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Horace Mann Educators Corp. (HMN)

Q4 2017 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Horace Mann's Fourth Quarter and Full Year 2017 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief 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, Ryan Greenier, Vice President of Investor Relations. Thank you, sir. You may begin.

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

Thank you, Christine, and good morning, everyone. Welcome to Horace Mann's discussion of our fourth quarter and full-year 2017 results. Yesterday, we issued our earnings release and Investor Financial Supplement and copies are available on the Investors page of our website. Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer. Bill Caldwell, Executive Vice President of Property and Casualty; Bret Benham, Executive Vice President of Life and Retirement; and Matt Sharpe, Executive Vice President of Strategy and Business Development 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

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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 measures. Reconciliations of these measures to the most comparable GAAP measure 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. Yesterday evening, we reported fourth quarter core earnings of $0.65 and full-year 2017 earnings of $1.74 per diluted share, excluding the favorable impact of tax reform. These results underscore our positive momentum as we move into 2018. I'm very pleased with our results, particularly in a year largely defined by record level catastrophe losses and industry disruption in the retirement space.

For a second consecutive quarter, our auto loss ratio improved significantly over prior year. In the fourth quarter, the auto loss ratio of 77.5% was more than five points better than the prior year. This is the result of rate actions combined with weather that was somewhat more favorable compared to our typical fourth quarter experience.

Due to this strong result, we were able to achieve a one-point, year-over-year improvement in our underlying auto combined ratio, and we expect continued improvement in 2018. And while many in the industry experienced another quarter of significant catastrophe impacts, our cat losses of 2.2 points were relatively small. For example, the California wildfire losses in the fourth quarter were about $1 million, significantly lower than our market share would indicate. This strong result was due to our stringent wildfire underwriting protocol that utilizes multiple risk assessment tools.

2016 and 2017 were two of the heaviest catastrophe years in recent history for the P&C industry with multiple firms estimating more than [ph] $100 billion (00:03:42) in losses in 2017 alone, and for both of these two years, our property results were solidly profitable. We did have higher catastrophe costs than our historic averages but our conservative underwriting standard, use of partner carriers for risks that exceed our underwriting appetite, and a continued focus on profitability resulted in a full-year property reported combined ratio of 97%. The Retirement and Life segments continue to provide steady, consistent returns. In Retirement, we finished the year in line with prior year, an impressive feat, given the amount of disruption in the industry. We rolled out our new Department of Labor compliant product suite and an open architecture of mutual fund platform. We built the tools to provide a solution-based sales process that is consistent across the agency force. And we trained our agents to deliver a customized, holistic plan to help customers achieve their financial goals.

Unlike many competitors, we took a consistent approach across all types of retirement savings accounts. A strategy that we believe is in the best interest of our customers and provides a clear, competitive advantage as the industry continues to evolve. Life earnings continue to be consistent year-over-year. We saw an increase in mortality cost in the fourth quarter. However, the full-year finished in line with historical trends. We continue to grow our Life business at a double-digit sales rate.

Over the last four years, we've made significant investments to modernize our company's products, distribution and infrastructure. As we head into 2018, I'm confident that we have laid the necessary foundation to fully leverage our strategic position to realize profitable growth. We have a robust, relevant product suite that meets the needs of our educator customers. We are also in the process of key infrastructure improvements to support greater volumes of business and provide an enhanced customer experience. And we have made good progress

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on improving distribution to develop multi-channel options that allow educators to interact with us the way they choose.

The strategic decisions we've made to improve profitability and ROE are beginning to show results. More than two years ago, we saw an increase in auto loss trends and acted accordingly with rate increases and profitability improvement initiatives. As the trends continue to emerge, it was clear we didn't take enough rate, and we responded more aggressively with additional rate actions and tighter underwriting standards, particularly in geographies that saw the most pressure and this approach is working. Since the midpoint of 2017, our auto loss ratio has improved by 2.2 points with a corresponding 60-basis-point increase in ROE.

We believe we are now solidly ahead of loss cost trends and expect another 2 points to 2.5 points of underlying auto loss ratio improvement in 2018. The passage of the U.S. tax reform and Jobs Act of 2017 is another tailwind. As a result of the re-measurement of our deferred tax liability, our net income for 2017 increased by $99 million, roughly equal to one year of core earnings. The one-time benefit resulted in corresponding increase of $2.43 in our book value, which ended the year at $30.73 per diluted share. We will also see lower, ongoing tax expense going forward. This gives us additional flexibility as we continue to invest in our business with a goal of accelerating profitable growth.

Reinvesting in our business is not new for us. We've been deploying earnings to improve our product, distribution and infrastructure over the past four years. We've worked to improve business efficiencies through systems modernization, created new platforms for fee revenue, and have grown and optimized our products set. These efforts have created a solid foundation that we can now build upon. As we look to leverage these achievements, it was the right time to dedicate a small team to focus on opportunities that could accelerate profitable growth, while also deepening our reach into the educator market.

Matt Sharpe worked closely with me on many of our successful, strategic initiatives such as modernizing our Life operations and creating a differentiated approach to retirement that leverages our multi-line business model.

I'm confident that by dedicating more focus to business development efforts, we will be able to more efficiently identify and act upon opportunities to accelerate profitable growth. We have focused on three areas, increasing the scale by finding hunks and chunks of Educator business, further diversifying our product portfolio through increased share of customer wallet and optimizing our position by prioritizing growth of more capital-efficient offerings like our fee-based Retirement products.

In order to do that, we needed to find a seasoned executive who could seamlessly take over the execution of our Life and Retirement strategy. Bret Benham has decades of experience driving strong results in the exact areas that we see our biggest opportunities. As Senior Vice President of Retirement at Ameritas, he was instrumental in building out an institutional channel. And as President and CEO of TIAA-CREF Life Insurance Company, he drove profitable growth and operational efficiencies in their Life business. We're happy to have him and officially welcome him onboard.

Before turning the call over to Bret Conklin, I want to highlight an additional initiative that we're focused on for 2018, Corporate Social Responsibility. As a mission-centric company, we've always aimed to have a positive impact on our communities, but we have never quantified the sum of those efforts until now. We plan to publish our first Corporate Social Responsibility report which is aligned to GRI Reporting Standards. This will be released on our website later this week. And I'm really proud of the many positive impacts we have had on our community and I look forward to sharing more success in the future.

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In closing, I am optimistic about what's to come in 2018. We have spent the last few years modernizing our products, strengthening our distribution and improving our infrastructure. We are clearly on track to ROE improvement and sustained earnings growth. We have a solid foundation, the right strategy, the right people and positive momentum. As we strengthen our focus on execution and take advantage of what we've built, I'm excited to see what we can accomplish with all of the pieces in place.

And with that, I'll turn the call over to Bret.

Bret A. Conklin

Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

Thanks, Marita, and good morning everyone. Fourth quarter core earnings of $0.65 were $0.13 above prior year, mostly attributable to a 5-point improvement in underlying auto loss ratio. Full year results of a $1.74 were $0.23 below prior year, primarily due to a high level of adverse non-cat weather in the first half of the year. When looking at full year results, it's really a tale of two halves, while our first half was heavily impacted by weather; the underlying auto improvement in the second half helped drive strong earnings growth.

A $1.34 of our full year earnings came in the second half of the year. We expect the positive trends we saw in the second half of the year to continue in 2018. Since we introduced our initiative to drive ROE improvement in the third quarter, we've improved ROE by 60 basis points. We aim to further increase ROE in 2018 by improving our auto loss ratio another 2 points to 2.5 points. In addition, continued focus on expense discipline and growing our fee-based retirement products will also result in higher ROEs over time.

For 2018, we are forecasting core earnings between $2.10 and $2.30 per diluted share. This reflects continued improvement in the P&C line led by auto, retirement and life results that are largely in line with 2017, and continued investment in strategic initiatives that will drive future profitable growth.

In P&C, we are forecasting net written premium to increase by 4% to 6% largely attributable to rate increases. From a probability perspective, we are seeing continued stabilization in loss trends in the mid-single digit range. Our 2018 rate plan assumes high-single digit auto rate increases and mid-single digit increases in property.

These rate actions coupled with those implemented in 2017 should lead to a 2 to 2.5-point improvement in the auto underlying loss ratio and a 1 to 1.5 point improvement in the property underlying loss ratio. These targets assume more normalized weather compared to the previous two years as does our cat load assumption of 6 to 7 points.

From a growth perspective, we anticipate PIF will be generally flat in 2018, despite the rate actions we've taken to improve in profitability, we're pleased that our retention levels and overall market share is stable. We are seeing new business growth emerged in geographies that meet P&C profitability targets and as we continue to take steps to address other less profitable market we would expect our new business growth rate to accelerate over time.

Although we plan to see continued growth in our retirement assets under management, we expect segment earnings to be largely in line with 2017. This is primarily due to lower net investment income which leads to spread pressure on our fixed annuity block of business. Our investment returns have benefited from strong prepayment activity over the past few years, including a meaningful spike this December as borrowers look to maximize their tax benefits relative to the tax reform changes.

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As a result, we expect a measurable drop in prepayment activity compared to the $14 million we received in 2017. We are forecasting $6 million less of prepayment activity in 2018, which equates to roughly $0.10 impact per diluted share.

In addition to prepayments, alternative returns have also been a solid contributor to the investment portfolio performance. We have about $275 million of limited partnership in alternative investments and our investments in this asset class have historically produced about a 5.5% annual return. This return may seem somewhat lower than what other companies earn on their alternative portfolio, but it is reflective of the type of relatively conservative risk profile of our alternative investments.

We focus on funds and investment types that provide good asset diversification such as real estate debt, corporate mezzanine debt, structured credit, private equity, infrastructure, and long and short funds, while returns can be volatile quarter-to-quarter, on an annual basis 2017 returns are similar to what we would expect in 2018.

In our fixed maturity portfolio, we are taking steps to improve the credit quality of our portfolio as we are late in the credit cycle. We have been actively reducing high yield exposure, as well as underweighting retail and consumer discretionary sectors. Spreads continue to tighten across many asset classes and for some higher risk assets we do not feel spreads commensurate with the risk assumed. The combination of tighter spreads and our desire to move the portfolio up in credit quality will likely result in a lower reinvestment rate versus what we achieved in 2017.

As a result, we are targeting a new money rate of 3.5% in the coming year. Clearly, these factors create some negative drain on our portfolio yield and equates to an additional $0.10 per diluted share. However, in the long run we believe this will serve us well in the event of a correction consistent with many of our previous portfolio decisions.

In summary, the combination of tighter spreads and a lower reinvestment rate, as well as the expectation of lower prepayments and our actions to improve the overall quality of the portfolio will result in a 20 basis point to 30 basis point decline in the annualized earned pre-tax net investment yield over the course of 2018.

For the fixed annuity business specifically, we would expect the net interest spread to decline to around 170 basis points. In Life, we expect earnings of $16 million to $18 million which is largely flat to 2017 due to a modest increase in mortality costs.

We continue to see the Life segment as an area of significant opportunity and plan to continue to grow the business in the double-digits. The tax reform changes clearly have favorable impacts going forward.

We estimate our total effective tax rate for 2018 will be between 15% to 18%, which has an ongoing earnings benefit of about $0.25 per diluted share. As Marita said earlier, we continue to budget for strategic initiatives and investments that are accretive to sustain profitable growth.

Overall, we see 2018 as a year of strong earnings growth, continued ROE improvement, and new opportunities to profitably grow our company.

We're in a strong position to do so, because we have aligned our strategic decisions with our company's mission in mind to take care of educators.

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By providing them with the products they need, delivered in the way they choose with trusted advisors who have their best interests in mind, we can achieve our vision to be the company of choice for the educator community. Thanks.

And I will turn it over to Ryan to start the Q&A.

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

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

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Thank you. Our first question comes from the line of Bob Glasspiegel with Janney. Please proceed with your question.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Good morning, Horace Mann.

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

A

Good morning, Bob.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Good morning.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

I was wondering if you could clarify your flat Life and annuity outlook that's after tax, so that would be a decent decline on a pre-tax basis, given the tax rate coming down on those two segments?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

That would be correct, Bob. All driven by the decline in net investment income, but the numbers that we provided were after tax, correct.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Do you have a Life and/or annuity tax rate, because PC a bit of...

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Yeah.

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Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC
Q

...what your profitability assumptions are?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

Yeah. We actually included a page – a new page in the investor presentation. I believe it's on page 38 where you can kind of pick up the...

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC
Q

Okay.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

...the various ranges by segment, but for Life which would traditionally be about a 35% effective rate, you could probably use a range of 18% to 21%, and as it relates to the Retirement segment what would normally be a 30% effective rate pre-tax reform that will be in the 17% to 20% range.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC
Q

Okay. So, you didn't talk about Life pre-tax earnings going down, is it the same investment income assumption or did you like building a cushion for Q1 mortality for the flu et cetera?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

No, it's strictly the lion's shares related to the decline in investment income.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC
Q

And no early read on January mortality?

Matthew P. Sharpe
Executive Vice President of Strategy and Business Development, Horace Mann Educators Corp.
A

No, early read.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC
Q

Okay.

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

But not being anything significantly out of line with model trends.

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Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Okay. That's good to hear. What sort of are you seeing any pushback on rates from any regulators on the tax reform, California commissioner's made some public comments, but what's your general read on your ability to get sort of your, I think you said high-single-digit rate you charge it...?

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

A

Yeah. Our target rate plan for 2018 is high-single digit. We're already halfway there from a filing perspective, half of our rate plan has already been filed and approved, and we're following the communications from the various DOIs and the consumer advocates, but the reality is the industry is still at a highly unprofitable situation right now. So I expect that will bleed in over time, but we still have our ways to go as an industry to get profitable. So, we haven't seen any pressure yet.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

In California specifically where I think commissioners have been most visible here, over 100 there or?

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

A

Yeah, I said it last year that in this we don't have the numbers for the industry for this year yet but last year California was the 109 for the industry, we're typically better than the industry by three points to five points and that's true in California as well, so we're still above 100. But we just had a rate filing approved that's effective in March for 6.8%. So our rates are already in the bag for 2018 for California.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

The rate approved was what amount?

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

A

6.8%.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

6.8%. I thought I heard 28%.

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

A

No, no.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

6.8%, I can process that. Thank you very much.

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

A

And Bob, even though there's been some discussion as to whether or not the department could go back on prior approved rate increases, even if we factored in the new effect of tax, we could actuarially justify the rate increase that we filed and that's what typically will happen. Companies will begin to put a new tax rate in their filing. So what comes out of the machine will be lower than what it was before that tax rate, but even in California, we can justify what we filed and what we got approved.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

And you got it approved when, what was the date in California?

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

A

Mid-March. March 15 or March 16.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

No, but I mean when did they give you the approval?

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

A

Early January.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Okay. Thank you.

Operator: [Operator Instructions] Our next question comes from the line of Christopher Campbell with KBW. Please proceed with your question.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Yes. Hi. Good morning.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Good morning, Chris.

A

Good morning.

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Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Just a few questions on the 2018 guidance. My first one was on the P&C expense ratio. I know last night, it's released and then the opening script didn't include an explicit assumption here, so if I go back to last couple of years with the investments that you're making in the business, it's been about 27.5%, is it still a good overall expense ratio assumption or should we be thinking about this any differently?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

Chris, this is Bret Conklin. With respect to the expense ratio, I think I even mentioned on the third quarter earnings call that on a go-forward basis, you probably need to bring that down to 27% instead of the 27.5% on a go-forward basis and we're still doing the balance between strategic and non-strategic initiatives, but you know we ended both this year and last year around 27%. So, I would lower that by 0.5% on a go-forward basis.

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

And Chris, this is Ryan. We included a separate slide, a new slide on page 17 of our Investor presentation that summarizes all of the guidance points that were made in either the press release or the script commentary. We thought it would just be easier for everybody to get it all in one place.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Excellent. And then finally, I know the guidance excludes any potential reserve releases, but if I'm thinking about the amount of rate that Horace Mann is putting through its auto book ended last year coupled with if you're assuming more moderate loss cost inflation with frequency concerns subside, then you'd have the potential that you could be building up some auto redundancies, that probability is increased a little bit?

And then just even going back to Horace Mann's history, our model goes back to 2008, so I can speak to then, consistent positive or consistent favorable releases in the book. So, how should we think about any potential upside to guidance? And what's your cadence in terms of just reserve reviews on that line or the P&C book in total?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

This is Bret Conklin again. I guess, with respect to the reserve position itself, there is actually a schedule in the Investor presentation and with respect to where we are at in the independent actuarial reserve range, we're basically consistent in the upper-half of their range so we really haven't moved out of our reserve position. I would say fair commentary that you made the last two years have seen minimal reserve releases, I believe 2016 was about $7.5 million.

The current year had about $2.7 million obviously in our guidance estimate. It does not include any reserve releases. And obviously as that book of business and the auto gets more healthy, the likelihood that there would be perhaps some modest reserves [ph] involved (00:26:01), I think that's a fair comment. But as is always the case, we will book it when we see it. But those loss ratios have been in excess of [ph] 100 (00:26:10). We are getting the rate that you said and we'll see what the loss costs do compared to the trends, and like I said, we'll book it if we see it.

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

A

That's right, Bret. I mean, I think, I would also add that the underlying issues that cause the industry miss in the first place haven't gone away. Increase the miles, driven the cost to repair, the effects of distracted driving. I mean, we've all worked pretty hard as an industry to get the price to keep up with those loss trends, but those loss trends really haven't gone away. And then the question is, what else is out there? I mean, we haven't, as an industry, fully contemplated the effect of the legalization and decriminalization of marijuana. How is that going to affect loss cost trends going forward? I mean, I feel really good about our improvement last year getting a full point, I feel good about our guidance of another 2 points to 2.5 points, but we're going to stay ahead of this and not – not declare victory and make sure we stay ahead of these trends.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Great. That's very helpful. And then just kind of dovetailing on that response, Marita, is that I know there has been – last couple of days, there has been market concerns about inflation potentially increasing. Can you give us some color on any inflationary trends you could be seeing in any of your auto or property claims cost and how would you be thinking about your current rate plan in the event inflation starts to accelerate in 2018?

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

A

Yeah. This is Bill, Chris. Our loss trends for auto we're thinking mid-single digits that's kind of where the claims cost are going, if there is an additional increase due to inflation that will get baked into our models and we'll take more rate, but we just haven't seen that yet and it's hard to proactively commence to regulate – the regulator – that inflation is coming and take breaks in advance of that. But as we see it, we will react just like frequency and severity.

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

A

And I also wonder whether this is another place where our educator niche is helpful. I mean, our educators may see less of an inflationary trend on either auto or property. I mean, it tends to be a pretty tight segment of the population as far as the cars they drive and the types of homes they live in.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Well, thanks for all the answers and best of luck in 2018.

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

A

Thank you.

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

A

Thanks.

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Operator: [Operator Instructions] Thank you. Our next question comes from the line of Gary Ransom with Dowling. Please proceed with your question.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Hi. Good morning. On the spreads in Retirement, you did mention how there was a spike in prepayments in the fourth quarter. But there has also been a general heightened level of that over the last several years of low interest rates. Have you incorporated the idea that interest rates will be moving higher into your 2018 guidance or that $6 million you mentioned, I'm just trying to understand what's in that number?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Gary, this is Bret Conklin. You know, I think in my prepared remarks, I shared that the actual prepayments that we received in 2017 were $14 million that comes on 2016 of $11 million. The spike related to and I'll just say for the fourth quarter, I think we've received about $5.5 million of prepayment. So, prepayments are lumpy, very hard to predict, yes, they've continued for the last couple of years. But in light of the lumpiness, I would say, we're trying to use kind of average in our guidance and not assume too much. The reality is that we ended the year at $194 million versus original plan which we shared with you at the beginning of 2017 of $182 million, and that difference was primarily related to prepayments as well as alt investment returns.

So, on a go forward basis we've dropped that down to $8 million in our plan for 2018. If it ends up more than that, yes, that's going to benefit our spread. But with rates going up, the spreads have been tightening. So, it's – you were not really anticipating that lift, but yes we are using a reduced amount of prepayments in 2018.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thank you. Another subject on tax reform, the long-term implications of this, I'm really just asking for an opinion perhaps, but there's a lot of discussion about who gets it, whether it's the consumer over time or whether the shareholders get to keep it or maybe it's the employees? And I wondered, Marita, if you had a view on what you think the final stickiness of that tax reform to shareholders might be?

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

A

Yeah, I mean I think you mentioned the buckets. I mean first when you think about employees, there obviously have been companies out there talking about returning some of this to employees in the way of a bonus, and I would suspect that the majority of those companies don't have an all employee bonus program, where the employees get to share in the results of the company; we do. I'm proud of the fact that our employees have the ability to earn a bonus based on the results of the company, and it keeps all of our employees aligned with our goals and lets them share in our success.

So, for us, we don't need to announce a one-time employee bonus, because we have an ongoing all the time annual employee bonus.

When I think about the other pieces, I do think over time this helps the consumer as we talked about it gets built into our rate review process, it certainly begins to over time find its way to the consumer, but for us, I think it is a benefit to our shareholders where now we have more capital that we can put towards the growth efforts that we

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have been talking about for a while. It's a very good time for us, because we have built the product, we have modernized our systems and we have built better tools for our distributors to serve our customers better.

So being able to deploy that capital and working with [ph] Matt (00:33:06) in the work that we're doing, I believe that we can take the good work that we've done in the individual customer by customer game, and do it more in hunks and chunks and put that capital to use, which I think ultimately does help the shareholder in the way of improving our stock price and the overall value of the company.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Just following on tax implications. Have you thought about how you might restructure any of your portfolios either on the Life or the P&C side. Or maybe this is more for the P&C side with the new tax law there and the switch in attractiveness of corporates versus munis?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

Yeah. I mean, we're obviously looking at that. There's actually I think some tendency even on the Life side to look at tax exempt that will become more favorable under the tax law changes. But I guess at the end of the day, we will look for the best after-tax yields on the portfolio. So, it's an ongoing process in the investment portfolio to get the highest yields possible to benefit all of the segments. So, yes we look at that all the time.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Is there any – would you be inclined to do any significant swapping over the course of the next few quarters or is this more of just a shift in strategy that you might use on new money coming in?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

I would say it's more maybe of a modest shift, but nothing in the next quarter or two of significance.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

All right. Thank you very much.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

Sure.

Operator: Our next question comes from the line of Sam Hoffman with Lincoln Square Capital. Please proceed with your questions.

Samuel Adam Hoffman
Portfolio Manager, Lincoln Square Capital Management LLC
Q

Good morning. I just have a question on the California insurance situation and what the impact you think will be on Horace Mann of the intention to pass on some of the tax savings to consumers?

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

Yeah, I don't know how that differs from the previous question. But...

Samuel Adam Hoffman
Portfolio Manager, Lincoln Square Capital Management LLC
Q

I may have missed it. Sorry.

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

Sorry, okay, California in 2016 around 109, I don't have the 2017 number, that's an industry number, so unprofitable when you think about annual mileage new vehicles, distracted driving in California has been at the center of it. We tend to run three to five points better than the industry, and that's true in California too. So, we're still above 100. So, we're not to the point where the tax reform would impact our ability to get rates. And, in fact, our 2018 rate filing of 6.8% was already approved in March. And again, we're starting from above 100. So the ability for California to roll that back would be unlikely at this point just because of our profit position.

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

And what Bill, what we were talking about earlier is even if we included the new tax rate in that filing, we could actuarially justify the rate need that we filed and we got approved. I think what comes into play is for companies that when they build in the new tax rate, they can't justify the rate increase that they're looking for if they're particularly profitable in the state. I think the state is going to look closely at those rate filings. But because of where we sit in the state even including the new tax rate in the filing, we certainly can justify the rate that we filed and have already gotten approved.

Samuel Adam Hoffman
Portfolio Manager, Lincoln Square Capital Management LLC
Q

Did you have any visibility on other states that might follow with similar policies?

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

I haven't seen anybody release something official like California. But there are various states that have profit provisions in their filing requirements that could be impacted like that, but it's too soon to tell I haven't heard anything outside of California.

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

Yeah. And I would say that those states that are prior approval will require companies to include the new tax rate in their filing, and we'll look closely to make sure that folks are adding that to the profit margin and keeping the profit margin component consistent, but that's – I think that's appropriate and to an earlier question that's where we'll see some of this tax benefit get to the consumer as that get passes through in the rate filings. But as Bill said, when the industry is sitting where the industry is in auto, there is a long way to go before, we don't – we can't justify the need for more rate in those filings.

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Samuel Adam Hoffman
Portfolio Manager, Lincoln Square Capital Management LLC

Okay. So you don't see on the competitive side, also you don't see any trends in the competitive behavior of other insurers, because it's not profitable enough based on tax reform, not [indiscernible] (00:38:17)?

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

We do have a robust product management structure and we track what our competitors do. So, we will see that as it unfolds, but so far they have been good. Most companies are starting from an unprofitable position and we're ahead of the industry referring to the corner before a lot of our competitors. So, I don't expect that to be an issue in this.

Samuel Adam Hoffman
Portfolio Manager, Lincoln Square Capital Management LLC

Terrific. Well, thanks for taking my questions.

Operator: Mr. Greenier, it appears we have no further questions. At this time, I would now like to turn the floor back over to you for closing comments.

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

Thank you very much, Christine, and thanks to all for joining us this morning on the fourth quarter earnings call. If there are any further questions don't hesitate to reach out to me. Thank you.

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

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