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Horace Mann Educators Corp. (HMN)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

I would now like to turn the conference over to your host, Heather Wietzel, Vice President, Investor Relations.

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you, Darren, and good morning, everyone. Welcome to Horace Mann's discussion of our second quarter 2019 result. Yesterday, we issued our earnings release and investor supplement. Copies are available on the Investor's page of our website along with our investor presentation, which was posted this morning.

Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer. Also available in Q&A are Bill Caldwell coming on P&C topics, Bret Benham on Life and Retirement, Matthew Sharpe on business strategy, Wade Rugenstein on supplementals, and Ryan Greenier on investments.

Before I turn 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 risk 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 that are described in our press release and SEC filings.

In our prepared remarks, we use some non-GAAP measure. Reconciliation of these measures to the most comparable GAAP measures are available in the supplemental section of our press release.

I'll now turn the call over to Marita.

Marita Zuraitis

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

Thanks, Heather. Good morning, everyone, and welcome to our call. Last night, we reported second quarter results of $0.17 per diluted share, a 31% increase over last year driven primarily by improved underlying profitability in the P&C segment. As well as catastrophe cost in line with expectations. We achieved these strong results even though the Retirement business is smaller due to our recent reinsurance transaction and our results do not yet include earnings from our new supplemental insurance business.

Before I turn to what we see going forward, I'd like to briefly review the exciting and significant activities of recent months. We reached an agreement with RGA to reinsure a $2.9-billion block of legacy annuity business that had a minimum crediting rate of 4.5%. In addition to reducing interest rate risk for the company, the transaction released $200 million in capital. And I'm particularly pleased with the timing of the transaction as interest rates have declined meaningfully in recent months. We redeployed the capital towards our acquisition of supplemental insurance provider National Teachers Associates, which closed on July 1. This business has higher margins and is less capital intensive than the reinsured legacy annuity block.

Bret will go into detail about the impact of the transactions on second quarter results later in the call. But the long-term upside of improving our earnings mix and reducing our interest rate risk is meaningful to reaching a double digit ROE and accelerating shareholder value creation. We have entered the second half of 2019 well-positioned to capitalize on the opportunities available in the education market, a group of customers we know better and care about more than any other company out there.

The recent actions are part of our careful deliberate planning to enhance our value proposition to the education market. We remain committed to understanding and solving the issues facing educators, helping them achieve lifelong financial success. These transactions made financial sense for Horace Mann and were aligned with aspects of our PDI growth strategy that drives our success in the education market.

First, we need products designed to meet educators' needs to protect their unique risks. Supplemental insurance products are a solution we've often been asked about by educators. They are concerned that the cost of an unexpected medical emergency or accident could derail their long-term savings plans. NTA is a leading provider of these products.

Second, we rely on knowledgeable trusted distribution tailored to educate our preferences. With the addition of NTA, we add to our base of 700-plus exclusive agents with 220 additional points of distribution with strong work district site marketing expertise. And third, we must be able to leverage modern, scalable infrastructure that is easy to do business with. This quarter, we successfully migrated our retirement advantage policies to recently acquired BCG's platform, eliminating the need for a third-party administrator.

Our deep niche marketing knowledge and expertise is key to our industry-leading cross-sell ratio of nearly 20% for our educator customer base versus 12% seen in the broader industry. Our retention metrics clearly illustrate that these customers are more loyal. Our mono-line auto retention percentage of 76% increases to as much as 95% for customers who also have Life and Retirement products.

We will build on this competitive advantage with the addition of supplemental insurance products. We are implementing a thoughtful, staged approach to our cross-sell strategy between the two agency forces to ensure a smooth transition for both our customers and our agents.

Our first priority has been to train Horace Mann agents to sell the high-margin supplemental insurance products. More than 200 Horace Mann agents in territories with the highest growth potential will be selling supplemental products for this back-to-school season. We plan to take the first steps to reach NTA's 150,000 households with Horace Mann's P&C products in the fall.

As we've said, we do not anticipate any meaningful benefit from cross-sell this calendar year, but we do expect it will account for an additional $5 million to $7 million of incremental annual earnings by 2021. These new opportunities will build upon the progress we've made on profitability initiatives over the past few years.

In particular, we're very confident that we will not only meet but exceed our multiyear goal of 5 points of improvement in the auto underlying loss ratio over 2017's loss ratio of 77.2%. Our second quarter underlying loss ratio of 72.8% was 5.9 points better than prior year. In the second half of 2019, we expect this to moderate somewhat in comparison to a strong second half of 2018.

It's also noteworthy, given our historical catastrophe loss distribution, that our combined ratio year-to-date is 99.7%. The last time we were under 100% at this point in the year was back in 2015. Given these improvements, we are accelerating our focus on P&C growth in regions that meet profitability target.

And although our Retirement book is smaller going forward, it is more profitable and better positioned for growth in both fee and spread-based products allowing our education market customers to select the product that best suits their needs. Annuities continue to be a preferred savings option for many educators, and our annuity sales increased 9% in the second quarter. We will also continue to exercise expense discipline including capitalizing on integration synergies with both NTA and BCG, and we expect expense savings to emerge over time.

Finally, as we've stated before, we expect a point of ROE accretion in the next 12 months attributable to the NTA acquisition. The sum of these strategic decisions provides more opportunity to drive growth in the education market, which accelerates the path to a double digit ROE for shareholders. Both our organic and inorganic initiatives have positioned us incredibly well to deliver on our vision, to be the company of choice to provide financial solutions for all educators, to help them protect what they have today, and prepare for a successful tomorrow.

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

Bret A. Conklin

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

Thanks, Marita, and good morning, everyone. As Marita noted, the $0.17 of second quarter core earnings demonstrated the clear progress we are making on key initiatives to generate more consistent earnings and improve long-term profitable growth, which together will drive a return to double digit ROE. In the quarter, underlying P&C profitability was very strong and cap losses were in line with our full year guidance.

Retirement results reflected the reinsurance transaction that reduced our exposure to interest rate risks. The reinsurance transaction also provided some of the capital that we used to purchase NTA. That acquisition closed on July 1, so we will begin reporting on the new supplemental segment in the third quarter.

Overall, results are consistent with the estimates we provided when we announced the reinsurance transaction. We recognized $107 million after-tax realized gain on the investments that were transferred to RGA, and we booked several onetime items that I'll review in a minute. As a result, book value excluding unrealized gains was up 5% and total reported book value grew 11% as unrealized gains on the retained portfolio rose significantly given the interest rate environment.

I'm going to review our P&C and Life segment results before I dive into Retirement, which has a few additional moving parts this quarter. I will also offer more insights to our guidance for 2019. As we noted in the release, we're modestly increasing our full year 2019 EPS guidance to $2.05 to $2.25.

So, beginning with the Property & Casualty segment, for the quarter, core earnings were $5 million versus a loss of $11 million last year. The reported combined ratio of 103.8% improved 11 points over last year, reflecting lower cap losses while the underlying combined ratio improved over 6 points. As Marita noted, the year-over-year delta will likely moderate in the second half of the year as we'll be comparing to a very strong second half 2018 underlying result.

The rate increases and other underwriting actions we have implemented were the primary factors driving better underlying underwriting performance. The underwriting performance was complemented by a 23% increase in P&C investment income due to very strong returns on our alternative portfolio.

For the quarter, the auto combined ratio improved 8.5 points to just over 100%. The underlying combined ratio was 99.4%. In auto, we continue to file rate increases to keep us ahead of lost costs. These increases average in the middle to single digits across the book. We're seeing the same trends here as in recent quarters. Severity remains elevated compared to historical levels although the pace of the increases has moderated somewhat and frequency is lower.

We expect auto to remain profitable on an underlying basis for the full year, and that we will be ahead of our objective of a cumulative 5 points of improvement in the underlying ratio since 2017. That loss ratio improvement is a key driver of our ROE.

In property, the combined ratio improved almost 16 points in the quarter, with the cat loss contribution improving 6.5 points and the underlying ratio improving more than 7 points. Homeowner rate increases tied to the higher cat and non-cat weather we saw in many geographies over the past few years were the primary reason for the improved profitability. We continue to expect the full-year underlying property loss ratio to improve 3 or so points over 2018.

In total, we believe rate increases will drive a low single digit increase in net written premium for the year. Overall, retention is down slightly from 2018. But in key geographies that are above our profitability targets, we are beginning to see positive trends in new business and expect this will accelerate over time. Underwriting results benefited from $2 million in favorable reserve releases evenly divided between property and auto. The expense ratio was 26.5%, in line with our target.

Q2 cat losses from the 17 storms spread across most of the country were $22 million pre-tax, in line with the update we provided in late June. That's about $5 million lower than on last year's second quarter and as expected, about half of what we had estimated for the full year 2019 cat losses. With first half cat losses at $33 million, we're on track to our full-year guidance for cat losses in the range to 7 to 7.5 points on a combined ratio.

Our total combined ratio for the first half of the year was 99.7%, a strong result considering the seasonal pattern we typically see in cat losses. Our target for the combined ratio for the P&C business for the full year remains in the high 90s with an underlying auto combined ratio below 100% and the underlying property combined ratio in the low 70s.

Turning to the Life segment. Second quarter sales of recurring premium products were even with last year's strong second quarter. Our agents continue to work to help more of our customers see how life insurance can contribute to the financial well-being of their families and we expect continued sales growth.

As a result of lower net investment income, core earnings were $5.2 million compared with $5.9 million last year. For the full year, we continue to expect earnings excluding DAC unlocking of $15 million to $17 million with full year sales growth in the double digits.

Before I turn to the Retirement segment, I want to walk through the details of the reinsurance transaction with RGA and how the various aspects are being reported in our financial statements. The transaction was the ideal way to address the interest rate risk of our legacy annuities, particularly taking into consideration how capital intensive this business was. The agreement was effective April 1 for a block of approximately 54,000 individual annuities written in 2002 and earlier, with a minimum crediting rate of 4.5%.

The transaction was structured as co-insurance for the fixed annuities, which represent about 75% of the total and modified co-insurance for the variable annuities and separate accounts that make up the remainder. The total capital release was $200 million, which was primarily redeployed into the higher margin NTA business. The required accounting treatment for the transaction is the deposit method because the annuities are functionally investment contracts that do not transfer morbidity or mortality risk.

On the balance sheet, the transferred investment assets now are being reported as a deposit asset on reinsurance. The receivable will be adjusted quarterly consistent with the reinsurance agreement terms, along with an accretive return. The offsetting reinsured fixed annuities will continue to be included in total policy and liabilities while the reinsured variable annuities will remain in separate account liabilities.

On the income statement, all results of operations related to the reinsured annuities are the responsibility of RGA. Fee income is reduced by the charges and fees transferred to RGA on the variable annuity block.

Total net investment income includes an entry for accretive investment income, which is calculated based on effective yield to accrete the deposit asset on reinsurance to the ultimate anticipated cash flows from the annuity transaction and is not based on income from specific assets. Interest credited to policyholders related to the reinsurance block continues to be reported, offsetting the accrued for the accreted income.

In our investor supplement, we are showing some of the retirement metrics excluding the reinsurance block to more clearly illustrate the results of ongoing operations. This quarter, we also had several significant onetime items associated with the transaction that are not included in the core earnings. First was the after-tax realized gains of $107 million on the investments that we have transferred to the dedicated trust managed by RGA. Second was the $28 million write-off of all legacy goodwill associated with the Retirement segment. As a result of these two noncash items, book value excluding unrealized gains rose 5% as a goodwill write-off offset a portion of the realized gain.

Turning to the retained portion of the Retirement business. At June 30, we had $2.2 billion in fixed asset – fixed annuity assets under management. More than 50% of the traditional fixed annuities we retained have minimum crediting rate of 2% and lower. As a result, our average fixed annuity crediting rate dropped to 2.5%, down from 3.6% before the transaction. We also have $1.6 billion of variable annuities and $400 million of fixed index annuities. In addition to the annuities, assets under administration include $3.6 billion in assets of our brokerage, advisory and record-keeping business, which generates fee income.

Annuity sales deposits were up 9% again this quarter. Annuities continue to be an important part of our products set as they appeal to the financial objectives of our educator customers while complementing our growing suite of fee-based products. The annualized net interest spread for the quarter was 233 basis points compared with 142 basis points in the first quarter benefiting from the lower average deferred crediting rate on the retained block of fixed annuities.

I'll talk more about interest rate environment in a moment, but we expect the net interest spread will be in the low 200s in the third and fourth quarter. Unfavorable DAC unlocking for the quarter was primarily due to the onetime $5 million or $0.10 per share write-off of the remaining debt balance associated with the reinsurance block. This write-off is included into our results.

Consistent with what we said when we announced the reinsurance transaction, we expect full year 2019 after-tax retirement earnings excluding DAC unlocking of $25 million to $27 million. Retirement segment core earnings excluding DAC unlocking were $7.4 million in the second quarter, down from $10.6 million in the first quarter because of the reinsurance transaction.

Beginning in the third quarter, the redeployment of capital to purchase NTA will further reduce Retirement net investment income and core earnings by approximately $1.5 million per quarter for a new Retirement earnings run rate of about $5 million per quarter at current yield.

So, let's look at investments. After the transfer of assets to RGA, the investment portfolio is $6.4 billion of assets that align with our strategy which remains unchanged, $5.4 billion of these assets for Life and Retirement with the remaining $1 billion supporting Property and Casualty. With the addition of NTA, we'll also have about $600 million supporting the supplemental segment beginning in Q3. We're in the process of repositioning that portfolio to improve risk adjusted returns over time.

Pre-tax yield in the portfolio was down slightly year-over-year at 5.14% in the second quarter. Duration was close to six years, essentially unchanged from prior periods. Our new money rate in the second quarter was around 415 basis points. The overall credit rating of the portfolio also was consistent with prior periods and remains very high with an average rating of A plus.

The portfolio continues to have a sizable allocation of highly liquid securities that will be available to opportunistically redeploy to investment grade corporates, high yield and structured securities in the event of a spread widening event. This would improve investment returns in the future.

Income on the investment portfolio was $70.3 million. Better than expected alternative investment returns led to higher net investment income for P&C and Retirement. The fair value of the alternatives portfolio was $351 million at June 30, up about $20 million from March 31 with year-to-date returns of over 10%. We are continuing to increase allocation to this asset class in response to the challenging yield environment.

The recent 25-basis point Fed reduction will further pressure yields, and now we are anticipating a sustained, low-interest rate environment making the timing of the reinsurance transaction even more valuable. We also now expect our new money rate for the second half of the year to be closer to 4%, below our current portfolio yield. We expect net investment income from the managed investment portfolios including NTA to be around $300 million for full year 2019.

The quarterly go-forward run rate of accreted investment income on the deposit asset on reinsurance should be within $1 million plus or minus of the $23 million reported for Q2. As a result, total 2019 net investment income should be in line with our previous guidance of roughly $370 million for the full year.

Turning back to our consolidated results, as we said in June, going forward, P&C should represent about 35% of earnings at normalized [ph] CATs (00:23:01). Mortality and morbidity based businesses will grow to about 45%, while Retirement declines to about 20%. For 2019, we are comfortable with forward EPS in the $2.05 to $2.25 range. In the third and fourth quarters, the new supplemental segment should add $6 million to $7 million to quarter earnings each quarter, while the run rate of corporate expenses will increase by about $1 million per quarter due to additional interest expense on the line of credit.

As we noted in the release, we have $135 million outstanding on the line of credit as of August 1 and our debt-to-cap ratio was about 24.6%, consistent with our current rates. All of our insurance subsidies will be at or above our target [ph] for 25% (00:23:50) RBC by year-end.

In summary, the benefits of our ongoing organic initiatives and our improved business mix should move ROE closer to double digits over the next several years. Marita talked about the initiatives underway including accelerating growth in P&C to leverage continued profitability improvements, higher sales of spread-based and fee-based Retirement products and expense discipline. We also expect the benefits of bringing together NTA's and Horace Mann's products and distribution forces will continue even beyond 2020. Approximately $7 million in incremental run rate after tax operating earnings adds about 0.5 point to ROE.

Finally, we also stand to gain some synergies and efficiencies through our combined infrastructures. All in, we're excited about Horace Mann's ability to generate excess capital. Our intent for that capital remains unchanged, focusing on the most accretive uses. This includes growing our business at returns at or above our ROE targets, returning a significant portion of annual earnings back to shareholders via compelling dividend, and opportunistically buying back shares when market conditions [indiscernible] (00:25:09).

Horace Mann is moving ahead with an even stronger, more diverse earnings base with an increased level of capital generation capacity. We're driving shareholder value and improving ROE. We are redeploying capital into higher return and less capital intensive businesses while staying true to our fundamental mission, serving the needs of this education market. We expect our progress will continue and we're excited about what the future holds for Horace Mann.

Thank you. And with that, I'll turn it back over to Heather for Q&A.

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you. Darren, if you could poll for questions, that'd be great.

QUESTION AND ANSWER SECTION

Operator: Absolutely. At this time, we will be conducting a question-and-answer session. [Operator Instructions] One moment, please, while we poll for questions. Our first question comes from Gary Ransom of Dowling & Partners. Please proceed with your question.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes. Good morning. I wanted to ask a little bit about the early read on NTA. You mentioned back-to-school sales on the products. I just was wondering, is that a – is back-to-school times a seasonally strong period for those supplemental products?

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

A

Yeah. This is Marita. Before I turn it over to Wade to comment if he has a comment here. Yes, it typically would be so we are – we're very excited about the timing. As we mentioned in the script, our first priority was to get our agents trained in NTA products, and one of the benefits, maybe one of the only benefits of state approvals in places like New York and Texas that take a little bit of time is it gave us time during that period to really get our top agents in the geographies with the most potential up to speed on the products.

As an example, we already have some production in the State of Iowa where we got on it quickly, and we also have a 403(b) endorsement in that state. So, although we don't really expect this to add up as we said from a cross-sell perspective until next year, it is nice to see our agents gravitating to the training and already beginning to sell these products.

And as we also said, this really was well thought out. This is a situation where our agents have been asked quite often to provide these products, and they really had to turn their customers over to another competitor to get that part of the equation solved. So, we're excited about what NTA brings to the table.

I don't know if you have anything to add as far as the seasonality?

Wade Rugenstein
CIO and Executive Vice President, Supplemental Benefits, Horace Mann Educators Corp.

A

Yeah. No, the only thing I would add is our agents take part in a lot of the back-to-school celebrations, and it's an important time of the year for the educators in making decisions about their benefits.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Are the NTA agents also active in the same way? You kind of were talking about the Horace Mann training and getting those agents up to speed. I assume the NTA agents are doing the same thing and building that up for the back-to-school period.

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

A

Not quite yet. I would say thinking about licensing in the P&C space, as you know, these agents are licensed in life and health...

Gary Kent Ransom Q
Analyst, Dowling & Partners Securities LLC

I was actually just asking specifically about what they'd already do to supplemental products. They're still pushing on that side as well, yes?

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

Yes.

Gary Kent Ransom Q
Analyst, Dowling & Partners Securities LLC

And then the timing on – what you were just about to talk about, on the P&C side, that I assume will take a few quarters or something.

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

Yeah. All I was going to say is we intentionally wanted to not disrupt NTA sales volume. They have strong sales plans as you can imagine. They're hitting those plans. We feel good about that and want to keep that strong.

But over time, those agents learning Horace Mann products makes some sense obviously as well, starting with those products that would be easier and make more sense, think about auto, think about some of our Life products and that will be our focus. But we will take – we will take our time to do that thoughtfully as to not disrupt their sales momentum.

Gary Kent Ransom Q
Analyst, Dowling & Partners Securities LLC

All right. Thank you and I wanted to also ask if you had any update on your telematics product at all, how that – I know that was just launched.

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

I think last time we talked we were in 14 states. We're now in 18 states. Certainly, acceptance is increasing over time. But our first customers only have about 90 days on the product. So, it's still relatively early. So, we're not really projecting loss cost savings from those. First, it's not enough. And second, we don't have enough data or enough time. But we are seeing good momentum from a sales perspective [indiscernible] (00:30:28).

Gary Kent Ransom Q
Analyst, Dowling & Partners Securities LLC

I mean, yeah, but the take up rate though is doing well or is in line with your expectations?

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

Yes. It's accelerating over time. Obviously, the sales process with telematics is a little bit more complicated. So, we're taking from our best agents and reinforcing that with the rest of our agent force. So, we are seeing good momentum with that feature of our product.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thank you very much.

Operator: Our next question comes from John Barnidge of Sandler O'Neill. Please proceed with your question.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Rates have come down materially since then. Is there any way to dimension on a per share basis how much that decline actually lowered your new earnings guidance?

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

A

John, could you repeat your question? It was cut at the very beginning. We want to make sure we've got it correctly.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Sure. So, the new guidance up from June yet rates have come down materially since then. Is there any way to dimension on a per share basis how much that decline may be lowered your new earnings guidance that is obviously up from where it was in June?

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

A

Yeah. Actually, John, I think even in my prepared remarks I mentioned that for the entire year we actually plan to get back to our original total net investment income amount of $370 million. I think I also mentioned via a couple of different ways obviously as I mentioned our new money rate is lower than we had planned but our alternatives are performing much better to the tune of a 10% return versus we probably plan about a 6% return on that. So, as it relates to 2019, we're not coming off of our total net investment income projection.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Okay. And then is your annual actuarial assumption review in the third quarter?

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

A

Yes. Yes, it is.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

How should we be thinking about that given the decline in rates from a year ago?

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

A

That's just one piece of the unlocking if you will. I mean, we'll fully look at expenses, lapse ratios, the spreads going forward, but that we typically will look at. And the process begins in the third quarter and I think we actually record that in October. It will be recorded in the fourth quarter, but there's many variables to that. But obviously, lowering the spreads and I don't have to tell you it's going to lower the future profits, no doubt about that, but then there's other pieces to the puzzle.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Okay. And then given current valuation multiples and now that the NTA transaction is closed, can you talk about how you think about share repurchases?

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

A

Sure. I think leading up to the acquisition I think on – for the past few quarters, I've said we've kind of put a pause, if you will, on share repurchase. Obviously, we used a lot of our excess capital to consummate the transactions of BCG as well as NTA, but I don't think our strategy has changed whatsoever. We're going to put that to the best use possible.

And obviously with the shares trading at the current levels, it's safe to say that at these levels I wouldn't anticipate any repurchase in the immediate future there. But, here again, as we generate excess capital which we totally intend to double with the purchase of NTA, we'll take a peek at that and opportunistically buy where the market provides us an opportunity to do so.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

All right. My last question, I'll re-queue from there. But can you talk about – you mentioned in the script Property and Casualty regions that exceeded profitability targets, can you talk about what those – where those regions actually are, please?

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

A

John, there are various places over the – all over the country. I wouldn't call out a specific region, but we align all of our states with our profit targets and where they see those targets as we're investing in agencies and marketing but I wouldn't say a specific region. I can give you some examples of where there are states that aren't meeting profitability targets. I think we're all pretty familiar with Florida and kind of the environment there and we shrunk Florida significantly over the past couple of years.

A more recent example is in California. Speaking to our underwriting discipline, we had a relatively pretty – a very large loss in Northern California. That changed the texture of California. So, we quickly take an underwriting guidelines so that will impact our denominators as well as our numerator for some time. But again as we double down in those states that are more green, we are seeing growth out of the states where we have exceeded our profitability targets. But again I wouldn't call out a particular region.

Operator: [Operator Instruction] Our next question comes from Christopher Campbell of KBW. Please proceed with your question.

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

Q

Yes. Hi. Good morning. Congrats on the quarter.

A

Thanks.

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

Q

First question is, can you guys share any initial thoughts on how we should be thinking about the benefits and expense ratios for supplemental?

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

A

Sure. I mean just specifically to supplemental or you just say as part of now the Horace Mann family, I guess? I mean obviously – well, I'll just make one other comment, Chris. I think NTA, I think as we've mentioned in general, is a very well-ran company that generates ROEs that that exceed what we had in the past and that includes a very expense conscious culture there.

So I think our culture here is the same. But as Marita said, as we have now completed the acquisition of NTA and BCG, we've talked about synergies, and yes, we are going to make sure that we look at those things as you would expect.

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

A

The only thing I'd add to that, Bret, is obviously in the deal economics we did not bake into the valuation extensive synergies. As a matter of fact, very limited. But yet, we know as we look at these two organization in similar customer bases, there are synergies, and we're working hard to gain those synergies so that we can drop them, quite frankly, straight to the bottom line.

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

Q

Got it. Yeah. I was thinking more like specifically like, I mean, I know you guys have a $6 million to $7 million quarterly guidance that you're – that you've done for supplemental. I was trying to think of what the breakout would be in terms of like the loss in expense ratios, just in terms of because I know you guys bought it at a big premium to book that I was just trying to think of like, are you going to have [indiscernible] (00:38:08) going through the expense ratio, or is there going to be kind of a noise like that that we're going to have to see for the next six months to a year before we get like a good view on what the expense ratio is?

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

A

Yeah, Chris. Chris, this is Bret, absolutely. I mean we're going to be recording some [indiscernible] (00:38:23). Yes, there will be noise in the system, if you will, but we will have that broken out when they become part of the supplemental segment, part of the Horace Mann consolidated results. You'll have key metrics that we'll provide you to guide you with that, including amortization of the intangibles. That will be – we're in the midst of that, as we speak, to try to get our reporting package together for the third quarter.

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

Q

Okay, great. Thanks, Bret.

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

A

Sure.

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

Q

The next question is on the guidance. So, I mean – and not the 2019, I'm thinking ahead to 2020, where the press release last night said that there would be about – guidance would be at least 10% above the $2 to $2.25 range, which I'd put it like something around like $2.25 to $2.48. Now, I'm just thinking about like the phrase, at least. So, where could there be additional upside to this 10% just given, I think, consensus is at like 2.59%, so it's already above that range, so what else could drive incremental upside beyond that 10%? And then how much P&C improvement is baked into the 10% assumption, at least?

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

A

Okay. I guess, let me – that's a loaded question there, but with respect to at least, I think one of the things that Marita mentioned in her script that I certainly did on mine was the $5 million to $7 million of cross-sell opportunity with NTA that's not per se baked into that until 2021.

That could happen maybe sooner. That could be a potential upside. I mean, I think we're still working through getting the P&C to the levels that we can get the 10% to 12% ROE. We're making significant progress. And to be honest with you, the only reported combined ratio below 100% at this point that Marita specifically called out would get us to where we need to be, but we're not expecting it back in the second half of the year.

I think the expense discipline/synergies will be another thing that we'll look at over the coming years. So, I think it's here again, growth. Growth, once we get profitable, I mean, there's a lot of levers to that, Chris, but I think we're just trying to – what we know right now, we feel confident that we'll generate at least 10% in 2020.

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

A

And maybe a little trite to say it is about profitable growth, but it is about profitable growth. We're growing a profitable Retirement segment by 9% this quarter. We expect that to continue. And we like the traction we're seeing in Retirement. We've had nice profitable growth in Life, double digits, and that's continuing in the quarter. As P&C turns that corner and we've talked a lot about, that profitable P&C growth that these kind of combined ratios start to be pretty accretive.

And then we look at supplemental sales with a very high ROE pattern and these are all 80% educators. I mean, if you look at NTA, they do what we do in the places that we do it. So now, we feel that we have everything that our educators need from a product standpoint. We've built very strong distribution and are looking at about 1,000 points of distribution across the country with all the combined distribution that we pulled together over the last year.

And from an infrastructure perspective, we've got the ability to leverage very efficient shops with BCG and NTA and we intend to do that and drive some expense synergies as well. So, I look at this as a really nice inflection point for us having all the pieces of the strategy that we've talked about when we talk about PDI coming together. So when I think about what that means going forward, we've got the pieces we need to take this out for a spin.

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

And I would just maybe add on to what Marita just said. Even looking at 2019 with all Horace Mann has accomplished and still to end up $0.05 ahead of the guidance for the year and you kind of have a mixed bag of tricks. You actually have three quarters of the reinsurance reflected against only two quarters of NTA. So to even get back, we've had some help from P&C. We've had some help from net investment income and some other pockets, but we're just at the initial stages of hooking up these companies to the Horace Mann family. So there's a – I think there's quite bit an upside.

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

Got it. Thanks. That's very helpful. And then just as you guys pivot towards growth in P&C, I was kind of looking back to 2008 as far as my model goes back. And just looking at cumulative discount like auto [ph] dis (00:43:34) is only about 84% of what it was back in 2008 and 75% in the homeowners book. And then just even looking at growth rates like homeowners [indiscernible] (00:43:44) like a positive quarter of growth since 2008, and there's only been like nine quarters of positive auto growth in the last [indiscernible] (00:43:51). So I guess just what gives you confidence that Horace Mann is going to be able to really grow this P&C business given like, I'd say, probably last decade we haven't seen that kind of positive growth?

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

Yeah. Chris, this is Bill. Just a little bit about just to go back to 2008 quickly to reflect on those numbers. Before our times in the room, there was a non-educator strategy that was implemented maybe appropriately, maybe not in a softer market that we had to clean up over the years. So when you look at our mix of business today, there might be less [indiscernible] (00:44:28), but there's more educators on our books and we're seeing that in the loss results.

I don't look at growth as an on or off switch. Our agents are out there quoting our competitive position. Our strategy is the price to exceed loss costs. I see a lot of – time will tell, but there's a lot of irrational rate [ph] increases (00:44:47) out there when there's a lot of questions around where loss trends are actually going. So I prefer to focus on profitability and maintaining the operating income levels, and the growth will come when it comes.

That said, we look closely at our year-over-year numbers on a monthly basis. And every month we get closer to exceeding that prior month of 2018, and we'll soon exceed sales on a monthly basis. But the denominator is a tough number to overcome. So, we are focusing on growth in profitable geographies but we do have a lot of defend the actions that we're working through and I mentioned some of them to John specifically in Florida and California and some other large markets.

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

Q

Got it. And then I guess just like has your – have your like quote or conversion rates changed over time that can be changing at because we just see the decline but I know you guys did work with Florida, with getting out of the homeowners book there. So, is like the reason for like [indiscernible] (00:45:50) declines in homeowners different today than it was three or four years ago?

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

A

Yeah. Well, two things. So, on the quote side, yes, quotes were down over a prolonged period because we are fixing profitability. So, when we started – we recognized these trends in 2015. We appropriately paid our underwriting box which restricts quoting. And now that has expanded over time but not to the point where it was maybe in 2013 or 2014. And yes, there has been an impact on conversion rates as the competitive environment has shifted, but again we're starting to see both of those metrics increase at the same time.

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

A

I'd also add to that that distributions are part of this as well. More strong agencies, more income sources for those agents as we add supplemental, as we improve the products from a Retirement perspective like Retirement advantage as we build Life products that we built. The opportunity for more distributors to have strong income for their agencies and building more stronger agencies. You can imagine that when they have more staff, they can ask to quote you on a more frequent basis. So, I think stronger distributions are part of that equation as well. [indiscernible] (00:47:13) almost 1,000 distributors out there across the country with the majority of the geography covered will also help that equation.

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

A

And lastly, we have our system – our modernization system launched in October. You saw what we were able to do in Queens. Look at our LE ratios. Look at our severities. I mean we've shown that we can implement a system and we get benefits pretty quickly. It may take us a longer time, but these projects are expensive for us. So we're very diligent about how we implement, but we're excited about the Guidewire launch in October in Illinois and that will be full admin and billing, ease of use of billing for agents, and also opens up opportunities for more online and digital capabilities.

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

Q

Got it. Is there an expense ratio benefit for that that we should be thinking about longer term?

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

A

Well, over time. But remember it's a multiyear project because these dates go one by one. So again, this year it's just one and that's the most expensive one, but we have 45 other states that need to convert. So we'll stay in that target of [ph] 27, plus or minus, a half a point But over time as those dip (00:48:15) move we will have efficiencies in our loss ratio – on our expense ratio.

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

Got it. And is there like a long-term like target you're looking for, like I mean [indiscernible] (00:48:28) but like over like 5 or 10 years?

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

Yes.

[indiscernible] (00:48:35)

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

And there's a lot of moving parts here with an acquisition and there's a lot of things that we have to work through.

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

Okay. Great. Well, thanks for all the answers. Best of luck with the two acquisitions in the next quarter.

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

Thanks a lot.

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

Thanks, Chris.

Operator: Our next question comes from Matthew Carletti of JMP Securities. Please proceed with your question.

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.

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

Good morning, Matt.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

I just wanted to – just a clarifying question. I want to circle back to I guess the start of kind of Chris's line of questioning just on the guidance and specifically the wording. When you say at least 10% in 2020, are you referencing just what the recent transactions will contribute to the 2020 earnings growth? Or are you referencing a minimum level of overall 2020 earnings growth, whether it be transactions or the underlying P&C improvement and everything else that's going on?

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

A

It's your former comment...

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay.

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

A

...with respect to reflecting the NTA and the reinsurance.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. Just wanted to clarify that. That's all I got. Thanks and best of luck going forward.

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

A

Thanks for the clarification, Matt.

Operator: Our next question is a follow-up from John Barnidge of Sandler O'Neill. Please proceed with your question.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Yes. Thanks. Any initial read on cat losses six weeks into 3Q that you want to speak to maybe as compared to one year ago?

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

A

Yeah. Six weeks into Q3, I'd say nothing unusual. Barry was one of the biggest events of the quarter and close to $1 million for us. So, nothing out of pattern in July.

John Bakewell Barnidge
Analyst, Sandler O'Neill & Partners LP

Q

Okay. Great. That's all I got. Thanks.

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

A

All right. Thanks.

Operator: Ladies and gentlemen, we have reached the end of our question-and-answer session. I would like to turn the call back to management for closing remarks.

Heather J. Wietzel
Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you, everyone, for joining us today. This is Heather Wietzel. I'm available for follow-up if there's any other details, and we look forward to talking to you again soon.

Operator: This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation and have a wonderful day.