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Horace Mann Educators Corp. (HMN)

Q3 2017 Earnings Call

CORPORATE PARTICIPANTS

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

OTHER PARTICIPANTS

Matthew J. Carletti
Analyst, JMP Securities LLC

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

DeForest Richard Hinman
Analyst, Walthausen & Co. LLC

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Horace Mann Third Quarter Earnings Conference Call. [Operator Instructions] It is now my pleasure to introduce your host, Mr. Ryan Greenier, Vice President of Investor Relations. Thank you, you may begin.

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you, Donna, and good morning everyone. Welcome to Horace Mann's discussion of our third quarter 2017 results. Yesterday, we issued our earnings release and investor financial supplement and copies are available on the Investors page of our website. Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer. Bill Caldwell, Executive Vice President of Property and Casualty; and Matt Sharpe, Executive Vice President of Life and Retirement 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 statements include risks and uncertainties and are not guarantees of future performance. These forward-looking statements are based on management's current expectations and we assume no obligation to update them. Actual results may differ materially due to a variety of factors, which are described in our press release and SEC filings. In our prepared remarks we may use some non GAAP measures. Reconciliations of these measures to the most comparable GAAP measures are available in the supplemental section of our press release.

And now, I'll turn the call over to Marita Zuraitis.

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

Thanks, Ryan and good morning everyone and welcome to our call. Last evening, we reported third quarter operating income of $0.69 per share. This strong result reflects the diversified earnings power of our multi-line business model. P&C results were very strong and show encouraging signs of underlying auto profitability improvement and our Life and Retirement segments, both had solid quarters.

The P&C industry continues to experience an unprecedented level of weather volatility. 2017 is shaping up to be one of the most costly catastrophe years in over a decade. Against such a challenging backdrop, it's important to focus on the fundamentals of what makes a successful insurance company; appropriate risk diversification, disciplined underwriting, and nimble reactions to macro trends. I believe our strong results in this challenging period reflects the successful execution of those principles.

As we've said before, our P&C book does tend to generate volatile second quarter results due to convective-storm activity in the Midwest. To balance those potential losses. We made a conscious decision to reduce coastal hurricane exposure and you're seeing the results of that strategy play out in our year-to-date results.

Our weather-related losses in the first half of the year were challenging, but in the third quarter, our loss experienced was significantly below market share estimates. This is largely due to prudent underwriting actions to avoid coastal areas that are more likely to experience hurricane damage. Third quarter catastrophe losses were similar to the prior year at $8.6 million or 3.5 (sic)[5.3](3:28) points.

These include $5 million related to Hurricane Harvey and $2.5 million related Irma. Irma losses were particularly low, as we chose to exit the Florida homeowner market several years ago. Today, our agents place property coverage for our customers in Florida with third-party partners.

Non-cat weather in the third quarter was in line with historical patterns, which resulted in a strong underlying property loss ratio of 46.3%. This is in contrast to the first half of the year where non-cat weather frequency was higher than average. We expect the property segment to produce a reported combined ratio slightly below 100% for the full year of 2017, a very strong result considering all the weather-related impacts for the industry, and further confirmation of our underlying quality of our property book of business.

We continue to see strong signs of margin improvement in auto. Last quarter, we were confident that our continued rate actions and profitability initiatives were taking hold, but because of the elevated non-cat weather-related losses we experienced, it was hard to see that improvement. In the third quarter, non-cat weather was more typical and as a result you can clearly see margin improvement. The underlying auto loss ratio was 74.5%, a 3.2 point improvement over the prior year. And on a nine month basis, we're tracking at 77%, a level close to the prior year.

The fourth quarter has historically produced our highest auto loss ratio, a trend we would expect to continue this year. But we are encouraged by the underlying trends we saw in the third quarter, which increases our confidence that we will achieve sustained improvement in underlying auto profitability in 2018.

As we stated recently at the KBW conference, we are laser-focused on getting our ROE back to double-digit level. To get there, we defined 3 key components, the first is 5 points of P&C loss ratio improvement compared to the full-year 2016 results, which included a reported auto loss ratio of 80.2%. This 5 point improvement will increase

ROE by nearly 2 points. While we won't get the entire 5 points of improvement in 2018, we expect 2 points to 2.5 points of improvement over the course of next year.

The second lever for ROE improvement is reducing our expense base. For every 5% reduction, we generate an additional 0.6 of a point of ROE. The infrastructure investments that we have made and continue to make are producing meaningful efficiency improvements. As a result, we are taking action to right-size certain areas of our organization and would expect the full-year impacts of these expense reductions to emerge over the course of 2018. That said, we will continue to invest in our business to ensure we have the right products for our educator customers, nimble customer-centric infrastructure to support their needs, and multi-channel distribution options that allow them to begin their relationship with us on their terms.

The third lever of ROE improvement is to aggressively grow our fee-based retirement assets under management. We recently introduced a Department of Labor compliant product suite, Retirement Advantage. It contains a traditional fixed crediting rate option, as well as an array of lower-cost mutual fund selections. The product design for both the retail and institutional markets eliminates surrender charges, as a robust fund line-up from third party vendors and a levelized compensation structure. The design is consistent with emerging industry trends and we are seeing significant consumer interest in our new product suite.

Growing fee-based retirement assets under management is a strategic priority, as they provide an additional source of earnings diversification; in addition, they produced a higher ROE as they are significantly less capital-intensive compared to our traditional spread-based annuity products.

Retirement sales remain in line with prior year. We are seeing strong growth in our fee-based mutual fund products. Sales were up nearly 30% and assets under management increased 17%. We are experiencing a decline in single premium fixed annuity sales consistent with the broader industry. Deposits into our reoccurring premium annuity products continue to be strong and are consistent with prior periods.

We have included a supplemental schedule in our investor presentation for the third quarter of 2017 that gives you additional sales and assets under management detail around the split between fee-based versus spread-based retirement products. We continue to make progress on overarching PDI strategy, ensuring we have the right products for our educator market, infrastructure that supports a modern, highly quality customer experience, and distribution options that allow customers to begin a relationship with us through their preferred channel.

On an infrastructure front, we successfully launched the first phase of our P&C systems modernization with Guidewire. This phase includes a new claims platform which will decrease claim's cycle time and improve customer experience. In addition, we launched a new data repository for P&C systems.

As we move forward with our multi-year modernization process, we will shift more of our segmented data to a singular data warehouse. This will allow for continued customer experience enhancements and further efficiencies. Our data will be highly-integrated across systems and provide our employees and our agents with a more holistic picture of a customer's household, which allows agents and employees to serve our customers better.

We also expect this robust data repository to provide additional underwriting and product efficiencies as well as further enhancement to our pricing segmentation abilities. This was the first phase of a multi-year project implementation schedule that will completely modernize every facet of our P&C systems. Like many of our other infrastructure investments, we expect to see expense efficiencies emerge over time, as we widen the pipes to support greater volumes of new business while also improving customer experience.

We were very pleased with the initial implementation phase, which was on-time and on-budget. We attribute our successful launch to the amount of time we spent in due diligence and in preparation for this implementation. We have a high degree of confidence in the continued smooth implementation.

Overall, I am very pleased with this quarter's results. They were strong and they illustrate the strong fundamentals of our multi-line business model and early signs of progress, and are focused on improved ROE over time.

Thanks, and now I'll turn the call over to Bret.

Bret A. Conklin

Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

Thanks, Marita, and good morning everyone. Third quarter operating earnings up $0.69 per diluted share was $0.11 higher than the prior-year quarter. Nearly all of the increase was from higher P&C earnings, driven by improvements in the underlying loss ratios in both auto and property as well as lowered expense ratios.

Third quarter P&C operating income doubled to $13.4 million compared to $6.7 million in the prior year. The reported combined ratio was 95.8%, an improvement of 5.7 points from prior year. The combined ratio reflected catastrophe losses and prior-year development comparable to last year's third quarter.

On an underlying basis, we experienced a 4.2 points improvement in the loss ratio, reflecting higher earned premiums as a result of our rate actions, the impact of underwriting profitability improvement initiatives, and the continued stabilization in auto loss trends. P&C results also benefited from a decrease in the expense ratio, which was 25.4% for the quarter. While we continue to expect the expense ratio to be approximately 27 points on a full-year basis, we did experience a benefit this quarter related to the timing of certain expense accruals.

In addition to timing, we are seeing a trend of lower employee benefit costs related to health plan usage. Last year, we implemented a state-of-the-art health and wellness program in partnership with HSHS Medical Group here in Springfield, Illinois. This program includes an on-site clinic and customized wellness programs for our employees. As a result, employee benefit costs were nearly $1 million lower and a portion of this benefit is reflected in the improved P&C expense ratio. As Marita mentioned, we expect additional expense saving opportunities to emerge, as our infrastructure investments begin to reap efficiency benefits over time. We continue to strategically invest in our businesses and as a result would expect the P&C expense ratio to remain around 27% for the foreseeable future.

Auto loss cost trends are stabilizing. This is the third quarter in a row where frequencies appear to have stabilized. We continue to see severity tracking in the low- to mid-digit range and are confident our rate plan will lead to margin expansion.

For 2017, we are targeting auto rate increases of around 10%, and as we look to 2018, we expect auto rate increases to remain in the low-double digits. That said, should there be any changes in loss cost trends, we will take actions additionally where needed. The 2000 rate plan for property remains on track at mid-single digits. Looking ahead to 2018, our property rate plan is also in the mid-single digits with heavier rate actions in more weather-exposed geographies.

Retention continues to remain strong at 83% in auto and 88% in property. Our agents are meeting with customers who are receiving sizable rate changes and we have equipped our agents with educational materials to assist with these conversations. Our trusted advisor agency model encourages a lifetime of financial success and is a less transactional agent customer relationship compared to many P&C-centric peers.

We believe our efforts to strengthen this model along with the rate actions of many competitors have contributed to the relatively stable retention, despite rate increases that have typically encouraged shopping behavior in the past.

Auto sales increased 5% and property sales were up 6%. While we are encouraged by the sales growth our policy count is comparable to the prior year. We continue to execute a disciplined underwriting strategy that aims to grow in geographies that are profitable from a P&C perspective, while thoughtfully considering our approach in other geographies that have become more challenging as a result of loss cost trends.

To ensure we retain our customers in these areas, we continue to increase third-party options as well as expand the Horace Mann General Agency. The General Agency is a complimentary tool that allows us to provide end-to-end risk protection that is tailored to an educator's unique circumstances. When an educator has a coverage need that is outside our underwriting appetite or is fairly unique and would not allow us to get to appropriate scale to offer such a product, we turn to our appointed relationships with other insurance carriers.

This unique model allows us to provide significantly more solutions to educators and to increase share of wallet in the educator household. The number of customers served by the General Agency is growing and we expect over time this will be a meaningful contributor to growing our fee-based income.

Life segment operating earnings were $4.8 million, an increase of 4% from the prior-year period. Both operating expenses and net investment income were slightly more favorable than prior year. For the first nine months of the year, Life sales were up over 8% and we would expect on a full-year basis to have double-digit sales increases compared to the prior year.

Retirement segment operating income excluding DAC unlocking was $13.2 million, a $2.4 million decrease from prior year. Much of the decrease was related to a higher level of operating expenses compared to the prior year, but consistent with prior quarters of 2017. The annualized net interest spread on fixed annuity assets was 188 basis points, down 1 basis points from the prior quarter and reflects continued strong investment portfolio performance.

Total retirement assets under management increased 9%, and our sales and deposit activity is similar to the levels we saw in the prior year. Consolidated net investment income of $92.3 million decreased modestly compared to the prior year. Prepayment activity was $2.7 million lower and returns on alternative investments, while still solid at 6%, were $2.2 million lower. On a year-to-date basis, our new money reinvestment rate was trending close to our 4% target and we continue to see good relative value in high-quality structured securities.

From a shareholder value creation perspective, our book value per share excluding unrealized gain on investments increased modestly in the quarter to $27.91, unrealized gains on investments totaled $6.29 per share, and total reported book value per share was $34.20. During the quarter, we paid over $11 million in dividends to our shareholders and did buy back a modest amount of shares.

The market volatility in the quarter created a compelling buying opportunity and we did deploy a modest amount of capital to share buybacks. We will continue to utilize the remaining $27.8 million share buyback authorization in a prudent manner to maximize shareholder returns.

Overall, third quarter results were very encouraging, the Life and Retirement segment earnings contributions were solid. In P&C, the decision we made a few years ago to reduce coastal exposure to mitigate hurricane-related losses proved to be the right one. And as a result of the more normal non-cat weather patterns, we were able to clearly demonstrate the underlying auto loss ratio improvement. This was a direct result of rate actions and profitability improvement initiatives that we've been implementing.

While it is early, we are seeing tangible signs of progress on our goal of improving the enterprise ROE. We certainly have more work to do, but we are very encouraged by what we have achieved in the third quarter.

Thanks, and I will turn the call over to Ryan to start to Q&A.

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] . Our first question is coming from Matthew Carletti of JMP Securities. Please go ahead.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Hey, thanks. Good morning.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Good morning, Matt.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Just had couple of questions on the P&C side, maybe start with auto. I appreciate your comments on – it's always helpful to hear kind of the rate plan and what you're seeing with stabilizing of loss cost trends. When you kind of net those two out, does it change your expectations at all for the kind of the timing or the timeframe by which you get to target underwriting returns in auto? Does it accelerate at all? Does it sound like it slows it down or does it keep the same?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

No, Matt, when you think about the rate we're taking in and the rate earning in, we're finally able to demonstrate that we're seeing underlying improvement. If you think about the first half of the year, we talked about 2 to 3 points of underlying that was impacted because of weather.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Right.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

But when I play out that the earned rate impact, think about 6 to 7 points of run rate, 4.5 to 5 points of underlying trend, it gets us to that 2.5 points that we're talking about next year. I mean, we're obviously a conservative company and there's opportunity for us to accelerate that, but I'm pretty confident in the 2, 2.5 points next year with that 5 points that Bret outlined in the ROE expansion coming within a few years.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay. Great. Very helpful. And then the other one more a property question, but just thinking about Q4 and obviously the fires in the Napa area, California is a big state for you guys, I think number 1 state, 10% or 11% of your business, but also it's a big state geographically, and just because you're there for the whole state doesn't mean every region is the same. How should we think about your California exposure and is there any color you can provide on what you've seen so far out of that event?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Sure, Matt. Like you said it's a big state for us, it's our number 1 property state. We are pretty well diversified across the state, really speaks to the concentration issues that you might avoid by writing educators. But when you think about wild fires, it tends to come down to three main impacts from an underwriting perspective; [indiscernible] (21:33), maybe layer in a little bit of wind and the winds were pretty bad, that can blow embers into typically not high risk areas. But when you think about the educator population, they tend not to live in those areas. And we also have – just like when we talk about hurricane, we have a good underwriting drill around wild fires.

We actually just went through a re-underwriting of that book and re-underwrote hundreds of policies that were in medium- to higher-risk areas either had the risk mitigated again from the fuel perspective or placed some of the business that we weren't comfortable with, with third-party carriers. But as it sits today, we have under a dozen claims and about $1 million in claim reserves. So when you think about our market share compared to the total losses, I think they're saying 5,000 structures destroyed, we've fared pretty well.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Yes, absolutely.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

The only thing I'd add to that is Bill and his team have a lot of prior experience in this area and we're very proud of the underwriting that they've put in place, and that is another example where the benefit of a Horace Mann General Agency allows us to continue to stay on that household if we do see outsized brush fire exposure from the models that we run, so we don't have to lose the household. But they've done a tremendous job and we're proud of sitting here with less than $1 million worth of losses in a large state for us.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Yes, I know that's quite an accomplishment. So, anyway. Thank you for the color and congrats on a nice quarter.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thank you.

Operator: Thank you. Our next question is coming from Bob Glasspiegel of Janney. Please go ahead.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Good morning, Horace Mann.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Good morning, Bob.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Good morning.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

The 2 to 2.5 point improvement in 2018, that's underlying total PC?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

That's underlying auto PC, Bob.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Underlying auto, and what are you saying for property?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

No, we haven't really committed to our guidance yet...

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Okay.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

...but we feel good about our property strategy. We're looking at rates of 4 to 5 points this year in addition to next year; again we talked about our underwriting drill. Our target is in the low-90s and we feel that the actions that we are putting in place will get us close to that target, but we haven't done the full modeling yet.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

And we've talked about this before Bob, ending last year around a 90% combined with 10 point of cat and looking at ending this year a little under 100% combined with all the weather volatility that the industry has seen speaks to the underlying profitability of our property book and the conservative underwriting that we apply to it. So it's pretty darn, it's pretty darn profitable.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

And the homeowners property this quarter, I understand you said you had sort of non-cat unfavorable in the first half in the underlying, were you saying that the third quarter was normal versus normal, because you had a pretty good, I think it was a 5 or 6 point underlying improvement in property, what were you saying about...

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

I'd characterize it as more benign, certainly there's volatility in weather from quarter-to-quarter, and in the first half of the year it's probably a little heavy and in the third quarter I'd say it was a little bit light. That speaks towards the underlying results on both auto and property. I mean it's speaks to...

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Great.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

...we don't have a lot of hurricane exposure, but that July is in the quarter two, which can come with wind and hail, and it was pretty late this quarter.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Okay. So, in general you'd say property is running roughly the same underlying or improving a little bit? Is your rate keeping up with loss cost growth?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Underlying, yes, it's about similar to last year, but more in the catastrophe bucket this year. But, again, you think about the 90% last year, that's all in – close to a 100% this year, that would be all in but mostly the variance is driven by catastrophe.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

Okay. Last question, was this an active or a passive adjusting guidance? I mean, it seemed like there were some good guys and some surprises in the results that weren't in line with your prior guidance, but if we take the 9 months from the year, you sure are saying 37 to 59 cent Q4. Was that an active or a passive?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Bob, this is Bret. Let me kind of respond to that. I would say in light of the third quarter results finishing certainly better than we had expected, we still feel comfortable with the range that we adjusted in the second quarter, but we're probably more at the high-end of the range versus the low-end of the range where we were in the second quarter. So I hope that helps, but just to guide you that here again with the strong third quarter, it bodes well for hitting the upper-end of that range by year-end.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

So, one, I lied, I had one more question. Statutory capital generation roughly, where are you sort of through 9 months?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Yes, statutory capital in total we are – I have that here in front of me, Bob. So total about [ph] $960 million, about $500 million in Life and $460 million in P&C (27:04).

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

In statutory earnings?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Statutory earnings?

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

A

I may have to grab that one for you offline, Bob.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC

Q

You can give it to me later.

Ryan E. Greenier
Vice President-Investor Relations, Horace Mann Educators Corp.

A

Hang on.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Bob, I do have that. So for statutory earnings of a life about $35 million and just south of $1 million for P&C.

Robert Glasspiegel
Analyst, Janney Montgomery Scott LLC
Q

Thanks a lot.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

Yeah. You bet.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Thanks, Bob.

Operator: Thank you. [Operator Instructions] . Our next question is coming from DeForest Hinman of Walthausen. Please go ahead.

DeForest Richard Hinman
Analyst, Walthausen & Co. LLC
Q

Hi, I had to get off the call for a second, but you may have touched on this and if you did I apologize, but we were thinking about Harvey and your loss exposure that you booked there, can you help us understand the breakdown in terms of the mix, in terms of auto losses versus wind or flood or anything related to the homes?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

Yeah, for Harvey, I would say about $5 million half property, half auto due to flood. When you think about where that storm impacted, it was south of Houston where we didn't have a lot of impact, but the flooding occurred in Houston where we have some customers, but not many relative to our expected market share. So I'd say about half auto and half property.

DeForest Richard Hinman
Analyst, Walthausen & Co. LLC
Q

So when we think about the state of Texas, I mean, do we have any concentrations in any geographies or cities?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

yeah, let me talk a little bit. I could breakdown Houston for you since that's the one in play. Obviously, Texas is a big state and a big state for us, but when you think about Houston, about 15% of the comprehensive exposures are in the Houston area. It's only 10% for us. So think about that as a third reduction compared to our expected market share concentration and then when you further decompose that, most of that is actually in Northern Houston. I think we have seven or eight agency in the Houston area, there's only one that was impacted by the flooding in the Southern Houston area. So we feel pretty good about our discipline around the coastal strategy and moving more inland even in a big city like Houston.

DeForest Richard Hinman
Analyst, Walthausen & Co. LLC
Q

And then the Florida claims, is that basically all auto?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Yeah, all auto. We do have [indiscernible] (29:43) policies in Florida, so some food spoilage, but obviously they're not high severity claims.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

And as we said we write no homeowners.

DeForest Richard Hinman
Analyst, Walthausen & Co. LLC

Q

Okay. And Puerto Rico, do we write business there at all or not?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

No, sir.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Not Puerto Rico.

DeForest Richard Hinman
Analyst, Walthausen & Co. LLC

Q

Okay. Thank you.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

You're welcome.

Operator: Thank you. Our next question is coming from Christopher Campbell of KBW, please go ahead.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Yes, good morning.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Good morning.

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.

A

Good morning.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

Q

So just circling back on auto, so the recent auto rate increase are, obviously it's driving better loss ratio performance, but is there an expected expense ratio benefit as well, just assuming some of your fixed P&C operating costs are relatively constant and independent of pricing? And does the 50 bps better guidance which is, I think Bret had said that now it's to – we've guided you full-year 27% versus the 27.5% previously, does that reflect that?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

Yes. That does reflect the reduction. I think at the end of the second quarter I had guided folks to more the 27.5%, but as Marita mentioned, beginning the ROE walk if you will, one of the levers of that is expenses and we are in the process of right-sizing our expenses. I did call out a specific guidance related to our medical utilization here at the home office, and that will benefit all the segments. Obviously, the expenses get allocated to auto and property as well as maps operations as well. But I think a combination of the medical benefits, we did true-up certain accruals and had some timing items in the quarter. But overall, I would use 27% as kind of the new foreseeable run rate.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Yes, I completely agree. The auto story though is really about getting the price we need to cover loss cost trends and reach our ROE targets over time, while we're holding retention and while our market share is remaining steady. That's hard to do, but we're proving with our homogeneous market segment and our knowledge of the customers that we can do it and it's a good result. We're proud of the combination of those three stats.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Right. And Marita, you had mentioned again shifting from Life, and now you're making more infrastructure and modernization investments in P&C. So how should we think about the impact of those on the expense ratio and P&C over time?

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

As we've said from the very beginning, they're built in. So that 27% that Bret talks about has the P&C modernization efforts in and that's why being on time and being on budget is so important to us and why we take a lot of time in the implementation phase and this will be a steady thoughtful rollout. We're seeing the efficiency improvements as we roll these phases in, but it's baked in.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And does that roll off at some point, 2 or 3 years down the line?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

This is Bret. I would hope to tell you that, that we hope there's no strategic initiatives are in there as we continue to grow. But in the foreseeable future as Marita said, a lot of these initiatives were started a couple years ago and will continue. I mean, the P&C modernization, the work that Matt's done in his shop, those are multi-year endeavors that, as Marita said, they're baked in to our run rate, and we will manage our expenses as we've done in the past.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

Yeah, I think we have a strong track record of being prudent in that regard and I think our expense base is appropriate, especially considering the fact that we're widening those pipes so that we can handle the future growth that will come as we build out this value proposition.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.
Q

And then just getting into the auto underlying combined ratio improvement, how does that break out between – is that all core loss ratio or is there any expense ratio impact as well?

William J. Caldwell
Executive Vice President-Property & Casualty, Horace Mann Educators Corp.
A

In the combined ratio, there were 3 point, 2 points of underlying improvement and the rest was the expense ratio. But as Bret said, don't count on that, that was kind of one-time timing issues related expense ratio. But the underlying loss ratio is expected to continue.

Christopher Campbell
Analyst, Keefe, Bruyette & Woods, Inc.
Q

Okay. And then just one final one on Life. So, the operating expenses, those are down about 13%, and they've been declining in the past few quarters, it sounds like right-sizing as well, but what's driving these cost efficiencies and how should we think about that operating expense run rate going forward for the Life?

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

Yes I mean, certainly for the quarter Life did benefit as the other segments did from the medical, which I would describe those as a new item for 2017 compared to 2016. I would say most of the strategic initiatives, the sixth sense that we've talked about and Matt shop has been more heavily on the annuity side. So I would say that the one-time benefit in the quarter of truing up our expenses with respect to incentive comp as well as the medical, those did aid the Life and P&C perhaps a little bit more than retirement, because it has the strategic investments going at the same time.

Marita Zuraitis
President, Chief Executive Officer & Director, Horace Mann Educators Corp.
A

And you said this, but a lot of the product enhancements, the building of an indexed universal Life product, the digital capabilities, the efficiencies, those are behind us. We've done those and we're probably seeing some of those underlying efficiencies come through as well.

Bret A. Conklin
Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.
A

Yes, and it's about $1 million decline that you saw in the quarter, but I would – prior to that, they've been running about $0.5 million, $600,000 higher. So I would have expected it to kind of go back to the normal, the normal run rate.

Christopher Campbell

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Right. Well, thanks for all the answers. Congrats on the quarter and good luck in the fourth quarter.

Marita Zuraitis

President, Chief Executive Officer & Director, Horace Mann Educators Corp.

A

Thank you.

Bret A. Conklin

Executive Vice President and Chief Financial Officer, Horace Mann Educators Corp.

A

All right. Thank you.

Operator: Thank you. At this time I would like to turn the floor back over for any additional or closing comments.

Ryan E. Greenier

Vice President-Investor Relations, Horace Mann Educators Corp.

Thanks, Donna and thank you all for joining us this morning on Horace Mann's third quarter earnings call. If there are any questions, don't hesitate to reach out to me. Thank you very much.

Operator: Ladies and gentlemen, thank you for your participation, you may disconnect your lines at this time and have a wonderful day.