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Horace Mann Educators Corp. (HMN)

Q4 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Horace Mann Q4 2014 Earnings Call. At this time, all participants are in 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 for today, Mr. Ryan Greenier, VP of Investor Relations. Thank you, sir. You may begin.

Ryan E. Greenier
Vice President-Investor Relations

Thank you, Latania, and good morning, everyone. Welcome to Horace Mann's discussion of our fourth quarter and full year 2014 results. Yesterday, we issued our earnings release and investor financial supplement. Copies are available on the Investor page of our website.

Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Dwayne Hallman, Executive Vice President and Chief Financial Officer. Bill Caldwell, Senior Vice President of Property and Casualty; Matt Sharpe, Executive Vice President of Annuity and Life; and Steve Cardinal, Execute Vice President and Chief Marketing Officer 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 Legislation (sic) [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.

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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 Marita Zuraitis.

Marita Zuraitis

President, Chief Executive Officer & Director

Thanks, Ryan. Good morning, everyone, and welcome to our call. After yesterday's market close, Horace Mann reported fourth quarter operating income of $0.68 per share, a strong end to a very good year. The quarter's P&C results were solid with a 91.9 point combined ratio. We did see an uptick in auto losses, which is not out of line with Horace Mann's historical fourth quarter results. Property results were favorable with a reported combined ratio of 69 points.

Reserves continued to develop favorably although at a lower level compared to prior year. Catastrophe activity in the quarter was relatively benign. Importantly, auto policies in-force continued to grow sequentially and were encouraged by the 13% increase in auto sales during the quarter.

Annuity earnings reflected strong spread management and continued growth in assets under management. Sales in the quarter increased more than 20% in part due to the success of our new Fixed Indexed Annuity product. Life earnings reflected a more normalized level of mortality cost and sales continued to grow.

Looking at the full year, 2014 operating income of $2.30 per share was another very strong result producing nearly 7% growth in book value per share excluding net unrealized gains on investments. P&C profitability continues to improve led by underlying improvement in auto. Within property, we believe the actions we've taken to improve homeowners' profitability by reducing coastal exposures are largely complete. And by midyear 2015, we will have fully eliminated our homeowners' property exposure in Florida.

In addition, we plan to introduce enhanced roof underwriting, pricing, and claims practices for certain policies in select markets, which will help reduce the impact of wind and hail exposure over time.

We achieved our rate plan of mid-single digit increases in both auto and property and plan a similar level in 2015. Even with these rate actions, retention remained high at 85% in auto and 88% in property, which is a testament to the loyalty of our customer base and reflects the large proportion of our book that is cross-sold.

Turning to annuities, over the course of 2014, ex-DAC earnings grew by 9%, supported by continued growth in assets under management as well as proactive crediting rate management. The investment portfolio continues to produce strong risk adjusted returns despite the challenging interest rate environment.

Life earnings while lower than previous year were in line with modeled mortality. In 2015, we are focused on achieving continued double-digit growth in life sales as they provide the building blocks for future earnings growth. In late 2015, we plan to launch our new Indexed Universal Life product, which will provide another lift in sales in 2016 and beyond.

From a distribution perspective, agent productivity improved in 2014 as we posted higher sales in all segments even with the agent count ending the year flat, as planned. We continue to focus our future agent productivity improvements in 2015, but are also looking to increase sales from direct and independent agent channels. We are seeing success in our strategy to find more, win more, and keep more educator households. In the second half of the year, we clearly saw emerging offense in our auto business.

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As we rollout more sophisticated product refinements across more territories, we are seeing higher quote volume, which has led to a higher level of sales. This is driven by improved segmentation, which better captures the characteristics of preferred educator households. Another benefit of this more sophisticated approach is the quicker identification of improvement opportunities in certain segments or geographies.

For the full year, new P&C sales increased more than 3% to $96 million. As I said, much of that increase emerged in the back half of the year and we have very strong momentum going into 2015. Importantly, we're pleased with the characteristics of the new business. These new customers tend to be preferred educator households, and more and more educators are electing electronic funds transfer and payroll deduction, which helps with retention. Continued growth in auto policies in-force during 2015, should result in our full year auto policy growth since 2007.

2014 annuity sales were strong, growing more than 20% over the prior year. Our continued focus on positioning our agency force as the trusted advisor to educators, as they plan for retirement was instrumental in driving the sustained growth we've seen in annuity sales year-over-year.

During 2014, more than 100,000 teachers, administrators and support personnel, attended one of our state teacher retirement seminars. These informal sessions are just one example of how our agents are uniquely positioned and thought of as a member of the education community. In addition, the market reception to our new Fixed Indexed Annuity product was strong. We believe this new product is deepening our reach into educator households, and we're pleased to see the level of enthusiasm within our agency force. In total, new Fixed Indexed sales accounted for roughly one-third of our total annuity sales.

Looking ahead to 2015, we expect sales to continue to trend upward, and we are focused on driving higher sales of our flexible premium products, consistent with our educator household acquisition strategy.

Sales momentum within the life segment was also strong in 2014, up more than 30% on a full year basis. We expect life sales to continue at double-digit pace in 2015, building on this year's strong momentum and benefiting from continued field education efforts and cross-sell initiatives. We expect the profitability initiatives and continued focus on growing the top line to drive solid increases in normalized operating earnings.

Dwayne will take you through the details, but we expect 2015 operating income to be between $2.15 and $2.35 per share.

Before we do that, let me talk about some of the capabilities we are building to accelerate the pace of educator household acquisition, while also driving deeper product penetration within households. These efforts are instrumental in building a best-in-class educator household acquisition strategy, which will support our multi-year strategy to profitably grow our business.

We have expanded our use of third-party data and analytics. The amount of consumer data available today is considerably greater than what was available just a few years ago. We are beginning to harness the power of big data to improve our targeted marketing efforts around educator household acquisition, but also to refine our risk selection. This is a first step in what will be a multi-year strategy to identify the most efficient ways to target preferred educator households and to effectively convert those households into customers.

Another find more strategy is to leverage our already strong relationship with DonorsChoose.org. In select markets where we have the appetite to grow our business, we have a series of direct mail marketing campaigns as

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well as coordinated DonorsChoose flash funding efforts. This combination is increasing brand awareness, improving school access and will ultimately help us grow our business.

We know from past experience that every additional product we place in an educator household supports our already strong retention and persistency levels. The quickest way to win and keep more and drive deeper penetration into households is to mine the existing customer base. We are focused on selling more products to existing customers. Nearly 20% of our customers currently purchase both a property-casualty and annuity-life product from us. While this cross-sell ratio is industry leading, we're confident that we can drive it higher.

Recent improvements in technology have positioned us to deliver a more seamless customer experience between the agency force and customer contact center. Now when a new or existing customer contacts us, we can effectively overlay our educator household data to identify potential product needs for that customer, and then through either an agent referral or a direct sale in the contact center, we can fill those needs. These cross-sell initiatives are in the very early stages, but over time we expect the customer contact centers' role in driving future sales growth to continue, to evolve and expand.

We are clearly encouraged by our sales momentum in the back half of 2014, and it is carrying us into 2015. As a result, we expect profitable sales growth in all four lines of business in 2015, as we execute our strategy to find more, win more, and keep more educator households. The solid results in 2014 are a clear indication that we're on the right track to achieve our goal at being a larger, more dominant player in the educator space.

We entered 2015 in a strong position to continue implementing our multi-year strategy to profitably grow our business.

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

Dwayne D. Hallman

Chief Financial Officer & Executive Vice President

Thanks Marita, and good morning, everyone. Fourth quarter operating income of $0.68 per diluted share was another strong result, reflecting solid performance in all three business segments. In P&C, results included prior year's reserve development and catastrophe losses that were more favorable than originally expected. Annuity results included a modest amount of unfavorable DAC unlocking versus a $0.03 of favorable unlocking in the prior year period.

P&C after-tax income of $16.2 million was $2.8 million lower than the prior year quarter. On a reported basis, the combined ratio of 91.9% was a solid result and reflected the typical fourth quarter loss seasonality in auto. That said, the auto loss ratio was higher this year as a result of elevated frequency in comp, collision and property damage compared to the prior year. In addition, we experienced a lower level of favorable prior year reserve development.

Fourth quarter annuity income excluding DAC unlocking was $11.4 million in line with the prior year quarter as was life operating income of $4.6 million. On a full year basis, operating income was $2.30 per share, another quality earnings year.

Full year P&C operating income was $46.9 million, a 6% improvement over the prior year. P&C results included a level of favorable prior year reserve development that was similar to 2013, which exceeded the assumptions in our earnings guidance.

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On an underlying basis, the combined ratio was in line with the prior year at 92.5%. We did see a one point improvement in the underlying auto combined ratio as earn rate exceeded our loss cost trends.

Property results reflected increased non-cat weather severities we mentioned earlier in the year. This trend resulted in a 3.5 point increase in our underlying combined ratio, which was still a respectable 96.5 points. Continued underwriting and rate actions, reinsurance cost reductions, and our assumption of more normal non-cat weather should contribute to property margin improvement in 2015. Our full year expense ratio improved 0.3 points to 27.4 points. In total, the combined ratio of 96.1 points was slightly better than the prior year.

Reported annuity operating income for the full year improved slightly from the previous year. More volatile equity markets in 2014 resulted in $0.02 of negative DAC unlocking versus the $0.06 of favorable unlocking in the prior year.

Excluding the impact of DAC unlocking and looking at the underlying earnings of our annuity business, income increased 9% over the previous year to $46.1 million. Assets under management grew 6% in 2014 and ended the year at $5.7 billion. We continued to see healthy sales growth of 22% over the prior year and stable persistency levels in excess of 94%.

The net interest spread of 201 basis points ended the year modestly higher than the prior year and clearly above our initial plans. This is the result of proactive crediting rate management, solid investment portfolio performance, and our ability to continue to find opportunities to put money to work at attractive risk adjusted returns.

In the life segment, full year operating earnings excluding DAC unlocking declined 15% to $17.4 million as a result of mortality that was consistent with our actuarial models. 2013 results included $0.07 of favorable mortality experience compared to our expectations.

Adjustment for the differences in DAC unlocking and life mortality, normalized consolidated operating earnings for full year 2014 increased by 7%. A solid result that illustrates the continued earnings power of our annuity segment, the solid contributions from life, as well as the improving profitability within the P&C segment.

Our 2014 results generated a 7% increase in book value per share, excluding the unrealized gains on investments, which ended the year at $25.38. These results contributed to the 11% five-year compounded growth in Horace Mann's adjusted book value per share plus dividends through year-end 2014.

In addition to strong book value growth, we believe paying a compelling dividend is an attractive differentiator to investors. As you may recall, we raised our dividend by 18% at our March 2014 board meeting to $0.92 per share, which was our sixth consecutive increase.

During 2014, we generated about $88 million of statutory operating income. While our RBC ratios aren't final we estimate that P&C is around 560% with a premium to surplus ratio of 1.26 and around 470% at the life company. As a result, we have a healthy quotient of excess capital which will fund the organic growth, particularly in the life company, while maintaining our strong capital position.

Looking ahead to 2015, our guidance for full year operating income is between $2.15 and $2.35 per share, the midpoint of which reflects continued earnings growth over 2014, after adjusting for DAC unlocking and favorable prior year reserve development. Our estimate reflects a small amount of margin expansion in P&C, modestly lower annuity earnings that reflect expected spread pressure and a slightly lower level of earnings from the life segment.

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Clearly, the current interest rate environment is pressuring net investment income. While our investment portfolio produced favorable results in 2014, we expect portfolio yields to contract in 2015. Our investment philosophy remains unchanged. We look for attractive, risk adjusted returns, and are focused on maintaining a relatively conservative investment portfolio.

In 2014, our annualized investment yield was 5.32%; a good result. But with the current interest rate environment challenges, the yield is obviously under pressure. We expect interest rates to continue to remain low in 2015 and as a result, our guidance includes a 3.75% reinvestment rate assumption.

Although the lower rate environment has generated sizeable prepayment activity over the last few years, we're assuming a material decline in such activity during 2015. As a result, we expect the annualized investment yield to decline about 20 basis points over the course of 2015. Although other factors could positively impact net investment income such as prepayment activity, the main driver would be a change in the reinvestment rate. We estimate that for every 25 basis points increase in the reinvestment rate, it generates about $0.02 of additional earnings per diluted share on an annual basis.

Turning to our outlook on business segments, let's start with Property & Casualty. We expect written premium to grow between 3% and 4%, which reflects continued rate increases and to a lesser extent higher auto sales. We expect retention to be relatively stable. Our mid-single digit rate actions as well as continued product refinements should result in a one point improvement in the underlying loss ratio. This improvement is coming from property as continued underwriting and rate actions, reinsurance cost savings, and an assumption of more normal non-cat weather contribute to a three-point to five-point improvement in the underlying combined ratio.

In auto, we expect the underlying combined ratio to improve by fractions of loss ratio points, reflecting continued product and underwriting enhancements, as well as rate increases that are generally aligned for loss cost trends. Additionally, we are assuming a 6.5 point catastrophe load for 2015 at a modest amount of favorable reserve development.

From an expense perspective, infrastructure and technology initiatives will continue. And as a result, we expect the P&C expense ratio to be in line with 2014. In total, we expect our reported combined ratio to be in the mid-90%s similar to 2014 with improvement in the underlying loss ratio, offset by more modest assumptions for favorable prior year reserve development.

In our annuity segment, we expect ex-DAC operating earnings to be slightly lower than full year 2014 earnings. While we have been successful in proactively managing crediting rates and sourcing new investments, the prolonged low rate environment is a clear headwind in 2015.

Given our views on interest rates, we anticipate spreads will grade down to the mid-180 basis points through 2015. This assumption reflects the positive spread contribution of new business, including continued success of the Fixed Indexed Annuity product.

Our life earnings assumptions reflect mortality, consistent with actuarial models, net investment income pressure given our reinvestment rate assumptions, and $1 million to $2 million of additional expenses related to our multi-year effort of continued infrastructure and technology investments. As a result, we expect life segment earnings to be in the range of $15 million to $17 million, a bit lower than 2014.

Overall, the 2015 operating income guidance of $2.15 per share to $2.35 per share, reflects continued earnings growth over normalized 2014 earnings, even factoring in strategic reinvestments in our business as well as a challenging interest rate environment.

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We are on the right track to achieve continued profitability improvements in our P&C operations while also growing policies in-force. Our annuity asset gathering abilities are strong with healthy sales and a solid persistency and we have life back in our life business demonstrated by the increase in the number of policies in-force during 2014, the first annual increase since 1998.

Like Marita said, we're successfully executing initiatives aligned with our vision of being the preferred insurance and financial services provider to the nation's educators.

As we enter 2015, we're confident that our tailored products, trusted, knowledgeable distribution, and a modern efficient infrastructure will result in growth in the number of educator households we serve, all of which supports our multi-year strategy to profitably grow our business.

With that I'll turn it over to Ryan to start the Q&A.

Ryan E. Greenier
Vice President-Investor Relations

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Bob Glasspiegel with Janney Capital. Please proceed with your question.

Bob R. Glasspiegel
Janney Montgomery Scott LLC

Q

Good morning, Springfield. I got a few questions. Number one, how much do you think you're going save in reinsurance costs, 2015 versus 2014?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

2014 going into 2015 is roughly $2 million, Bob.

Bob R. Glasspiegel
Janney Montgomery Scott LLC

Q

Okay. My annual excess capital calculation – how much do you have at the parent? How much do you have at the subs based on where you want to be for rating purposes?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Bob, the way we calculate it, we just assume an RBC ratio of say roughly 425% in the life company and 500% in the P&C company. Not that we would take it all the way down to 425%, but just for consistency purposes to keep numbers level from year-to-year. Using those numbers, the combination of P&C and life have about $80 million of excess capital and then we currently have just north of $20 million of cash at the holding company.

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Bob R. Glasspiegel
Janney Montgomery Scott LLC
Q

Okay. And dividend capabilities from the subs to the parent ahead of your share dividend announcement which we think in terms of how much you're going to want a dividend?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President
A

Well, the dividend available without any regulatory preapproval is roughly $82 million and that's about $37 million out of the life company and roughly $45 million out of the P&C companies.

Bob R. Glasspiegel
Janney Montgomery Scott LLC
Q

Any guess on how much you're going to want a dividend up or...?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President
A

As far as our plans, the way we operate, we bring up enough dividends to fund the dividends and debt service and holding company expenses. Over the last couple of years, we've had an opportunity to build up a little excess cash at the holding company for the just-in-case scenario. So if you added those components up, you could roughly guess what the dividends would be minus any intercompany tax sharing agreements. And that will generally be split evenly between the life and P&C companies.

Bob R. Glasspiegel
Janney Montgomery Scott LLC
Q

Okay. And no preliminary thoughts on what sort of dividend we should be looking for in March?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President
A

No, sir, that will occur at our March board meeting and will be promptly announced.

Bob R. Glasspiegel
Janney Montgomery Scott LLC
Q

Okay. Last question. Personal lines, auto, you've given sort of a similar speech maybe to what Allstate saw the frequency uptick in – Allstate was sort of not clear on whether they're going to immediately price for it or may have to price for it. So I guess the question is, was this a left field to you, a blip, a trend, and how are you thinking about it in terms of triggering your price increase needs for 2015 in auto?

William J. Caldwell
Senior Vice President-Property & Casualty
A

Hey, Bob, it's Bill Caldwell.

Bob R. Glasspiegel
Janney Montgomery Scott LLC
Q

Hi Bill.

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William J. Caldwell
Senior Vice President-Property & Casualty

A

Hey, how are you?

Bob R. Glasspiegel
Janney Montgomery Scott LLC

Q

Doing great.

William J. Caldwell
Senior Vice President-Property & Casualty

A

I would say, when we look back at prior fourth quarters, we have the unfavorable comparisons to 2013, which was an exceptional year for Horace Mann and the industry, but not surprising when we go back further and look at prior fourth quarters. That said, we're committed to a defensive actions in all of our markets. So we're looking at – as that data comes in, we're looking at a disciplined rate actions, again mid-single digits for auto, tightened the underwriting box where appropriate in some markets. And what I like about this model is our agents are progressive available too. So we're able maintain the household. There's risk out there, we're not comfortable with that segment and we're able to access progressive and bring that risk back when we're more comfortable with our segmentation.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Yeah. And this is Marita. What I'd add to that is, we're pleased with the full year loss ratio in auto and continued improvement, albeit fractions of loss ratio points as we continue to say. The loss ratio is ahead of the industry, continues to improve on a full-year basis, also because of the fact that we have this homogenous segment of customers of educators, we're able to go back in and begin to unpack the fourth quarter.

So Bill and his group have spent a fair amount of time looking at the historical fourth quarter being higher notwithstanding the unfavorable comparison to a pretty decent 2013, but looking at that fourth quarter pattern and saying what is it about our educator customers that drive a higher loss ratio in the fourth quarter and seeing what we can learn about that, so that maybe in the fourth quarter result we can even improve that further when we have the learning. So another benefit of having a very homogenous slice over the population. But overall the answer to that question is the full-year loss ratio is decent and we're happy with the result.

Bob R. Glasspiegel
Janney Montgomery Scott LLC

Q

So sort of stay tuned is the answer on frequency?

Marita Zuraitis
President, Chief Executive Officer & Director

A

Yeah. I mean I'd say it could be a blip. We're unpacking it but on a full-year basis we're not concerned and the trends are relatively benign.

Bob R. Glasspiegel
Janney Montgomery Scott LLC

Q

Got you. Thank you.

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Marita Zuraitis
President, Chief Executive Officer & Director
A

Yeah.

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President
A

Bob, just one quick follow-up to provide you a benchmark to help with your model, is the dividends that came out of the statutory companies during 2014 was roughly $46 million.

Bob R. Glasspiegel
Janney Montgomery Scott LLC
Q

Got you. Thank you.

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President
A

Yeah.

Operator: Our next question comes from Sean Dargan with Macquarie. Please proceed with your question.

Sean Dargan
Macquarie Capital (USA), Inc.
Q

Thank you and good morning, and thanks for kind of framing the earnings headwinds from lower interest rates. I think you just did your annual actuarial reserve assumption review. And so I should take it from your RBC level that there were no reserve additions or any capital impacts from your outlook of lower interest rates?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President
A

That would be a correct assumption.

Sean Dargan
Macquarie Capital (USA), Inc.
Q

Okay. And just thinking of the mortality expectations based in your life outlook, you did have a string of pretty favorable years there and I just want to make sure that that nothing's changed in your outlook of mortality, was there anything in pricing relative to tables that you think has maybe trended more negatively going forward?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President
A

Sean, this is Dwayne. I guess, the way I would think about it from an actuarial model as you look at a trend line, we will have years that will be favorable to that trend line, and as you would expect you ultimately have to catch back up to that trend line. So we had two years, three years on the row that were favorable. A couple of years ago, it's not so favorable, and we're kind of back on the trend line. That's what we're assuming.

As far as our internal numbers, a variance off of that trend line then moved more than plus or minus 5%. But given our size, a $3 million, $4 million difference would obviously present a little noise. As far as into pricing, mortality,

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table changes, are the business performing basically any different than we expected over a long period of time with life business? I would say, no.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Okay. Thanks. Just one last question. Can you give us any color around your exposure to the energy sector in your investment portfolio?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Sure, I'll be glad to. The energy sector makes up about 4.2% of our portfolio, so it's just sort of $300 million and that position has a – as you would guess, a pretty sizable unrealized gain associated with it. We had very minimal exposure to oilfield services, oil and gas drilling. We do have a very, very small position relative to our portfolio and high yield of roughly $10 million or so. So not big numbers.

Now, we'll say that if you follow us in the past we do tend to take pretty hard positions of certain events and this one is no different. We expressed our portfolio at oil prices significantly below the current levels and started doing that in the fourth quarter of last year and actually made several trades in the fourth quarter and actually continued some trades into the first quarter.

So I think you'll see by the time we get to the end of the first quarter that 4.2% will be down a bit more as well, but we were proactively modeling and reducing exposure of any names that we thought could come under stress if oil prices stayed low for a multi-month or a double-digit month in the 12-month and 18-month period versus assuming this was only a three-month to six-month expectation.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Great. Thank you.

Operator: [Operator Instructions] Our next question comes from Vincent DeAugustino with KBW. Please proceed with your question.

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

Good morning, everyone.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Hey, Vincent.

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Good morning.

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

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On the guidance, I'm just curious if you're giving yourself much credit from some of the recent or ongoing P&C initiatives, and here I'm particularly thinking about auto. Or if this is something that we should anticipate I guess in light of your conservative nature if some of that benefit won't work their way into your initial accident-year PICs until there is some proof in the development of your paid claims?

Marita Zuraitis
President, Chief Executive Officer & Director

A

Yeah. Vincent, it's early. I mean I think we're doing all the right things. We're encouraged by the momentum in auto and some of the offense that we put in place in some of these better places to do business. We're encouraged by the defense and some of the pieces of the underlying improvement we're seeing in the defense. We're convinced we can provide a nice broad price point for a decent sector of the educators on a state-by-state basis, and we're happy with the early signs that we're seeing, but they're early.

So the answer would be, we're really pleased with the momentum. We love the uptick in the fourth quarter. We like where it's coming from. We like the percentage of folks that are choosing electronic funds transfer. We like the productivity in the agency plant.

We said from the beginning that we were going to step back and focus on the products, focus on the support of the distribution, and focus on the technology and the customer, contact center data needed to support the educators and we're pulling on all three of those levers and it's beginning to work and you're starting to see it come through in the numbers, but this is early for us.

We're going to focus on the same things in 2015, and we believe that it's going to continue to give us momentum in sales and continue to eat at fractions of loss ratio points in that auto line. On a full-year basis, you saw a little bit of improvement come through. We expect that to continue as we look to 2015.

Quantifying it this early is difficult but we're pleased with both what we're seeing on the offense as well as the defense. It's right where we hoped it would be.

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

All very good. And then just a separate question entirely here. I believe you guys have a pretty tight definition of cats compared to some of your peers that maybe having dollar thresholds. And one of the topics that we've all been kind of facing in the industry is just that, non-cat and smaller cat weather has been a bigger issue. So in light of some of this smaller cat activity and then turning that with some of your micro concentration risk around whether you have a high-performing agent or a large school district. I'm just wondering if a shift to a dollar threshold around your cat definitions might be more helpful in isolating trends between the core and obviously you pay claims on weather, so it's still core. But at least showing like underlying trends versus some of that volatility around weather.

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

I'll take the first part, Vincent. This is Dwayne. As far as our cat definition is we've disclosed, we follow the PCS definition. So if there is a cat declared, then that's how we code it and that's how our reinsurance contracts respond as well. The thing about property business for the most part outside of large fire losses, et cetera, it is pretty much all about the weather whether it's cat or non-cat. I will say to go to a dollar amount until there is a few companies that do that, there is one a very, very large company, in particular in the Chicago area that has a dollar threshold.

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And if we were to do something on a same relative basis, the dollar amount for us would be extremely low. I would probably say in the $100,000 to $200,000 level. So we would probably start moving in the direction that all of our weather would basically be coded cat and we don't think that's necessarily appropriate.

Then also from the non-cat weather, that is what gets into the normal flow of business, the pricing and it's taken into account in our annual filings whereas the cat is obviously treated a bit different on a longer-term basis.

But I'll turn it over to Marita for the concentration and agent component.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Yeah. I mean, whether it's – no pun intended – whether it's cat or non-cat weather, it's still weather and for us it is about other wind, pricing and underwriting. So rather than spending a lot of time on the dissection of whether it's a cat, whether it's a kitty cat or whether it's just short-wind, we're doing all the right things from an underwriting and pricing perspective, whether it's age of roof, whether it's ACV, whether it's re-inspection programs. From a property standpoint, I think we have upped our DNA in underwriting and pricing other wind. We're going to continue more of that as we push through 2015, but bringing underwriting and pricing sophistication to the property line is going to help there as well.

We talked about it in the script; I'm sure you'll hear more about it as we go through 2015. But we're not spending a lot of time focusing on the categorization of whether it's a cat or a kitty cat. We're focused on making sure that we're doing the right things in our underwriting and pricing drill, to make sure that we're driving the best profitability that we can drive in the property segment and improving our segmentation in pricing even in property, so that we can attract a broad spectrum of educators including the more preferred educator clients.

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

Okay. Thank you for that. One, I guess, additional question, just around auto. You guys definitely had some comments here on the call this morning around that. On the loss cost side, obviously it's very early, and I guess from my standpoint it's kind of silly for me to ask anything on January, because it's even earlier yet. But cheap gas is something that we're watching, we're hearing some comments. In Mercury's call, yesterday they had mentioned that that might be a potential cause to some of the frequency that they're seeing. Is there anything either in fourth quarter or like I said in January, even though it's early, that makes you think that there is or is not any response in driving trends?

William J. Caldwell
Senior Vice President-Property & Casualty

A

Hey, it's Bill Caldwell. I just want to remind the folks that we have a homogeneous slice of the market so we're not impacted by gas prices like the broad market would be. That said, we do continue to monitor it. We use CARFAX in a number of states for underwriting and pricing, so that gives us some idea of how the educator is driving and we really haven't seen any uptick in annual mileage, which would be the impact of lower gas prices, but we do continue to monitor. And as it comes into our results we will price for that but we just haven't seen it yet.

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

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Okay. Bill, if I could just I guess rely on your experience here a little bit if – could there be a situation where your educator might not be driving more but there could be more vehicles on the road around them that would potentially increase frequency or it might impact you still, so I'm just wondering if that's -?

William J. Caldwell
Senior Vice President-Property & Casualty

A

Yeah. That is the world around them could change and increase frequency but again we'll watch for that in the data and respond to it. But I just haven't seen evidence of that yet.

Marita Zuraitis
President, Chief Executive Officer & Director

A

It's a benefit for us to be in two relatively short lines of business both with your auto question as well as your property question. The good news is that being in such short tail lines, you can price for it when you see the trends and build it into the pricing. But I think this is – it's an interesting topic for us again. I think Bill's right. We benefit from a group of people who don't necessarily change the amount of time they're on the road because of who they are and what they do. But I do agree with you the world changes when there is more vehicles on the road and we've seen some of the improvements in trends coming out of an improved atmosphere with auto. This might be one of those that takes it the other way. But to Bill's point, too early to tell for us but we clearly think about it, watch it, and look for in our trends as well.

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

Okay. Thank you very much. Best of luck.

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Vincent?

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

Yes, sir.

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

This is Dwayne. Just a little part of your question as far as the frequency, obviously is kind of final preparation of our guidance we've been able to see what has been happening in January and it wouldn't be anything outside of our expectations. And as far as the fourth quarter is concerned, to your question, this industry is a strange industry. And I would say, our October-November frequency was up, maybe not such as significant fall off to December, but the first two months of the quarter were a bit different than December.

Vincent M. DeAugustino
Keefe, Bruyette & Woods, Inc.

Q

Okay. Appreciate that. Thank you.

Operator: At this time, I would like to turn the call back over to Mr. Ryan Greenier for final comments.

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Ryan E. Greenier

Vice President-Investor Relations

Latania, thanks, and thank you to all for joining us this morning on Horace Mann's fourth quarter earnings call. If there is any further questions, please don't hesitate to reach out to me or Kristi. Thanks.

Operator: Thank you. This does conclude today's teleconference. You may disconnect your lines at this time and have a great day.

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