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Horace Mann Educators Corp. (HMN)

Q4 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to Horace Mann Fourth Quarter 2018 Earnings Call. At this time, all participants are in listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

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

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

Thank you, Cheri, and good morning, everyone. Welcome to Horace Mann's discussion of our fourth quarter and full-year 2018 results. Yesterday, we issued our earnings release and investor supplement. Copies are available on the Investor's page of our website, along with our investor presentation, which was posted this morning.

Our speakers today are Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer. Bill Caldwell, Executive Vice President, Property and Casualty; Bret Benham, Executive Vice President, Life and Retirement; and Ryan Greenier, Vice President, Corporate Finance, are also available for the question-and-answer session that follows our prepared remarks.

Before turning it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not guarantees of future performance. These forward-looking statements are based on management's current expectations, and we assume no obligation to update them. Actual results may differ materially due to a variety of factors, which are described in our press release and SEC filings. In our prepared remarks, we use some non-GAAP measures. Reconciliations of these measures to the most comparable GAAP measures are available in the supplemental sections of our press release.

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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. Yesterday evening, we reported a fourth quarter core loss of $0.21 per diluted share, reflecting the Camp Fire's unprecedented level of losses, the challenging investment environment, and transaction-related expenses. Underlying performance was solid as we continued to make progress on our strategic initiatives.

The Camp Fire accounted for the majority of the quarter's losses with gross losses of about $150 million as we previously disclosed. The total financial impact was $38 million pre-tax or $0.72 per share after tax. This was not a typical wildfire and it was an unprecedented event for Horace Mann. Situations like this is why we have our conservative reinsurance program, which provides coverage for $25 million in losses up to $175 million. In fact, the Camp Fire was the first claim we've had against that program since the equally unprecedented Hurricane Katrina in 2005.

Even though our losses from the Fire were not disproportionate to our implied market share, we're looking carefully at what we can learn from this type of event in the context of the growing frequency of more severe weather events. We are continually evaluating our aggregation management, underwriting standards and reinsurance strategy to ensure our property line achieves profitability targets in the long term. Remember, in 2016 and 2017, even with elevated catastrophe losses, we achieved combined ratios below 100.

Before moving from the Camp Fire, I want to take a moment to thank our claims professionals, our agents and our contact-center personnel for their quick and compassionate response in taking care of our customers. We take our responsibility to our policyholders very seriously, and these representatives help us deliver when it matters most. From making wellness checks on every policyholder in the affected area regardless of claim status to delivering new supplies to schools in need, our staff went above and beyond to help the communities of Paradise and Chico begin to rebuild.

Turning to the full-year results, our earnings per diluted share of $0.68 were below prior year due mostly to the impact of the Camp Fire and other catastrophe events throughout the year. These results certainly do not represent the earnings potential of our business or capture the progress we are making on our strategic initiatives to drive profitable growth and return to a double-digit ROE. In 2018, we saw important progress on each of the three levers that we've identified to drive ROE, most significant is restoring profitability in our Auto line of business. We finished the year with an underlying Auto loss ratio improvement up 2.6 points exceeding our 2018 goal for this metric and further improvement anticipated in 2019.

Second, Retirement and Life sales continue to outpace our target with 33% increase in fee based Retirement sales and a 20% increase in Life sales. And third, we continue to exercise a disciplined approach to expenses prioritizing initiatives that support our business strategy.

As we look forward to 2019, we are forecasting EPS of $2 to $2.20, and a core ROE in the range of 7% to 7.5%, putting us back on track to return to a double-digit ROE even before the benefit of the pending NTA acquisition. Bret will talk about the details of our guidance for 2019, but before we do that I'd like to take a step back to provide the strategic context of why we feel confident in our long-term outlook.

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Our company's unique value proposition and the strategy to unlock its potential hasn't changed in the five years since I came to Horace Mann. We provide solutions tailored to educators at each stage of their lives empowering them to achieve lifelong financial success. To bring this value to more customers and achieve profitable growth, we built the long-term growth strategy designed to meet the long-term range of the education market's financial needs through what we call PDI. Products designed to meet educators' needs and protect their unique risks, knowledgeable trusted distribution tailored to educator preferences, and modern scalable infrastructure that is easy to do business with.

We have continuously evaluated how best to deliver the P, the D, and the I whether to build capabilities internally when we have the expertise and risk appetite like we did with the retirement and life product suite, to partner with organizations with specific expertise like we did with many of our specialty coverages through the Horace Mann general agency, or to take advantage of unique opportunities to purchase companies that advance the PDI strategy in the education market and make financial sense.

Retirement plan provider Benefit Consultants Group advances all three components of the PDI strategy. It improves our products by providing plan design and administration capabilities that are key to being competitive in the employers' space. BCG also brings a new, well-respected and established network of distributors, and BCG improves our infrastructure with an efficient and scalable ISO 9001 compliant platform that delivers solutions in the way that employers prefer them.

Taken together, these capabilities will bolster the value proposition we provide to school districts nationwide and support Horace Mann's growth over the next three years to five years. The deal closed on January 2 and we are now actively working to integrate our Retirement Advantage product onto BCG's platform.

With the planned acquisition of supplemental insurance provider National Teachers Associates, we gain roughly 150,000 additional customer households, about 80% are educators with little expected overlap with our customer base. We gain a complementary product set that enables us to better meet the financial needs of educators, more than 200 additional points of distribution and an experienced team focused on delivering great customer experiences.

As we mentioned on our call with you in December, we originally began discussions with NTA for a potential partnership. But the more we talked about the company's missions, strategies and goals, the more we realized that we could accomplish more as one company. We are working with the relevant departments of insurance to finalize our applications with an anticipated close date in mid-year. In the meantime, our cross company integration team is building plans so that we can connect the companies effectively and efficiently shortly after close and hit the ground running.

On day one after closing, Horace Mann will have a new product line that diversifies our revenue mix, reduces earnings volatility, and adds geographies. Plus we expect to see a full point of ROE improvement in the first 12 months after closing before any synergies. Our leadership team is hard at work to make sure we take full advantage of the additional opportunities with this acquisition, including leveraging cross-sell and cost savings opportunities.

In summary, Horace Mann is on the cusp of being the company we started describing five years ago, offering a full suite of products educators need, delivered in a way that's tailored to their preference, and built on systems that are easy to do business with. To underscore this point, I just got back from our Annual Sales Meeting in Nashville last week. There's a tangible energy and excitement in our agency force about new products, upgraded systems, and the ease of doing business improvements. They also see the exciting potential to reach more

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educators with a streamlined, proven approach, as well as provide those educators with more solutions to achieve lifelong financial success.

Before turning the call over to Bret, I wanted to note that we published our second corporate social responsibility report in December. It tells the stories of how our company and our employees are living our commitment to educators, and making a difference in the world around us. In fact, last month, we were named the 2019 Bloomberg Gender-Equality Index, which recognizes commitment to advancing women in the workplace. Promoting diversity and inclusion is an important objective of ours, and we appreciate the recognition for that aspect of our overall commitment to making a difference to our communities, our customers, employees and our agents.

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. Marita described our view of our financial performance for 2018 and the fourth quarter, and I'll reiterate. The results we're reporting do not represent the earnings potential of our business, nor do they capture the progress we're making on our strategic initiatives to drive profitable growth and return Horace Mann to a double-digit ROE.

So what happened, it's been discussed all year and should be no surprise. Cat losses were nearly 2.5 times higher than what our modeling anticipated or what our historic average would imply. You can measure the impact of those losses in different ways. But one would be to say that cats cost us over three points in ROE. In the fourth quarter, the Camp Fire alone accounted for $0.72 per share of $0.85 from catastrophe events, clearly making it the single most significant factor to the quarter and year. We're not ignoring the risk associated with heightened severity and frequency of severe weather, but we also know that the Camp Fire was the first event to reach our re-insurance retention since Hurricane Katrina in 2005. In other words, it was unusual.

In addition, in the fourth quarter, expenses associated with the two transactions we announced during the period to help drive the long-term value had an $0.08 impact on core earnings. Further, DAC unlocking due to the volatile equity markets in the later part of the year had a $0.07 impact. I'll note that we've already recouped about half of that so far in the first quarter.

Based on the progress we did see on the key drivers of ROE going forward, underlying Auto loss ratio improvement, fee income growth and continued expense discipline, we do expect 2019 to better reflect our earnings potential. ROE should be in the range of 7% to 7.5%, moving us back towards double-digits. EPS should be in the range of $2 to $2.20 without any contribution from NTA. And as Marita mentioned earlier, with NTA's contribution, we anticipate ROE increasing to 8% to 8.5% before cross-sell or other synergies.

In particular, our guidance assumes about $10 million more in catastrophe losses than we assumed would be a reasonable cat load for 2018, and $5 million to $6 million less in total net investment income than we reported for 2018.

Pre-tax, that's about $15 million affecting our after tax EPS guidance by about $0.25 per share. In a moment, I'll cover segment performance and the specific drivers for each business. But first, I want to talk a bit about why we expect an even more challenging investment environment.

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Over the past 18 months, we've been upgrading the credit quality of our portfolio as we continue to believe we are in the late stages of the economic cycle. Today, the overall credit quality of the portfolio is A-plus, a notch above our historic average quality level. We believe our prudent investment positioning will serve us well to avoid significant impairment in credit losses in an upcoming recession.

In addition, the movement up in quality has created a sizable amount of bandwidth to take on additional credit risk when spreads widen, which is typical as economic volatility increases. We are confident this portfolio position will serve us well over the long term. These actions are consistent with our approach at the tail end of the previous credit cycle. We identified the heightened possibility of a recession and positioned our portfolio accordingly. This allowed us to opportunistically add credit risk through the financial crisis, which resulted in strong portfolio returns over time.

Before I turn to the segments, let me break down our 2019 investment guidance into three components. Number one, prepayments; number two, new money rates; and thirdly, alternative returns. As I mentioned earlier, we expect net investment income to be $5 million to $6 million below 2018's results. The majority of that decline is related to a lower level of prepayment activity. In 2018, we had $16.8 million of prepayments, which was nearly double the level of prepayment activity we had forecast. We are assuming prepayment activity reverts back to more normalized levels in 2019. As a result, our guidance includes a total of $6 million pre-tax of prepayment activity.

In addition, our investment outlook continues to be pressured by a lower new money rate compared to our average portfolio yield. For full-year 2018, our pre-tax investment portfolio yield was 5.11%. This exceeded our average new money rate by over 100 basis points. Our 2019 guidance includes a new money rate assumption of 4.5%, which is based on increasing interest rates, as well as modestly wider spreads for most asset classes. Because our new money rate is still below our average portfolio earned rate, we expect to see further spread compression in retirement, as well as lower net investment income life and P&C.

Finally, our expectation for alternative returns is similar to 2018. While these returns can be choppy from quarter-to-quarter, overall, this asset class generated an average return of about 6% for full-year 2018. At year end, our alternative portfolio had a fair value of about $350 million. Assuming a similar return, we expect these investments to generate slightly more than $20 million of net investment income in 2019, representing an increase of $4 million over 2018.

Turning to P&C segment. For the year, written premiums excluding reinsurance reinstatement premiums came in about where we had anticipated with rate running a bit ahead of plan and Auto PIF a bit behind plan. For 2019, we expect a low single-digit increase in total net written premiums again primarily due to rate increases that will average in the mid-single digits across the book. In property, we filed rate increases to address higher cat and non-cat weather losses in many geographies. Where needed, we're still filing rate increases for Auto to stay ahead of loss cost trends.

I'd also like to mention that we are solidly in the upper half of the independent actuaries range for total P&C reserves. We expect overall P&C PIF will be down slightly. In selected markets that no longer meet our performance targets, particularly in the southeast, we are typically shedding monoline auto and non-educator business, which led to a decrease in overall Auto PIF in 2018. At the same time, in the growing number of geographies that are at or above profitability targets, we are seeing new business growth and we expect that to accelerate over time and drive higher PIFs.

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Keep in mind, the cross-sell opportunities from NTA are not yet incorporated into these estimates and will offer additional upside going forward. Importantly, the rate actions as well as the compounding effects of previous year's actions should lead to further improvement in the Auto underlying loss ratio of about 2 points from the 74.6% for 2018. We expect Auto to be at breakeven on underlying basis by year-end. In addition, the property underlying loss ratio should improve another 3-or-so-points from 46.2% in 2018. We expect the expense ratio to remain within a 0.5 point plus or minus of 27%. In 2018, the full-year ratio was right at 27% although it has and will fluctuate quarter-by-quarter because of the timing of expenses.

As I noted earlier, our estimate for 2019 catastrophe losses is $45 million to $55 million or 7 points to 7.5 points, up 20% what we had initially included for 2018. We are more heavily weighting more recent years in our forecasting to reflect the impact of sustained elevated catastrophe loss trends.

Note that our historical pattern pre-2018 indicates we would incur about half of those losses in the second quarter. Wind and hail activity across the Midwest has made the second quarter historically our most active catastrophe quarter. Also, for 2019, our reinsurance structure is unchanged with premiums rising $1.3 million. Our target for the combined ratio for the P&C business for the full-year is the high 90s.

Turning to the Retirement segment, we are very pleased with the growth in sales of fee based products that complement our selection of spread based annuity products. Annuities continue to be an important part of our product set as they appeal to the financial objectives identified by our educator customers. Segment earnings were impacted by the lower spread compared with last year.

As I noted, in 2019, we expect the spread to be in the mid-140s declining from 2018 for the investment related reasons I discussed earlier. The negative DAC unlocking for the quarter and 2018 was largely due to the weak equity markets in late 2018. Through January month end we've effectively reversed about half of the fourth quarter loss.

As a result of the lower spread in the business investment, core earnings excluding DAC unlocking were down about 10% for 2018 to $44.8 million. Looking to 2019, we expect earnings on the same basis to be in the range of $39 million to $41 million, largely driven by our expectations for continued spread pressure and lower portfolio yields.

Last but certainly not least, we were very pleased with the continued strong growth in new policy issuance in the Life segment. Our agents continue to introduce educators to the right products to address their financial needs while leveraging our recently-introduced ease-of-doing-business initiatives to sell more policies. We expect continued growth as more agents embrace the opportunity to help more customers see how life insurance can contribute to the financial well-being of their families.

As mortality costs have trended below actuarial assumptions for a number of quarters, we're modeling a return to a more normalized trend. Due to lower net investment income, we expect earnings excluding DAC unlocking of $15 million to $17 million with sale growth in the double digits.

Stepping back to our overall outlook, our guidance assumes no contribution from NTA, although we expect to close on that transaction mid-year. In the first 12 months after closing, we expect an additional $15 million to $20 million in after-tax earnings and 100 basis points to ROE. As we look out further, we continue to expect an additional $1 million in after-tax net investment income by 2020, and cross-sell initiatives with NTA to provide an initial $5 million to $7 million after-tax run rate contribution to operating earnings by 2021.

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When we announced the transaction, we estimated deal-related expenses would be in the range of $4 million to $5.5 million after tax. The majority of that was included in the $3.5 million in corporate expenses associated with both transactions recorded in the fourth quarter of 2018. The remainder will be concentrated in the quarter that the transaction closes, although we will incur some expenses in intervening periods. As you saw in our release, we are including those expenses in core earnings.

In summary, the results of the fourth quarter and by extension 2018 were below our expectations, largely due to external factors that don't detract from the viability of our long-term strategy. In fact, we made improvements to our key drivers of ROE improvement and expect our progress will continue. We've announced thoughtful, significant transactions that better position us to meet the product, distribution, and infrastructure needs, and expectations of the nation's education market. We're prepared to execute on those opportunities in 2019 and beyond and are very excited about what the future holds for Horace Mann.

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

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

Thank you. Cheri, if you could queue for questions.

QUESTION AND ANSWER SECTION

Operator: Yes. [Operator Instructions] Our first question is from Christopher Campbell with KBW. Please proceed with your question.

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

Q

Yeah. Hi, good morning.

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

A

Hey, Chris.

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

A

Hey, Chris.

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

Q

Yeah. I guess my first question is just kind of on the guidance. So, if I'm looking at the overall original 2018 target on Slide 16 of the deck you guys have 7.6%. Now the core ROE expectation is 7 bps to 750 bps (sic) [7% and 7.5%] (00:25:23) which sounds like there is some net investment income issues. But it seems like you guys are still on track on the P&C core loss ratio improvement, which I know was like the overall target was about 500 bps to get you guys to double-digits. So I guess just how should we think about like when would we expect in terms of timing to get to double-digits at this point. Excluding the extra 100 bps that you guys are expecting per synergy from NTA?

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

A

Yeah, Chris, this is Bret. Let me just begin by saying that our opinion on our financial strategy and the value of our company hasn't changed one bit since what we've been talking about since we began this ROE journey. We feel we have a very compelling value proposition and are very confident in its trajectory. And I think as we've said before that the return to a double-digit ROE, it's a multi journey, and obviously, in 2018, we were impacted by the outsized cats, if you will, compared to our historic averages. So, when you look at that guidance that we're coming out with this year, yes, in fact that is below the guidance that we came out a year ago, mainly because of two items. I mean we have factored in $10 million more in catastrophe loss as bringing that cat load up to 7% to 7.5%, which is an increase from what we've estimated in prior years, and then also as we've talked about the lower net investment income of about $5 million to $6 million in total for the organization. So it's really those two items there that gets you to that drop in the guidance coming out this year versus what we did a year ago.

And if you recall last year too, I believe we came out with guidance that was below where the Street has, and it was all related to net investment income. I would also say that, we tend to be conservative or cautious with our net investment income projections. And we did get back to basically flat net investment income for 2018. As you recall, when we went into 2018, we were basically projecting a decline of $10 million. But as we've disclosed and discussed with you throughout the year, we did benefit from increased prepayments.

And as I said in my earlier remarks, we had over $16 million in prepayments, double of what we actually anticipated, but we're taking that back down to $6 million. So if we get higher prepayments than what's in the plan, if we get a new money rate that exceeds the 4.5% that's baked into our new money rate for and perhaps we'll exceed the expectations. But I think we're somewhat cautious on the net investment income front in light of the markets. And obviously we are being impacted by the quality of our portfolio as well, taking it up in quality.

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

A

Yeah, I think that's right, Bret, to put a finer point on it. When I think about the three levers we identified to drive ROE improvement. First, restoring Auto profitability in the book and the fact that we're ahead of our initial plans on that and I've already gotten the one that we talked about last year, the 2.5 we actually exceeded that with 2.6, more built into 2019. I feel very confident in us being even ahead of ourselves on Auto loss ratio improvement. When I think about fee income, really strong fee income growth from the Horace Mann general agency with a 33% increase in Retirement fee products is a nice start to that lever that we identified, and expenses holding relatively flat outside of the acquisition expenses.

So when I look at those levers, I feel good about what we identified to improve ROE. And then I think about new levers that we didn't have when we talked about getting to a double-digit ROE. With a full point improvement with NTA right out of the blocks before you even started thinking about cross-sell opportunities and cost synergies, and then the benefit – the benefit that BCG brings to us in that in that employer space, we even have I think more levers that we didn't have when we identified our track to get back to a double-digit today than we had when we identified those levers.

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

Q

Got it. And then you guys haven't quantified any expected ROE impact from BCG yet. Correct?

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

Correct. The only thing that we've stated publicly is probably for a couple of years to be a non-contributor of any significance in the first couple of years.

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

Okay, got it. And then I guess...

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

And then the one thing Bret didn't mention was cats, and the only thing you know about cats is your guess is going to be wrong, right. But we do know that the elevated cats we saw in 2016 and 2017 and to reiterate with those elevated cats we still ended the year at a better than 100 combined in-property in both of those years obviously with the Camp Fire this year unprecedented, we didn't. But feel good about the underlying performance of our property book even when we have elevated cats. But when you take 2016, 2017 and now 2018 and update those more recent years, it's prudent to put more cats in the plan. But it's just a plan and it'll be what it is. All we know that whatever number we pick is going to be wrong.

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

Got it. And then just kind of following on – that's a good point, Marita. If I'm looking at just the core combined ratio ex-cat and then prior year's development like going back in time like 2008, it seems like you guys are pretty much like averaging about a 93%, but the cat loss ratio usually adds about like just on average, including the most recent year, that adds about 10%. So, I guess I'm thinking right you guys are good in terms of a core combined ratio. But I guess the first question is this 700 bps to 750 bps (sic) [7% and 7.5%] (00:31:48) far enough given your 10-year average is 10%. And then also could this be an opportunity to buy more reinsurance to help better control this catastrophe costs so that like it's less of a drag on your overall combined ratio?

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

Yeah. So, Chris, this is Bret again. So, the 7% to 7.5% that I'm going to maybe dovetail on Marita's prior comments, the last two years prior to 2018, our average cats were about $60 million. Prior – and those were in the kind of 9% to 10% cat load. But prior – the prior five years averaged about $40 million. So, here again, you're using the 10-year average. We're using more recent vintage in here again not assuming that there's going to be a $100 million plus of cat next year. Here again we took our cat estimate up, but we feel comfortable with the 7% to 7.5% because prior to that we were basically assuming more around the 6%-ish range in recent history, probably in the last five years. So, here again it's a balancing act based on probably the more recent events.

And Bill, I think you can make the comment...

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

Yeah. Just a little bit more color on property too. We typically talk about property as low 90s combined target. We'll move that to high 80s given the elevated catastrophe. Obviously, we believe that our catastrophe costs are increasing and we have to have better underlying performance. So, we'll have more rate activity. We've

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implemented replacement cost calculation updates on our entire book, which equates to another 1 point, 1.5 point rate. So you'll see us react in that method as well.

On the reinsurance side, we're always looking at it. But as Bret said, this was our first reinsurance claim since 2005. It's harder to change our reinsurance program after. We have a claim, obviously, if we would have known this was happening, it would be a great time to buy an aggregate, but to look back now to buy an aggregate cover, the cost of that has gone up, and it tends to be a cash swap at a certain point. But that said, we have a very diligent reinsurance program. We go to London and Bermuda every year and we're totally always evaluating what's in the marketplace. And when we see opportunities we tend to take. And we've improved it incrementally over time, but there's nothing available at a reasonable cost that would significantly improve our reinsurance position at this time.

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

Okay, got it. That's very helpful. And then just one final one, I think maybe this is for Bret. I guess if you're targeting the $15 million to $20 million net income from NTA, which I'd put it like maybe $0.36 to $0.48 run rate EPS in that first 12 months. I guess is there going to be because you guys are buying it and probably a significant premium to book, I forget the actual, but it was like upper 2s in terms of the multiple. I guess, are there any initial thoughts on intangibles amortization? And whether you guys are going to treat those as operating or non-operating?

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

I think it's a little bit premature to have a discussion on the intangibles, but we're going to be obviously when we close the deal we'll have that all hashed out and will be reflected in our pro formas, but I'll save that for a future conversation.

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

Okay, great. Well, thanks for all the answers. Best of luck in 2019.

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

Thanks very much.

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

Thanks, Chris.

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

Thanks, Chris.

Operator: [Operator Instructions] Our next question is from Matt Carletti with JMP Securities. Please proceed with your question.

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Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Yeah, thanks. Good morning.

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

A

Good morning.

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

A

Good morning.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Just few questions. Maybe just following on some of the P&C questions Chris had. Can you give us a little bit of color on that 3-or-so-points of expected improvement in the property underlying loss ratio. Is that a function of pricing? Is that a function of some expectation of higher non-cat weather kind of normalizing or is it a function of something else.

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

A

Good question, so I'll unpack that for you because there are multiple pieces here. Some of that is simply the reinstatement or reinstatement premiums. So that naturally causes about a 1 point of underlying improvement. There's a 1 point of LAE that have as move off of our Guidewire transition, that moves into the administration system. So remember, underlying includes LAE to some systems cost, and then a 1 point of natural underlying improvement, I'll call it, given the rate and replacement cost actions that we're taking on the entire book.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Got it. Okay, that's very helpful. I guess while we're on P&C maybe can you talk a little bit about just I mean the Camp Fire in particular, but the past couple of fire seasons have been pretty unprecedented. What are some of the lessons learned and are you changing anything on the underwriting side or are you pretty happy with kind of how you approach them and how you performed when events of that big, you can't do much to fight them.

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

A

Yeah, happy would be a pretty strong word for our feeling on the Camp Fire.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Fair enough.

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

A

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But if I go back and look at the long-term wildfire history in California, just a reminder, we have a pretty conservative approach. We use two tools to underwrite the nature of our educator is that they tend not to live in those areas typically on the edge of the forest where historically that's typically where the fires have happened. When we look back excluding the Camp Fire over the past four years or five years, our total catastrophe wildfires were only $10 million. So that had proved effective over time.

So that said, we look at the Camp Fire, certainly a different event, unexpected event. You had a utility with questionable infrastructure on top of winds, on top of a smaller city in Northern California. The entire city burned. I did visit Paradise two days after the fire. The entire infrastructure was demolished including schools, hospitals, fast-food restaurants, things that typically don't burn. So, certainly, a different event from what we expect, and even our reinsurers expect, our book is run through a multiple, dozens of reinsurers every year and I don't think anybody was pricing for this type of risk.

So as we take that information certainly we have learnings, we look for other areas that might be Paradise-like. We've tightened our underwriting, we already have a rate filing in – at the Department of Insurance. We are fortunate that we're working on it as the Camp Fire was occurring. So we're a little bit ahead of the curve there. We expect that to be implemented in second quarter. So, again, it's the combination of rates and underwriting, we've tightened our underwriting box in the entire state with our – what we call, our [ph] fire-line score (00:39:05), which is the tool that we use. So certainly a lot of learnings and a lot of re-underwriting that will happen over the next few months and years.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay. Great. Thanks. And maybe just one more if I could, just for Bret. You talked a bit about how you've improved the credit quality in investment portfolio, taken the rating – average rating up a notch. Can you speak to the other side of that and give us some idea of typically there would be some cost or investment yield that you're giving up currently for that less risky portfolio. Can you talk a little bit about how you view that and is that something that you can put a number on?

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

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Sure. Sure. And it's a fair question. Obviously it's something we've been working on as I mentioned over the past 18 months-plus. But quantifying that I would say that the impact of this staying up in credit quality is worth about $0.05 for the full-year 2019. And given our current economic outlook, we think it's a very prudent trade that will serve us well as I said over the long-term. I think it's also important to remember that 90% of our investment portfolio supports our L&R obligations and that has a longer duration than a typical P&C portfolio personal lines, and it's really because of that that our portfolio yield remains higher than many of the P&C peers at 5.11% that I mentioned earlier in my prepared remarks.

So, I think our starting point, if you will, to begin with is higher than most and we'll take a look at that. But I even remember in the – you go back a few years if you pulled our Qs and Ks, there was nothing to apologize for what we did as we've talked about two in the last credit cycle where things were – where we experienced pressure. So, we feel the P&C pre-tax equivalent yield is 4.49%. Life, I think is 5.21% that kind of gets to the blended 5.11% rate. And you've got different durations. But I think we just need to remind folks that $7.5 billion of the $8.5 billion portfolio supports the Life and Retirement segments.

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Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. Yeah, $0.05 seems like a...

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

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$0.05 for 2019.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Yeah. It seems like a pretty small price to pay for some added security.

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

A

You got it.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

So anyway. Thank you for the color and best of luck in 2019.

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

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Thank you very much.

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

A

Yeah.

Operator: Ladies and gentlemen, we have reached the end of our question-and-answer session. I would like to turn the conference back over to Heather for closing comments.

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

Thank you, Cheri, and thank you everyone for joining us today. We're fully aware it's a very busy reporting day today and tomorrow. But if you do want to follow up we'll have to be happy to help on the phone and chat through anything that's on your minds. And then finally if we don't get the chance to talk in the next few days hopefully you'll go to AIFA and we can see you in early March in Florida. So thank you again for joining us.

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

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