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Horace Mann Educators Corp. (HMN)

Q2 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and welcome to the Horace Mann Educators Q2 2021 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 second quarter results. Yesterday, we issued our earnings release, investor supplement and investor presentation. Copies of all three are available on the Investors page of our website.

On today's call, Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer, will give the formal remarks. 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, with Ryan Greenier available 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-looking statements are based on management's current expectations and we assume no obligation to update

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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.

Now I'll 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 second quarter core earnings of $1.02, our highest second quarter result ever. We benefited from particularly strong investment income in our alternatives portfolio and lower-than-guided catastrophe losses. As previously announced, this led us to raise our full year core EPS guidance to a range of $3.50 to $3.70, with an expected return on equity above 10%.

We saw strong earnings growth in each segment in the second quarter and solid sales momentum in the Retirement line. Annuity contract deposits increased by double digits over the prior year. Bret will go over the quarterly results in more detail later in the call. I want to focus on our progress towards our long-term objectives of a sustainable double-digit ROE and significant expansion in the education market.

Over the past year and a half, through unprecedented disruption in all aspects of our day-to-day life, Horace Mann has continued to be successful. I attribute this success to two factors. First, our unwavering dedication to the deserving education market. We know our customers, we know them well and we respond to the issues they face. Second, our multiline model. We have the premium and earnings risk diversification that enables us to remain focused on our long-term objectives throughout occurrences of weather volatility, market volatility and mortality and morbidity trend changes.

While the COVID-19 pandemic added an extra year to the transformational stage of our growth journey, it also gave us time to analyze and improve the ways we can fulfill our value proposition for the education market. Examples of the outcomes of this focus include an accelerated integration of NTA agents, initiating key improvements and infrastructure, and expansion of our Student Loan Solutions program nationwide. It also set the stage for the entry into the employer-paid benefits market with the planned acquisition of Madison National Life Insurance Company. This acquisition brings together two educator-centric companies with complementary strength in product distribution and infrastructure.

Horace Mann's most established channel for serving educators has always been individual products sold through our agency force of local, trusted advisors. In recent years, we invested in upgrading our Section 125 benefits administration program, which enable school districts to offer voluntary worksite plans. Benefits, including our individual Supplemental products, are provided or introduced through the school district, but paid for by individual educators. In some cases, educators can fund these purchases with pre-tax dollars.

Madison National represents a new third way for us to serve educators. In line with emerging workplace trends, school districts are increasingly adding and enhancing employee benefits to attract and retain educators for hard-to-fill positions. Madison National's employer-paid and sponsored group products will enable us to provide educators with solutions like short- and long-term disability, while helping school districts improve recruiting and retention efforts. Districts generally work with independent benefit brokers to purchase Madison National's group products and educator staff are automatically enrolled.

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With this addition, Horace Mann will now have complementary distribution capabilities in each of the ways the country's 6.5 million public K-12 educators receive insurance solutions, dramatically increasing our addressable market. In terms of scope, Horace Mann has at least one educator household located in 75% of the roughly 12,000 K-12 school districts in our market footprint. When we bought NTA, we added approximately 120,000 educator households.

With the acquisition of Madison National, we gain a solid base in this growth segment, as they serve 1,200 districts that provide employer-paid and sponsored products to about 350,000 educators. There's some overlap between Horace Mann's presence and those of NTA and Madison National, but each of the transactions has clearly added to our market share. And with the Madison National transaction, our total addressable market expands to include a portion of the $160 billion that school districts spend annually on employer-paid benefits, a market sector that has grown more than 30% over the past five years.

As we look at ways in which Madison National aligns with our business strategy from a product perspective, Madison National bring 60 years of experience, designing and underwriting a portfolio of group products. These products can offer educators peace of mind that their families will be able to respond to unexpected events without depleting their savings.

From a distribution perspective, independent brokers are key in the complex public sector benefit space, where districts, particularly large ones, rely on their assistance to design plans and offerings that are typically offered to every employee in the district. Working with independent brokers is completely complementary to our established distribution through local, trusted advisors.

We have already signed a long-term distribution agreement with National Insurance Services, an employee benefit brokerage subsidiary of Assured Partners that has been a key distribution partner for Madison National for nearly 40 years. It will take effect concurrently with the acquisition, giving us immediate access to the employer-paid and sponsored portion of the market. After the transaction closes, we will be complementing Madison National's current group offerings, which include Supplemental products with enhanced offerings.

Our product development team has been leveraging NTA's 50-plus years of success in Supplemental market to accelerate filings for group products customized for educators such as cancer and hospitalization. These will allow us to work with Madison National and NIS to provide a comprehensive group product suite.

In terms of infrastructure, Madison National brings an exceptional experienced team focused on delivering great educator customer experiences supported by modern and scalable infrastructure. They're ready to add scale and we're the right partner to help them do so.

In 2022, we expect Madison National to add 50 basis points of ROE with upside potential in future years. We remain focused on three additional drivers of higher ROE across the entire business. First, driving higher net investment income by increasing the allocation to alternative investments. While our alternative portfolio returns can be volatile, recent performance clearly illustrates the value this asset class brings.

Second, expense initiatives. We continue to realize savings from actions such as the full integration of the Supplemental segment in 2020, as well as benefits from continued infrastructure improvements. Third, market share expansion through cross-sell and new sales through each of our distribution channels.

Before I turn the call over to Bret, I want to add that as educators across the country prepare to return to in-person learning environments this fall, we have similarly prepared to support them during the back-to-school season. We

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bring the ability to combine the new virtual marketing approaches we tested and refined over the past year and a half with our traditional in-person activities. We look to build on the sales momentum we established in the first half of the year and are seeing a lot of optimism in the agency force around scheduling meetings and events in their schools this fall.

The 2021-2022 school year will certainly be more normal than the previous one. However, there is concern about new COVID-19 variants. We believe most schools will avoid a return to a hybrid or remote environment. Notably, nearly 90% of educators are vaccinated against COVID-19, a far higher rate than the general population. Further, educators have overwhelmingly made the case that the best educational environment for students is in-person.

At Horace Mann, this past year and a half has provided us an ever growing list of reasons and reminders of why we do what we do. It is an honor to serve the educators who have gone above and beyond to reach every student through the COVID-19 pandemic. Their dedication and selflessness to our country's children continues to inspire us to do more and this year we will.

Thank you. And with that, I'll ask Bret to take you through the results.

Bret A. Conklin

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

Thanks, Marita, and good morning, everyone. Second quarter core EPS was $1.02, up 52% over last year and our third consecutive record quarter. Six-month core EPS was $2.12, more than halfway to the increased full year EPS guidance of $3.50 to $3.70.

As we said last quarter, our outlook has always presumed a gradual recovery from the effects of the COVID-19 pandemic on results and that's largely what we've seen so far this year. In that context, we're encouraged by the signs of momentum we are seeing with the vaccine rollout and continued strong performance across the business.

As a result, on July 1, we brought guidance to a level that aligned with the strong second quarter net investment income returns and the lower than historical average level of second quarter catastrophe losses. As I talk through the segments, I will address the changes we've made to align full year segment outlooks with the updated guidance. I'll finish up with a recap of how we continue to think about allocating capital to maximize value for our shareholders.

When we raised EPS guidance, we also raised our expectation for 2021 core return on equity to greater than 10% for the year. Core return on equity for the second quarter was 11.7% and it was 12.1% for the 12 months, up from 9% for the prior 12 months. Although the pandemic and other unusual factors continue to contribute to the improvement, our strategic initiatives are equally as important and we remain on track to our long-term target of a sustainable double-digit ROE.

And as we look ahead, the Madison National transaction will be a strategic use of capital to accelerate our shareholder value creation. In addition to the strong fit of Madison National, this is another business with predictable and stable underwriting profitability, as well as strong capital generation that serves to further diversify our business profile.

In 2020, Madison National had net premiums of approximately $108 million and statutory income of approximately $14 million. Madison National's premium have grown in the mid-single digits over the past five years with the

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trailing five-year loss ratio below 50%. The transaction is expected to be accretive by mid-single digits to Horace Mann's earnings from the level we would anticipate for 2022, taking into account a normal cat load.

We'll see that benefit even though amortization of intangibles related to purchase accounting means that GAAP earnings will be somewhat lower than statutory income. The transaction also will deliver about 50 points 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 independent distribution bring to Horace Mann.

Turning to segment results for the quarter. In Property and Casualty, core earnings for the quarter were up about $8 million or 70.8% due to the strong contribution from net investment income, which was driven by the returns in the alternatives portfolio. Due to a higher underlying loss ratio, underwriting income was down by about $6 million, despite significantly lower catastrophe losses and an improved expense ratio that reflected our continued focus on expense optimization.

Premiums for the quarter were $156 million with new business volume remaining below historical levels as we work through the impact of the pandemic on sales. Auto average premiums were down slightly in the quarter, while Property average premiums are starting to rise.

In line with our July 1 announcement, cat losses for the quarter were $17.5 million, contributing 11.3 points to the combined ratio, significantly below last year and below what we anticipated when the year started. The 17 events designated as cat in the second quarter were generally less severe and not as widespread as the 20 declared cat events in last year's second quarter.

Our revised full year 2021 guidance reflects our assumption that second half cat losses will be between $20 million and $25 million, which is unchanged from what we guided to at the beginning of the year and is in line with the 10-year average for second half cat losses.

Turning to the underlying loss ratios, our experience in the second quarter and the first half aligns with overall industry trends. Driving is returning to more normal patterns, while inflationary trends in labor and materials are driving costs higher across all businesses.

Let's look first at auto where the loss ratio has been one of the most pandemic-impacted metrics for the entire P&C industry. Even as miles driven ramps back up, through the first six months of 2021, our underwriting discipline is key to why we are reporting an underlying auto loss ratio below the 70.6% we reported for full year 2019. However, because of the inflationary component of the increase in loss costs over 2020, we are initiating appropriate rate filings in selected geographies to help keep us at our targeted loss ratio. We're confident our agents will remain competitive on the business they quote even as these filings begin to take effect.

For Property, not only is inflation a concern, but similar to others, we are seeing increased frequency of fire and non-weather water losses in our case with several larger claims from those causes. To address, we're now planning to file for property rate increases in the mid-single digits in many geographies in the second half of the year, a bit above our original rate plan for this year. We're also making sure the insured values of covered properties remain in line with data on the rising value of homes across the country.

Finally, we released $4.2 million in prior period reserves during the second quarter with approximately $3 million from 2019 in prior auto liability. With our six-month combined ratio at 92.7%, we are still on track to achieve a full year combined ratio in line with our longer-term target of 95% to 96%. Our updated guidance for 2021 core earnings of $66 million to $70 million reflects the strong contribution of net investment income in the first half.

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Turning to Supplemental, the segment contributed $31.6 million in premiums and $12 million to core earnings. Supplemental continues to experience favorable trends in reserves and is still seeing the benefit of changes in policyholder behavior due to the pandemic. Net investment income on the Supplemental portfolio reflects the solid progress we are making in improving the Supplemental investment yield. Supplemental sales were $1.2 million in the second quarter, up from both this year's first quarter and the year ago period.

As we've said, the individual Supplemental products that we currently offer have traditionally been sold through a consultative enrollment model that has been among the most impacted by the worksite access limitations of the past year and a half. As we prepare for a more normal back-to-school season, Horace Mann agents continue to sell our individual Supplemental products with steady sales metrics in more open geographies. Premium persistency remains above 90%, a testament to the value educators place on these coverages with about 282,000 policies in force.

Our revised outlook for Supplemental's 2021 core earnings of $41 million to $43 million reflects a higher contribution from net investment income. We are also seeing the return to historical policyholder claims behavior occur more slowly than we had anticipated in this business. We now expect a full year 2021 pre-tax profit margin better than our longer-term target of mid-20%.

In the Life segment, June was the highest month for Life sales since the pandemic began. Annualized sales for the second quarter were ahead of first quarter with retention steady. We also saw an increase in single-premium Life sales. These sales tend to be lumpy, but they are a reflection of improving access as these are more consultative sales, typically requiring multiple contacts with the customer.

Core earnings more than doubled from last year to $5 million as mortality costs returned to within actuarial expectations, total benefits and expenses returned to targeted levels and net investment income rose 26.9%. Nevertheless, because of the higher mortality costs in the first quarter, we've modestly lowered our outlook for full year 2021 Life segment core earnings to the range of $14 million to $16 million.

For the Retirement segment, second quarter core earnings ex DAC unlocking were up 88.3%, reflecting the strong net interest margin. DAC unlocking was favorable by about $200,000 compared with $3.7 million in last year's second quarter. The net interest spread improved 79 basis points over last year's second quarter to 265 bps, in part due to strong returns on the alternatives portfolio. This is above our threshold to achieve a double-digit ROE in this business.

Our solutions for augmenting retirement savings remain a core need for educators. Annuity contract deposits were ahead of last year's second quarter by 15.6% with the June beating out March, the previous record as the highest month for deposit for several years. Our educator customers continue to see annuities as an important way to achieve their financial objectives and these products are complemented by our suite of fee-based products. Based on the strong results through the first half, we increased our full year 2021 outlook for Retirement core earnings ex DAC unlocking to the range of $43 million to $45 million.

Turning to investments, total net investment income on the managed portfolio was up almost 50% to $84.1 million with total net investment income up 35.8%. The increase in NII on the managed portfolio was largely because our alternatives portfolio generated outsized returns in the second quarter. As we've said, driving higher investment income through increasing our allocations to the alternative investments portfolio will be a strategic driver of a sustained double-digit return on equity.

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Year-to-date, private equity returns have been quite strong, given the relative strength of the equity markets and the active IPO window. As a result, second quarter alternative results were significantly above expectations.

In addition to the private equity returns, our other alternative strategies, such as private credit, infrastructure and commercial mortgage loan funds posted solid performance in the quarter. We expect to reach our targeted 15% allocation to alternative investments within the next two years and expect this diversified portfolio to generate high single-digit annual returns on average over time.

The fixed income portfolio had a yield of 4.3% in the second quarter compared with 4.39% a year ago. Second quarter purchase activity was largely opportunistic and focused on BBB corporate and high yield securities with attractive relative yields. The core new money rate was 3.35% in the second quarter and based on current market conditions, we continue to anticipate a core new money rate of about 3% for the year.

Our updated guidance reflects the higher assumption for total net investment income of $385 million to $405 million, including approximately $100 million of accreted investment income on the deposit asset on reinsurance. This expectation for investment income is captured in the segment by segment outlook I've summarized and in our core EPS guidance range of $3.50 to $3.70.

In closing, we are very pleased with our business progress through the first half of 2021 and excited about the potential of this year's back to school, as well as the progress we anticipate in 2022 and beyond. As we stated last quarter, our top priority for the use of excess capital remains growing our business at returns that meet or exceed our ROE targets. The acquisition of Madison National is an ideal use of capital to accelerate our path to sustained double-digit ROE.

Further, after the transaction, Horace Mann should generate more than $50 million in excess capital annually, assuming normalized Property and Casualty results. We're committed to prudently using that capital to create additional value for shareholders. Beyond growth initiatives, our capital generation provides scope for repurchase, as well as maintaining our track record of annual increases in our cash dividend, which is currently generating yield slightly above 3%.

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

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Thanks, Bret. And operator, we're ready for questions.

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Gary Ransom with Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes, good morning.

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

A

Good morning, Gary.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

I wanted to dig a little deeper into the inflation topic and the labor, material costs you're talking about that affect auto and home. And I just wondered if you can talk a little bit about how you're – how you've seen it emerge, I mean, if it's still accelerating? Are we at a point where it seems more persistent as opposed to everyone talking about a transitory or your views on that? And I guess I was also wondering if I can get a sense of how much your homeowners' automatic inflation increases? How much more of that has been ticked up versus what it might be over the long run?

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

A

Yeah, Gary, it's Marita. Thanks for the question. You're right. There's been an awful lot of industry discussion on the topic, lots of questions asked and answered. And I think it's clear that we're all seeing it because it's there.

I'll turn the call over to Mark in a minute, but at a real high level to a degree, it's a reflection of a healthy economy and, therefore, a shortage in supply. That's somewhat likely to be temporary. And to the extent that it could drive interest rates up, that would obviously favorably impact our investment yields. But I assume you really want to hear more about its effect on P&C and, obviously, we've been spending an awful lot of time digging through the numbers and looking at this, not just this quarter, but for many quarters.

So I'll turn it over to Mark to talk about that as well as the effect on rate actions that we might take to address the inflation. So, Mark.

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

A

Sure. Thanks.

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

A

Yeah.

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

A

Yeah, as you pointed, consistent with what the broader industry is seeing, we've certainly seen the impact of inflation on both of the auto and property lines. I think digging first into auto, it's primarily been cost of labor, cost of parts, maybe a lesser extent some return to normalization in social inflation and attorney involvement.

One additional thing I'd point out on the auto side with severity is we have continued to see a little bit less impact of fender bender. So, that phenomenon of less fender bender is driving kind of the math of it and causing increased severity is – it's still there.

When switching over to Property, and I think more of your question was focused on the Property side, we – again, we've see the cost of labor, cost of materials. I'd say that one other thing that we've seen is losses are more severe because customers are slower to mitigate some of the losses, either because they aren't reacting in getting folks in to fix the issues or they're having trouble finding contractors or water mitigation companies come in and deal with the mitigation and, therefore, some of the losses are growing from that.

In terms of the transitory impact, I mean, I think some of it clearly is – I don't think lumber prices will remain double or triple forever, but we're seeing really increases in that kind of mid- to high-single-digit, low-double-digit across many aspects of the various components of materials and labor. So, while it may be transitory in nature for some factors, some things I think I do see continuing longer into the future and I'm also not sure that once something comes up in cost, how much will it come down and we need to be able to address that.

So, to your question on inflation factors, that's certainly something that we are in the process of making adjustments to. We normally would make adjustments once a year. We're probably going to make the second adjustment to those factors in the next few weeks to a few months to increase coverage values commensurate with what we're seeing with increased replacement costs.

Additionally, I think in both lines of business, we'll be looking at rate actions. So, on the auto side, we had an expectation coming into the year that we would be at our target combined run rate probably by the end of this year, beginning of next year. We're pretty satisfied with where we are year-to-date. It's right on with what we thought, but certainly we're concerned with the increasing severity coupled with inching back frequency toward the pre-pandemic levels. So, we're probably going to accelerate rate actions on the auto side, probably more normal long-term inflationary type increases, up by a quarter or two and start to file some of those.

And then on the Property side, we had already had plans for low-single-digit rate increases and we'll probably be looking to push those more towards mid-single-digit as they come up.

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

A

Yeah, Mark. Thanks for that. Well said. And I think that thinking about the absolute loss ratios that we have as a starting point, the book has historically and continues to be very profitable. So, when I think about our current auto loss ratios being even better than what they were in 2019 before the pandemic started, it's a good place to start and our Property book has been historically profitable. So as Mark said, we did anticipate and this just means that the normal rate increase environment happens a little sooner.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

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Can I get a little bit of a sense of the automatic homeowners increases if – and I'm kind of guessing here that maybe it's usually 3% or 2% or 3%? Is that going to be 5% or 6% now or just sort of the order of magnitude, how much is that changing?

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

A

Yeah. So at the beginning of the year, we actually increased to about 5% and now we're looking at potentially pushing into that 7% to 8% range is what we're seeing more recently and some of the replacement cost estimates we're seeing in clients.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Interesting. Okay. Yeah. Thank you. And I just – you mentioned along the way also on the – a little bit of a social inflation and lawyers getting involved a little bit more. There was at least one other auto company talking about lawyers getting more interested in smaller limits and may be going – getting involved in more auto claims, even though the limits are not as high as elsewhere. Is that something you're seeing as well?

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

A

No, I wouldn't say that. I'd call it more of returning to closer to what we saw pre-pandemic. So, obviously during the pandemic courts were shutdown. Lawyers were anxious to settle things. There wasn't as much of that happening. That was a kind of positive phenomenon during the pandemic and we've certainly seen things start to normalize as courts open and so forth.

The other thing I'd point out is some of the states where this business is more significant like a Florida, our market position has deliberately reduced over the last four to five years. And so I think it's a factor for us, but it's not a big factor. It's just something we are noticing that that's starting to return more towards normal.

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

A

Very true. And the other thing that I would add is we do tend to have a pretty standard book. So, as far as limit coverages, I think that's another place where our homogeneous market segment certainly not, as we say, not immune, but somewhat insulated is helpful. And as Mark said, the underwriting actions we took and drove prior to this timing worked out really well. We started at a really good place. And as it relates to Florida, very intentional, very clear, saw that one coming, if you will.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Thank you. Just one last question on inflation. Is there any product within Supplemental where rising medical costs might have – be a factor? Or are those all controlled by those daily limits and other things you might have in place there?

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

A

Yeah, I'll turn it over to Tyson to answer that question. Go ahead, Tyson.

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Tyson Sanders
Vice President, Supplemental, Horace Mann Educators Corp.

A

Yeah, I don't believe that I think Marita's comments that we're not completely insulated, are immune but insulated I think is appropriate here. We're not impacted by the inflationary measures that are in place right now with the Supplemental products.

[indiscernible] (00:36:20)

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

A

Yeah. And I'd also add to that as we said in the script and as we've said all along, the margin improvement that we're seeing in Supplemental is certainly aided by folks being a little more reluctant to seek treatment and to be out there in some of the places where we would see those expenses come through. We're not seeing them. We do expect that to begin to return.

So, we have an interesting offsetting, maybe less propensity for our agents out there because of school closures, but we're getting the benefit of not seeing it on the claims side. We would expect that to begin to reverse a little bit, where the claims would start to come through as sales begin to increase. And as we said in the script, we are seeing some nice momentum in the Supplemental quarter-over-quarter and month-over-month. So, we are starting to see sales increase and we would expect claims to begin to come back as the world opens up a little bit. So, pretty much as we thought it would come through.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

That's great. Thank you very much.

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

A

You're welcome.

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. Just wanted to follow up on some of kind of Gary's questions there and Mark's commentary on particularly Property. Can you help us in the quarter of the elevated boxes you guys cited both frequency and severity of fire and water losses? Was it particularly one or the other? I'm thinking the severity side is more of these loss cost issues, inflation you're talking about, and will be dealt with price, whereas frequency can bounce around a bit. Was it much more one or the other or fairly evenly both?

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

A

Yeah. I'll start and then I'll turn it over to Mark. Starting with fire, remember, this is very lumpy for us due to the size of the book. A few fire losses, one way or another, can have an unusually good quarter or an unusually lumpy quarter from a fire perspective. But from a water perspective, you obviously have people at home using their plumbing and their water more frequently. I don't know what you might want to add to that, Mark.

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

A

Yeah, I think [ph] Marita, you've got it (00:38:41) right. I'd say that the fires are kind of that normal lumpiness, if you will, from quarter to quarter. A few big fires, they make a significant difference, but the water losses are certainly the one that's the new phenomenon. And that's probably what I was referring to in my earlier response with – we believe that some of those are getting worse because it's – customers are slower to mitigate them.

And if you're slow to mitigate them, the problem just gets worse. And that I think is [ph] partly (00:39:15) a factor of the demand out there and the supply of the labor to come in and do that where -you get some of the water mitigation companies in to stop the problem, and that's something that we've seen in that. I'd say is one bigger than the other, probably not, but I would again reiterate that the fires are lumpy and the water loss is a thing that is kind of a new phenomenon that we're seeing.

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

A

Yeah. When you look at fire on an annual basis and we do year over year over year, again, very profitable for that portion of that line of business. But when we look at the water, you are seeing an uptick and I think it's similar to what the industry is seeing, and I think Mark explained it well.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Okay, great. Thank you. And then Marita, I just want to go back to your comments. You gave some good numbers on kind of the growth in the number of household relationships. I was hoping – I mean obviously you guys give PIF by segment and I think that obviously can skew things, right? I mean, when you look at P&C or auto and it's been going down, but I know you guys have a relationship with, I believe it's progressive, where it doesn't capture that, right? It's more of a household level. So, I was hoping, can you give us any color on taking out those acquisitions over even a few year period, excluding last year, what sort of organic growth would you estimate, even ballpark you guys have been achieving in household relationships, not of particular lines PIF, but the broader Horace Mann relationship with an educator?

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

A

Yeah, Matt, it's a great question. We would love to be able to report on a household basis and I'm looking at the team in the room smiling at me because they know how I feel about this and eventually we will be able to give you some decent household stats. What I know, and I think Gary actually said this in a question on the last call, the total addressable market for us has increased pretty substantially over the last 24 months.

I mean, I'm proud of the place when you think about our worksite drill closed up pretty dramatically and instead of having that affect our success as a company, it really propelled us to address the things we could address during that time period, and that was completing the integration of the NTA agents, working really hard on closing the agreement with Madison National. And what that did for us is both the increase in households that we saw from NTA and we had estimated that to be approximately 150,000 households with the additional districts from Madison National, which was 1,200 districts and 350,000 households.

That's more folks under the umbrella, where rather than just being leads, now they are customers. And when we think about our cross-sell history, when we think about our persistency and retention, getting them in the house and then cross-selling them, we tend to keep them. So, I feel really good about what we did during this year and a

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half, was increase the opportunity to do what we're really good at, and that is cross-sell households and retain households.

So for me that addressable market really did change substantially during this time period. So, we do know we have an increase in households. And for us, I think the work that we did to improve our profitability in P&C, some of that was sticking to our knitting, maybe using progressive for some of the non-educators, using progressive for what they're good at in some of the non-standard areas of our book. And that allowed us to come from a place of strength.

So, I think you're right. For us, it is about the households, it is about penetration of the household. And I look at the significant increase in Retirement deposits and we saw it again this quarter. I see the success in our Life business and we're selling Life business through the pandemic. And I know that will translate to an increase in the other lines over time. So, I feel very optimistic about where we are.

Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. And one last question, if I could. We'd appreciate your comments on – hopeful with Delta and everything. We don't go – the school systems don't go back to hybrid, and I think that's probably the case. I guess, my question is, as we came out of the pandemic last year or any point during the school year in the pandemic, did you see school districts that were physically in session, maybe still not let kind of outsiders or your agents in? They might [ph] hold (00:44:03) school and the educators are there, but have more strict practices on visitors coming in or generally would you expect that it would be back to fairly business as usual?

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

A

Yeah. I think we saw a little bit of that during the lockdowns, right. And for our business, there are some districts where we've never been in, where they don't allow anyone in, and I would imagine that would continue in those places. There's different ways for us to conduct our business. I am excited about our back-to-school efforts and what our agents are seeing and reporting.

This is the annual time where, from a sales perspective, we do our rallies. Our agents have been engaged in the school districts. Many of them have physical appointments where they didn't have physical appointments last year. We're seeing some very encouraging signs from our agents. And I think that comes from the fact that as a population, educators are more highly vaccinated than the rest of the population.

The NEA reports that, and this was as of a couple of weeks ago, and I'm sure the numbers have increased, 86% of their members are vaccinated, 89% of the AFT members are vaccinated. And that compares to a much lower number in the 60s for the general population. I think the efficacy of vaccines, kids 12 and over, whether they'll be able to do that for all elementary school kids in this school year, I think will be important as well. A lot of discussion on masks or no masks, but not a lot of discussion about not coming back. It's almost to the point where everyone realizes and the studies have been done that in-classroom learning is the best way to go.

So folks are saying we're going to be back, what's the best way to be back. And whether that's staggered, whether that's with masks, whether that's with appropriate social distancing depending on what the school districts can do. So, our agents feel like this is much more normal, not completely normal. There will still be some access issues, but we feel very good about the efforts that we've put into this back to school and our agents seem quite optimistic.

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Matthew J. Carletti
Analyst, JMP Securities LLC

Q

Great. Thank you very much for the insights. Appreciate it.

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

A

Yeah.

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

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you very much. You've had meaningfully better Supplemental claims utilization trends for probably longer than anticipated. It's not something that it's simply only Horace Mann, but have you been starting to think through maybe some of these claims trends? Could they be somewhat semi-permanent in nature that people's just behaviors are changing and how they use some of the products?

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

A

Yeah, potentially. I mean like all of this, who knows the psyche, who knows whether it's changed, what people will do, how they'll do it, how often they'll do it, are their lifestyle changes, will return to office, working from home versus being in the worksite, will that change potentially some of accidents or those types of things you might see some semi permanency, but we are anticipating that the majority of this would come back. I don't know if you have anything to add, Tyson.

Tyson Sanders
Vice President, Supplemental, Horace Mann Educators Corp.

A

Yeah. I think – if you think about the different product lines, there are some where – have been more drastically impacted in a pandemic environment. An accident is a really easy example. Folks have avoided those optional activities that they would have done in the pre-pandemic environment. I fully expect that those types of claims will come back in full force in a post-pandemic environment, but there is going to be behavior change. And I think that is indicative of the society that we're in right now.

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

A

Yeah, John, this is Bret. I would also add that you saw in our guidance change page that's in the investor presentation, we did take the guidance up for the year about $8 million. And to your point, the experience through the first half was better than planned. In the second half of the year, we actually did anticipate the claims activity going up, but certainly not to the level of our original plan for the year. So, there is some built in favorable experience in the second half below what our original plan was, but I would agree with Marita. There's probably going to be potentially some permanent benefit, but yes...

[indiscernible] (00:48:51)

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

A

Consistent with our conservative nature.

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

A

Yeah.

Tyson Sanders
Vice President, Supplemental, Horace Mann Educators Corp.

A

For sure. I would think one other thing to add there has been that educators are going to be back in the classrooms. They're not going to have the option to work remotely. So, the behavior that we've seen over the last 18 months is not going to be long term for our niche.

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

A

Right.

John Barnidge
Analyst, Piper Sandler & Co.

Q

That's a very good point. Within that vein, obviously educators have spouses that are not educators. Is there any way to capture the size of the Supplemental PIF market that's actually insuring people that actually are spouses of educators and not educators themselves?

Tyson Sanders
Vice President, Supplemental, Horace Mann Educators Corp.

A

It's not necessarily an easy thing to do. A lot of our products are built on covering the entire family. There are measures that we could get you there. I don't have it handy, but it's something that we could certainly present in the future.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Okay.

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

A

Yeah, I mean we would know that across our whole book for auto, for home, for Life. We clearly quote it that way. So, I mean, if you're interested, we can get you that breakdown.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Yeah. That would be interesting. And then my last question on alternative investment income, it's been remarkably strong. Can you talk a little bit about real-time reporting versus one quarter lag within that $330 million of alternative investments you have? Thank you.

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

Sure, John. This is Bret. To your question, almost all of our alts report on a quarter lag and certainly we've had outsized performance in the first quarter to the tune of – return of about just south of 11%. I think the second quarter was just south of 20% year-to-date. I think it's in the investor presentation. We had a return of almost 15%, which has certainly outsized in comparison to a typical plan of about high-single digits.

But as it relates to the second quarter, let me turn it over to Ryan, and he can provide some color on specifically what drove the outperformance of the [indiscernible] (00:51:04) for the quarter.

Ryan E. Greenier
Chief Investment Officer & Senior Vice President-Finance, Horace Mann Educators Corp.
A

Sure, John. This is Ryan. As Bret mentioned, a lot of that outperformance was really episodic and tied to IPO realizations and a handful of private equity funds. So, obviously a rising equity market does bode well for continued strong performance, but I'll flag that if we isolate for just the LP component of the alternatives, the return was over 30% on an annualized basis for the quarter. So, we'll absolutely take it, but we certainly didn't reflect that level of continued performance into the updated guidance.

John Barnidge
Analyst, Piper Sandler & Co.
Q

Thank you for your answers and best luck in the quarter ahead.

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

Thanks.

Ryan E. Greenier
Chief Investment Officer & Senior Vice President-Finance, Horace Mann Educators Corp.
A

Thanks, John.

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

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

Good morning. Thanks for squeezing me in.

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

Good morning.

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

I want to pivot back to the Madison National acquisition. I'm looking at your slide deck page 6 and one of the points you highlight here is that you're able to leverage long-standing relationships with K-12 districts and

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effectively cross-sell this product into your relationships. And then I also listened to your comments about Assured Partners in the new relationship or the reaffirmation of the relationship there.

So, two questions on this. First, as you go in the cross-sell, is there a big switching cost as it relates to getting your product and replacing whoever the legacy provider is? And then secondly with Assured, are there other distribution partners out there that you think you can bring into the fold and strike similar deals with going forward?

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

A

Yeah. Great question. First on the switching cost, the answer is no. But what I would say as it relates to Madison National Life right out of the get-go is, and we made this very clear on our initial call, is that this is completely complementary for us. So, what's really exciting is when we go back to our PDI strategy, building products that are relevant to educators, growing our distribution, having educators find us anyway they choose, building our infrastructure, Madison National checked all three of those boxes. And what's interesting about the distribution for us is whether educators get individual products from our EAs or they get it at school in a benefits package from their school district through Madison National, we can cover the whole educator.

And what's interesting about having be the provider with the district and the superintendent is that builds credibility, it builds reputation, it builds purpose. So if you're an educator and you're getting Horace Mann products at school and then you're approached by a local trusted advisor at the point of sale with other Horace Mann products that connectivity, that reputation, I think really does help that individual sale as well. So, we're really excited about that.

Madison National has been working with NIS, who is, as you mentioned, a division, if you will, of Assured Partners for over 30 years. This is a relationship that's been built where together they go into the school and they do what they do and they do it very well for us. Taking that relationship that they've built over 30 years with 1,200 districts and expanding around that relationship with what we do and how we do it is one thing, but then there's also the other side of the house where we've got relationships with many more districts where we can introduce Madison National and NIS and their offerings to those districts.

So, for us, I really do think it's back to that total addressable market. It's back to our homogeneous market niche where it's focusing on bringing educators everything they need, whether they buy it themselves or they get it at work. And we are very excited about it working both ways and the fact that it's completely complementary.

As far as going anywhere beyond the relationship with NIS, we don't need to at this point. The relationship is strong. They are good at what they do and I'd like to spend some time harvesting that and seeing together what we can do because we think it's pretty powerful.

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

Q

Got it. The other question I had is based off slide 31. And you spoke about the lift you had for net investment income from the alternative portfolio, and I think you also mentioned that you plan to allocate more towards the alternatives going forward. And so, I'm looking at this slide and 14.97% return year-to-date and all I'm thinking is statistics and reversion to the mean. And I look at the rest of the year as those results are less profound and I'm just wondering going forward, certainly, the first half of next year, it seems like the setup for some headwinds, just for less really strong performance, certainly seems very real, but maybe you could comment there?

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

A

Sure. Let me start, Greg. This is Bret. And then if Ryan wants to chime in, he can do so. But I guess a couple of things. Certainly, that would not be our long-term yield assumption or return for that asset class. However, we are going to have a larger number of dollars invested. So that that contribution to net investment income, let's call it, between $25 million and $30 million prior to this year, that was kind of our plan from this asset class.

So, we're at 8% of our invested assets in this asset class, as is contained on that slide. We are targeting to take that up to 15%. Yes, this asset class can be lumpy from time to time, but from a pure contribution standpoint, alts will be a larger contributor to the bottom line even though the yield may be less. And as you saw on our ROE slide, this is a strategic lever of our growth in the ROE, not just today, but certainly in the future.

Ryan, I don't know if you wanted to add anything there?

Ryan E. Greenier
Chief Investment Officer & Senior Vice President-Finance, Horace Mann Educators Corp.

A

Yeah. The only additional commentary I'd provide is that long-term target is in line with many of our other larger Life peers. And when I think about it, I'd break it into two pieces, 10% allocation to commercial mortgage loan and investment grade infrastructure funds. Those have a much steadier, less volatile return and we're targeting a mid-single-digit return for that asset class, performed well during the pandemic. It's a good source of cash flow.

In addition to that, the other 5% again is in line with Life peers. But that is more volatile, but that is where you'll see more outsized returns in periods like we just saw this quarter. I'll point out we have about $600 million in commitments in the pipeline right now and we expect to put that capital to work over the next 12 to 24 months. So, the absolute dollar contribution of alternatives should ramp up meaningfully over the next few years and the majority of that capital commitment is in the commercial mortgage loan space. We think it's a very attractive time to put money to work there.

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

Q

Got it. Thank you for your answers.

Ryan E. Greenier
Chief Investment Officer & Senior Vice President-Finance, Horace Mann Educators Corp.

A

Thank you.

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

A

Yeah. Thanks.

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

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

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Thank you, Sarah. Thanks to everyone for joining us today. We expect to be available to meet with investors ramping back up into the fall, looking forward to being at the KBW Conference in particular. Feel free to reach out. Love to schedule a time to talk. And thank you all again.

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

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