined underwriting, continued claims enhancements and an intense focus on pursuing growth in profitable geographies and segments, will result in a one point of improvement to the underlying auto combined ratio over the course of 2017.

Underlying property results were very strong in 2016 and our 2017 guidance includes an assumption that non-cat weather related losses return to a more normalized level. As a result, underlying property results are two to three points higher or in the low-70s.

From an expense perspective, we continued to invest in all of our businesses and as a result expect the expense ratio to remain around 27.5%, a level we expect to persist over the multi-year implementation phase of our new P&C systems.

Our catastrophe estimate is around six points, which represents our average annual modeled losses of our current book of auto and property business. We expect sales momentum to continue in 2017 with both auto and property businesses growing, continued strong retention and mid-digit rate increases to result in a 4% to 6% increase in net written premium. Putting it all together, we expect 2017 to be a year of incremental profit improvement in P&C. We are laser focused on improving auto profitability and we'll continue to react to changes in loss trends quickly.

Expenses in the Retirement segment increased as a result of our strategic investments, that I mentioned earlier. In addition, we assume a lower level of investment prepayment activity and modestly lower alternative income. And as a result, the net interest margin declines into the 180s reflecting the low interest rate environment.

While rates have increased, spreads continue to tighten, and as a result our expectation is that new money rates will be around 4% again in 2017. Therefore, our guidance assumes a modest decline in Retirement operating earnings in 2017.

Our Life earning assumptions reflect mortality consistent with our actuarial models as well as continued net investment income pressure, given our reinvestment rate assumptions. As a result, we expect Life segment earnings to be in the range of $14 million to $16 million. Overall, our operating income guidance of $1.95 to $2.15 per share reflects the challenging macroeconomic backdrop of elevated auto severity trends for a long to low interest rates, and $0.10 of strategic investments that will position us to capitalize on the opportunities of our new retirement platform.

In closing, 2016 was a strong year for Horace Mann. We continue to make significant progress, enhancing our product offerings, expanding distribution, and improving our infrastructure. These investments are the right tools to create long-term shareholder value. Because of our intense focus on the educator market at Horace Mann, we are confident that our new proprietary educational tool will serve this deserving group in a differentiated and unique way.

We frequently said that there are only two types of educators, Horace Mann customers and future Horace Mann customers. And with this new tool, combined with the other significant improvements we've made over the past few years, I am more confident than ever, that we are on the right path to achieving our goal of being the preferred financial services company for the nation's educators, and we expect to see further market share gains in 2017. Thanks.

And now I'll turn the call back to Ryan to start our Q&A.

Ryan E. Greenier

Vice President-Investor Relations, Horace Mann Educators Corp.

Thanks Marita. Donna, please open up the line to begin the Q&A portion of the call.

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question is coming from Bob Glasspiegel of Janney Montgomery Scott. Please proceed with your question.

Robert Glasspiegel

Analyst, Janney Montgomery Scott LLC

Q

Good morning, Horace Mann, and condolences to you and Dwayne's family on the big loss.

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thanks Bob. Dwayne, as you can imagine, left us with a very strong team and they're ready to step up and that's exactly what they're doing, but we appreciate the comments.

Robert Glasspiegel

Analyst, Janney Montgomery Scott LLC

Q

You anticipated my segue, which was going to be – that I do think he has a strong bench team, that's been my experience. With that said, do you anticipate an outside search or not?

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

That's probably way too early to tell at this point, Bob. Our plans are to go with a good succession plan that we had in place. Bret, obviously, has stepped up to the plate over the last few days, tough time for us, but a great team around him, and we're going to take some time and figure that out. But, I feel good about the support I've got around the table, and in usual Dwayne fashion, he had all these folks involved in every aspect of the business. So, although we're going to miss him personally, I don't think we're going to be skip a beat.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

I appreciate that. Moving on, Southeast losses in January, I think, we've seen a record number of January events, your comment about warm weather. Any early indication on whether the Mississippi, Georgia matches up with your book of business?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah. I would say, way too early to tell, but there's nothing concerning us at this time. Obviously, what you've got is, probably more January storm activity, but also a much warmer January. And when you add those things together, I don't see anything out of pattern of what we normally see into January, and nothing that we're overly concerned about.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Okay. That's good news. What's the excess capital at the parent and the holding companies that targeted RBC ratios, have you done the math on that?

Bret A. Conklin
Acting Chief Financial Officer, Chief Accounting Officer, Senior Vice President & Controller, Horace Mann Educators Corp.

A

Yeah, Bob. This is Bret Conklin. As I mentioned in my prepared remarks, we're still finalizing RBC estimates at this point, but our excess capital is about $80 million in total and that's in excess of 425% and 500% RBCs at the Life and P&C companies respectively. And I guess at the holding co, there's about $3 million to $5 million of cash up at the holding company level.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Okay. Good luck on 2017. Thanks.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thanks, Bob.

Operator: Thank you. [Operator Instructions] Our next question is coming from Meyer Shields of KBW. Please proceed with your question.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks. Good morning. I also want to offer our sympathies on Dwayne's unfortunate passing?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thank you.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Two quick questions in terms of the guidance. One, if I've done the math right, the $0.10 impact of retirement related investments is about $6.5 million. I'm trying to figure what the corresponding number was in 2016?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah. I think, before we go there, maybe a little more explanation on the $0.10, and I can have Matt give you a little more specific as to some of the buckets for 2016. But if you think about the PDI investments that we've made so far, I think they've clearly hit the mark. I mean 28% CAGR in our Life business, multiple years of high-single digit growth in assets under management. We've got momentum back in the P&C business, with consistent mid-single digit growth. And we've kept very strong, industry-leading both persistency and retention. So, I think, we've proven that we – when we invest in the business, we make those investments work and I think we have a proven track record over the last several years of doing just that.

Matt can give you a little more specifics about what those investments are in the Retirement space, but I thought it was important for us to put that in context before we answer the past question. Matt?

Matthew P. Sharpe
Executive Vice President, Life and Retirement Division, Horace Mann Educators Corp.

A

Thanks, Marita. Good morning, Meyer.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Good morning.

Matthew P. Sharpe
Executive Vice President, Life and Retirement Division, Horace Mann Educators Corp.

A

The strategic investments are related to completing the product and new educational tool builds related to our strategy shift that was precipitated a little bit by the Department of Labor. Also building out, as Marita said in her script, the additional B2B capabilities, expanding our reach into the medium and larger size school districts and adjacent markets such as the private K-12 space, that's a key for us driving sales across all of our lines of business, not just in the Retirement space. We started making those investments in 2016 and we'll continue to make those investments into 2017.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. That's helpful. Second, also in terms of the guidance. I think I got this wrong in my initial take with regard to the reserve development that is anticipated in the guidance. I was wondering, if I can get something both numerically and conceptually what favorable development is anticipated?

Bret A. Conklin
Acting Chief Financial Officer, Chief Accounting Officer, Senior Vice President & Controller, Horace Mann Educators Corp.

A

Yeah. So this is Bret Conklin again. I guess as it relates to our 2017 guidance, we did not factor in any material amount of reserve releases. And as we've done in the past, we'll record it when we see it. I think if you've tracked us a while, we've had a 10 year record of net favorable reserve releases. However, you can look back at the last three years and that favorable development certainly has been less than what it has been in years prior to that, but as far as our guidance is concerned, there was not a material amount in our 2017 numbers.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And then two other quick questions. One, the P&C expenses in the quarter were down, little more than [indiscernible] (33:38) year-over-year. Was there anything unusual in that or is fourth quarter a decent run rate?

Bret A. Conklin
Acting Chief Financial Officer, Chief Accounting Officer, Senior Vice President & Controller, Horace Mann Educators Corp.

A

This is Bret again. I wouldn't say there was anything overly unusual, both this year and last year's, even for the full year are probably a slightly less than what we were anticipating running at, and as Marita mentioned that was at the 27.5% level with respect to expense ratio. I would mention that we did have a true-up adjustment with respect to some employee-related benefit costs in the fourth quarter of this year, but nothing material. So if you kind of look at the run rate year-over-year, we're basically about flat. But as we continue investments in the P&C infrastructure arena, we would anticipate going back up to the 27.5% run rate that we've mentioned in years past.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah. I think, Bret's exactly right. I think, focusing on that 27.5% run rate that we've talked about quite frankly for some time is really the key. But in this level of investment in P&C, it might be lumpy quarter-over-quarter, because it's really a timing issue when we see a difference, but very confident on that 27.5% run rate. And when you look at where we are vis-à-vis our competitors, even with this level of investment, I think, it's quite competitive.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Yeah, that makes sense. And then – and finally, just hoping you could comment a little bit on loss trends within the property book?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

In the property book, Meyer, we're just contemplating, as we do in every planning cycle, normalized cat activities, normalized ex-cat weather activity. So it's not really that we expect the book to perform any worse in the long run, it's just over a very exceptional year from a weather perspective.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

And in our conservative nature, as we've always done, you're not going to bank on this level of property profitability, but yet at the same time, I am not going to have a problem with planning in the 70s.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

No, that's certainly true. Okay, thanks so much for your help.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thanks a lot.

Operator: Thank you. Our next question is coming from Matt Carletti of JMP Securities. Please proceed with your question.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Hey, thanks, good morning. Just had one question left, the others you guys have answered already. I was hoping just dig in a little bit to the ex-cat accident year loss ratio in the auto book. It was up a little bit year-over-year. I was hoping you could give a little color on what's the difference [indiscernible] (36:19) assessment of non-cat weather year-over-year. Is that part of what's driving it? Is it more just the underlying auto loss trends that we're – been seeing, just trying to get a starting point for where, I should think about starting off 2017?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Yeah, Matt. With ex-catastrophe in auto, it's a little bit harder to pull out. I think we talked about this last quarter, we get the catastrophe which would be comp, but anything that's not in that comp bucket goes into the ex-cat weather. So additional accidents, hit in the rear because of rain, that goes into our underlying loss ratio. And so when we look at next year, we're expecting that to be in the normalized environment and covered by rate. But, that said, we'll continue to work and/or identify, diagnose, respond to environment.

As an example, we had a rate plan last year of six points. We saw some of that weather activity emerge in March, March and April time period, particularly in the Southeast and responded pretty quickly and executed our rate plan by 50 points. And I said it's pretty frequently that it's hard to do a mid-course correction on a rate plan, just because of the cycle of the analysis, the filings, the implementation of the rates. So we'll continue to react in that environment. And as Marita said, we're looking at eight points for next year. And if we continue to see adverse trends, we'll react appropriately.

The good thing about working in a niche is that, we tend to recognize these trends a lot faster. They stand out more quickly than they would in a broad market book. So we've been talking about these trends for two years, and like I said we'll continue to react in that type of environment.

But talking about, if we do go back, keep in mind, this will be lumpy. In the first quarter of last year, we did run at 99, which later developed to 104 in the second quarter. So if you look at first quarter and second quarter combined, they were about the same. But we expect going in the first quarter of 2017, somewhat of an unfavorable comparison, just because of that development that happened in the second quarter.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Right. That makes sense. More broadly, just from a kind of longer term quarter-to-quarter seasonality of that book, am I right in thinking about Q4 historically or go forward usually is a higher underlying quarter because of the weather involved in it and that other quarters tend to be a little lighter.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Yeah, I would say. I look back over the last couple of years and it's typically – if you look at our average combined ratio for the year, fourth quarter is four to six points higher, generally speaking.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay. Great.

Matthew P. Sharpe
Executive Vice President, Life and Retirement Division, Horace Mann Educators Corp.

A

I would say that, that's really a mix perspective. If you look at the states written and weighted by our premium for the industry, you would see similar impacts from the market.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

And you know, we're clearly not declaring victory, but we do like the underlying signs that we saw in the fourth quarter, so you're thinking about it the right way.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. Thanks for the answers. Best of luck in 2017.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thank you.

Matthew P. Sharpe
Executive Vice President, Life and Retirement Division, Horace Mann Educators Corp.

A

Thanks, Matt.

Operator: Thank you. Our next question is coming from Bob Glasspiegel of Janney Montgomery Scott. Please proceed with your question.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Yeah, so just a big picture question. Is there anything in President Trump's stated agenda and his education Secretary that impacts the company one way or another?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah, I mean, as we think about this new administration, obviously, when we think about changes in Dodd-Frank, we think about changes potentially in the DOL fiduciary rule. We think about tax reform, and we've obviously spent a fair amount of time over a protracted election shall we say, modeling the effects for us on those types of things. But when we think about our education sector, you know, Bob, that we've – our roots are in public education, but we've grown and expanded to the private sector, the parochial sector, charter schools. And in many areas, charter schools are actually part of the K through 12 payroll slots. So we're focused on the educator.

So I'm not sure his pick or any changes in this administration are going to affect the customers we have available to sell to, or our potential market share. We're really focused and think that, when we look out to 2017 and beyond, we've got what it takes to penetrate this broader educational sector and we're feeling really good about our potential growth going forward.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Is the company sort of market neutral in public versus private education or I didn't know whether to try to get into slots you have to be viewed as a pro-lobbying for the public sector education market?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yeah, I mean, we're an educator company. We don't get heavily involved or aren't particularly political. I would say that our routes are in public K through 12s, but we have business and educators across the broad educator market, and I think the way you described it is correct.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Cool. Thanks a lot.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thanks, Bob.

Operator: Thank you. At this time, I'd like to turn the floor back over to management for any additional or closing comment.

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

Thanks, Donna. And thank you to everyone this morning that joined us on Horace Mann's fourth quarter and full year earnings call. If there are any additional questions, please don't hesitate to reach out to Kristi Niles or me. Thank you very much.

Operator: Ladies and gentlemen, thank you for your participation. This concludes today's teleconference. You may disconnect your lines at this time and have a wonderful day.