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PRESENTATION

Operator

Good morning. My name is Julie and I will be your conference operator today. At this time, I would like to welcome everyone to the Horace Mann Second Quarter 2013 Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. (Operator Instructions) Thank you.

Mr. Ryan Greenier, you may begin your conference.

Ryan Greenier - *Horace Mann Educators Corp. - VP, IR*

Thank you, Julie, and good morning everyone. Welcome to Horace Mann's discussion of our second quarter results. Yesterday, we issued our earnings release and investor financial supplement. If you need a copy, you can find them on the Investor page of our website. Our speakers today are Pete Heckman, President and Chief Executive Officer; Dwayne Hallman, Executive Vice President and Chief Financial Officer; Marita Zuraitis, President and Chief Executive Officer-Elect; Steve Cardinal, Executive Vice President of Marketing, Matt Sharpe, Executive Vice President of Annuity and Life; and Tom Wilkinson, Executive Vice President of Property and Casualty.

Before turning it over to Pete, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Legislation Reform Act of 1995. The Company cautions investors that any forward-looking statements include risks and uncertainties and are not a guarantee 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 the 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 Pete Heckman.

Pete Heckman - *Horace Mann Educators Corp. - President & CEO*

Good morning everyone and welcome to our call. After yesterday's market close, Horace Mann reported second quarter operating income of $0.39 per share, a solid result, considering the elevated level of catastrophe losses in the quarter. Underlying earnings in all three segments of our multiline insurance platform met or exceeded our expectations. Excluding cats and another quarter of favorable prior year's reserve development, the underlying P&C combined ratio improved in both auto and property. The improvements reflected expanding margins from the right actions we've taken over the past 18 months, as well as favorable non-cat weather in the quarter.

Excluding DAC unlocking, annuity earnings were a bit better than we expected, with growth in assets under management offsetting a modest degree of spread compression. On a reported basis, annuity operating income included $1 million of pretax or about $0.02 per share of negative DAC unlocking, due to market performance and realized capital gains.

Life segment earnings, while ahead of our expectations, were below prior year in the quarter, reflecting a more normalized level of mortality losses, as well as a slight decline in investment income. The quarter's solid earnings resulted in a 2% sequential increase in book value per share, excluding FAS 115, to $22.79. On a year-over-year basis, the increase was 11%.

Now (inaudible) the last several quarters, let me comment briefly on how we're doing relative to our four key 2013 performance priorities. The first priority is to maintain the strong level of P&C new business sales we achieved last year, while further increasing our retention ratios. At the halfway point in the year, we remain very much on track. Auto new sales premiums were up 7% for both the quarter and six months, while property increased 5% and 11% over those same periods. And retention continues to improve. The 12-month auto renewal ratio has moved above 85%, while property is over 89%. Given our niche market focus, we monitor these metrics closely and believe policy retention to be a strong indicator of customer satisfaction. With that in mind and as I've mentioned on recent calls, we continue to implement programs, such as annual policy reviews and invest in infrastructure, including expanded staffing, training, and service hours in our customer contact centers, along with enhancements to our P&C billing capabilities, designed to improve our customer experience and in turn support our retention and cross-sale ratios.

The second key priority this year is to make further progress toward our total P&C combined ratio goal of the mid-90s, with an ex-cat property combined ratio in the low-to-mid 70s and an auto combined in the high 90s. On a year-to-date basis, our total P&C reported combined ratio of 100.3% was higher than we'd like, in large part due to elevated catastrophe losses. However, on an underlying basis, the total combined was 92.3% through six months, a good result and almost 2 points better than prior year. The property component is solidly on track relative to our expectations. This quarter's auto results were encouraging and brought the year-to-date combined below 100%, but we still have work to do there. Meanwhile, we're on track with our 2013 rate plan, which includes a mid single-digit increases in auto and a low double-digit increase in property.

The third priority for 2013 is to continue to grow our retirement annuity business, while maintaining spreads on new sales at or above pricing targets. Total annuity sales were up in the quarter, including a 5% increase in Horace Mann agency sales and spreads on new business continued to exceed pricing targets. Meanwhile, assets under management increased 10% year-over-year and reached the $5 billion mark. So profitable growth continues in this very important segment of our business.

Our final key priority in 2013 is to continue to aggressively grow our Horace Mann Life business. Sales of proprietary life products were up approximately 30% for the quarter and on a year-to-date basis. And a few weeks ago, we introduced an electronic Life New Business application system, which was well received by the agency force. We expect that enhancement, as well as other related process improvements to support continued strong sales momentum.

In closing, the second quarter was another solid one for Horace Mann. Strong underlying combined ratios helped get our year-to-date Property and Casualty results closer to where we needed them to be. The combined Annuity and Life earnings exceeded our expectations and growth and retention continued to trend favorably across all lines of business.

Now before turning it over to Dwayne, I wanted to mention that Marita Zuraitis and I have been working closely together since she came on board as Horace Mann's new President and CEO-Elect, a little over two months ago. The transition process is going well and I know she will be glad to share her initial thoughts with you during our upcoming Q&A session. But, first, here is Dwayne Hallman to provide additional detail on our financial results. Dwayne?

Dwayne Hallman - *Horace Mann Educators Corp. - EVP & CFO*

Thanks, Pete, and good morning everyone. Second quarter operating income was $0.39 per share, which was $0.23 better than the prior year. The improvement in operating income was primarily related to lower catastrophe losses, as well as improved underlying P&C results. P&C after-tax earnings of $4.1 million were $8.2 million higher than the second quarter 2012. Historically, the second quarter has been a volatile catastrophic quarter for Horace Mann and this year was no exception. Catastrophe losses of $22.5 million or 16.1% of earned premium were higher than our expectations, but still $7 million lower than the prior year.

The other significant contributor to higher earnings was the improved underlying combined ratio, which was 89% for the quarter. This was a 5.6-point improvement over the prior year. Auto improved 4.5 points to 97.1% and property results were in the low 70s. For the first half of the year, the underlying P&C combined ratio was 92.3%, a 1.7-point improvement. Stronger non-cat property results were the primary driver, but importantly, the auto combined ratio improved one point. As we've said before, our auto results can be volatile quarter-to-quarter, given the seasonality and the size of our book. We are encouraged that the reported auto combined ratio for the first six months of the year is back below 100%.

Annuity after-tax net income, excluding DAC unlocking, was $10 million, a 10% improvement over the prior year. Assets under management also increased 10% over the prior year, bolstered by strong deposits and sales, as well as financial market returns. The growth in assets helped offset the operating income impact of declining investment spreads. The year-to-date net interest spread of 1.98% declined 3 basis points from the prior quarter. This gradual decline is in line with what we expected and consistent with our full-year earnings guidance.

We anticipate the net interest spread to continue trending downward gradually over the remainder of the year. However, as was the case this quarter, we expect continued asset growth to offset the operating income impact of spread compression. Horace Mann agency sales have increased in each of the last four years and deposits continue to grow steadily. And as Pete mentioned, we are comfortably above the pricing targets on new business and continue to see opportunities to grow our assets under management.

Our Life segment operating income was $5.6 million, down 8% from the prior year. The decline was primarily the result of a return to more normalized mortality levels. In addition, we saw some modest pressure on investment income due to lower interest rates. On a consolidated basis, after-tax net investment income was $52.1 million, modestly higher than the prior year quarter. Our assets under management in the Annuity segment were the primary contributor.

During the second quarter, our new money reinvestment rate was about 4%, in line with what we assumed in our full-year guidance.

In regards to our investment portfolio, rising rates and wider credit spreads during the quarter resulted in a decrease in our net unrealized gain, which ended the quarter at $344 million. As a result, reported book value declined 13% on a sequential basis to $27.72, a 4.5% decline year-over-year. Net realized gains in the second quarter were $10 million after-tax, or $0.24 a share. We took advantage of gains taking opportunities and some short-dated corporates. The program worked marginally better than expected, as we were able to reinvest the proceeds at a higher than anticipated levels, given the rise in rates towards the back end of the quarter.

During the second quarter, we repurchased about 80,000 shares at an average price of $24.35. This brings the total number of shares repurchased under our current authorization to over $1.2 million, at an average price of $17.40. We have $28.4 million remaining in our repurchase authorization and we will continue to be in the market as opportunities present themselves.

In summary, we're pleased with the first half of the year. This quarter's strong results, excluding catastrophes, moved us closer to our underlying P&C combined ratio goal. Annuity sales remained strong and the spread compression we are seeing is in line with our expectations and very manageable. And Life operating income is on track as well. We are successfully executing our 2013 key priorities and anticipate that to continue in the second half of the year.

Now I'll turn the call over to Ryan to start Q&A.

Ryan Greenier - *Horace Mann Educators Corp. - VP, IR*

Thanks, Dwayne. Operator, please open the line to begin the Q&A portion of the call.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Robert Glasspiegel, Janney Capital.

Robert Glasspiegel - *Janney Capital - Analyst*

Good morning, everyone. Dwayne, you gave the same speech on annuities, [which you gave] in the last three or four quarters, despite the fact we have a 20% up S&P and -- a little bit less than 20% and long bond yields are up 70 basis points over the last quarter. Do those not have any impact on what your outlook is for this business over the next 12 to 18 months?

Dwayne Hallman - *Horace Mann Educators Corp. - EVP & CFO*

Hey, Bob. Thanks for the question. I guess, the speech, as you referred to, is really been around our spread compression and our expected decline in our spreads --

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Robert Glasspiegel - *Janney Capital - Analyst*

And your Life, Annuity outlook for flat earnings?

Dwayne Hallman - *Horace Mann Educators Corp. - EVP & CFO*

Right. But the spreads are declining. Yeah, rates did pop up in relative terms slightly during the end of the last quarter and into July. But keep in mind, the current yield on the portfolio is still quite a bit above our reinvestment rate. So, as we continue to put money to work, especially on our older blocks of business. It's still below our current portfolio yield. So we would expect spreads to continue to decline.

Now, on the new business coming in, we're at or exceeding our spread target. So it certainly helps mitigate some of the spread compression. But until the reinvestment rate starts to increase in a slow and more material level, I think you'll continue to see the spread compression through the rest of the year.

Robert Glasspiegel - *Janney Capital - Analyst*

Obviously, we're going to have spread compression, but the guidance was for flat Life and Annuity earnings, which you have revised and I would have thought an up 19% S&P and investing new money at 70 basis points might allow you to be able to grow the business, grow earnings?

Dwayne Hallman - *Horace Mann Educators Corp. - EVP & CFO*

Yeah. I mean, Bob, generally you're correct. But as we mentioned, the growth in assets is helping offset the spread compression. So keeping it relatively flat. Yes, in regards to the S&P, fee income is up, but as we stay at these levels, I think you'll see the fee income have more of an impact in the third and fourth quarter if we didn't have any pullback there. But, generally, it's in line with our expectations and wouldn't expect any material jump in Life or Annuity earnings.

Robert Glasspiegel - *Janney Capital - Analyst*

But you obviously know more about what's going on than I do with your Company. But I'll take the [over] on your guidance. Let's see, on Auto underwriting, how excited should we be about? We turned the corner or is this just a volatile positive quarter, we need more data?

Tom Wilkinson - *Horace Mann Educators Corp. - EVP, Property & Casualty*

Bob, this is Tom Wilkinson. I would say a little bit of both in what you just said. We had a good quarter. We're feeling pretty good about the quarter, but as you mentioned and as Dwayne mentioned, we, with our size and our seasonality, we do have volatility from quarter to quarter. And when you look at the last two quarters put together, year-to-date, we got the auto underwriting combined ratio back down below 100%, 99%, a point better than last year. It's in our range. We feel pretty good about the loss trends. We still feel pretty positive about our rate targets in the mid-single digit areas. We've done that now for 18 months now and retention is still looking pretty good, production is still looking pretty good. So, we're feeling good. We feel like we've got momentum on our side. We are just kind of -- the seasonality, the volatility is still a little bit of an issue for us.

Robert Glasspiegel - *Janney Capital - Analyst*

Okay. And my last question is for Marita. I know you're going to -- it's way too early to give a lot of strategy and operation observations, but what surprised you as you go out to visit the field and get to know Horace Mann, either positively or negatively, versus what your expectations was coming in to join the Company?

Marita Zuraitis - *Horace Mann Educators Corp. - President & CEO-Elect*

Hey, Bob. Thanks for the question. You're right, it really has been a little over two months. So, it's way too early to get specific, but I have spent a fair amount of time getting to know Horace Mann in general and really understanding the unique customer niche that we have. And what I've learned so far is really what I thought coming in. We have a very attractive customer base and our unique value proposition, being able to provide P&C, Annuity and Life together, really tailored to the needs of educators is a pretty compelling value proposition to that customer base. I have also spent a fair amount of time with the agency plant across the country and what's really obvious to me is that our top agents are very impressive. They've got penetration numbers and cross-sell numbers that really far exceed the industry benchmarks that are out there and I clearly think we'll be able to leverage this success and be able to replicate it going forward.

And, finally, what I'd say is that Pete and his team have a really good job building a solid foundation that I clearly think we can build on going forward. So I wouldn't say any surprises. I'd say more of a confirmation of why I took the job in the first place.

Robert Glasspiegel - *Janney Capital - Analyst*

Okay. Look forward to talking to you in the future.

Marita Zuraitis - *Horace Mann Educators Corp. - President & CEO-Elect*

Me too. Thanks, Bob.

Operator

(Operator Instructions) Vincent DeAugustino, KBW.

Vincent DeAugustino - *Keefe, Bruyette & Woods - Analyst*

Hi. And good morning, all.

Pete Heckman - *Horace Mann Educators Corp. - President & CEO*

Good morning.

Vincent DeAugustino - *Keefe, Bruyette & Woods - Analyst*

Thanks for taking my questions. And I guess the first one up is a bit of a competitive landscape one. So, over the last few years, we've seen competitors try to emulate progressive and kind of what I'm referring to here is increased reliance on technology, maybe just a little less client touch and a more scalable platform with -- leading on price. And so, [With Travelers Auto] comments earlier this week that kind of echoed that trend. And, I guess, the first question is, is with mid-single digit Auto rate increase planned for Auto in 2013, how should we think about retention in an environment where we're potentially going to see increased rate competition, just because so far it's not just been Travelers that have kind of made this comments about your direction of where the rates will be heading. But if we see more of that just with more players getting competitive on Auto, how do you feel about your rate strategy in terms of impact on retention and topline growth?

Tom Wilkinson - *Horace Mann Educators Corp. - EVP, Property & Casualty*

Vincent, this is Tom again. My thoughts on that are this is a -- even absent the Travelers commentary, this is and has been a pretty competitive auto insurance market for the last couple of years. And, during that period time, there have been companies who have been more aggressive on rates and trying to get more competitive and trying to gain share and then there have been competitors who have strengthened profitability. And as we've talked about, we're trying to do both. We're trying to get our combined ratios in the range that we want them and grow at the same period of time.

So with that backdrop and I've kind of mentioned it already, we've been fairly successful in this very competitive market, getting new business growth and maintaining -- improving our retention and also maintaining it. And a lot of that, I think, has to do with our agency force and -- our customer base, our niche market, as well as our agency force and the fact that we have agents. Our model is more high touch. The majority of our customers, or over 80% of them are cross-sold in the P&C line of business, which is good for the profitability of the customer, the Company, and also for the stickiness of the customer with us. Our business is very highly cross-sold between the financial services piece and the P&C side, probably twice the industry average, maybe almost twice the industry average. That's a pretty -- again, a sticky book, a pretty good customer. They're in touch with our agents and they're the ones that are really helping us keep the customers while growing, while we're taking these mid-single digit rates. I kind of think that's going to continue. It's still to be seen whether -- you mentioned Travelers holiday and [as per their] strategy, I guess, it sounds like they want to get more aggressive with rates and we will see how that plays out. But we generally don't compete with them too much head-to-head. And so, I think it's still -- I think the outlook is still favorable. We've got some pretty good momentum. It's still hard work to keep it going, but that is our plan over the next -- this year and going forward.

Vincent DeAugustino - *Keefe, Bruyette & Woods - Analyst*

Okay, great. And just to lob one over to Marita and say welcome as well. As somebody that is embarked on margin improvement strategies and has been part of segmentation improvement initiatives, I am just curious if your initial assessment, and maybe it's still little too early to tell, but just, again, your assessment of Horace Mann's fancy pricing position from a rating and analytic standpoint, I'm just -- so maybe from your experience at Hanover, maybe how the two, and obviously more of a focus on discussing Horace Mann, but just from a comparative standpoint, how do you feel about the need for any sort of upgrades from a technology or analytic standpoint from the Horace Mann side?

Marita Zuraitis - *Horace Mann Educators Corp. - President & CEO-Elect*

First, thanks for the welcome. It's good to hear your voice and it's good to be here. I think Tom and his team have made a lot of progress, but I hope that I can bring my experience in this space to bear and help continue that improvement. I do think it's about balance. I do think that in the areas that you mentioned there are some things that we can do to boost and continue that improvement, but I think we're off to a really good start.

Vincent DeAugustino - *Keefe, Bruyette & Woods - Analyst*

Okay, perfect. And just jumping to Matt real quick, and this is a little bit of a technical question, but the net transfers going between the variable product and the fixed Annuity product has slowed a little and given the dynamic with the Annuity deposit growth on variable side rebounding, I'm just curious if your thoughts on the potential for net transfers to pivot as well. And so far, this has been a relatively small drop in the bucket as flows go, but the reason I ask is, if I'm recalling correctly, maybe about a third of the assets under the variable wrap or allocated to the fixed account. So if I'm just looking at that nugget and wondering how likely it is that we see a rotation, I just be curious what the margin differences between a dollar AUM invested in the VA product, but that's sitting in a fixed account versus a dollar of AUM in the VA product that is in some underlying fund option?

Matt Sharpe - *Horace Mann Educators Corp. - EVP, Annuity & Life*

Thanks for the questions, Vince, and good to talk to you. We have seen a bit of a change in the way the flows are going into the separate account. Back in 2011, about 25% of our flows were going into the separate account. Today, about 35% on a year-to-date basis is going into the separate accounts. We have seen a little bit of a shift and that's a good thing for us. There is about a 200 basis point, between 100 and 200 basis point spread differential in terms of our ROEs for assets that are in the separate account, versus assets that are in the fixed account.

So that's a good thing and we have seen the flows from the separate account into the fixed account as well, as you noted, in the Annuity roll forward. So all of that's good news for us and we hope that trend continues, although I might point out that historically we haven't had a large allocation towards the variable account or the separate account, because of the nature of our customer base.

Vincent DeAugustino - *Keefe, Bruyette & Woods - Analyst*

Okay. And then, just to follow up on Bob's question, just with the concept of rising rates, as far as new product sales on the fixed side, has there been any change or would you expect there to be any change in -- a rise for the guaranteed minimum crediting rate for new sales?

Matt Sharpe - *Horace Mann Educators Corp. - EVP, Annuity & Life*

Currently -- that's a great question, Vincent. Currently, on our best selling product, the annual guaranteed rate now is 1.1%. So we're almost at the bottom, the ultimate guarantees being between 1% and 1.5%, depending on which product line they are in. With the rate move, we expect to see an increase in our base rate for new sales going forward, starting in August, and that just reflects our current purchase rates. But at that increase, we're still able to maintain the pricing spreads and have been maintaining our pricing spreads all the way through.

Vincent DeAugustino - *Keefe, Bruyette & Woods - Analyst*

Okay. Perfect. That's all I have. Nice quarter, and look forward to talking to you soon.

Pete Heckman - *Horace Mann Educators Corp. - President & CEO*

Thanks, Vince.

Operator

There are no further questions at this time. I will turn the call back over to the presenters.

Ryan Greenier - *Horace Mann Educators Corp. - VP, IR*

Thank you. Thanks for joining us this morning on Horace Mann's Second Quarter Earnings Call. If there are any further questions, please don't hesitate to reach out to me. Thanks and have a good morning.

Operator

This concludes today's conference call. You may now disconnect.