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HMN - Q1 2013 Horace Mann Educators Corp. Earnings Conference Call

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Bob Glasspiegel *Langen McAlenney - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Horace Mann first-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.

I would now like to turn the conference over to Mr. Ryan Greenier. Sir, you may begin.

Ryan Greenier - *Horace Mann Educators Corporation - VP, IR*

Thank you, Raquel, and good morning, everyone. Welcome to Horace Mann's discussion of our first-quarter results. Yesterday we issued our earnings release, including financial statements, as well as supplemental business segment information. If you need a copy of the release you can find it on the Investors page of our website.

Our speakers today are Pete Heckman, President and Chief Executive Officer; and Dwayne Hallman, Executive Vice President and Chief Financial Officer. 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, are also available for the question-and-answer session that follows our prepared comments.

Before turning it over to Pete, 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 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 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.

I'll now turn the call over to Pete Heckman.

Pete Heckman - *Horace Mann Educators Corporation - President & CEO*

Good morning, everyone, and welcome to our call. Before commenting on Horace Mann's first-quarter earnings, I wanted to acknowledge the most important of the two press releases that went out after the markets closed yesterday, where we announced Marita Zuraitis as our new President and Chief Executive Officer Elect. Marita is a 30-year veteran of the property casualty industry with both commercial and personal lines experience.

She comes to us from the Hanover Group, where she was a member of the executive leadership team and ran their $3 billion P&C business since joining them in 2004. Prior to that, she held senior leadership positions with the St. Paul/Travelers Companies and the USF&G.

Marita will be working closely with me, our senior management team, and the Board over the next several months as she transitions to the President and CEO position. As she gains a deeper understanding of Horace Mann's niche market of product offerings and our business model, Marita will be able to leverage her considerable leadership and teambuilding experience and have a very positive impact on the Company.

We have an experienced senior management team in place at Horace Mann. We have aggressive but realistic goals, and the appropriate strategies to achieve them. And our operating and financial results have been solid. We are excited to welcome Marita to the Horace Mann team to help us further enhance the service we provide to our educator customers, and profitably grow the business. She'll be starting in a couple of weeks, and will be joining me on next quarter's call, so you'll be able to hear her thoughts on the Company and how her transition is going at that time.

Now let me move on to first-quarter earnings. After yesterday's market close, Horace Mann reported operating income of $0.55 per share for the quarter, a good start to the year. In total, operating earnings were consistent with our expectations. For P&C, our combined ratio of 97% reflected solid underlying property results which offset some deterioration in auto markets. Excluding DAC unlocking, annuity earnings were in line with expectations, as higher assets under management more than offset some compression in net interest spread.

On a reported basis, annuity earnings benefited from $0.03 of DAC unlocking. In the life segment, we saw a return to more normal levels of mortality, consistent with our full-year earnings guidance.

Horace Mann Agency sales continued to be strong, and the growth rate in property and casualty written premiums ticked up a bit. This quarter's solid earnings resulted in a 2% sequential increase in book value per share, excluding FAS 115, to $22.38. On a year-over-year basis, this measure was about 10%. We continued to return capital to shareholders in the first quarter, both in the form of a dividend increase as well as opportunistic share repurchases. This was our fifth consecutive double-digit dividend increase, and reflects not only our strong capital position, but also a confidence in our future earnings power.

Now let me give you a brief update on how we are doing relative to the four key 2013 performance priorities we established on last quarter's call. Our first priority is to maintain the high level of P&C new business sales we achieved last year, and further increase our retention ratios. And we are off to a reasonably good start here. True new auto sales units were modestly higher in the first quarter compared to prior year, and we had a 7% increase in new property units.

Efforts to improve retention, such as initiatives to increase the number of customers on automatic payroll deduction and electronic funds transfer, as well as proactive agent communications in advance of rate increases, have contributed to a nearly 2-point improvement over the last 12 months in the auto retention ratio, which ended the quarter at 85%. And we've added additional programs, including an annual customer policy review process which we kicked off recently to help sustain this improved retention level.

Our second priority is to make further progress toward our total P&C combined ratio goal of the mid-90s. We plan to get there with a non-cap property combined ratio in the low- to mid-70s, and an auto combined in the high 90s. Our total underlying combined ratio was 95.4 which, given the seasonality of the first quarter, is a pretty good result. When we look at the components here, we are reasonably satisfied with our property results, but still have more work to do in auto. Importantly, we are on track with our 2013 rate plan in both lines, which includes mid-single-digit rate increases for auto, and double-digit increases for property.

Our third priority for 2013 is to continue to grow our retirement annuity business while maintaining the spreads on new sales at or above pricing targets. Total annuity sales were down 3% in the quarter, reflecting a decline in independent agent sales. However, Horace Mann Agency sales were up 5%, and spreads on new business exceeded pricing targets. As we move through 2013, we expect sales comparisons to prior year to continue to be somewhat challenging, given the fact that 2012 was the fourth consecutive year of record annuity sales.

Our final key priority in 2013 is to continue to aggressively grow our Horace Mann life business, and sales in the first quarter were up 28%. We successfully introduced our new cash value term product in February, which is an attractively priced mortality product that also builds cash value.

And in the second quarter, we will be rolling out a new electronic application system. This will enable agents to take and submit an application in real-time, a nice enhancement, and one that we expect will help maintain our sales growth momentum.

Now, before I turn it over to Dwayne, if you wouldn't mind indulging me for just a minute, I'd like to acknowledge some recognition that Horace Mann received recently; one award and one nomination. First, we are pleased to have been selected in 2013 as one of Forbes' Top 100 Most Trustworthy Companies. This award is given to companies that consistently demonstrate transparent and conservative accounting practices and solid corporate governance. Now, it's not like we're doing anything differently in this regard, but it certainly is gratifying to be recognized for our long-standing financial conservatism, transparency, and governance practices.

Second, we are honored to be a finalist for one of the Halo awards, sponsored by the Cause Marketing Forum. Our selection validates the success of our cause-based marketing approach and strategic partnership with DonorsChoose.org. We are now in the third full year of this program, and Horace Mann and our agents have donated more than $1.7 million in the schools we serve; which, along with another $43 million from citizen philanthropists and other organizations, has funded over 81,000 classroom projects, benefiting more than 3.7 million students.

While these two items are not directly related to our quarterly results, they do provide some insight into what's important to us and how we go about doing our business at Horace Mann.

Turning back toward financial results, the first quarter represented a solid start for 2013. While we have some work to do in Auto, our underlying property results were good, and the annuity and life segments are performing as expected.

And with that, I will turn the call over to Dwayne for some additional detail on our results. Dwayne?

Dwayne Hallman - *Horace Mann Educators Corporation - EVP & CFO*

Thanks, Pete, and good morning, everyone. First-quarter operating income was $0.55 per share, which included $0.03 of positive DAC unlocking in our annuity segment. Excluding the DAC unlocking, operating income of $0.52 was generally consistent with management's overall expectations; but lower than the prior year, primarily due to a higher combined ratio in property and casualty.

Property and casualty after-tax earnings of $10.2 million were $3 million lower compared to the first quarter of 2012. Catastrophe losses were in line with expectations, at 4.2% of earned premium. 2.4 points of favorable prior years' reserve development was modestly lower than the first quarter of last year. The total P&C underlying combined ratio was 95.4, which included a strong property component in the mid-70s. This helped mitigate some of the increase in the auto loss ratio which, as Pete mentioned, was above our expectations for the quarter.

The increase was primarily driven by lower anticipated current accident years salvage and subrogation recovery as compared to the assumptions used in the first quarter of 2012. This reduced level is consistent with declines in salvage values experienced throughout 2012 as the result of a supply glut in the salvage and parts marketplace, which was exacerbated in late 2012 as a result of events related to Superstorm Sandy.

Our recovery assumption in the first quarter of 2013 is generally in line with the levels we established for the fourth quarter of 2012, and anticipates a stabilization in salvage values for the remainder of the year.

Topline trends remained solid, with written premiums of $132 million, up over 3% from the prior year. And Tom and his team are successfully implementing the P&C rate plan.

Turning to our annuity segment, after-tax income, excluding DAC unlocking, was approximately $10 million, slightly higher than the prior year. Increased assets under management in the quarter helped offset the operating income impact of the decline in investment spreads. The first-quarter net interest spread of 2.01%, while down 10 basis points from the prior year, was slightly above our expectations. Importantly, we remain above our pricing targets for the new annuity business, and continue to pursue opportunities to grow our assets under management.

Our life segment after-tax operating income was $4.3 million, down almost $1 million from the prior year. During the quarter, mortality returned to a more normalized level compared to the favorable experience throughout 2012.

Turning to investments, after-tax net investment income was $52 million, more than 2% higher than the prior year. The majority of the increase was driven by higher annuity assets under management. This quarter's income continued to benefit from the modest allocation to alternative investments that we added throughout 2012. The reinvestment rate in the quarter was in line with the 4% assumption used in our full-year guidance.

We ended the quarter in a net unrealized gain position of about $640 million, a slight decline from year-end. Reported book value ended the quarter at $31.81 per share, a 16% increase year-over-year, driven by strong operating results and an increase in unrealized gains in investment portfolio. Book value per share, excluding unrealized gains, grew 10% to $22.38 per share. As Pete mentioned, we were active in our buyback program during the quarter, taking advantage of market volatility. We repurchased almost 90,000 shares this quarter at an average price of $20.53.

Since we began the program in the fourth quarter of 2011, we have repurchased almost 1.2 million shares at an average price of $16.89 per share. We have $30.4 million remaining under the share buyback authorization, and will continue to be opportunistic in our approach to further repurchases.

Overall, we are pleased with the solid start to the year. First-quarter earnings were in line with our expectations. We also made good progress on all four of our key priorities for 2013.

Before I turn the call over to Ryan, I want to mention that we plan to post a financial supplement on the Investors page of our website after this morning's call. I think you'll find the format of the supplement easy to work with, and we welcome your feedback. Going forward, it is our intention to issue the supplement in tandem with our earnings release, which is typically the evening before the earnings call.

And now, let's move to the question-and-answer session. Ryan?

Ryan Greenier - *Horace Mann Educators Corporation - VP, IR*

Thanks, Dwayne. Raquel, if you would like to compile questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Bob Glasspiegel, Langen McAlenney.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Pretty good job on that. She didn't completely mangle it, so I guess the bar is pretty low. The selection of Marita, just want to focus on that. Initially, from my perspective, knowing her a long time, it seems like a really good fit. Pete, what do you think the Board saw in her that made her the best candidate?

Pete Heckman - *Horace Mann Educators Corporation - President & CEO*

Well, a variety of things, Bob, and I agree with you; and the Board certainly does as well. Marita has a pretty solid track record, is well-known in the industry; but really, it primarily came down to a few things -- leadership and management skills. I think Maria has proven that she is a team builder, works well in establishing and building and developing people. She, of course, has public company P&L experience, personal lines P&C experience. But a lot of what she was working on and accomplished at the Hanover was, in some ways, similar to Horace Mann strategy, where she was trying to provide to their distribution channel and customers the breadth of products and services that a large company could bring to bear, with the flexibility and adaptability and nimbleness, if you will, and service levels of a smaller company. And that's a lot about the differentiation and the focus on distribution that Horace Mann has here. So, she'll bring a lot of new and complementary skills to the Horace Mann senior management team. And, like you say, we're very pleased that she's joining us.

Bob Glasspiegel - *Langen McAlenney - Analyst*

I think the original plan was you were going to possibly hang around until the end of the year. Is that still the plan, or has that changed?

Pete Heckman - *Horace Mann Educators Corporation - President & CEO*

I think that's possibly the plan. As we mentioned in the release, I intend to be here for several months for the transition, to make sure that it goes well; Marita has all she needs. And the exact amount of my time here, which could include being up to the end of the year, is going to be determined by the Board, with input from Marita.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay.

Pete Heckman - *Horace Mann Educators Corporation - President & CEO*

But, yes, I'm not leaving in the next few weeks.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay. On the auto side, how many points was the subro pressure?

Dwayne Hallman - *Horace Mann Educators Corporation - EVP & CFO*

This is Dwayne. What's interesting on the salvage is, if you look at our experience as well as industry experience, the peak of the value, or the positive value, occurred in the first -- the end of 2011 and the first-quarter 2012. So the two data points we are comparing obviously is the high point over the last four years. And then the first quarter of 2013 as far as both our numbers and industry, is basically the low point.

So with the increase in salvage and subro; the decrease in the anticipated recoveries just in auto for the first quarter, about 1.5 points; and then the remaining part is obviously an the increase in the expense ratio. But the level that we've established in the first quarter is generally consistent with year-end numbers. I guess the important thing here is, although the auto loss result is still elevated above our expectations, as far as that underlying piece, it's basically spot on year-over-year, before salvage and subro and expenses.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Do you have to adjust rates further for this? Or you can get your plan in (multiple speakers)?

Unidentified Company Representative

Yes, I think we can get it with our current pricing plan.

Dwayne Hallman - *Horace Mann Educators Corporation - EVP & CFO*

In the last -- during 2012, we saw the decline. So it was -- that new run rate level off of the peaks at of the end of 2011 and 2012 was somewhat already considered in Tom's strategy.

Tom Wilkinson - *Horace Mann Educators Corporation - EVP, Property and Casualty*

Yes, it was built into our elevated auto rate plan that we took the second half of 2012. You may recall it was higher than the first-half rates. And then that continues into 2013.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay. On the annuities side, you weren't factoring in an up 10% Q1 market in your plan. So I think you had been leading to flat, flattish earnings because of the DAC unlocking and margin pressure and spread compression; plus getting a big market appreciation in Q1, which raises the level of assets under management for the full year. Does that allow for an up year, potentially, if the market holds here?

Unidentified Company Representative

In the plan, Bob, we assume -- excuse me.

Bob Glasspiegel - *Langen McAlenney - Analyst*

8% a year (multiple speakers).

Unidentified Company Representative

-- built into the plan, and the market expectation built into the plan, was lower than the actual returns that we got in the current quarter.

Bob Glasspiegel - *Langen McAlenney - Analyst*

By a decent bit, I'm going to assume. If we get it all in Q1, that raises the average assets for the whole year. So, it's more than just getting -- if you assumed 8% for the year, and you get 10% in Q1, it's more than just -- you know.

Pete Heckman - *Horace Mann Educators Corporation - President & CEO*

Yes, it will start our -- and really, that impacts the variable component of our annuity (multiple speakers). 30 or so percent; it was 70% being a fixed annuity. So, you're right, on that 30%, if the market basically remains flat for the remainder of the year, we'll be relatively close to our full-year plan. But we will have a little bit of front-ended asset growth. On the 70%, the fixed side -- again, the increase in assets there pretty much exactly offset the anticipated decline in spreads. So the total income off of the fixed block was about what we thought.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay, so a little bit of headwind. (Multiple speakers). Tailwind, I mean. Tailwind. Tailwind.

Pete Heckman - *Horace Mann Educators Corporation - President & CEO*

Yes, tailwind.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Correct me if I'm wrong -- as I recall, you normally get an erosion in agent count in Q1 and then build over the course of the year. So I assume you're still on plan for what your agent balance is going to be at the end of the year, or do I have that wrong?

Steve Cardinal - *Horace Mann Educators Corporation - EVP, Marketing*

Yes, Bob -- this is Steve Cardinal. No, you're exactly right. We have a little bit of erosion the first part of the year. We've done that the last few years. We think we're on track for a good -- that will be our fifth year in a row of growing agency count again, consistent with what we've had -- agent retention has been very solid, and productivity is up, so a lot of good indicators for us.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay. Good luck on turning it over in hurricane season.

Pete Heckman - *Horace Mann Educators Corporation - President & CEO*

Thank you.

Dwayne Hallman - *Horace Mann Educators Corporation - EVP & CFO*

Thanks, Bob.

Operator

(Operator Instructions). There are no further questions at this time.

Ryan Greenier - *Horace Mann Educators Corporation - VP, IR*

Thank you, Racquel. Thank you, everyone, for your interest and participation in today's call. Should you have any other questions, I am available after the call. Thanks.

Operator

Thank you, ladies and gentlemen. This concludes today's conference call. You may now disconnect. Have a wonderful day.
