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Horace Mann Educators Corp. (HMN)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Horace Mann Second Quarter 2020 Results Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Heather Wietzel, Vice President, Investor Relations. Please go ahead.

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

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

Marita Zuraitis, President and Chief Executive Officer, and Bret Conklin, Executive Vice President and Chief Financial Officer, will give the formal remarks on today's call. With us for Q&A, we have Matt Sharpe on Distribution; Mark Desrochers on P&C; Wade Rugenstein on Supplemental; Mike Weckenbrock on Life & Retirement; and Ryan Greenier on Investments.

Before turning 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. Those 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 news release and

SEC filings. In our prepared remarks, we use some non-GAAP measures. Reconciliations of these measures to the most comparable GAAP measures are available in our news release.

With that, 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 core earnings of $0.67 per diluted share. These results clearly reflect the value we bring to the educators we serve through our solutions orientation as well as the positive impact of our long-term profitability initiatives and the transformational actions we took in 2019. They also reflect some unusual pandemic-related effects that make comparisons to other periods challenging.

Bret will help distinguish between the positive outcomes of our strategic initiatives and the ways in which the pandemic has influenced our performance later in the call. But at a high level, we are raising our 2020 full year core EPS guidance to a range between $2.80 and $3 to reflect the strong first half results.

In my remarks, I want to focus on how we are adjusting and evolving our business practices to better meet the needs of a more physically distant educator workforce. For the past 75 years, what has remained constant at Horace Mann is our commitment to supporting educators. Today, educators are facing immense challenges in their professional lives, on top of the challenges the pandemic has caused in all of our personal lives. Whether educators are in schools, at home, or working in a hybrid model in the upcoming school year, we're here to help them protect what they have today and prepare for a successful tomorrow.

We delivered on that promise this quarter in three ways. First, we helped customers across the country affected by tornadoes and other severe weather repair their homes and property. We have regularly noted that second quarter is historically our most costly quarter for catastrophes, but this quarter's weather was especially severe causing $34.7 million in damage to our customers in line with the extremely high industry cat losses this quarter. The second quarter continues the trend of more severe weather that we have seen accelerate over the past decade.

Catastrophe loss costs added 22 points to our combined ratio which is higher than both our 5-year and 10-year averages. I remain proud of our employees and agents for quickly and compassionately helping educators put their lives back together, but I'm especially proud of that commitment during a pandemic when everyone is facing challenges in their own lives as well. Second, we provided premium flexibility to our customers on both the companywide and individual basis.

Our P&C results reflected the impact of $10 million in premium credits for the reduction in driving during the second quarter. Across all of our products, a grace period was available through the second quarter, and we worked with customers to adjust coverages as needed. And third, we continue to invest in new solutions to help educators with the issues they face. For example, for four years, our agents and employees have helped educators address the burden of student loan debt through complementary student loan solutions programs. Beginning with small group and one-on-one meetings, this direct consultative model provided guidance on federal student loan forgiveness programs and payment plan options. Through this program we identified $250 million in forgiveness opportunities for educators.

We are scaling up the program this school year by partnering with Tuition.io to offer complimentary online student loan management accounts for all educators nationwide. Educator student loan debt is holding them back from reaching life milestones and taking care of their own families, a factor contributing to the national teacher shortage. In June, 34% of educators surveyed by Horace Mann were considering leaving the profession within the next three years for a higher paying job. The current climate could very well accelerate this trend driving good teachers who care about their students out of the profession. An overwhelming majority of teachers told us that having their student loans forgiven or a lower monthly payment would make them more likely to stay in their chosen field. As a company dedicated to supporting educators, we want to help facilitate that, not only to help those teachers but also the communities that benefit from their influence.

Looking ahead, we remain committed to our long-term objective of a double-digit return on equity and significant education market share expansion. The strategic actions we've taken over the past several years have positioned us very well for the current environment. Last year's transaction to reinsure a block of legacy annuity business with 4.5% minimum crediting rates significantly mitigated our interest rate risk. The addition of our Supplemental segment is diversifying earnings and providing another solution that educators want. Our profitability initiatives including improving our underlying auto loss ratio by more than 5 points reinforced our strong financial foundation. These factors contributed to our 9% return on equity for the quarter. Pandemic related factors also contributed.

For example, P&C earnings increased as average auto frequency dropped substantially for the entire second quarter. But our telematics data shows that people have started taking longer trips that they are driving at different times of the day, and that generally there is less congestion. This is consistent with anecdotal comments that people are opting to drive for their summer travel this year. Bottom line, mileage is returning to more normal levels, but the miles driven are different than pre-pandemic miles.

The pandemic is also having an impact on the trajectory of our market share expansion. New sales for our Supplemental line especially have historically relied more heavily on worksite marketing efforts consistent with industry practice. While the Retirement segment saw a 3% growth in annuity deposits, we were not surprised that there was a short-term impact on our overall second quarter sales whether due to complexities brought on by the pandemic or by fewer face-to-face interactions. But our relationships with educators are built on more than a physical location. We understand the issues that they are facing and we work together to solve them. That's what educators deserve and what we've proudly accomplished over the past 75 years.

We always aim to interact with educators in a way they prefer, and that remains applicable whether schools are open or not. In the current environment, obviously, more educators are conducting business virtually, and we have the tools in place to provide a seamless experience for both agents and customers. Remember Horace Mann has relationships with educators in roughly half of the schools in the country. Some of our agents traditionally reached educators with in-building interactions, others primarily reached educators through direct marketing, referrals and events. Many agents do both. We are now seeing more agents fully engage in our end-to-end virtual sales process, including online financial wellness workshops and appointment setting.

Our online workshops are going especially well as we are utilizing the same technology many educators have recently adopted for teaching. We are also piloting a number of new virtual events and engagement strategies that leverage our 75 years serving the education market. These include social media-based teacher appreciation events, special back-to-school promotions that encourage digital engagement and special offers for student loan solutions leveraging our new relationship with Tuition.io. Successful approaches will be a valuable part of our marketing tool kit whatever the post-vaccine world looks like.

While reaching educators at school will always be beneficial for agents, it's not required for us to be successful. We are successful because we provide products designed to meet educators' unique needs: knowledgeable trusted distribution tailored to educator preferences, a modern scalable infrastructure that's easy to do business with. That doesn't change during a pandemic. What we are doing is focusing on those approaches that better align with educator preferences in this pre-vaccine environment.

During these challenging times, people are more likely to focus on protection and preparation, and this is especially true for educators. We are proud to provide the solutions to help educators protect what they have today and prepare for a lifetime of financial success. For 75 years, the core of our business has been a deep appreciation for the work that educators do. That appreciation has only grown in 2020 as we all more fully understand the impact educators have on our families, our communities and our country.

Thank you, and with that, 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, our core earnings were up 4 times over last year's second quarter. Property and Casualty core earnings were substantially higher than the year ago period. We're benefiting from the long-term improvements in underlying auto loss ratio that we had achieved over the past few years, but the short-term effect of lower auto frequency due to reduced driving was also significant. Lower auto frequency more than offset the effect of auto premium rebates as well as unusually high catastrophe losses on our property results.

The Supplemental business made another strong earnings contribution. The second quarter is normally their lightest for new business, but sales were lower than normal due to limited worksite access due to the pandemic. Annuity contract deposits grew again in the Retirement segment as our educator customer base continues to look for ways to secure their financial future. Our Retirement products are just one of the ways we can help them achieve their financial objectives. Our managed investment portfolio has held up well despite this year's economic volatility.

The modest sequential decline in net investment income due to the mark-to-market adjustments in the alternatives portfolio primarily impacted the Property and Casualty segment. The losses we booked in the second quarter reflected the first quarter performance of limited partnership funds that report on a one quarter lag. As we indicated in yesterday's release, we've increased our full year 2020 core EPS guidance range to $2.80 to $3. We've raised our expectations to reflect some updates to our assumptions for the Property and Casualty segment, which I'll discuss in a moment. Performance for our other segments remains generally in line with the expectations we described when we announced first quarter results.

Looking at the business by segment, for Property and Casualty, core earnings more than doubled to $11.3 million from $5.1 million last year. Premiums were down about 10% primarily because of the premium credits. The 15% credit recognizes the lower level of driving by policyholders in April and May. The reported combined ratio improved 8 points from last year's second quarter, primarily because the quarter began with low loss frequency due to reduced driving. According to data from HMDrive, our telematics app, daily customer miles driven started trending upwards starting in mid-April, loss frequency averaged well below our historical levels over the entire quarter for the equivalent of about $25 million in reduced losses.

In addition to the lower frequency related to the pandemic, the combined ratio reflects the long-term benefits of the progress we've made over several years to improve our auto results as well as a 6.8 point improvement to the second quarter property underlying loss ratio largely from lower non-cat weather losses and 22.2 points from catastrophe losses, 9.3 points higher than last year's second quarter. The fundamental progress we've made in

Property and Casualty certainly supports our strong outlook for the segment. However, our revised outlook for $70 million to $75 million in P&C segment earnings also reflects for other assumptions.

First, when we think about frequency and severity in the coming months, we're anticipating total mileage to continue to move back to near historic levels. That said, HMDrive supports those miles are likely to be different than before. For example, more long-distance driving and less concentration during to-school and home-from-school hours. While those differences may help keep frequency lower, we see indication that severity is moving higher. As a result we have planned for an underlying auto loss ratio near pre-pandemic levels for the remainder of the year. Second, we have raised our full year catastrophe guidance to approximately 10 points on the full year combined ratio or about $60 million to $70 million. Through the first half of the year, catastrophe losses totaled $43.5 million. Second half catastrophe losses have averaged about $21 million over the past 10 years.

Third, lower net investment income for the segment due to the performance of the alternative portfolio. And finally, the subrogation benefits related to PG&E's successful emergence from bankruptcy on July 1. In the third quarter, favorable prior year reserve development will include approximately $4.8 million pre-tax for our share of the recovered losses. Third quarter premiums will include approximately $3.5 million for the return of reinsurance reinstatement plans. Policyholder retention remains steady and we are seeing some rebound in new business. However, rates appear very stable in the current environment, so net written premiums for 2020 will be below 2019 even before the $10 million impact of the premium credit.

Turning to Supplemental, over the first four quarters, this business has been part of Horace Mann. It has provided 14% of total premiums and contract charges and about 32% of core earnings, dramatically illustrating the diversification value it provides. This quarter, Supplemental added $33.3 million in premiums, and segment core earnings were $9.5 million. Net investment income on the Supplemental portfolio was in line with our expectations. Supplemental sales were $700,000 in the second quarter. New relationships with NTA have traditionally come from in-person events at schools and historically been lower in the summer months. As we said last quarter, we're accelerating the integration of the NTA agents into our distribution system, so that they have access to more tools to reach more customers. We expect sales to begin to return to a more normal trajectory in the coming months.

Premium persistency remain stable at about 89% with almost 300,000 policies in force. As we've said, policyholder retention for this business is relatively stable quarter-to-quarter. We are still benefiting from the changes in policyholder behavior related to COVID-19. For example, policyholders may opt to treat minor accidental injuries at home rather than visit a healthcare facility. Our outlook for Supplemental's full year core earnings remains in the range of $31 million to $33 million with the pre-tax profit margin moving toward the low to mid 20s.

For the Life segment, sales were below last year's second quarter, primarily because of lower sales of single premium products. Sales of recurring premium products were stable. Core earnings for the quarter also reflected lower net investment income. We continue to expect the segment will deliver $10 million to $12 million in ex-DAC earnings in 2020 with mortality continuing to meet expectations. The volume of claims related to COVID-19 remains very low with face values averaging about 30,000.

For the Retirement segment, we are now close to having comparable year-over-year result following last year's annuity reinsurance transaction. The reinsurance agreement addressed the interest rate risk of a legacy block of individual annuities with a minimum crediting rate of 4.5%. We continue to see growth as our solutions for augmenting retirement savings remain a core need for educators. Annuity contract deposits were up nearly 3%

for the quarter, and they continue to be an important part of the product set. Annuities appeal to the financial objectives of our educator customers while complementing our growing suite of fee-based products.

For the quarter, Retirement earnings ex-DAC were $6 million down from a year ago but more than double the first quarter. Operating expenses continue to trend down which will be a long-term positive and net investment income recovered. We continue to expect core earnings for 2020 will be in the range of $22 million to $24 million.

Turning to Investments, total net investment income was down about $1.9 million sequentially as we experienced the negative impact of the first quarter market decline in valuation for our alternatives portfolio which generally reports on a one quarter lag. We experienced negative marks across different fun types including private equity, infrastructure, private credit and commercial mortgage loan funds. We remain confident in the long-term returns from these investments, but we have reduced our 2020 outlook to reflect their market-driven negative performance in the first half of the year. As a result, we now expect alternative investment income to be between $5 million and $10 million on a full year basis below our longer term return expectation for this asset class.

Further, our core fixed maturity portfolio remains well-positioned to weather the near-term market volatility in COVID-19 induced economic downturn. The core fixed income portfolio had a yield of 4.39% in the second quarter compared with 4.74% a year ago. The addition of the Supplemental portfolio on July 1 last year reduced the yield on the consolidated core portfolio, but we are making solid progress in improving the Supplemental investment yield. In the second quarter, the consolidated new money rate was about 4%, and based on current market conditions, we anticipate purchases near that level for the remainder of the year.

In the early part of the second quarter, we opportunistically purchased some BBB and BB rated corporate credit and investment grade asset-backed securities at attractive spreads. As the quarter progressed, spreads tightened and we saw fewer attractive opportunities. As a result, our purchases later in the quarter focused on high-quality municipals in government agency securities. Net realized investment gains of $3.2 million in the second quarter were partially offset by $500,000 of impairment losses. In addition, we had the mark-to-market gains of $6.6 million on equity securities.

Total 2020 net investment income is now expected to be between $340 million and $345 million, including accreted investment income on the deposit asset on reinsurance. You will recall this amount is an actuarial driven calculation and should not be affected in the short-term by market volatility or prevailing interest rates. This expectation for investment income is captured in the segment-by-segment outlook summarized in our investor presentation and in our core EPS guidance range of $2.80 to $3.

To summarize we continue to see the positive impact of our transformational actions and profitability initiatives, particularly the addition of the Supplemental segment and the annuity reinsurance transaction in our Retirement segment. Our outlook for these segments remains unchanged. In Property and Casualty, full year results will be higher than we anticipated last quarter despite slightly lower net investment income because of the subrogation recovery as well as the atypical reduction in miles driven because of the pandemic.

These factors have the potential to help us reach an ROE near 9% for 2020 and were key to the increase in our guidance range for 2020. But make no mistake, we remain committed to achieving a sustainable double-digit return on equity with significant growth in our education market share. We can achieve the former by executing on our PDI initiatives in completing the integration of NTA, fulfilling our cross-sell objectives and aligning their investment portfolio with our current strategies. The current environment may push back our timeline for market expansion, but our objective remains unchanged, and it's the same one we've had for 75 years to reach more educators with solutions that help them meet their financial objectives, Thank you.

And with that, I'll turn it back over to Heather.

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

Yes, we are ready for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] And the first question will come from Matt Carletti with JMP Securities. Please go ahead.

Matthew J. Carletti Q
Analyst, JMP Securities LLC

Morning.

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

Good morning, Matt.

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

Good morning.

Matthew J. Carletti Q
Analyst, JMP Securities LLC

Marita, I was hoping you could maybe expand on some of the comments you had at the beginning of the call about adapting to the current environment, and more specifically maybe talk a bit in more depth about how you adapt to selling in what's looking like an increasingly remote environment at least in the near term. Maybe a little bit on how that differs between kind of the existing schools you're in and trying to get into schools that you aren't in. Are there areas of your [ph] book lines (26:53) of business or otherwise where that's more challenging versus others?

And lastly, what – on the other side of this, if things get back closer to normal, do you think you'll be left with tools that will – you'll still be able to leverage in that environment or they really just – people prefer [indiscernible] (27:13) now?

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

Thanks, Matt. I appreciate the question. We obviously spent a fair amount of time in the script addressing this, and you spent a fair amount of time asking a very good question. I mean at the end of the day, I think this starts with the fact we've been doing this for 75 years. We've been in this homogeneous segment servicing educators for a very long period of time. And if you think about the changes that have occurred in our country and to the education system over time, we're a company that adapts to a fair amount of change and manages this quite well.

Regardless of the outcome of a pandemic, this is a company that adapts well to change. I mean, our core principle of protecting educators and helping them protect what they have today and secure their retirement is just something that we do. Not being pure product purveyors is probably also helpful to us, that solution orientation that we provide. We know this space well. We have strong relationships. We talk to educators. We see what they face, and we adjust our business model. I mean let's face it in this kind of environment, we're not alone. Every business, every individual has to adjust to this very odd set of circumstances that we find ourselves in. And there's a lot of unknowns. But what we do know is that there will be some limit to school access.

So what we did is we assumed that we would have little or no access for this entire school year, and we built that into our business – into our business plans. We've completely virtualized our sales process. Most of the capabilities were already built because of the modernization efforts that we built into our PDI plans. Whether it's e-signature or electronic applications, online enrollment, quick quote capability, all those things are very helpful in this type of an environment. You combine that with some brand new capabilities, online financial workshops that we're getting an awful lot of people posting to. And as we mentioned in our script, we're also highlighting a lot of new digital engagement strategies and events, and we'll scale up those that are successful and probably not repeat the ones that aren't. For me, when I think about two things, our relationship model, very helpful in this environment and our multi-line model. I mean we're just not model line product purveyors, we have strong relationships with this very tight homogeneous market niche that we have.

You asked a question about what's a little more challenging, I think I'd say it's probably the Supplemental space sales for supplemental for us and quite frankly for the whole industry. Traditionally, we're built more around worksite marketing, but again, I think this is where our multi-line model is very helpful. One of the things, I'd say, is about a third of the Horace Mann agents are already selling supplemental insurance and incorporating that into their repeatable sales process into their overall relationship with the client, and I think this is where our cross-selling opportunities are very helpful to us.

We already took this opportunity to accelerate the NTA agents selling Horace Mann products. If you remembered, we always talked about that as being the longer pole in the tent. We accelerated it. It made sense for us to do that, and that will be complete this fall. And I think I'd sum it up by saying the need for our products doesn't go away. It may be postponed, people may have more pressing issues that they're concerned with, but they still need the products in the solution orientation that we bring to the table.

And lastly a comment on momentum. Obviously, we did see a hit to new sales in the second quarter, and I think that's understandable, and you're seeing that across the industry, but what we are seeing is May was better than April, June was better than May, July is better than June. So the momentum is picking up, as people learn the new way to navigate in this environment and take advantage of the relationships that they took years to build. Long answer to a short question, but I wanted to make sure that I got it in there because I do think it is the question and it's a right question but we're very optimistic.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Right. No, that's very helpful. I guess just one follow-up to that. Just you guys are clearly, it sounds like, tackling this very head on and adapting very quickly. Do you have a sense just in general terms, would you characterize your competition is doing the same, or are they dragging feet more or they just don't have the tools to do it because I know a lot of this stuff you guys had kind of underway already before this happened? How would you kind of classify the competition generally on that?

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

A

I think what I'd say is I'm glad we're us. I don't want to speak about competition, but I'll speak about us. I mean we can pivot. Now with the addition of our Supplemental product line, the things that we did in 2019 to position ourselves, I think we did what we said we would do, and we've built a very strong total value proposition for what educators need probably now more than ever. So, I believe in our agent's ability to respond. I think their relationships with the schools that they work with and the individual customers that they work with is really important and something that we can leverage. When you think about school access, we're in half of the buildings across the country. We have relationships, some extremely strong, some just beginning. I think it's harder to start a school relationship virtually, but I give us a better shot at doing that because of the relationships we have with the school next door or the relationship we have with the association that someone [indiscernible] (33:52) to or that a teacher moves to. We're known in the space. We're number one in the market doing what we're doing with educators.

And so I give our chances to navigate this environment much higher probability than those that are trying to do it on a single product basis. Many of our agents have full access now. Many of our successful agents don't have physical access. When you saw some of the access restrictions coming from unfortunate school shootings or violence in our school systems, we adapted well to that and got through it. So we know the market, and I like the fact that we've got a full cadre of products to sell these educators and even more importantly built on solutions understanding what they're facing right now. And I think we all know with what we're watching on TV and reading in the newspaper, it's a difficult environment for them to navigate and we're here to help them through that and they're turning to us.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. Well, thank you very much for the color and yeah, best of luck.

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

A

Thanks.

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

A

Thanks, Matt.

Operator: The next question comes from John Barnidge with Piper Sandler. Please go ahead.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you. Can you quantify COVID claims experience [indiscernible] (35:15)? It was de minimis, but just wanted to figure that out.

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

A

Sure, John. This is Bret. I think even taking you back to the first quarter, we mentioned we only had a couple COVID claims on that side. But through the second quarter, cumulatively both first and second quarter, we've had about 24 claims with an average face value of $30,000. So from a dollar amount, just slightly less than a $1 million. And I would also add that when you kind of look at our mortality, the increase in the mortality is actually greater than the prior year, and it's really a matter of fact that the prior year was more favorable than the current year being unfavorable. We're actually pretty much spot on to our plan. But that kind of gives you the magnitude, slightly less than $1 million.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Okay. Great. Thank you very much. My other question I have, there was a comment in the press release about the timeline to achieve some long-term targets may be extended. Can you expound on this a little bit because I know slide deck 7 – page 7 in the slide deck, it still has had double-digit core ROE for 2021 to 2025 [indiscernible] (36:34)?

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

A

Yeah. I mean, the first thing I'd say is I think it's what I just said in response to Matt's question. When you go back and you look at the core components of our ROE improvement that we outlined, those underlying improvements are all there, almost exactly the way we said. Whether it was the reinsurance transaction to mitigate our interest rate risk, whether it was the purchase of NTA to broaden our product offering and improve our earnings, whether it was our auto profitability improvement, or the efficiency expense reduction initiatives, those all added up to the ROE improvement that we said that we would generate.

And when I think about how I think about the timeline, it does get slightly extended because of the softness in the top line temporarily that we and quite frankly, the whole industry will experience. As customers get back to whatever the new normal looks like for everyone, you'll begin to see those numbers start to increase for us and the industry, as we all find our new way and navigate through this. So it isn't – I wouldn't even say it's a pause, I would just say it's an extension in those improvements, and I feel really good that we can check those boxes that we outlined as far as our ROE improvement and set ourselves up really well for the next chapter of our journey.

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

A

Yeah. I guess I would maybe just echo Marita's comments. And we delivered on the ROE that we set out to achieve in 2019, we are certainly delivering them, the 1 point improvement that we set out to achieve in 2020. And yes, we are reaping some benefits, COVID-related, but make no mistake what we set out to achieve, we are in fact executing on those initiatives that we put in place. And obviously, we confirmed our guidance at the end of the first quarter, and obviously, we increased our guidance in the second quarter. And to echo Marita's comment, we feel very good that we're operating from a position of strength. And yes, we are still focused on growth. It may be a more of a virtual flavor to it, but that has continue – has been and continues to be the focal point.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Okay. Thank you. I'll re-queue.

Operator: And the next question will come from Meyer Shields with KBW. Please go ahead.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Great. Thanks, and 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.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Sorry. I want to start by asking about Supplemental, two quick questions. One, is the behavior, policyholder behavior normalizing along with the recovery in driving? In other words, are we seeing the magnitude of the impact shrink month to month?

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

A

And you're talking Supplement, Meyer, just the...

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Yeah.

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

A

...COVID behavior of that group. I would say similar to our comments, and we talked about it that we certainly reaped some benefits in the second quarter with having a full quarter of maybe opting out, not to go to the hospital for minor activities, that certainly benefited the benefits ratio. But I would say like the auto frequency, there is still uncertainty, what the latter half of the year is going to bring there. So we're being cautious with respect to getting ahead of our skies and baking in continual increases in frequency. Yes, there are benefits of frequency, but they've lessened as we've moved out in the quarter. And really, we do anticipate as we talked to in the script that we would anticipate that those getting back to near historic levels. And probably similar to auto, when people delay, sometimes, the severity of those claims can go up too. So obviously, on the P&C side, auto specifically, we are anticipating frequency returning back to more normal levels, but also kind of anticipating severity to probably have a measured increase as well.

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

A

On the supplemental piece, I think Bret is right. And I think about it like everything else we see in the world. There is a closer to normal level that begins to emerge. But you wonder whether it goes back to a full measure pre-vaccine. Right? And that's probably true about everything we see in the world. So we're watching it. You're absolutely right, I think people postpone some of these things for obvious reasons, but you would expect that post-vaccine, you would assume a more normal run rate.

On the sales side of that, there's been a fair amount of research done about whether there's also a pent-up demand for the products post pandemic, as people think about protecting risk, as people think about out-of-pocket expenses after an event like this. So there have been a fair amount of studies and we are encouraged by the fact that the uptick rate from a sales perspective in Supplemental post pandemic might also be favorable.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. [indiscernible] (42:21) helpful. Should I assume that pricing for Supplemental assumes kind of pre-pandemic behavior?

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

A

There really has been no change to the pricing methodology or thought process as it relates to Supplemental. It's pretty standard.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. And then final question on the auto size. So everything that we're hearing this morning is consistent with sort of broader theme of recovering, driving. But I was wondering if you could talk about the stability of the trends that you're seeing right now and your ability to respond dynamically, when we have things like infection rates spiking in a few states and then maybe a plateauing rather than increase in driving.

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

A

Yeah. Meyer, I'm going to actually let Mark Desrochers talk specifically on what we are seeing here at Horace Mann and our actual data in terms of the trends in the driving miles, the driving behavior and how it's impacting our frequency, severity. He can definitely add some color, commentary there. So Mark, if you want to talk through that, that'd be great.

Mark R. Desrochers
Chief Corporate Actuary & Senior Vice President, Property & Casualty, Horace Mann Educators Corp.

A

Yes, sure. Thanks, Bret. Meyer, as you know, we track our HMDrive data, our telematics app, pretty closely, on a weekly or even daily basis watching that data. And as we look at the second quarter, throughout the quarter, as you've heard from other companies, we saw a steady increase in miles driven to the point that it's approaching, as Bret and Marita have both alluded to earlier, near normal levels. But those are different miles than they were from a pre-COVID standpoint. When we look at the data that we're seeing in HMDrive, what we're seeing is what would typically be a lot of miles, say, between 7 and 8 or 6 and 7 in the morning driving to school and then in the afternoon driving from school that those miles have shifted significantly to be spread throughout the middle of the day.

And what we think that's driving is people are driving close to the same number of miles that they were pre-COVID, but those miles being different has caused the frequency while steadily increasing as well throughout the quarter to not increase at the same rate that we've seen the increase in miles driven. The one thing that's really offsetting that is that we have seen somewhat of elevated severity throughout the quarter. So what we would typically expect to be low to mid-single digit severity across the board, now we're seeing more mid to high single digits. And we remain concerned. I think as the year progresses, if unemployment rates stay high, that we have the potential to see increased UIM claims that would somewhat offset any benefits that we may continue to see on the frequency side.

Meyer Shields
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Fantastic. Thank you so much.

Mark R. Desrochers
Chief Corporate Actuary & Senior Vice President, Property & Casualty, Horace Mann Educators Corp.

A

You're welcome.

Operator: And the next question will be from Gary Ransom with Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes, good morning. Hi.

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

A

Good morning, Gary.

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

A

Good morning, Gary.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

I wanted to ask about the PG&E recovery. Is the – the $4.8 million portion, is that just from your 5% sliver. Is that...

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

A

That's correct.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

[ph] how to think about (46:05) that number?

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

A

Yeah. That's exactly right, Gary, and then the remainder is the return of the reinstatement premium. So the sum of those two pieces equates to the $8.3 million that we'll recognize in the third quarter.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. And I – so if I [indiscernible] (46:24) up that $4.8 million, I can figure out what the reinsurers receive in the process.

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

A

Correct.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. All right. Yeah, I did want to ask a little bit about the severity question that you touched upon it fairly just now. But a lot of the companies are talking about the higher speeds, the actual higher impact. It's not necessarily just the disappearance of commuting, our fender benders, but the bad claims actually are worse. And I just wondered if you were seeing anything like that as well.

Mark R. Desrochers
Chief Corporate Actuary & Senior Vice President, Property & Casualty, Horace Mann Educators Corp.

A

Yeah. I'll answer that, Gary. Not so much, believe it or not. When we look at the data in HMDrive, we haven't seen significant increase in speeds of our drivers. Now, obviously, we're not immune from the effect of speeding in general that's going on on the highway, so we may – our drivers may not be speeding to the same extent as other companies are seeing, but we certainly run into folks every now and then that have been speeding. And we certainly see no increase in deaths or severe accidents. So it – for us, it hasn't been as much about a significant pop in those kinds of accidents, so that may be why we're not seeing severity even higher which some people had speculated severity could go into double-digits and we haven't seen that as of yet.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. That's helpful. And on the growth potential, I mean, and this – and I'm thinking property, casualty here and just getting new business. I am – everyone is talking about shopping being down generally, but maybe it's starting to return and I just wondered what you're seeing in that regard. Is there – I know you're seasonally different, but as we get close to the beginning of the school year, are you seeing some opportunities to reengage and get a little better growth in new business?

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

A

Yeah. Absolutely, Gary. As I mentioned, we did see momentum ramping up, I mean first folks figuring out their repeatable sales process, the tweaks they have to make, the tools that they have to employ. You kind of have to reinvent as we all are in our daily lives, the way you do things, and our agents are quite resilient in doing that, and we're seeing that momentum ramp up. I like the fact to your point, retentions are clearly holding probably because of the shopping behavior comment that you made. But what I would say is what gives us an awful lot of confidence is the fact that we are in half the school buildings across the country, we have strong educator roots and relationships, and now, we have the ability to cross-sell across that total value proposition. Right? We spent an awful lot of time over the last several years building product and improving our infrastructure and modernizing it, and strengthening the tools that are our distributors have to serve this segment, and it's all coming together.

So when I look at the opportunity for us to cross-sell, now I've got a third of my Horace Mann agents already writing supplemental insurance ahead of where we thought we'd be. And I've got 220 or so NTA agents joining us where that conversion will be complete in the fall where they'll be able to sell Horace Mann products to their supplemental clients. And like we said, this creates – it may be taking a little bit longer than we had originally thought, but make no mistake, it's there, the ability to cross-sell the existing clients and then the ability to take the strength and bringing it to the other half of the schools that we're not in.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Just to follow up on that, when you said complete in the fall, does that mean all the agents will be licensed, complete their licensing process they need to do?

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

A

Yes.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes. Okay. Okay, good. And then maybe my last question is just on telematics and just – is there – has the demand increased for that, as we've seen maybe at some of the other auto competitors? And is there a need for an actual by the mile product that you detect in your teacher community?

Mark R. Desrochers
Chief Corporate Actuary & Senior Vice President, Property & Casualty, Horace Mann Educators Corp.

A

Yeah. I'll take that, Gary. This is...

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

A

Yeah, I mean – go ahead, Mark.

Mark R. Desrochers
Chief Corporate Actuary & Senior Vice President, Property & Casualty, Horace Mann Educators Corp.

A

Yeah. We've certainly seen in the second quarter an increase in our HMDrive registered users of about 30% from where we were in the first quarter and the first quarter growth was about 15%. So we've seen certainly acceleration, I think, in demand for that product that we continue to look to roll it out to more states as time goes on. And regarding the question on mileage, I mean that's something I think we all need to look at and evaluate. Certainly, we have more granular ratings by mileage in our rating plans, but certainly not at a per mile basis like I think you're thinking of.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yeah. That's what I was thinking of. Yes.

Mark R. Desrochers
Chief Corporate Actuary & Senior Vice President, Property & Casualty, Horace Mann Educators Corp.

A

Yeah.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. Thank you very much for those answers.

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

A

Thanks, Gary.

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

A

Thanks, Gary.

Operator: And our next question is a follow-up question from John Barnidge with Piper Sandler. Please go ahead.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you. I'd kind of want to go back to that comment about sequential improvement in sales volume [ph] dropped in quarter (52:31) and into July. [indiscernible] (52:34) lockdown. With July being above June was interesting given the dynamics of the traditional summer months. Do you sense what – you just got a rush of demand in July? Well, how does the July compare to a traditional July?

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

A

Yeah. It is July over July. So it's an interesting question because the way we think about it is the summer the same as a traditional summer, right? Schools closed earlier. Our agents' typical summer activity didn't really become a typical summer activity. When you think about back-to-school, back-to-school wasn't a typical back-to-school. So, we probably did see some smoothing of the [ph] low that would (53:24) typically occur in a normal summer, so I'll certainly give you that. But we were really happy to see agents remaining in the game, agents understanding that this is a atypical environment as it is for all of us, and they're continuing to push. Like all of us, I think that they're expanding their hours, they're expanding their outreach, they're present, and I think that's part of what we're seeing as well.

John Barnidge
Analyst, Piper Sandler & Co.

Q

That's fantastic. And then [ph] my other (53:58) question, I guess you're preparing to have a virtual school year, the entirety, and that's probably prudent. But I was curious what percent of your addressable market of 6.5 million K-12 educators has announced they're returning to a physical environment in the fall at least one day a week? Give me something that...

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

A

Considering that changes daily, if I think that [indiscernible] (54:25) who knows. Whether it's Chicago public schools, Rochester here, Springfield here, Boston, anywhere you look across the country, you get an announcement that we're going to be 100% present and then there were some cases that shut things down and you get an announcement they're going to be 100% virtual and they bring some back.

At the end of the day, we decided very early on that we weren't going to spend a lot of time and energy on whether schools were back or not, we were going to make a planned assumption that we would be virtual for the whole year, plan around that, work really hard on virtualizing our entire sales process, were really hard in bringing the tools that agents need to do this in a new way. And in some ways, it's a forcing mechanism for our agents that might have been somewhat less likely to change their sales process, maybe some agents are little more rooted in a traditional face-to-face sales process. Well, now there's this forcing mechanism as we've all learned through Zoom and other tools that we may not have used in the past that there is a way to do this and do it well.

So we're taking the opportunity to virtualize our sales process, so that when there is physical presence either now in the short term or eventually in the long term when physical presence is there, it's icing on the cake and not just a cake. So we took that opportunity to say to folks assume that you can't get in and let's be there for the educators. And in some cases, we're finding that we can reach them that they're posting to our online webinars. You saw the increase in Retirement sales. They are conservative folks that prepare in times like this and they're taking our calls.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you very much.

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

A

Thanks, John.

Operator: Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

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

Thank you very much. And thank you everyone for joining us today. We look forward to connecting over the coming months whether it's virtual, which we're good at or in person. Feel free to reach out if you have any follow-up questions. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.