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HMN - Q4 2012 Horace Mann Educators Corp. Earnings Conference Call

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CORPORATE PARTICIPANTS

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

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

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

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

CONFERENCE CALL PARTICIPANTS

Bob Glasspiegel *Langen McAlenney - Analyst*

PRESENTATION

Operator

Good morning. My name is Patrick and I will be your conference operator today. At this time I would like to welcome everyone to the fourth-quarter and full-year 2012 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)

I would now like to turn the call over to the Vice President of Investor Relations, Mr. Ryan Greenier, to begin the conference. Sir?

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

Thank you, Patrick. Good morning, everyone. Welcome to Horace Mann's discussion of our fourth-quarter results.

Yesterday we issued our earnings release, including financial statements, as well as supplemental business 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 Casualty, are also available for the question-and-answer session that follows our prepared comments.

Before turning it over to Pete I wanted 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 is 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 from those projected in forward-looking statements due to a variety of factors. These factors are described in our press release and SEC filings.

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

Now I will turn the call over to Pete Heckman.

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

Good morning, everyone, and welcome to our call. After yesterday's market closed Horus Mann reported fourth-quarter operating income of $0.67 per share, which was only slightly below the record quarterly EPS we recorded a year ago. Full-year operating income was $2.08 per share.

Underlying earnings continued to be strong across all three segments of our multi-line insurance platform. Cat losses in the quarter were minimal as we do not write business in New York or New Jersey. In addition, fourth-quarter earnings benefited from favorable prior year P&C reserve development, positive DAC unlocking in our Annuity segment, and favorable mortality in our Life business. Each of those items was well above our expectations in both the current quarter and for the full year.

In addition to strong bottom-line results, the broad-based increases in new business sales and policy retention over the last several quarters continued in the fourth quarter.

We are pleased with the solid earnings we have delivered to our shareholders in 2012. Horace Mann's book value per share, excluding FAS 115, increased 11% year over year and in December we announced our fourth consecutive double-digit dividend increase. Our dividend has tripled since the financial crisis and is up more than 50% from pre-crisis levels. This track record reflects our strong capital position, as well as confidence in our future earnings power.

Going forward, the Board will be moving their annual review of dividend and other capital management actions from December to March so that actual year-end results can be taken into consideration. This change will be made starting with next month's board meeting.

Now last year around this time I outlined the five key performance priorities that Horace Mann would be focusing on in 2012. As you might expect, given my commentary on the last three earnings calls and our results this quarter, my end-of-year report is a very positive one. Horace Mann's agency force recorded double-digit sales increases in all four lines of business in 2012 and we grew our agency count for the fourth consecutive year.

In the auto line successful implementation of state-specific pricing, underwriting, and marketing programs resulted in a 20% increase in true new unit sales. Retention was 1.7 points, benefiting from the continued focus on expanding the number of multi-line customers and the utilization of automatic payment plans. Meanwhile, the increase in both new sales and retention resulted in a stabilization of our auto PIF counts.

In property, while we still have a ways to go, we continued to make progress on the underlying combined ratio which improved more than 2 points in 2012 to end the year at 75.9%. Our retirement Annuity business recorded its fourth consecutive year of record sales and assets under management increased 10%. This was in no small part due to the nearly 8,000 state teacher retirement seminars conducted by our agencies in 2012.

In addition to strong sales, Annuity net interest margins were better than expected as a result of higher-than-anticipated re-investment rates, prudent crediting rate management, and new business spreads that were well above our pricing targets. Finally, sales of Horace Mann manufactured life products were up 40% from the prior year, consistent with our strategic commitment to grow our underwritten mortality-based business. This increase was supported by a number of improvements in our new business application and underwriting process during 2012.

Our strong performance relative to these key 2012 priorities contributed significantly to an outstanding full-year operating EPS of $2.08. But as I mentioned earlier, we also benefited from a number of items which were considerably more favorable than we would have normally expected. Dwayne will take you through those details in just a moment.

We anticipate 2013 operating earnings to be between $1.75 and $1.95 per share. This estimate reflects improved underlying P&C underwriting results offset by a reduced level of favorable P&C reserve development and a return to normal mortality and DAC unlocking. It also reflects the investment of $3 million to $4 million of our excess capital, or roughly $0.05 per share, in customer service and infrastructure improvements.

These investments are being made to enhance our overall customer experience and to support further improvement in our already strong policy retention and cross-sale ratios.

Dwayne will also provide a reconciliation of our earnings guidance for you, but before he does I would like to lay out the four key performance priorities we will be focusing on in 2013. Our first priority is to maintain the current high level of P&C new business sales and further increase our retention ratios. We will continue the state-specific growth initiatives from 2012 and will launch additional customer contact programs, which we expect to contribute to further improvement in retention.

At the same time, we will continue to focus on achieving an appropriate growth/profit balance, which leads to the second key priority for 2013 which is to make further progress toward our total P&C combined ratio goal of the mid-90s by an improving both the auto and underlying property profit margins. Our 2013 auto rate plan includes targeted increases averaging in the mid-single digits. In property we are targeting double digits. These rate actions, combined with those taken in 2012, should result in improved margins and expanding premium growth.

Our third priority for 2013 is to continue to grow our retirement annuity business while maintaining spreads on new sales at or above our pricing targets. Finally, we plan to continue aggressively growing our life insurance business and are once again targeting double-digit growth in sales of Horace Mann manufactured products. To help sustain the strong growth momentum in this line we are in the process of introducing a cash value term product which has received strong initial feedback from our agency force, and we also plan to introduce an electronic new business application and submission system in the third quarter.

So, in addition to our underlying company-wide focus on improving the customer experience, those are the four key priorities for 2013. As we did last year, we plan to update our progress relative to these priorities on subsequent quarterly calls. In that regard, I believe Horace Mann is entering 2013 from a position of strength with positive, sustainable momentum and we are looking forward to another good year.

Now let me turn it over to Dwayne for more detail on both our results and our earnings guidance. Dwayne?

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

Thanks, Pete, and good morning, everyone. Fourth-quarter operating income of $0.67 per share benefited from relatively low cat losses, stronger-than-expected prior-year reserve development, $0.04 of positive DAC unlocking, and $0.04 of favorable earnings in Life primarily related to mortality. Offsetting these positive items was $0.05 of expenses related to CEO and other incentive compensation.

Adjusted for these items, fourth-quarter earnings would have been $0.50 to $0.55 per share, at the top end of our guidance range. On a full-year basis operating income of $2.08 per share also benefited from a number of items that weren't included in our original guidance. Prior-year P&C reserves continued to develop favorably; however, the level of releases in 2012 was higher than we expected.

Favorable mortality in our Life segment contributed $0.07. Strong equity markets and improved annuity persistency resulted in positive DAC unlocking of $0.07. Adjusted for these items normalized 2012 earnings would have been in the $1.85 range.

Pretax net investment income of $77 million was up over 3% from the prior-year quarter, primarily related to the Annuity segment. Our reinvestment rate in the quarter was around 4.2%, which was ahead of expectations. We continue to find opportunities to put money to work at attractive risk-adjusted yields without venturing into asset classes or individual securities inconsistent with our conservative investment philosophy.

That said we did enhance our annuity portfolio returns during 2012 by adding a modest allocation to alternative investments, which helped mitigate what would have otherwise been a declining interest spread in the second half of the year. On a full-year basis the average spread in Annuity was 211 basis points. Without the alternative investments, the average net spread would have been around 200.

Reported book value ended the year at $31.65 per share, a 19% increase year over year driven by solid operating results and an increase in unrealized gains in the investment portfolio. The continued combination of low Treasury yields and tightened spreads resulted in a net unrealized gain of $650 million at year-end. Book value, excluding net unrealized gains, grew 11% to end the year at $21.93 per share.

In terms of our capital position, we generated roughly $90 million of statutory operating income and $25 million of additional excess capital in 2012. While RBC ratios aren't final, our initial estimates have been comfortably above our targets. The P&C ratio is estimated at 550% with a premium-to-surplus ratio of 1.35 while Life company RBC should end the year around 470%.

During the quarter we repurchased 115,000 common shares, utilizing an additional $2 million of our authorization. We now have $32 million remaining. When we originally authorized our share repurchase program in December of 2011 Horace Mann stock was trading around $13 per share, or 65% of book value, excluding net unrealized investment gains. The Board authorized the program in light of our excess capital position and a clearly undervalued stock price.

While the strong price appreciation of our stock during 2012 was welcomed, it has reduced the relative desirability of share repurchases and has tipped the scale somewhat in favor of dividends as a means of returning capital to shareholders. With that said, however, we will continue to be opportunistic in our share repurchases and are well positioned to capitalize on any market dislocation.

As Pete mentioned, our outlook for 2013 operating earnings is $1.75 to $1.95 per share. We expect underlying results to improve in Property and Casualty offset by a reduction in favorable pricing reserve development, a reversion to modeled mortality experience in our Life operations, no benefit from DAC unlocking, and $0.05 of spend on customer experience in infrastructure investments. Let me break down our 2013 outlook by segment and provide some additional color behind our assumptions.

In Property Casualty we expect written premium to grow 2% to 3%, which reflects a 2013 rate plan of mid-single-digit increases in auto and a double-digit increase in property. We expect those rates, coupled with 2012 pricing actions, to outpace loss costs and contribute to about a 2-point improvement in the underlying P&C loss ratio in 2013. We anticipate this improvement will be offset by a reduced level of favorable prior-year reserve development as well as a modest increase in expense ratio.

So all-in, on a reported basis we expect the P&C combined ratio to basically be flat with 2012 results.

In Annuity, after adjusting 2012 for the $0.07 benefit from DAC unlocking we anticipate operating earnings to be relatively stable in 2013 as growth in Annuity assets is expected to offset a decline in spreads. Using a 4% reinvestment rate assumption, we expect the full-year average net interest spread in 2013 to be in the low 190 basis point range.

And, finally, in our Life segment we are anticipating a return to modeled mortality along with a modestly lower portfolio yield in 2013, which should result in about a $5 million to $6 million after-tax decline in operating earnings. As you can see, our consolidated 2013 operating earnings guidance is generally in line with 2012 results after adjusting for the favorable items we just discussed.

So to summarize, 2012 was a solid year for Horace Mann. We saw broad-based increases in new business sales and policy retention, as well as improvement in the underlying earnings across all three segments of our multi-line insurance platform. Moving into 2013, we are well positioned to capitalize on the strong momentum while re-investing in our business to set the stage for continued, profitable growth.

Now I will turn the call over to Ryan to begin the Q&A session.

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

Thanks, Dwayne. Patrick, we are ready.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Bob Glasspiegel.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Good morning, everyone. On the projections it seems like a few years ago you were saying you would target a 12% to 14% ROE with a 92 to 94 combined ratio. Now I think you are talking more about getting into 95 a year from now. Is that book from the original goal or it is that still where you were two to three years ago?

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

Yes, Bob, this is Pete. Good morning. We still look at our franchise as being able to deliver in the low teens, as you say, ROE and that would include P&C combined ratio in the mid-90s. As you know, over the last couple of years it has been a very competitive market, and we have and continue to try to balance growth and profit.

So we have made some progress on the underlying combined in 2012 and are targeting additional progress in 2013. We will continue to move down toward the mid-90s, but again we need to balance growth with profit appropriately.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Is there a date that you are -- have we illuminated the date on the goal achievement publicly?

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

We don't have a specific date or month or year or anything like that, Bob. We just --

Bob Glasspiegel - *Langen McAlenney - Analyst*

You used to say two to three years two years ago, so you sort of had a date before.

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

Well, you know, the market is dynamic and we continue, as I say, to make progress toward it. We feel comfortable that we are on the right track and we are going to get there in a reasonable amount of time.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay. Second question, I am going to flip my third-quarter question where I said why aren't you declaring victory on auto where you had very strong underlying results. This quarter, I mean your underlying auto was 106; maybe there is some seasonality in it.

But I was wondering where are you in auto. There was a lot of reserve releases in auto for a pretty high combined ratio year. Maybe we could talk through how that plays out.

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

Well, Bob, this is Tom Wilkinson. On the underlying side, you may recall our conversation in the third quarter; we do have significant seasonality in our business in the fourth quarter where the combined ratio historically shoots over 100%. And it did again this year.

We are encouraged that it didn't go as high as it was last year, giving us the second quarter in a row where our underlying combined this current accident year was better than what it was the prior accident year.

In terms of overall level, the full-year accident year is still over 100. As Pete was saying, it is trending down. Our target for total P&C is to get the total bucket in the mid-90s range. We still think that to be competitive and to balance growth and profit our auto target is going to be in the high 90s range.

We are not declaring victory yet. We feel pretty good about it. We feel that we got the trends going in the right direction and we are effectively moving towards our target while at the same time setting the stage for future policy growth.

Bob Glasspiegel - *Langen McAlenney - Analyst*

You don't normally see that large of reserve release when you are pushing rates pretty hard too. Was there a positive in the quarter on the reserve picture that you saw?

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

Bob, this is Dwayne Hallman. Nothing in particular just in the quarter. We were seeing favorable returns throughout the year in the fourth quarter, kind of reaffirmed our belief what we are seeing in prior years.

So our reserve releases from prior years were not just from 2011; there was some longer tail auto lines, especially in the liability component, was coming from 2009 and 2010 as well. But the underlying favorable trend did continue into the fourth quarter on those prior years.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay. My last question and I will go back in the queue. I'm not sure I followed; your capital management meeting will be in March. Does that mean that we could have a possibility of another dividend increase pretty quickly, that you are not doing buyback with all that excess capital, or was I misreading body language?

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

Well, we are going to move the conversation or consideration around capital management, including dividends, to March. Again, we have done it historically in December but feel that it would be probably more in line with the competition or our peers, but also it gives us a chance to see where the year ends up to make a more informed decision.

So it will be on the agenda in March now starting next month. We will continue to have excess capital and discuss the best ways to deploy that to the shareholders or to invest it in the Company. We are beginning to do some of the latter, as you heard this year and going forward, but it will be a topic that the Board will discuss next month.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Thanks. I will go back in the queue.

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

Bob, it is Ryan. Actually, if you have any additional questions, we can continue to take them.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay. Pete, are you going to be attending any of those retirement seminars any time soon? I'm not trying to push you off; I enjoy chatting with you and enjoy additional quality time with you, but maybe you could feed us in on how the search for your successor is progressing.

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

Well, to your first comment, Bob, I would like to know which ones you are going to because those would be the good ones that I would want to attend as well.

But to your point, we have had a search process; the Board has had a search process that has begun now for a little over a couple months. It is making progress, but it is too soon to report anything. There is really nothing at this point to comment on, but certainly we will keep you and everybody up to speed as things move forward.

As you know my retirement date is going to be the end of the year, so the process has a reasonable amount of runway left. The Board is going to be very careful and deliberate in choosing my successor.

Bob Glasspiegel - *Langen McAlenney - Analyst*

Okay, I guess that is about it for me. Thanks.

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

Thanks, Bob.

Operator

There are no further questions. I would now like to turn the call back over to Mr. Greenier to close the call.

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

Thank you very much for your interest in today's call. If anyone has any further questions, I am available as always. We look forward to meeting with you and talking to everyone soon. Thanks.

Operator

This does conclude today's conference call. All lines may disconnect at this time. Thank you.