29-Jul-2015

Horace Mann Educators Corp. (HMN)

Q2 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Horace Mann Second Quarter 2015 Earnings Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

I'd now like to turn the conference over to Ryan Greenier, Vice President of Investor Relations. Thank you, Please go ahead.

Ryan E. Greenier
Vice President-Investor Relations

Thank you, Brenda 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. 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, Executive Vice President of Property and Casualty, and Matt Sharpe, Executive Vice President of Annuity and Life are also available for the question-and-answer session that follows our prepared comments.

Before turning it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statement 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 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 measure are available in the supplemental section 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 second quarter operating income of $0.36 per share. This was a solid quarter for us, but as you know, historically, second quarter has the highest levels of weather related impacts and this year's results reflected that.

When we unpacked the results, we liked the underlying trends we're seeing. We're clearly on the right track and making solid progress finding, winning and keeping more educator households.

The normal second quarter weather volatility impacted quarterly P&C results. In annuity, results were strong. Assets under management grew 7%. A disciplined spread management continues to help offset the impact of our interest rate environment. In the life segment, mortality losses were elevated versus the more normal experience in the prior year. On a year-to-date basis, we're tracking consistent with our overall profitability goals.

In P&C, the underlying current accident year combined ratio improved by 1.6 points. Property was better than 5.6 points, while auto was basically flat. And we are seeing momentum in auto new business. In annuity, top-line growth continues to be strong, and profitability is solid. In life, we continue to successfully grow.

Year-to-date operating earnings at $1.08 per share are consistent with prior year, and we continue to grow book value per share excluding net unrealized gains at a favorable pace, ending the quarter at $26.30, a 7% increase compared to a year-ago. Looking more closely at our P&C business, we incurred 14.5 points of catastrophe losses in the second quarter primarily due to convective storm activity.

We are seeing year-to-date progress in our P&C book. The defensive actions we've implemented along with the rate plan that continues to outpace loss costs are supporting continued margin expansion. Underlying property results have improved over 5 points.

Underlying auto results are similar to last year, but during the second quarter, we did experience an uptick in physical damage severities. Despite the uptick in PD severities, we are seeing relatively stable frequency across other coverages including BI. All that said, we are seeing signs of sustainable true improvement in the auto line. Our growth plans are targeted state specific strategies. As we have told you in the past, auto profitability is a game of inches, and we are focused on finding fractions of points of improvement, and I'm confident that we're moving in the right direction.

The P&C top-line grew 3% in the quarter, retention was solid, and we like the sales momentum we are seeing in auto. In addition, we're encouraged by sales growth in property, and in both auto and property, we are growing where we want to grow. Our offense consists of targeted states specific strategies; specific educator cohorts of business where we have strong agent presence, solid profitability and a favorable regulatory climate.

That strategy has resulted in continued sales momentum in auto, up 4% on a year-to-date basis, a positive movement in PIF. And we are beginning to see a lift in property sales, up 7% on a year-to-date basis, driven by those emerging offensive actions as well as cross-sell initiatives to existing customers. Shifting to annuity and life

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business, we are seeing solid sales momentum in both lines. Annuity sales were up 14% in the quarter reflecting sales increases in both our exclusive agent and independent agency channels.

Life sales were on track. We had almost 50 more agents to sell at least one life policy this year compared to last year, and we delivered 8% more policies. As we continue to roll out our training and support, we expect more of our agency force to feel more confident helping customers design a holistic goal-based financial plan that includes appropriate insurance risk protection.

Part of our overall strategy is to ensure our educators have appropriate insurance protection in place to help them achieve their financial goals. The continued momentum in life insurance sales gives me confidence that we're on the right track to help educators identify and cover their life insurance needs. Potential for increased retention on the P&C business is another benefit, because we know based on historical statistics that P&C business that is cross-sold with life or annuity tends to have much higher retention.

From a product perspective, we are on track for a fourth quarter launch of our new Indexed Universal Life product. The IUL product provides simple, tax-efficient savings with the death benefit that is designed to offer premium and base amount flexibility throughout the life stages of educators. With one product, educators can adjust premium to meet budget needs and evolve base amounts throughout their life. Like our Indexed Annuity product, we believe this life insurance product will further improve our reach into educator households.

We continue to improve our distribution capabilities in support of sales growth and are providing agents with additional tools to accelerate that growth. For example, we continue to leverage big data to learn more about our educator niche and equip agents with tailored information about existing and potential customers within the schools they serve. This enables them to identify specific product needs for each customer and household as part of a holistic solution-based orientation. Taking this approach provides the opportunity to develop a deeper more meaningful customer relationship with higher cross line penetration and retention.

Although we manage each line of business for profitable growth, our long-term strategy is an educator household acquisition strategy, and our efforts are focused on finding more, winning more and keeping more educator households. In support of that approach, we packaged our back-to-school marketing efforts to continue to advance targeted advertising in states where we have historically – have had strong P&C combined ratios, a good agent network and attractive financial services opportunities.

These efforts are focused on both new and existing customers. Agent feedback is encouraging, and with the complementary support of the inside sales team, we are seeing early signs of success with both new and existing customers. While we are focusing on these distribution improvements, we continue to be pleased with the progress we are making to upgrade our infrastructure.

On the life and annuity front, we are on track to have the necessary components in place for a successful fourth quarter launch of our new Indexed Universal Life product. With the product launch occurring late in the fourth quarter, we expect the resulting increase in life sales to be in 2016.

Within P&C, we made significant improvements to our property sales process for agents this quarter. Our IT team worked closely with both the P&C underwriting team and agents to redesign our property quoting tool for agents. The goal was to create a more user-friendly experience that would not only save agents time but also provide a better sense of underwriting tier and the related price at the beginning of the quoting process.

Agents have responded with an uptick in property applications. As we roll out our property offense over the next 12 months to 18 months, we expect the combination of more refined product and pricing sophistication with the

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improved technology interface to result in further increase in property sales in geographies where we want more property exposure.

From a people perspective, we continue to be successful in attracting top industry talent to Horace Mann. Last week, we announced Kelly Stacy joined Horace Mann as Senior Vice President of Field Operations and Distribution. He will lead our exclusive agency channel and related field operations. I worked closely with Kelly in the past and I'm confident, his leadership will accelerate the pace of improvement in our exclusive agency channel.

So far 2015 is shaping up to be another profitable year for Horace Mann. We're on track to deliver margin improvement in P&C. Annuity spreads and sales momentum are strong. And we continue to see likes in our life business. We are ensuring we have the products tailored to meet educators' specific needs providing client-centric distribution options and making good progress on modernizing our infrastructure. I continue to be confident that we're on the right path to be the company of choice of our nation's educators to protect against short-term risks and secure their long-term financial goals.

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. Second quarter operating income of $0.36 per diluted share reflected the impact of property and casualty catastrophe losses in elevated life mortality. Somewhat offset by strong results in the annuity segment. P&C after-tax income of $3.3 million was $1.6 million lower than the prior year quarter largely due to an increase in the auto loss ratio compared to the very favorable results in the second quarter of the prior year.

Included in the results was $21.3 million or 14.5 points of catastrophe losses. Both cap and non-cap property losses were modestly lower than the prior year, but still at elevated levels. As we've said before, given the size of our book, there can be some quarterly volatility in our results. Therefore, we look at the year-to-date trends to determine if we're on track to continue to produce margin improvement.

Looking at Auto results to the first two quarters, the comparison of the prior year is more in line with what we would expect given the higher severity trend in physical damage than Marita referenced a few minutes ago. In the property line, we're seeing the benefit of rate actions, lower reinsurance cost and the impact of our underwriting actions. Through the first half of the year, the underlying combined ratio improved by more than 5 points.

Looking at our P&C book in total, the reported combined ratio of 97% improved by more than 1 point compared to the prior year-to-date. Catastrophes of 10.7 points were modestly higher than our expectations due to storms in the Southwest and Midwest. In addition, we had nearly 1 point of development related to the first quarter catastrophes. As you may recall, the winter storms were particularly severe, and we weren't surprised to see unusual claims emergence related to these storms. Although, the catastrophe losses were elevated in the first half of the year, we're still anticipating approximately 6.5 points of catastrophe losses for the full year.

This assumes catastrophes in the second half of the year are generally in line with last year. That said, the severe hurricane or adverse weather conditions in the second half of the year will obviously cause a reevaluation of the ultimate cat load. Through the first six months, we've reported 2.4 points of favorable prior year reserve development in line with the previous year. We're seeing favorable development across all lines, including auto, property and other liability. In addition, we continue to see favorable non-cat severity trends within property.

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Our initial loss picks for more recent accident years, in particularly 2014, have been developing favorably. And as a result, the trend is reflected in our initial loss picks for the current accident year. The expense ratio for the quarter was 26.8% similar to the prior year. We continue to expect the full year expense ratio to be similar to last year's result of 27.4%, including planned infrastructure expenses during the second half of the year. P&C written premiums increased 3% to $152.5 million for the quarter, largely on rate actions. Written premium for auto was up 4% and property was flat, reflecting the impacts of the Florida non-renewal program. At this point, our Florida property exposure primarily consists of a few hundred tenant policies.

Property retention remained relatively stable at approximately 88%, but excluding Florida non-renewals the current year retention is 2 points higher. We are pleased with our retention levels as we continue to improve our underwriting standards and take appropriate rate actions. We expect property written premium to begin to grow, as we put more significant, defensive actions behind us. We still have some targeted under writing actions to take, but are encouraged by some of the initial signs of property sales momentum this quarter. Importantly the property sales are coming from targeted states with favorable loss ratio history. And auto retention improved modestly to 85% supporting our efforts to grow auto policies in force.

In the Annuity segment, operating income excluding DAC unlocking was $11.9 million, $700,000 higher than the prior year quarter. Assets under management grew 7% to just under $6 billion, driven by per sistency remaining above 94%, and continued strong sales. The annualized net interest spread of 190 basis points declined 4 basis points from last quarter, consistent with our expected trend line for 2015. We continue to be disciplined in crediting rate management and are finding opportunities to put money to work at attractive risk adjusted returns despite the challenging market environment.

That said we continue to expect the annualized net interest spread to decline by the mid-180s by year-end. In the Life segment, operating earnings excluding DAC unlocking declined $1.3 million to $3.6 million on higher mortality cost. Given the moderate size of our in force book, a number of larger claims in one quarter can have a meaningful impact on earnings. However, we did not see anything unusual in this quarter's mortality numbers, especially considering policy age that would challenge our assumptions that the mortality experience should revert back to an actuarial trend over time. Consolidated net investment income increased to $84 million for the quarter due to higher asset balances in the annuity segment and continued strong investment portfolio performance.

The recent uptick in rates and wider spreads resulted in purchase yields that exceeded our targeted new money reinvestment rate of 3.75%. Assuming the continued low interest rate environment, we expect yields to remain pressured as we move through 2015. During the quarter we utilized our credit facility to repay $75 million of senior notes that matured on June 15. We have an additional $125 million of senior notes maturing in April 2016, and as you would expect we're diligently monitoring the capital markets for an appropriate window to refinance our total debt structure.

Our [ph] plain (17:01) use of the credit facility was all along an integral part of our refinancing strategy based on our view that net interest rates would remain low. Overall, on a reported basis, book value per share was $31.73, and we saw the impact of higher interest rates and wider spread from a net unrealized gain position which was $397 million at the end of the quarter. We continue to build book value excluding net unrealized gains on investments ending the quarter at $26.30, a 7% increase compared to last June.

Looking at the results over a longer period of time, the five-year compounded annual growth of Horace Mann's adjusted book value per share plus dividends was 11% through the second quarter. On a year-to-date basis, overall operating earnings were solid at $1.08 per diluted share. While second quarter results for P&C were impacted by

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weather, overall the quarterly results were solid. We continue to see margin improvement in P&C and annuity earnings are strong. Importantly, we're seeing good sales momentum in all three of our business lines.

As a result, we are confident in our ability to continue to generate strong growth in both earnings and book value per share. Producing solid results with continued momentum has been our consistent message. We believe new products on the horizon, focus on improving agent productivity and continued execution on our technology improvements will accelerate our efforts to become the company of choice for educators.

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

Ryan E. Greenier
Vice President-Investor Relations

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

QUESTION AND ANSWER SECTION

Operator: [Operator instructions] Our first question comes from the line of Bob Glasspiegel with Janney. Please go ahead with your questions.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC

Q

Good morning, Horace Mann. Quick question on auto, how much do you think non-cat weather penalized the underwriting in auto?

William J. Caldwell
Senior Vice President-Property & Casualty

A

Hey Bob, this is Bill Caldwell.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC

Q

Hey Bill.

William J. Caldwell
Senior Vice President-Property & Casualty

A

Hi, how are you?

Robert Ray Glasspiegel
Janney Montgomery Scott LLC

Q

Doing great.

William J. Caldwell
Senior Vice President-Property & Casualty

A

This is a reminder, we talked last quarter, we didn't over celebrate last quarter, and we're not really overly concerned about this quarter, the comparison is still unusually favorable second quarter in 2014, and on

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underlying basis, on year-to-date basis, we're roughly close to last year's performance. That said we do recognize an uptick in physical damage severity primarily associated with the increased weather activity combined with improvements in vehicle technology. When you think about the value priced vehicles that our educators typically drive, there is more technology in those vehicles, but not only increased parts but also labor and refinishing c osts. I just want to note that frequency has stayed relatively stable, adverse to what some of our competitors are seeing. So we do – although we are growing, we're keeping frequency stable which is a sign of good underwriting quality. We do like the new business mix coming in, educator cross sold, good credit and underwriting peers. And lastly we are confident that our rate actions continue to underwriting defensive actions, and targeted improvements and competitive position will continue to improve our loss ratio fractions of a point.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Yeah. And Bob, I think that Bill is absolutely right, looking back to last year, you'll remember that we had a better second quarter than the first quarter. This year it's the opposite, we got a better first quarter over the second quarter. But half year over half year we're tracking well. We've talked all along that auto loss ratios, a game of inches we're seeing fractions of loss ratio improvement on a year-to-date basis, we're on track. I remind you too that our educator book produces better than average industry loss ratio on an absolute basis anyway. We've got a good book of business, we've got a mid-90%s combined target and it's still our target and we think we're on track.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC

Q

You don't have a quantification of what non-cat weather did to auto; you said it was better year-over-year, but worse than normal. You don't have a quantification?

Marita Zuraitis
President, Chief Executive Officer & Director

A

You know as well as we know that that's really hard to divide out.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC

Q

Right.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Obviously, weather has an impact both cat and non-cat. Bill mentioned some of the other things that may contribute to a PD severity jump. Weather obviously had an impact. It's very hard to determine exactly what that impact is. As companies, you look at the amount of days in a given quarter, where you have weather, where you had a cat, where you've had a non-cat, where you've had heavy rain and heavy flooding. And all I can tell you is in the second quarter that's a lot of days.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC

Q

Correct.

Marita Zuraitis
President, Chief Executive Officer & Director

A

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And it's hard to impact exactly what that means, but I can tell you it was a pretty wet quarter.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC **Q**

Okay. I mean, it was just a response to Dwayne's comment that non-cat weather was elevated, but it's just a subjective feel, not something you've quantified. That's fair.

Marita Zuraitis
President, Chief Executive Officer & Director **A**

Okay.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC **Q**

You're growing auto pretty rapidly, but are you happy about the auto? I think you said 4% increase in new applications on auto. Do we need to like tap the breaks a little in response to this or would that be an overreaction?

Marita Zuraitis
President, Chief Executive Officer & Director **A**

That would definitely be an overreaction. I like the fact that we were very thoughtful. How we thought about growth? We broke it down by state. We broke it down by the rate in that state. We broke it down by the underwriting in that state, by the regulatory climate. And we took our time and we did it the right way. Again, we have a very homogeneous set of educator clients, and anybody who rates on occupation knows that this educator segment is a very profitable segment. And quite frankly, we've proven this out over a long period of time. We have good underlying auto results. Due to the size of the book, it might be bouncy quarter-over-quarter, but overall a very profitable book of business that we want to grow, and we feel very good about it.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC **Q**

Marita, I like your conviction with the direction of auto, and given my track record with you I won't worry.

Marita Zuraitis
President, Chief Executive Officer & Director **A**

Great.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC **Q**

Thank you.

Marita Zuraitis
President, Chief Executive Officer & Director **A**

Thanks a lot.

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

Thanks a lot.

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Operator: Your next question comes from the line of Joab Dempsey with KBW. Please go ahead with your questions.

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Hi, good morning everyone and thanks for taking my questions. First of all in your prepared remarks, you mentioned an uptick in physical severity. I know in the past, you've mentioned targeting mid-single digit auto rate increases. Do you think there's room to the upside for getting further rate going forward?

A

Bill?

William J. Caldwell
Senior Vice President-Property & Casualty

A

Yes, Joe, it's Bill Caldwell again. We continually look at our rate plan. And as we see changes in trends, we react very quickly. I wouldn't say there's significant more rate that needs to be taken, but we continually try to stay ahead of loss cost trends, so as loss cost trends increase, so does our rate activity and our rate plans.

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Okay.

William J. Caldwell
Senior Vice President-Property & Casualty

A

But I still characterize it as low-mid single digits for rate.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Yes, and I would also say considering the bounciness in the industry, I would submit probably not alone and we'll keep an eye on that, and if we can get more, we'll get more.

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Certainly. I think we track vehicle miles travelled here and we've certainly seen an uptick with the cheaper gas and then slightly improving economy there.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Exactly, right.

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Secondly, just looking at this quarter just from a capital management perspective it didn't look like there were any share repurchases and only a modest amount I believe in the past quarter. Clearly the stock has done well in the

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past year. So I am just curious kind of being where you are today has the appetite sort of changed overall or should we just think about it as Horace Mann being more opportunistic going forward?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Hi, this is Dwayne Hallman. The last part of your statement about being opportunistic that is the way we've approached, this way we publicly have talked about it. Over the last couple of years, if you track where we did buy shares back, in hindsight you will find that we did very well against the VWAP and did try to take advantage of those opportunities. You're correct the stock has performed extremely well over the last year at levels where the buyback opportunity was probably a little less for us, especially lined up against where we're trying to put our capital to work in growing the company.

As we grow the Life operations, that becomes a bit more of a hog as far as capital is concerned, especially at the statutory level, but we're well very positioned on the P&C side to grow as well. But we watch it every day. If there is opportunities, you will see us buying shares back, but the one thing we don't do is just blindly go in market and pick up shares every day just for the sake of buying shares.

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Okay, yeah, that's what I thought. I just I wanted to confirm. And mortality cost, let me just preface it by saying, I know this is kind of an issue that the industry in general is dealing with, but is this more of a short-term blip and we're going to see a reversion to the mean? I mean there is nothing fundamental here that's changing any long-term assumptions on your part right?

Matthew P. Sharpe
Executive Vice President-Annuity & Life Division

A

Joe, it's Matt Sharpe. How are you today?

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Good. How are you?

Matthew P. Sharpe
Executive Vice President-Annuity & Life Division

A

Fine, great, thanks. Yeah, on the mortality as Dwayne pointed out in his comments, it appears to be normal variation driven by the small mature block of our in-force business and a small number of claims can materially impact those overall results. If you look back in our history, recent history, we've had lumpiness in the results in the 2010 to 2011 timeframe. We had four quarters above the trend line followed by four quarters out of five quarters below the trend line and one on the trend line. So it's within the range of normal variation.

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Okay. Great. And just one last question, recently we've seen another dip in oil and oil-related names recently. Can you provide us any color around your exposure to the energy sector in the investment portfolio?

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Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Sure. This is Dwayne. As far as our exposure to the energy names and I'll include energy utilities, natural gas kind of the whole component we still have in that portfolio about $50 million unrealized gain. We have gone through our portfolio and I believe I mentioned it on our last quarterly call, we went through and stressed oil prices at significantly depressed levels much, much lower than where we are today to determine if we had any unusual exposure, could anticipate any expected defaults, potential defaults based on a sustained oil price level. And I would say materially below $50. We reacted and made a few trades in our portfolio based on that information, but where we sit today and our continued view that oil prices will remain low, we are confident with the holdings that we do have.

Joab Dempsey
Keefe, Bruyette & Woods, Inc.

Q

Okay. All right. Great. That's all I had. Thanks very much for taking my questions today.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Thank you.

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Sure.

Operator: Our next question comes from the line of Sean Dargan with Macquarie. Please go ahead with your questions.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Thanks and good morning. I have a question of how to think of your book value and your capital. GAAP book value as reported has barely moved over the last year and I think you called out that's because the unrealized gain position has contracted as interest rates have risen a little and spreads have widened out a bit. Is it safe to assume that that shrinking of the unrealized gain position comes from assets backing Life liabilities primarily?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

Hi, this is Dwayne. Yeah, if you look at our portfolio obviously it's predominantly a life and annuity portfolio. And that's as you would guess where the unrealized gains sits. So on the Life company side, very, very different from a P&C only company as we are not managing the life and annuity, liabilities or ALM, et cetera, based o n the unrealized gain or loss position of the book. Our book is very solid, it's very persistent, it's not hot money. So even in a lot of our stress scenarios we don't assume that there is going to be a run on the bank or if we look back to the financial stress of 2008 and 2009 persistency for us actually went up a bit and didn't see the stress. So we are more than confident we can manage through any changes on unrealized gains and losses as it relates to the life and annuity portfolio.

On the P&C side, we don't run a big equity portfolio so unrealized gain; there really tends to be obviously in the bond portfolio, primarily in the muni portfolio. And as you could probably track from our trading activity, we are

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not big traders in the muni portfolio either. But your assumption was absolutely correct, it's primarily all in the life company portfolio.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

All right. And then if I can follow up. When the rating agencies look at your statutory capital, would I be correct to assume that your P&C stat capital is unaffected by changes in unrealized gains on the Life side? I mean, do they look at you holistically? I mean, I am just trying to figure out what kind of impact this has in the way that they think about your capital?

Dwayne D. Hallman
Chief Financial Officer & Executive Vice President

A

From a capital perspective if you look at any of the rating agency formulas, their stress test, if you look at the A.M. Best in their BCAR our ratings are not supported at all based on unrealized gains or losses. And especially on the P&C side, and probably what you might be alluding to is on the P&C side, some companies do leverage up their writings based on unrealized gains that might be in their portfolio. That's not our view, nor have we ever taken that view, because as rates move, or as equity markets move obviously that leverage could compound substantially, if that was one's approach. But from a capital perspective in our ratings with all the rating agencies the capital position has never been an area of question or concern. At our rating levels, as I would say, even rating levels above where we are it's a solid capital level.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Got it. And if I can just turn to the annuity segment, last quarter I think I asked about the DOL fiduciary duty requirement. And I am wondering if your thoughts have changed three months later and I am also wondering about what kind of perhaps added compliance spend you would need to make sure that you ar e compliant with these regulations. I am wondering what kind of compliance infrastructure you have now and if you think that would be adequate to allow you to comply with whatever finalized rules are coming down the pike.

Matthew P. Sharpe
Executive Vice President-Annuity & Life Division

A

Sean, it's Matt. As you think about the DOL, you kind of have to step back and think about our overall strategy for solving the needs of K-12 public educators. And it's primarily along three lines, savings for retirement, primarily through 403(b) which is the non-ERISA segment to the market, protecting loved ones with life insurance and then managing the risk through auto, home and liability in Bill's area. So we have a broad multiline relationship strategy, unlike many mono-line vendors you might find out there.

So 403(b)s are not part of the regulatory proposal in our view because it's a non-ERISA plan that's our interpretation of it. And given our exclusive distribution force, the close relationships we have with our homogeneous segment of educator customers, I think we're well-positioned to take advantage of any regulatory change.

And quite frankly, we are used to working in a highly regulatory environment and believe we have the infrastructure to modify our business model, if necessary, on a go forward basis. But there's really – it's too soon to tell as almost any vendor will tell you the same answer that I am giving you. As we see more details emerge and see whether the proposal is likely to be implemented, I'll be able to give you a much tighter answer.

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Marita Zuraitis
President, Chief Executive Officer & Director

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Yeah, and I would just add. Matt's absolutely right. From my perspective, I am very impressed, how in front of this we are the per capita talent we've got here Matt's leadership. It's been a very thoughtful approach and somewhere in your question you are including the size of the company and I think that's a right thing to think about, but I'll tell you per capita for our size, I stack this up against the big guys as far as a thoughtful approach of thinking through this as well as the insulation to some extent our book has not only because of our approach as Matt said, but because of the type of customers that we serve.

Sean Dargan
Macquarie Capital (USA), Inc.

Q

Great, thanks.

Marita Zuraitis
President, Chief Executive Officer & Director

A

Yes.

Operator: Thank you. This concludes today's question-and-answer session. I would like to turn the floor back to Mr. Ryan Greenier for closing remarks.

Ryan E. Greenier
Vice President-Investor Relations

Thank you, Brenda. And thanks to all for joining us this morning on Horace Mann's second quarter earnings call. As always Kristi Niles and I are available for additional questions, so don't hesitate to reach out to us. Thanks.

Operator: This concludes today's teleconference. You may disconnect your lines at this time and thank you for your participation.

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