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Horace Mann Educators Corp. (HMN)

Q3 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Horace Mann's Third Quarter Investor 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 of 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 third quarter results. Yesterday, we issued our earnings release, investor supplement and investor presentation. Copies are available on the Investors page of our website.

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 the Q&A, we have Matt Sharpe on Business Development and Distribution; Mark Desrochers on P&C; Tyson Sanders on Supplemental; and Mike Weckenbrock on Life & Retirement; and Ryan Greenier on Investments.

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-

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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.

I'll now turn the call over to Marita.

Marita Zuraitis

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

Thanks, Heather, and good morning, everyone. Last night, we reported third quarter core earnings of $0.50 per diluted share, reflecting our continued strong business performance throughout 2021. In addition, net investment income was up 11% on the strength of our alternative investment strategy.

In line with our previous announcement, catastrophe losses were above our 10-year average, which drove the core earnings decrease from prior year, along with auto loss costs approaching pre-pandemic levels. Our underlying P&C performance remains strong.

As we've stated before, our educator customer base is insulated, but not immune from larger industry trends. The auto line is reflecting changes in driver behavior that we fully expected to normalize, and it remains profitable despite rising costs. We have already initiated rate filings to address these rising costs.

In property, we also continue to see the effects of supply chain disruption and other factors contributing to higher prices, which we are addressing with inflation adjustments and appropriate rate increases. We will enter 2022 with solid underlying performance and expect to remain competitively priced in both auto and property as we move through the year.

Bret will discuss each business segment and outlook later in the call, but we expect a strong fourth quarter with $0.65 to $0.80 in core EPS and full year return on equity close to 10%. This marks a steady increase in our ROE attributable to our strategic initiatives and is another strong step towards our long-term objective of a sustained double-digit ROE.

The third quarter encompasses back-to-school season for our agency force and their successes were encouraging for our long-term outlook, particularly what it means for expanding our education market share in 2022 and beyond.

Echoing the news we read every day about our country's recovery from the effects of the pandemic, the path back to a "normal" school environment is fluid. There are variations geographically, even down to the district level. This is contributing to variations in the growth trajectories of different segments.

But Horace Mann's long-term strength lies in the sum of those parts: our holistic multi-line approach that supports educators with insurance and financial solutions at each stage of their lives. Through the pandemic, our agents have shown their resilience and passion for serving our nation's educators. And now, across the businesses, there is positive momentum in bringing educator households to Horace Mann.

Our retirement business has remained steady since the beginning of the pandemic and continues to build on that strength. Third quarter sales were the highest in several years, extending back even before the pandemic. Retirement conversations continue to be a door opener to other cross-sell initiatives. This is partially due to our Retirement Advantage platform, which strengthens our value proposition for districts and educators.

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For example, we were recently chosen as the single retirement provider at one of the largest school districts in Kansas. During back-to-school season, we were able to complete dozens of informational meetings across the district, hosted lead generation activities and enrolled nearly 500 clients or about 20% of the district's staff in our Retirement Advantage mutual fund platform. Our opportunity now is to effectively cross-sell those customers with complementary solutions.

In supplemental, where sales were most impacted by the pandemic, we saw the best quarter since schools moved to remote learning in the spring of 2020. Districts and educators continue to recognize that supplemental products have an important role in the changing healthcare landscape, which often means higher deductible healthcare plans.

This fall, we've seen educators respond positively to our supplemental solutions across geographies and in settings ranging from Section 125 worksite enrollments to retirement seminars to normal back-to-school activities.

Our Section 125 enrollments also are offering cross-sell opportunities. By making supplemental products available to Horace Mann's approximately 350 longstanding Section 125 districts this fall, a step delayed a year by the pandemic, we are offering a more robust benefit to the district and educators.

About two-thirds of the districts we serve for Section 125 opted for expanded solutions this year. We expect that percentage to grow, and for the expanded offerings to gain traction with additional districts over the coming years.

We're seeing additional cross-sell momentum in the life segment, where sales improved over prior year. Providing life products has come naturally to the supplemental agents who already have strength in providing solutions to protect against unexpected events. Of our top 50 agents for life sales so far in 2021, 7 of them joined Horace Mann when we acquired NTA.

For property and casualty, we are encouraged by strong close rates and a healthy increase in retention as we continue to work with our agents to drive new sales. We're leveraging the variety of ways we are reaching educators to introduce our solutions and have experienced stable new sales volumes over the past few quarters. For example, this fall many of our agents used outdoor back-to-school events as a way to navigate pandemic-related concerns.

It's worth noting that the recent changes to the public service loan forgiveness program offer another opportunity to introduce Horace Mann to educators to our Student Loan Solutions platform. This online student loan management program is provided at no cost to K-12 public school educators to help them reduce the burden of student loan debt. We are updating the platform to reflect the additional qualifying payment opportunities announced last month. We believe this valuable program will continue to bring new educator households to Horace Mann through its availability.

In addition, Horace Mann agent recruitment looks to be back on track. To be fair, recruitment and new agent training during the height of the pandemic was challenging and our team shifted focus to completing the integration of supplemental agents. In many cases, this gave those agents the opportunity to support uncovered Horace Mann territories.

But we're excited about what we're seeing today in recruitment opportunities. Our team has upgraded their recruiting and referral tools to more effectively and efficiently find candidates, and the pipeline is strong. We are

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also finding traction with our associate exclusive agent path, where new recruits are embedded in a top agency to learn the job on the job.

As we look across our current businesses through the fourth quarter and into next year, we expect to see this momentum continue, with the caveat that we continue to expect variations by geography, by product, and even by agent, as the pandemic recovery waxes and wanes. But overall, that momentum offers the potential for growth in customer relationships, households and total top line.

In a few months, we will truly complement our established strength in the individual educator space with the closing of the acquisition of Madison National. Madison National enables us to offer employer paid group products like short- and long-term disability that cover all the staff within a district. The demand for these products is growing at a steady rate as more school districts invest in comprehensive employee benefit packages to improve recruiting and retention efforts.

Adding Madison National at the start of 2022 will both bolster our top line by about 10% even before we see any growth across the businesses and their solutions expand our total addressable market substantially. Madison's bolt-on values doesn't reflect the growth we believe we can achieve in the worksite business and our expectation of earnings accretion of $0.15 to $0.20 also does not reflect the value of expanding this business.

Over the past five years, Madison National has grown at an average annual rate of about 5%. We're enthusiastic about improving on that growth as we look to expand beyond the eight Midwestern states where they currently write the majority of their business.

It's also exciting to think about how this enhances our value proposition for the education market over the long term. Bringing on a well-respected company with strong products distribution and infrastructure that meet the needs of superintendents and school business officials is the perfect complement to our established strength in providing educators with individual solutions and provides a nice boost to our brand recognition and credibility with administrators.

As we noted in our acquisition announcement, we have already signed a long-term agreement with Madison National's long time distribution partner that will take effect concurrently with the acquisition. Further, we continue to make solid progress towards an early 2022 close. We have cleared the antitrust review and are working with the Wisconsin Insurance Department on the requisite regulatory approvals.

With these pieces all in place, we will be able to serve educators and school districts in any of the ways they receive their insurance and financial solutions. Bringing these pieces together will enable Horace Mann to leverage its strong position in the education market to increase our market share in 2022 and beyond.

Before I turn the call over to Bret, I want to comment briefly on our new strategic partnership with the International Association of Fire Fighters to provide voluntary supplemental benefits to their more than 300,000 members. Similar to Horace Mann, NTA's customer base was historically about 80% educators. The remaining 20% is other public service employees who serve their communities, primarily firefighters. NTA built these relationships over a number of years, and we're happy to make this partnership official.

I also want to take a moment to congratulate Horace Mann Director, Perry Hines, on his recent inclusion in Savoy Magazine's 2021 Most Influential Black Corporate Directors list. Perry has been with the board since 2018 and has provided valuable guidance based on his unique combination of experience in marketing, financial services and education.

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Finally, although our current sales environment remains fluid, as we return to a more normal environment, we do so stronger with a full suite of competitive solutions to serve those who are looking after our children and moving our communities forward. 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. Our third quarter core EPS of $0.50 reflected strong performance across our businesses as Marita discussed. It is also a testament to the value of the revenue and earnings diversification we've accomplished in recent years.

In a quarter where the P&C industry at large was impacted by heavy catastrophe losses, Horace Mann achieved a healthy overall profit and we're on track to deliver record or near-record results for the full year. We also expect 2021 return on equity near 10%, moving steadily closer to our target of a sustainable double-digit ROE.

Diversifying our business has resulted in steadier, more consistent capital generation, which will improve the consistency of our shareholder value creation over the long term. Adding the profitable and growing business of Madison National will further diversify our business and will further enhance the consistency of our capital generation.

You may recall that to purchase Madison National, we will combine excess capital with new borrowing on our expanded revolving credit facility to finance the $172.5 million purchase price. When we close, our debt to total capitalization will be approximately 25%, supporting our current credit ratings. After Madison National joins us, Horace Mann should generate more than $50 million in excess capital annually. Looking ahead, we're committed to continuing to build on our successful track record of capital allocation to increase EPS and generate higher ROEs.

Beyond supporting anticipated growth, we have several levers to further enhance shareholder value. First, there is almost $19 million remaining on our stock repurchase authorization. Further, we expect to maintain our track record of annual increases in our cash dividend, which is currently generating a yield slightly above 3%.

Now, turning to the results for the quarter. As Marita noted, we presume for the past year that there would be a gradual wind down of the effects of the pandemic on policyholder behavior, although the pace is varying by business area, and that is what we are seeing. In this context, we're encouraged by our momentum and very pleased at how our employees and agents continue to adapt in the still fluid environment. So, let's look at each segment.

Bottom line results from the P&C segment were impacted by catastrophe losses, particularly from Hurricane Ida, in auto frequency that continues to return to pre-pandemic levels, coupled with rising severity due to the increasing costs of parts and labor. Last year's third quarter also benefited from the campfire subrogation recovery with the reinsurance reinstatement recovery portion adding $3.5 million to last year's premiums and favorable development lowering loss costs by $5.2 million.

In line with our October 4 announcement, catastrophe losses were $38.6 million, contributing 25.1 points to the combined ratio above last year and our 10-year average for the third quarter. Our fourth quarter 2021 guidance

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assumes catastrophe losses for that period between $7 million and $9 million, in line with our 10-year average for the fourth quarter. As a side note, we do not see any outsized catastrophe losses in October.

Premiums for the quarter were $163.8 million with new business volume remaining below historical levels. We continue to work through the impact of the pandemic on our ability to reach new educators to drive sales.

Let's look at auto and property separately. In auto, average premiums were down slightly, in part due to changes in miles driven during the pandemic. We fully anticipate the average to start to rise in the next several quarters based on current driving patterns. We are initiating appropriate mid-single digit rate filings to address normalizing frequency and rising severity.

Overall, we remain better positioned than some carriers that opted to lower rates during the height of the pandemic. We are confident our agents will remain competitive on the business they quote as our rate filings begin to take effect.

In property, the underlying property loss ratio improved over prior year. However, rising labor and material costs continue to also impact property severity. We're addressing this with inflation factor adjustments that help make certain insured values of covered properties remain in line with rising replacement costs.

Some of the adjustments made early in the year are starting to take effect, which accounted for the slight rise in average property premiums in the third quarter. Renewal price increases over the next year should be in the high-single digits due to the combined impact of anticipated rate increases and changes to inflation factors, which will begin impacting renewals in most states, starting in November.

Turning to supplemental, the segment contributed $31 million in premiums and $11.4 million to core earnings, maintaining its very strong pre-tax profit margin. It continues to experience favorable trends in reserves and is still seeing the benefit of changes in policyholder behavior due to the pandemic. We expect the margin will remain better than our longer term target of mid to high 20% for at least the next several quarters.

Net investment income on the supplemental portfolio continues to reflect the solid progress we have made in improving investment yield. Supplemental sales were $2 million in the third quarter, the best quarterly sales performance since the pandemic began, although still not back to pre-pandemic levels.

We're very pleased to see opportunities for our agents to work with educators in the consultative enrollment model this fall. That has been the most successful route for sales of individual supplemental policies and also among the most-impacted routes of reaching educators due to the worksite access limitations of the past year and a half.

We expect to see steady progress in supplemental sales over the coming quarters, keeping in mind that there is some level of seasonality in that business due to holiday breaks. Premium persistency remains above 90%, a testament to the value educators placed on these coverages with about 280,000 policies in force.

In the life segment, sales continued their steady pace and retention remained consistent. We again saw an increase in single premium life sales. These sales tend to be lumpy, but are a reflection of improving access. They are typically more consultative sales, requiring multiple contacts with the customer. Core earnings of $5.1 million were ahead of last year. Mortality costs were slightly elevated, and total benefits and expenses returned to targeted levels, and net investment income rose 15.9%.

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For the retirement segment, third quarter core earnings, ex DAC unlocking, were up 85%, reflecting the strong net interest margin. The net interest spread improved almost 75 bps over last year's third quarter to 297 bps, in part due to strong returns on the alternatives portfolio. The spread on our fixed annuity business remains comfortably above our threshold to achieve a double-digit return on equity in this business.

Our solutions for augmenting retirement savings remain a core need for educators. Annuity contract deposits were ahead of last year's third quarter by 2.3% with new annuity sales at their highest level in several years. While still a small part of the total, we also are beginning to see measurable progress in the number of Retirement Advantage contracts in force with an increase of almost 2,000 or 16% over prior year.

Retirement Advantage is the fee-based mutual fund platform that we believe represents long-term value for this business segment. The platform offers important benefits for both educators and their employers, which is especially valuable because our retirement products are often in educator's first introduction to Horace Mann.

Turning to investments. Total net investment income on the managed portfolio was up almost 13% to $78.1 million with total net investment income up 10.7%. The increase in NII on the managed portfolio was again due to the contribution of our alternatives portfolio.

Alternative returns are running ahead of our targeted levels this year due to the relative strength of equity valuations, which have resulted in strong private equity and venture capital returns. Our other alternative strategies such as private credit, infrastructure and real estate also posted solid performance, and our commercial mortgage loan funds continue to perform as expected. Overall, we expect these strategies to – combined to generate high-single digit annual returns on average over time.

As we near our targeted allocation for these asset classes, we're pleased to see them delivering the intended value, a higher income contribution than could be generated through traditional fixed income investments in today's markets without any meaningful shift in the risk profile of our overall portfolio. Generating a higher yield on our investments will help us achieve our targeted sustained double-digit ROE.

The traditional fixed income portfolio had a yield of 4.36% in the third quarter compared to 4.18% a year ago. Third quarter purchase activity continues to focus on sectors and issuers with more attractive relative value such as BBB corporate, high-yield credit and taxable munis. The core new money rate was 3.44% in the third quarter. And based on current market conditions, we continue to anticipate a core new money rate above 3% for the year.

Our fourth quarter guidance assumes total net investment income of $95 million to $100 million, including approximately $25 million of accreted investment income on the deposit asset on reinsurance. This expectation for investment income is captured in our fourth quarter core EPS guidance range of $0.65 to $0.80 in our segment outlooks.

On the segment by segment basis, for the fourth quarter, we are expecting property and casualty segment core earnings in the range of $10 million to $13 million; supplemental segment core earnings in the range of $10 million to $11 million; life segment core earnings in the range of $3 million to $4 million; and lastly, the retirement segment core earnings in the range of $10 million to 11 million.

In closing, we are very pleased with our business progress through the first nine months of 2021 and excited about the momentum that is building in our core business. We are looking forward to closing the Madison National transaction in early 2022. This will strengthen our value proposition for the education market and provide further opportunities for significant growth over the long term.

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The transaction is expected to be accretive to Horace Mann's 2022 GAAP earnings by $0.15 to $0.20 without taking into account their potential for growth. We'll see at least the $0.15 to $0.20 benefit, even though the amortization of intangibles related to purchase accounting means that Madison's GAAP earnings will be somewhat lower than statutory income.

The transaction also will deliver at least 50 bps of ROE improvement in the first 12 months after closing. We expect that contribution to grow over time as we leverage the new opportunities that Madison National and its complementary independent distribution bring to Horace Mann. Thank you.

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

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

Thank you, Bret. Operator, we are ready for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Meyer Shields with KBW. Please go ahead.

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

Q

Thanks and good morning, everyone.

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

A

Good morning.

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

Q

One thing that we're trying to get our arms around is just the regulatory friction in terms of getting auto rate increases approved. I was hoping you could sort of just give us your expectations and your experience so far.

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

A

Sure. Let me turn it over to Mark since he is obviously much closer to that. Go ahead, Mark.

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

A

Yeah. I mean, obviously, Meyer, we're in a completely different situation than we might have experienced historically. And it would be difficult, I think, to predict, but we believe there's a number of jurisdictions that we don't anticipate significant regulatory restrictions and there are certainly others where we do, notably California comes to mind, it's a big portion of our book. We expect that to be a challenge. However, what I would say there

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is our rating structure is very responsive to mileage changes. So as mileage starts to increase back in some of those jurisdictions, we do expect to see premium naturally flow back, and even in those places, we cannot get rate.

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

Okay. That actually brings me to my next question. And it's more of a conceptual one, is there any way of incorporating car values into physical damage pricing?

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

I mean, to some extent, they are in there in terms of the original costs, new, in terms of vehicle symbols, but are you referring to changes in used car pricing and things like that?

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

Yeah, exactly, because that seems to have been a broader issue. I don't know if it was a [ph] shock (00:30:41), but it was an across the industry and it's, typically, less of a problem when the exposure unit incorporates value. I just don't know whether that's feasible [indiscernible] (00:30:50).

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

Yeah. I mean – I think it's a good question. It's something – it's worth looking at. It's not something we've dealt with typically, as an industry, historically, right, where we've seen these kind of surge in used car pricing. But I get you drawing the analogy to what we might see on the property side, right, where we can get it through property inflation changes.

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

Okay. No, that's helpful. And then, finally, I was hoping if you dig in a little bit, if we look at the accident year, ex cat loss ratio, in property, it was actually, to my mind, fantastic. And I was wondering if there was anything unusual in there.

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

Well, I mean, as you know, we have a pretty strong performing underlying book that in the early part of the year, we had commented several times on the increase that we had seen in both fire activity and non-weather water losses. And when we look at this quarter, that strong kind of underlying frequency is there, but we also have just less – we've seen less of the fire and non-water losses, especially the larger, more significant ones of those. And they can be lumpy from quarter-to-quarter. And we're certainly still seeing, I think, very similar trends to what others are seeing. When you look at the cost of materials and labor, on a claim-by-claim basis, those are certainly up, but we saw significantly reduced frequency, I think, in the kind of large fire and large non-weather water losses.

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

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And Meyer, this is Bret, if I could just add, even when you look at the fourth quarter last year, it's not unusual to be at that lower level underlying. So, it's unusual compared to last year for the third quarter. But sometimes property, as Mark said, can be lumpy and have pretty low underlying loss ratios.

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

No. Perfect. That makes a lot of...

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

The key point there...

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

Yes. Go ahead, I'm sorry.

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

The key point there is a good underlying profitable book of business that underlies that, for sure.

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

Right. Absolutely understood. Great. Thank you very much.

Operator: Our next question comes from Matt Carletti with JMP. Please go ahead.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Hey. Thanks. Good morning.

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

Hey, Matt.

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

Good morning.

Matthew J. Carletti
Analyst, JMP Securities LLC
Q

Marita, in your opening comments, you termed kind of the back-to-school process which has happened since we last spoke as, I think you said, encouraging. I was hoping you could dig in a little deeper there and just give us some color on from a kind of operational or tactical kind of standpoint. What were some of the successes that you walked away and thought that things that you put in place really worked? And what might be some of the challenges that you still face in adapting to, I think as you termed today, a very fluid rebound out of the pandemic?

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

A

Yeah. Matt, I think you, as you usually do, embedded in your question, there is certainly the answer. I think both encouraging and fluid, I think they're good words. And historically, we've always had variations by geography. But in this environment, I think those variations are by geography, by district and, in many cases, even by building. And I think we've all seen those variations and fluidity in this kind of environment across all of our lives, quite frankly. And I think this is, clearly, a time where having local agents at the point of sale, the strength of our distribution, they've shown their resilience, they've shown their creativity.

We talk about outdoor activities. I can't tell you how much has taken place in parking lots, but the fact that we have local people that we're not all trying to do this in a centralized virtual way is really solidifying our strength and our distribution out there. But Horace Mann's always taken a very holistic approach to the educator market. We talk about the sum of our parts is where our strength is, and that's true. But when you step back and you really look at what we've done, there is positive momentum. There has been positive momentum.

I mean, you look at retirement, this third quarter, the sales were the highest they've been in several years, even including pre-pandemic environments. That means many new customers to Horace Mann, not fully cross sold, but our goal will be to cross-sell them the way we usually do. Supplemental, which was hardest hit by the pandemic, traditionally, fully worksite, had the best quarter since the spring of 2020 when this all started.

We're seeing cross-sell momentum in our life business. And in P&C, I mean, we held our own, and sales have been pretty consistent. When you look at educators, do you think their top priority in a pandemic, with everything that they've been dealing with, is shopping their auto insurance? I don't think so. But during that time, our close rate has remained relatively strong and consistent and our retention went up. And in this environment, I don't necessarily think that's a bad thing.

Agent recruitment this quarter, really nice signs of life. We're back in the game from a recruitment standpoint, even with all the things you hear in the environment about hiring and getting, quite frankly, butts in seats. We are seeing that energy back in recruitment. And that is a certain leading indicator to getting the quotes up, right, for sure. So, I feel good about what we've done in this environment. But fluid is a really good word and our agents have gotten to get creative.

And what's really cool about all this, all these new capabilities, all this virtual approach, all these things that are occurring in parking lots, new ways to enroll, new ways to engage in conversations, they don't go away. So, we will have all of our traditional access – and we saw a lot of that, combined with new abilities, as we build, I think, an even more robust sales process going forward. So, I mean I am very encouraged about having the ability to do many of the things that others try to do in a more virtual, digital way, combined with good local trusted advisers at the point of sale that do what they've been doing for a long period of time.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. That's very helpful.

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

A

Long [ph] answer, but (00:37:43)...

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Matthew J. Carletti
Analyst, JMP Securities LLC

Q

No, the color is great. No, I appreciate it. One other kind of higher level question for you. I'm just trying to think about – you mentioned a couple of times, I think, in your comments kind of expanding the TAM or the addressable market for Horace Mann. And so, whether it's in a number of households or dollars of premium or however you can kind of give it a feel, how do you think about kind of what old Horace Mann – and what I mean by that is like pre-NTA, pre-Madison National, what old Horace Mann's TAM was, for lack of a better word, and what New Horace Mann's TAM is? And then, some gauge, if you can, of how you guys view your market share kind of currently within kind of that sandbox.

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

A

Yeah. Always a really hard question for us, and if you can hold that thought, it really is a big part of what we are working on right now. As we close in on the acquisition of Madison National, as we digest all the learnings from NTA, I get encouraged about more ways to reach educators, right. We know what the K-12 population looks like. And although that waxes and wanes slightly, it's still a knowable number, right? How many K-12 educators out there?

We have good information on the amount of extended educators that are out there beyond K-12. And then, when you start thinking about others who serve the community, the 20% of NTA's business that was firefighters, the new endorsement with the International Association of Fire Fighters, what that could be and what that becomes, I think the denominator is very clear and we're working really hard on being able to express the numerator a little more clearly. Meaning, what do we have in-house today so that you can start to see the leading indicators a little sooner.

For example, when we think about Student Loan Solutions and our work with educators on their student loans, they might not have a product yet, but they're still in Horace Mann family. When we think about all the customers that may be single threaded from just an individual supplemental product, they're in the Horace Mann family and they are a customer.

So building that pyramid up from the foundation, we're dealing with them on a solution, whether it's student loan or DonorsChoose to, okay, now they have their first product, the cross-sell propensity as they work up to be a full customer, we're hoping to be able to give you a little more transparency on that lifecycle of a customer, if you will, and what that total household value is worth to us. And as you can imagine, the information and the data we get from NTA and from Madison National with those acquisitions are added to the more robust data work we've been doing on what you call the traditional Horace Mann, now all Horace Mann.

And in this environment, folks are entering the family a little bit differently than maybe they have before. So, we have the historic data. But think about the ability to have a retirement conversation and the willingness to have a retirement conversation, that might have been a customer that, in the past, entered through the garage and now they're entering a different way. And we have the data, we're capturing the data and we're working through that. So, we can give you much more transparency around that numerator discussion. But what we get encouraged about is there are more folks that are in the Horace Mann family doing something with us than ever before.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Makes sense. I look forward to a little more detail down the road. Thank you for the answers.

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

John Barnidge
Analyst, Piper Sandler & Co.

Q

Good morning, and thank you for taking my question. Can you maybe talk about claims utilization trends for supplemental? Number of industry participants continue to see some level of tailwind. And so, I'm just curious, where are we on that path to normalizing claims trends.

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

A

Yeah. I mean, I don't really think we've seen a dramatic change. Obviously, we saw the pandemic-related effects on claims patterns within supplemental. And that has certainly maybe not gotten back to a more normal level as quickly as we might have anticipated, which, obviously, is a good thing from a margin perspective. But we fully expect that to return to a more normal level, at some point, for sure.

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

A

Yeah. John, this is Bret. If you go back to our supplemental page in the investor deck, you can see the gradual incline in the benefits paid ratio, south of 31% at the first quarter, slightly above 31% at the end of June. And then in the third quarter, it was 33.5%. As Marita mentioned, still running below what we would expect. But we are continuing to expect probably an uptick in that in the fourth quarter as well. Here again, who knows when it will get back to normal, if you will. But we are seeing a slight uptick in that ratio quarter after quarter and are planning for that in the fourth quarter as well.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you for the answer. A follow-up, on that slide around guidance, the alternatives portfolio, is that mid- to high-single digit quarterly return or annualized?

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

A

That's on an annualized basis, John. Certainly, we're...

John Barnidge
Analyst, Piper Sandler & Co.

Q

Okay.

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

A

I think, year-to-date, we're hovering around 20% on the alternative or on the limited partnerships.

John Barnidge
Analyst, Piper Sandler & Co.

Q

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Thanks, Bret. That's real helpful. And my final question, wanted to go back to your commentary about steady progress expected on supplemental, keeping in mind holidays. Is that suggested that there may be some sequential deceleration in sales for the fourth quarter?

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

I think we're not declaring a deceleration, but just with the holidays and schools closed, that sold in a worksite environment, that access is, during the holidays, slightly limited. But we were very encouraged in the third quarter with the $2 million in sales. But we're not saying that there is a absolute deceleration.

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

Yeah. I mean, there is a natural seasonality to the supplemental business considering around enrollments, et cetera, et cetera, and that's still there. But what I get excited about is seeing an increase in the trend of being able to be there to have the conversations. And that certainly is increasing. It's also going to be interesting to see the benefit and the power of an NTA, together with the benefit and the power of a Madison National, and what that means in this space going forward. But I would say, if you took a normal trend to supplemental sales, that trend is still there. We're just starting to see some of the restriction of a COVID environment easing a bit.

John Barnidge Q
Analyst, Piper Sandler & Co.

Thanks for the answers, and best of luck.

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

Thank you very much.

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

Thanks, John.

Operator: Our next question comes from Geoffrey Dunn with Dowling & Partners. Please go ahead.

Gary Kent Ransom Q
Analyst, Dowling & Partners Securities LLC

I'm sorry, I think it's supposed to be Gary Ransom, but thank you for taking my question. I had a big picture...

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

Well, thanks for [ph] coming in (00:46:04), Gary.

Gary Kent Ransom Q
Analyst, Dowling & Partners Securities LLC

Yeah. I had a big picture question. You've got all of these products. There's array of products around the educator. If I postulate a perfect Horace Mann's customer that through their life buys all their products from

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Horace Mann for protection and savings, what does that overall mix of business look like in sort of a present value sense? I'm a little bit asking property/casualty versus life, but even supplemental, life, retirement, within those segments as well, do you have a sense of that?

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

A

Yeah. I mean, we do have a sense of when you think about the lifecycle of an educator, what they need, when they need it, and what portion of that we believe we can and should get. So, it's a very complicated question that would include our life cycle chart that we certainly can show to you, from studying to be an educator, all the way through retirement, because that answer is going to differ depending on whether you're talking about a 20-year old studying to be a teacher, a brand-new teacher, or somebody at 60 getting close to thinking about retirement and what those products are. And they change over the lifecycle of that customer. I mean, auto is relatively consistent. Most people have a car and they drive, and that would be consistent.

But the type of life insurance, the type of annuity product, whether you save for retirement, when you save for retirement, when you think about a need for supplemental products and how they fit, it really is a different answer, depending on the lifecycle of the customer. And then, we can take that one step further and say, in the entire population, what does that mean as far – how you would split up the size of the company by those pieces as well as the margin that we would expect by those pieces. And I suspect that's really where you're going with that question. But it's a more complicated answer than a quick response on an earnings call. But that's how we think about it. We have a pretty clear view, depending on what pocket you fall into, what we should be doing with you, and then what economic value we believe we should get from that type of educator.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

I guess, what I was getting at a little bit, as I was – I'm sensing that overall those lifecycles, the supplemental, retirement products will become more important over time; whereas, as you said, auto and property are sort of stable, and thinking that those might, over the long run, grow faster. I don't know if I'm off the mark on that, but...

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

A

No, I don't think you're off the mark at all. I mean, we would hope that as the need for those products – and we're clearly seeing it both on an individual level and a district level. As the need for those products become more evident and more robust, especially as districts are trying to solidify their benefits packages to attract and retain educators, as you can imagine in this environment, right. I think that's why we get very encouraged about building the strength of our offering with the addition of NTA and now Madison National that we've got the whole gamut covered.

And as we can bring more – as we can build those products that both districts and educators need in their retirement, potentially you might see – and I alluded to this in a response to an earlier question – a slightly higher percentage of educators starting their relationship with Horace Mann through a retirement account that maybe might have been a little bit higher entering through the garage. And that's okay.

We'll have the ability to be able to cross-sell those accounts. And why we're encouraged that many of the retirement deposits that we saw in this very strong quarter, many of those are brand-new Horace Mann customers, which we will have the ability to cross-sell. But I agree with you. I think districts especially are looking

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for ways that, in their benefits package, that they can bring a very robust retirement offering to those educators to attract them and to retain them.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

All right. Thank you. And just switching quickly over to auto, you said along the way that your rates are more sensitive to miles. I just wanted to make sure I understood what you meant. Is that classification upon renewal or are you referring to your telematics offerings?

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

A

Yeah. That's specifically, Gary, around our renewal classification, right. So as policies renew and we revalidate mileage, the pricing will move and probably most significantly, across the country, in California.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Got it. Okay. And then, one more on auto. As you start to take rates, I'm just trying to get a sense of whether the rates you are taking are, in fact, what you think is the required rate for the average time of claim out there six months, or whatever the time is. And as opposed to doing it with little smaller steps and purposely trying to then not disrupt and taking in a couple of bites instead of going all the way. Are you – is there – do you understand the question? I'm just trying to see if you're taking it all you think you need right now.

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

A

Yeah. I think it's a great question. And before I turn it over to Mark, I do want to just – from an industry pressure perspective, I want you to remember that we weren't the company or a company to lower rates or to ramp up advertising costs to increase sales, right. We don't address this as a pure auto play because we have a holistic approach, because we have the sum of the parts. The delta of what we're talking about here is much smaller for us than it may be for some other pure auto players or large auto players. And I think it's important for us to remember that, because we tend to be – we tend not to sell on price. So, therefore, we get our fair share. We realize that price is important, but we tend not to wax and wane as much as the industry does on this issue. So when we talk about being insulated, but not immune, that's what we mean.

So, Mark, I don't know if you want to answer that question specifically.

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

A

Yeah. I mean, specific to the question about rates and do we take it all in one big chunk, generally, our pricing philosophy is try to be slow and steady. And to Marita's point, if we had not been in a pandemic over the course of the last 18 to 24 months, we may have been taking 2 points or 3 points just to keep up with normal inflation, because we don't really want to be in a position where we have to take significant rate increases. Now, does that mean jurisdiction by jurisdiction will be the same? No, there are other jurisdictions that we need more rate. We may take a little bit heavier approach there. But we want to be cognizant, I think, of two things.

One, retention is important to us. And growing our book of business through both new business and retaining our book is a key area of focus. So if we have to temper some of those rate increases in the places maybe we need a little bit more, then that may make more sense in the long run from a financial perspective. And also to some

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extent, we're reacting to the trends we're seeing. And you listen to what all the other companies are saying, you follow the industry that this is an unprecedented situation. It's a little difficult to predict exactly what's going to happen. I think we're in a position now, from an overall loss cost standpoint, that's probably where we thought we would be in the first quarter or second quarter of next year, and that's when we thought we'd need to take rate.

That's kind of been a little steeper, a little faster than we thought. We're starting to take those actions and we'll have to watch to see how it emerges. If we jump and immediately react to some of the significant trends and then we see things start to flatten out or even reverse a little bit, we don't want to be overpriced either. So, I think steady and cautious is the way to go. But certainly, looking to be a little bit more aggressive than we might be in a normal year where we might be thinking about 2 points or 3 points.

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

As well as our long track record of being conservative in our picks. I mean, you can go back and look, we are not a company to have significant surprises, right. We worked really hard on the profitability initiatives that we had in place prior to the pandemic, and those are there and we are seeing them. And to Mark's point, we knew we would be here. We planned to be here. And we've already begun to take the appropriate action that we knew we'd be taking at the appropriate time. We have a profitable book of business with a profitable, predictable, homogeneous niche. We are not in some of the more problematic places, like Florida, in great – and to a great extent. So, we feel good about our ability to navigate the place we knew we'd be.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC
Q

Thank you very much for those answers.

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

Thank you.

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

Thanks.

Operator: The next question comes from Greg Peters with Raymond James. Please go ahead.

C. Gregory Peters
Analyst, Raymond James & Associates, Inc.
Q

Good morning. All of my questions have been asked. I guess, the final question that hasn't been really covered. I know you guys have been working on improving your operational efficiency across the franchise. Expense ratio was up in your property/casualty business. Can you just give us an update on sort of how you're approaching overhead across the footprint? I know you're investing in your business, but just some updated perspectives would be helpful. Thank you.

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

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Sure, Greg. This is Bret. I think, with respect, I wouldn't get overly excited about the expense ratio being up for just the quarter. That will go up and down with the timing of several expenses. And I would say, we've typically guided to around the 27% expense ratio and don't really see that changing. Obviously, I think we do a good job of managing the expense ratio from operational efficiency standpoint, that work continues and will continue even well into next year. We're adding another company to the fold and, obviously, we're going to wring out some of the efficiencies there as well. So, that work – as we get bigger and into different lines of business, we're very cognizant of making sure that we're bringing these operations together in the most efficient manner possible. So, it's ongoing, but I think we have always guided to around a 27% expense ratio.

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

A

Yeah. And we are proud of our expense picture. The fact that a company of our size can absorb acquisition and integration cost, the fact that we can absorb major technology advancements like the implementation of Guidewire, I think, says a lot as to who we are as a company. And I'd also say that some of the decreases that many of us have seen as it relates to travel and entertainment in a pandemic environment, taking some of those and using them to advance your digital capabilities and your digital road map, I think, is a wise investment as well. So, Bret's right, we have a target. We're holding to that target. But I think we're also thoughtful as to how we advance the company and use the dollars wisely.

C. Gregory Peters
Analyst, Raymond James & Associates, Inc.

Q

Got it. Thank you for fitting me in.

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

A

Thank you.

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

A

Sure.

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

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

Thank you, and thank you, everyone, for joining us today. We look forward to talking again soon. Just as an update, we are looking forward to the Raymond James Virtual Conference next week, JMP Conference, virtual, the following week, and we do expect to be doing some virtual meetings with Piper in early December. So if you'd like to – we look forward to talking and hopefully hear from you. Have a great day.

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

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