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Horace Mann Educators Corp. (HMN)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Horace Mann Educators' Fourth Quarter and Full Year 2019 Investor Conference Call. All participants will be in a 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. Ms. Wietzel, 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 fourth quarter and full year 2019 results. Yesterday, we issued our earnings release and investor supplement. Copies are available on the Investor 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 for the Q&A are Bill Caldwell, EVP-Product; Matt Sharpe, EVP-Distribution and Business Development; Wade Rugenstein, EVP-Operations; and Ryan Greenier, SVP-Corporate Finance.

Before turning it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not guarantees of future performance. These forward-looking statements are based on management's current expectations, and we assume no obligation to update them. Actual results may differ materially due to a variety of factors, which are described in our 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. Finally, we wanted to let you know that we will be attending AIFA in early March. We're hoping to see many of you there.

With that, I'll 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 full year 2019 core earnings of $2.20 per diluted share, surpassing our guidance with strong results across all our business lines. Year-over-year core earnings were up threefold reflecting lower catastrophe losses, improved underlying profitability in the P&C segment without sacrificing market share, better margins in the Retirement business, the addition of the new Supplemental segment, and we accomplished all of this while funding for our future.

Further, 2019's results show the potential of our strategic initiatives. By building on our transformational work in 2020, we expanded our market reach to provide solutions to more educators and further accelerate shareholder value creation. Bret will cover the details of our 2020 guidance later in the call. At a high level, we're confident that we can grow our core EPS by at least 20% over 2019 without projecting a significant increase in sales. We expect at least a full point of ROE improvement and remain focused on reaching a double-digit return on equity over the next few years.

Our strong outlook reflects the investments we have made over the past five years in the company's products distribution and infrastructure, combined with the impact of transformational steps we completed in 2019, the acquisition of National Teachers Associates and Benefit Consultants Group as well as the Legacy Annuity reinsurance transaction.

Before I expand on that outlook, let me touch on a few highlights of our operations in 2019. First, we achieved our best auto combined ratio since 2010. We not only met but exceeded our underlying auto loss ratio goal which was a cumulative 5-point improvement since 2017. We actually achieved 6.6 points of improvement over the three years through a combination of underwriting initiatives and rate actions.

At the same time, we've been able to retain preferred policyholders in targeted markets, so premiums are up modestly over the three years. With the property business also profitable, we are well positioned for the challenges facing the P&C market. We continue to work closely with agents to add new P&C business in a growing number of profitable geographies.

Further, we're seeing tangible benefits of our infrastructure investments. Our expense reduction initiatives successfully reduce our 2020 operating expense run rate by at least $15 million. Related severance cost affected fourth quarter earnings by $0.08 per share or a total of $4.1 million. These savings include efficiency advantages due to systems upgrades we have already made across every segment of our business. And the second phase of our Guidewire implementation currently underway will generate benefits in future years.

Similar to the Guidewire claim system implementation, the new P&C administration system offers substantial benefits in terms of data segmentation and analysis, digital capabilities and ease of use.

The transactions we completed in 2019 also play an important role in our strong outlook. Reinsuring the legacy block of annuities, which had a higher crediting rate, has improved our fixed annuity interest spread despite the sustained low interest rate environment that is expected to continue through 2020. In addition to reducing the company's interest rate exposure, the transaction freed up capital that was used to acquire the higher-margin Supplemental business.

We ended 2019 with a significantly improved business mix due to both the de-risking of the Retirement portfolio and the addition of supplemental products. The performance of the new Supplemental segment is not correlated to weather seasonality, like the P&C business, or the mortality risk of the Life business. It is also not subject to interest rate fluctuations like the Retirement segment.

With its more predictable returns, the earning diversification is even more valuable. And another three months into the integration, we remain very pleased with every aspect of the transaction. Today, we have a full complement of solutions that address educators' unique needs and expanded agency force and modernized systems that provide the type of customer experience our educators want and deserve.

Considering that progress in tandem with the profitability initiatives we've completed in 2019, it is clear that we are well equipped to substantially increase our market share in the coming years. In 2020, we expect to make progress on further expense synergies and efficiencies as well as gaining the first benefits of aligning the supplemental investment portfolio with our current strategies.

As we've said before, these achievements are part of our path to a double-digit ROE. As we look beyond 2020, ROE will benefit from additional net investment income from the Supplemental portfolio as well as growth in supplemental products sales including cross-selling these to Horace Mann households. The supplemental product line fits perfectly into our solutions orientation aimed at helping educators achieve lifelong financial success. They are something that we've been asked about by educators concerned with the cost of an unexpected medical emergency or accident that could derail their long-term savings plans.

Before we joined forces, NTA had a 50-year history as a very successful business, offering these important solutions to educators. Our first objective in bringing the two companies together was to undertake a thoughtful staged approach to ensure we're building a base of sustainable growth. I'm very pleased with what we've seen so far including the focus of the NTA agents, who achieved their sales targets for the year. At this stage, most Horace Mann agents have the appropriate licensing and have been appointed by NTA so they can sell the supplemental products. We are collectively working to reinforce the training that helps them incorporate the new products into their repeatable sales processes.

Last month, we hosted our annual national sales meeting and for the first time, we brought our best agents from both companies together with management to share best practices. It was rewarding to see the knowledge embedded in our expanded agency force. By bringing together two such similar mission-centric groups experienced in the same niche market, we truly are able to utilize the best of each company to achieve greater success. Our path to a double-digit ROE relies on factors largely under our control while growth in our existing businesses offers additional potential.

With the addition of supplemental agents we now have a presence in roughly half of the school locations in the country excluding the handful of states in which Horace Mann currently does not do business. There is significant opportunity in both the schools where our current presence is low as well as those where we do not have an active presence.

Before I turn the call over to Bret, I wanted to highlight Horace Mann's commitment to corporate social responsibility as a fundamental element of our business success. For example, we believe that an inclusive culture, in which individual differences are recognized, respected and appreciated, provides value to all of our constituents.

In 2019, we undertook several company-wide events and actions to strengthen our inclusive culture. These included a day of understanding, encouraging meaningful conversations about bias in the workplace and a week of diversity workshops featuring experts from throughout the country. Last month these efforts and others were globally recognized.

For the second year in a row, Horace Mann was named to the Bloomberg Gender-Equality Index, which includes public companies committed to more equal and inclusive workplaces. We're very pleased to be among 325 companies named to the Index. It's a group of some of the best and brightest. While we can always do more to strengthen our inclusive culture, and we're planning on it, it's good to have external confirmations that we're on the right track.

To sum up, 2019 was a strong year that illustrated the strength of our corporate strategy and vision and we're confident we will continue to build on that success in 2020. This year we are celebrating the 75th Anniversary of Horace Mann. Our continued success as a company has and will continue to be largely due to the unwavering commitment to educators that inspired our founders and our vision: To be the company of choice to provide financial solutions to all educators to help them protect what they have today and prepare for a successful tomorrow.

Thanks. 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, 2019 results confirm that we are better equipped than ever before to meet the financial needs of educators. We have become a larger, more diverse company on the path to a double-digit ROE. We expect to see the earnings potential of our business even more clearly in 2020 as we build on our transformational work.

Marita covered the highlights of 2019 results. So let me dive right into the performance and outlook for each segment. Then I will finish up with a few comments on how it all comes together in our EPS guidance.

Let me start with Supplemental. NTA has been part of Horace Mann since July 1 and added $65.8 million in premiums with $8.2 million in new business. The segment represented approximately 14% of total second-half premiums and contract charges and about 30% of second-half core earnings, illustrating the diversification value it brings. Premium persistency was 89.3% with almost 300,000 policies in force. As we've said, premiums for this business are relatively stable quarter to quarter. Net investment income on the Supplemental portfolio was $7.5 million in the second half.

For the six months, the benefits ratio was 37.5% reflecting favorable reserve changes and the operating expense ratio was 27.3%. Operating expenses included $6.6 million in non-cash amortization of intangible assets. The annual run rate for intangible amortization should be $12.5 million to $13 million pre-tax, which could be relatively constant for the foreseeable future. The pre-tax profit margin for the six months benefited from a better-than-expected benefit ratio, so the segment contributed $18 million to core earnings in the second half of the year ahead of our guidance of $12 million to $14 million.

Going forward, we expect the full-year pre-tax profit margin to be in the low to mid 20s with Supplemental adding between $28 million and $30 million to 2020 core earnings. During the year, segment investment income will start to benefit from portfolio repositioning.

Turning to the Property and Casualty segment, core earnings were $54.3 million for 2019 versus a loss of $14.3 million last year. The reported combined ratio of $96.5 million improved substantially over last year to the best it has been since 2015. The full-year reported combined ratio benefited from cat losses that were less than half of our net cat costs in 2018, largely because last year's fourth quarter included the Camp Fire. This year, 13 cat events resulted in $4.4 million in losses in Q4.

On the Camp Fire, we're part of the ad hoc subrogation group that reached an $11 billion agreement with PG&E for subrogation claims. The timing of the final settlement from the bankruptcy court is unclear but the process that will allow us to recover some of those losses continues to move forward. Full-year 2019 cat losses totaled $52 million or 7.6 points to the combined ratio and were in line with the guidance we offered last quarter.

Turning to auto performance, we're very pleased with the results. For the full year, the auto underlying loss ratio improved by 4 points while the reported combined ratio improved by 5.5 points for the year. As Marita noted, our cumulative loss ratio improvement is well ahead of our original objective and it has been a key driver of ROE improvement. Rate increases average in the low to mid-single digits across the auto book and continue to keep pace with loss costs and loss trends remain consistent.

Property also generated strong results. For the full year, the property combined ratio was 94.2%, although we are pleased with the profitability of the line, we will continue to take low to mid-single digit rates in our focus on underwriting and claims initiatives that we expect will bring the line closer to our target of around a 90% combined ratio.

The full-year P&C combined ratio benefited by 1.1 point from favorable reserve releases in both the auto and property books earlier in the year. Total Property and Casualty reserves remain solidly in the upper half of the independent actuaries range. The P&C expense ratio was 26.9 points for the year in line with our guidance.

For 2020, we expect full-year P&C core earnings of $55 million to $60 million with a combined ratio between 95% and 97%, as we expect to maintain the progress we've made on the underlying loss ratios, and make some additional improvement in the expense ratio. And this guidance presumes the cat load would again be in the range of $45 million to $55 million or about 7.5 points on the full-year combined ratio.

Net written premiums for 2020 should be in line with 2019. On the plus side, rate increases continue and we are seeing positive trends in new business in the growing number of geographies that are achieving our profitability targets. We expect this will accelerate over time leading to growth in policy counts and improve retention as the year progresses.

For the Life segment the number of policy issued increased 2% over prior year. Life sales were lower than prior year primarily because of lower sales of single premium products and the introduction of products with pricing based on the updated mortality table. Core earnings for the year were in line with our guidance, as lower mortality cost helped offset higher expenses and lower net investment income. We anticipate full-year total life sales will be flat in 2020.

Our agents continue to help more of our customers see how life insurance can contribute to the financial well-being of their families. We continue to expect long-term sales growth of our recurring premium products. The segment should deliver $14 million to $16 million in ex-DACs earnings in 2020 with a return to modeled mortality.

Before I turn to the Retirement segment, just a reminder that our results since April 1 reflect the annuity reinsurance transaction we completed in the second quarter. The transaction addressed interest rate risk of a legacy block of individual annuities with a minimum crediting rate of 4.5%. The transaction released $200 million of capital, $185 million of which was redeployed to purchase NTA, reducing Retirement segment invested assets effective July 1st.

Under the required accounting treatment for the transaction, elements of the transaction continue to flow through our financials even though they are the responsibility of the reinsurer, RGA. Our balance sheet now shows a deposit asset on reinsurance and total net investment income includes an entry for accreted investment income. The investor supplement shows some of the retirement metrics, excluding the reinsured block to more clearly illustrate the results of ongoing operations.

For the retained Retirement business, at year end, we had $4.4 billion in assets under management and $8.3 billion in assets under administration. Annuity sales deposits were up for both the quarter and the year, and they continue to be an important part of our product set. Annuities appeal to the financial objectives of our educator customers, while complementing our growing suite of fee-based products.

After the reinsurance transaction, the average crediting rate on traditional fixed annuities is now 2.5% versus 3.6% previously. The 194 basis points net interest spread for full-year 2019 includes the 142 basis points spread for the first quarter, which was prior to the transaction. I'll talk more about the interest rate environment in a moment, but we expect the net interest spread between 220 basis points and 230 basis points in 2020.

For the full-year, Retirement earnings, ex-DAC, were $26 million in line with our guidance. Fourth quarter core earnings reflected higher expenses including severance cost as well as lower alternative investment income and prepayments compared to the strong third quarter. We expect core earnings for 2020 to be in the range of $27 million to $29 million. The segment will benefit from a lower expense run rate offset somewhat by lower investment income.

Turning to the investment portfolio. Total investment income for full year 2019 came in very close to our guidance, despite the challenging interest rate environment. Total income on the managed investment portfolio in the fourth quarter was lower than our expected run rate of $62 million. Alternative investment income and prepayments were below the very strong levels of the second and third quarters. As a result the pre-tax yield on the portfolio in the fourth quarter was 4.28%.

With the Fed reducing rates by a total 75 bps over the second half of 2019, yields for public fixed income securities continue to be challenging. The new money rate in the fourth quarter was 386 basis points. We expect further spread compression in 2020 with the new money rate around 3.5% for the core fixed income portfolio. We continue to see more compelling risk-adjusted returns in commercial mortgage loans, private credit and infrastructure and continue to increase allocation to these asset classes via limited partnership investments.

The year-end fair value of this portfolio was $384 million and it contributed nearly $26 million to investment income. We expect to fund an additional $150 million of alternative investments in 2020. With our target return for

2020 on this portfolio between 6% and 7%, its contribution to 2020 investment income should be similar to the 2019.

We expect total 2020 net investment income from the managed investment portfolios, including NTA, will be around $275 million generally in line with the quarterly run rate we've seen since the reinsurance transaction. We expect returns on the fixed maturity portfolio will be constrained due to the rate environment, but we'll benefit and the steady contribution of our alternative portfolio and the repositioning of the NTA portfolio.

Accreted investment income on the deposit asset on reinsurance should be approximately $92 million or about $23 million per quarter. Putting the pieces together, total 2020 net investment income should be flat with 2019, although Retirement net investment income will reflect the segment's small portfolio after the reinsurance transaction and NTA acquisition. NTA's investment income is the primary offset in total net investment income.

In summary, our 2019 results were solid across all segments. In line with our guidance, fourth quarter results included $0.08 of severance charges. As we noted yesterday in the release, we expect full year 2020 core EPS to rise about 20% to the range of $2.55 to $2.75 with ROE up at least 1 point to above 8%. Each segment contributes to our strong outlook. Our guidance for each reflects the 2020 benefit they will see from their share of the $15 million in expense reductions.

To recap, Property and Casualty should contribute $55 million to $60 million to core earnings assuming cat losses at about 7.5 points on the combined ratio. Supplemental should contribute between $28 million and $30 million with rising net investment income. Retirement should contribute $27 million to $29 million, benefiting from a lower expense run rate. And lastly Life should contribute between $14 million and $16 million in 2020, reflecting a return to modeled mortality.

Looking further ahead, future ROE improvement will reflect the NTA integration as we fulfill our cross-sell objectives and align their investment portfolio with our current strategies. Further, the solid foundation, we've built in the past few years will support market share expansion with ROE benefiting from growth across the businesses. Of course, while there are many positive drivers of future ROE, they may be partially offset by factors such as the sustained, low interest rate environment and the additional capital again being created by the business.

Our intent for the excess capital generated by our stronger organization remains focused on the most accretive uses. This includes, one, growing our business at returns that meet or exceed our ROE targets; two, returning a significant portion of annual earnings back to shareholders via a compelling dividend; and third, opportunistically buying back shares when market conditions warrant.

To close, the results we achieved in 2019 set the stage for a continued improvement in 2020 and beyond. Our P&C profitability initiatives have been successful. Supplemental is delivering the intended benefits of revenue and earnings diversification. And finally, our ROE profile is strong and more than capable of reaching double-digits in the next few years.

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

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Well, welcome everyone. We're ready Anita for the Q&A, if you want to poll.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question today comes from Matt Carletti with JMP. Please go ahead.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Hi. I just have a couple of questions. First is, Marita, I was hoping you could give us an update on the Supplemental business, just, I mean, a few things. One is just, maybe a little more detail on the positive reserve changes in the quarter and how we should think about those. But the higher level, how the integration has gone so far and kind of how you feel about it, any updates or things new about how you think about it going forward in 2020?

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

A

Yeah, Matt. I couldn't be more pleased with where we are with NTA. I think the most important point to point out is that despite the distraction that comes with a major transaction like this, the NTA agents actually made their sales plans for the year. I'll let Wade chime in on the specifics to your question. But overall, on every front, we're extremely pleased that the transaction is going very well from an integration standpoint and clearly producing the results we expected during our due diligence. Wade?

Wade A. Rugenstein
Executive Vice President-Supplemental and Operations, Horace Mann Educators Corp.

A

Yeah. Matt, on the comment on the reserves is, as Brett mentioned, the benefits ratio for the first six months reflected favorable reserve changes. That's driven by better morbidity on some of our products that we've seen in the past, and in addition we had a non-educator, really kind of a non-strategic payroll slot with some older policies that lapsed, and that can cause a small favorable spike in reserves also. So, that's really what makes up that change.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay, great. And then just my other question, actually going to shift to the P&C for a second. I mean you made a great progress there, I mean auto is in a very good spot and it sounds like you expect to be stable. Property, been performing well and it sounds like you expect maybe a little bit better. I'm focused on PIF, and I just wanted kind of your thoughts on – that's been under pressure for a while and that's not surprising when you're pushing a lot of rate through a book and kind of re-underwriting it. How do you think about kind of that inflection point or when should we think about the P&C business starting to grow again on a PIF count basis.

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

A

Hey, Matt. Before Bill gets specific with P&C PIF, I think the growth question is the right question and it clearly is our focus. But I think it's important for us to recap a little bit again what we saw in 2019. We're really proud of the heavy lifting and the results we had in 2019. I mean across the board, the 5-point increase in ROE book value, up 11%. We added a 150,000 educator households, we added 220 new agents from NTA, three major transactions including a reinsurance transaction that de-risked our interest rate sensitivity. We added a brand new, new business segment and despite all that activity, we held market share.

I think that's a pretty strong result. And then when we look at 2020, we have an over a 20% increase in earnings without planning for significant growth. I think that's pretty, I think that's pretty solid. And with all that said...

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Sure.

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

A

...it really does set a solid foundation for growth. When you think about our PDI strategy, our product game board is complete. NTA was really with the addition of the supplemental products, the last big product addition that we wanted to do. From a distribution standpoint, our sales force is much stronger. We mentioned in the script that we're in half of the school locations across the country, some with relatively low penetration, so we have the opportunity there as well as the ones that we're not even in.

And from an infrastructure standpoint, our Guidewire implementation really positions us well there with decreased expenses and increased efficiency. So clearly, the opportunity is there. We just don't want to get ahead of ourselves. And with that, Bill, with the Guidewire implementation, can talk a little bit about how he's feeling about P&C.

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

Yeah, Matt. Just a little bit on the sales front. So we are expecting a significant increase in sales in 2020. As you said, while some of that is offset by retention, we still have some rate flowing in from prior years, from 2018 into 2019. Also, significant re-underwriting actions in Colorado, although Colorado had a good year last year, it came off many years of high catastrophe. Certainly California with the wildfire re-underwriting. When the Property goes, there goes the auto. And a lot of good work in Florida, we shrunk Florida significantly. And you'll hear a lot of our cohorts talk about social inflation and I think we're somewhat insulated from that due to our smaller Florida books. So, despite the increase in sales, we are coming up the bottom of our retention number. On the positive side, we did see three consecutive increases in retention coming into 2020 and we expect that to continue. But the reality is that's just a – we're just coming out of that retention hole.

Lastly on Guidewire, that goes live in the next few weeks, significant improvements into our pricing capabilities, our product offering, ease of doing business, our digital capabilities. So we also expect that to provide growth, but remember the way we're implementing that system is on a state-by-state, policy-by-policy basis. So, our first state is Illinois, as those policies expire on our old system, we'll renew on to the new system. But certainly the new business will be available for the whole state when we go live.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. And then just one kind of related P&C question. I see the guidance for kind of flat top line overall. Any thoughts on kind of how that might look auto versus property? Would it look maybe a little bit like 2019 where property grew a little bit, auto shrunk a tiny bit? Is it kind of flat overall, but is it just the question about the component pieces?

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

I'll start with looking at my numbers. I think, I mean, it will be similar to 2019 certainly. We've been very steady with rate in property and auto rate is decelerating. So maybe a slight change in mix but not anything significant.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. Well. Thank you for the answers. And congrats on, I think, what will be looked back at as a very transformational 2019, and congrats going forward, best of the luck, going forward.

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

A

We think so too. Thanks, Matt.

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

Thanks.

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

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thanks. The commentary on the 2020 analysts modeling considerations around a return to modeled mortality in life, is that more just about favorable mortality in 2019 that you think is prudent to start a base off of, or is there any additional commentary?

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

A

Yeah. That's exactly 100% accurate, John. We obviously experienced some favorable results in 2019 coming down from what we experienced in 2018 and it's basically just kind of getting back to the norm. So it's an aging block of business and you'd expect that, so nothing unusual. If you get a favorable one year you're most likely to see an increase in the following year.

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

And this is Bill, John. I would just add, it's certainly within our actuarial ranges and our expectations which is still lower side. So as you plan for next year, we normalize that to account for the favorable mortality in 2019.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Great. And then can you maybe talk about new product development within NTA? Is that something we should expect or really not in the near term?

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

A

Yeah. I can let Wade chime in if he'd like, but from my perspective, I think NTA has the base portfolio of the products that we need. And from our perspective, I wouldn't expect any heavy lifting from a product development perspective. One of the really cool things in the due diligence is when we looked at what our customers were looking for. When you look at the fact that NTA's current portfolio is 80% educator just like our portfolio. They obviously have the products that our educator customers are looking for, so we wouldn't expect a significant amount of product development. I don't know if you have anything to add to that, Wade.

Wade A. Rugenstein A

Executive Vice President-Supplemental and Operations, Horace Mann Educators Corp.

Yeah. No, I think that's fair. I mean, we always, on a year-by-year basis, look for trends around cancer and heart and how those are being treated and might make some minor adjustments. But I agree we have the products that we feel comfortable with and certainly support the education community.

John Barnidge Q

Analyst, Piper Sandler & Co.

Great. And then just one quick one. Have you changed the underwriting standards in your life insurance products for teatures that vape or use e-cigs?

William J. Caldwell A

Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

No there's been no change.

John Barnidge Q

Analyst, Piper Sandler & Co.

Okay. Great.

William J. Caldwell A

Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

We get that question a lot around marijuana and that's just considered a tobacco. And we have a tobacco rate and that's included there as with the cigarettes, but not significant.

John Barnidge Q

Analyst, Piper Sandler & Co.

Okay. Thank you very much. Congrats on the quarter.

Wade A. Rugenstein A

Executive Vice President-Supplemental and Operations, Horace Mann Educators Corp.

Thanks.

Marita Zuraitis A

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

Thank you.

Operator: The next question comes from Meyer Shields with KBW. Please go ahead.

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

Q

Great. Thanks. Good morning. One basic question. We're not seeing it in the numbers, but I'm wondering as the general employment numbers domestically remain very strong is there any under-the-surface impact on either new agent recruitment or retention?

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

A

No, we don't really see that. As a matter of fact, when we looked at our agency plant across the bifurcation that we used. We've got three swimlanes. We have a new agent segment, we have a growing and developing segment and then we have a well-established segment. In our new agent segment, we've put a lot of focus on new agent recruiting. Obviously, that's also the place where we're looking to make sure that the NTA agents over time have the ability to sell Horace Mann products, and the Horace Mann agents getting up to speed on the supplemental products. And in that new agents swimlane, we have been able to attract the new agents that we want, according to our numbers in that model and we feel good about the new agent recruitment there.

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

Q

Okay. Fantastic. And I think Wade touched on this. I just want to confirm that the reserve release in supplemental in the fourth quarter, that doesn't have any implications for current pricing, does it? In other words, does it suggest the current pricing is too high, margin's too high or whatever?

Wade A. Rugenstein
Executive Vice President-Supplemental and Operations, Horace Mann Educators Corp.

A

That's correct. Yes. Yeah.

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

Q

Okay. Fantastic.

Wade A. Rugenstein
Executive Vice President-Supplemental and Operations, Horace Mann Educators Corp.

A

And it's quite a bit related to morbidity, which obviously ties into loss ratios.

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

Q

Perfect. Thank you so much.

Operator: The next question comes from Gary Ransom with Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes. Good morning. I wanted to ask about this, the supplemental reserve, also just more from a qualitative point of view of whether this is a – are the reserves being run similarly to the way they were under the prior ownership, where I viewed it as conservative and maybe overly conservative? And I wasn't sure if that has changed at all, or if there's any way you can describe your strategy of reserving in that in that category or that segment?

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

A

Gary, this is Bret. And let me start, and if Wade wants to chime in to add color, I'll let him do that as well. But kind of a couple of pieces to your question. Certainly with the acquisition of NTA, we're basically required to update the reserve factors, if you will, to reflect experience. And I would say, similarly to Horace Mann, NTA's reserving practices in the past have been on the conservative side, and we don't really intend to change that practice at all. We're not going to run thin reserves. So, we did have a portion of the reserves that had to be trued up as required by purchase accounting – PGAAP – on a acquisition.

Wade also added some color about losing a non-educator group, better morbidity. So, all in, there were some benefits of 2019, and probably expect the factors going forward as we add new business, new products that those would be set with a certain level of conservatism built into those. So, no, we're not intending to change the reserving practices of NTA in the past. Ad like the non-NTA reserves here, we intend to carry those on the conservative end of the range.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Just so I understand the nature of this, I think of these products as largely having fixed payments that if you put it into property and casualty terms, the severity is fairly well known and we're just talking about frequency. Is that a reasonable way to think about it or is there more to it than that?

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

A

No I think that's a very fair description Gary.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay.

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

A

And I think – this is Marita. I think that's why when we were looking to either build, buy or bolt-on a supplemental product offering, this 50-year old company that's been in the marketplace with educators doing it this way for a very long period of time was a nice clean bet because of some of the things that we're talking about now. Very clear understanding of the products. Our educators buy these products because they can't afford the out-of-pocket expenses from an unexpected event. But it's very clear-cut and easy for us to get our arms around.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Thank you for that. Just another question on the frequency and severity trends in auto also. If you could – I assume your frequency trends are still going down as in what we see in the industry. But on the severity side, there are a lot of signs of acceleration in some of the industry numbers. And I just wondered if you could comment on that. I guess I'm thinking both will be mostly BI but there is a little bit in the auto repair side as well.

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

Sure, sure. Got it. The – certainly severities are higher than what I would call, inflationary. A lot of that is due to the social inflation that's being talked about as well as the technology in vehicles. But we are still seeing improved frequencies, which is an offset to that. So, I would say, I don't think we're seeing it as high as much social inflation as some other companies. A lot of that is because of the mix issues that we've been forced over the last couple of years as well as a very tight early identification program with respect to claims.

Unlike a lot of our competitors, we can engage with our sales force very quickly to get engaged with the claim process early on. And it tends to be those small fender benders that could go sideways pretty fast. So, our agents are engaged, they're getting us that information faster. The quicker you can document the claim, the less chance are that it kind of spirals out of control. So, we think we have the processes in place to control it, but again, at a high level, there are some more-than-inflationary increases in injury.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

All right. Thank you. And just one last question on the implementation of Guidewire. As you mentioned a couple times that this will provide some additional analytics and capabilities, and I'm trying to understand how big of a change that is. Will this really be able to give you better selection and pricing power as you market the auto product or is that...

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

I would say.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

...any qualitative there.

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

Sure, sure. I would say our analytics are very strong. A lot of work goes into our pricing segmentation. I would say that the translation of that into our technologies, we don't have – I'll use a simple example as many fields as you might need, to have the most sophisticated products. And Guidewire certainly opens that up. The ability to tie in multiple third-party data sources on demand, greater discounts around being paperless and things that help expenses, there just a whole slew of benefits that we get because the system is just more flexible.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. That's helpful. Thank you very much.

William J. Caldwell
Executive Vice President-P&C and L&R, Horace Mann Educators Corp.

A

Thank you.

Operator: This concludes our question-and-answer session. I would now like to turn the conference back over to Heather Wietzel for any closing remarks.

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you everyone for joining us today. We look forward to seeing many of you in the coming couple of months and if there are any questions in the interim, feel free to give me a call. Appreciate it. Thank you.

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