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Horace Mann Educators Corp. (HMN)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Horace Mann Fourth Quarter and Full Year 2021 Results Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Heather Wietzel, 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 fourth quarter and full year 2021 results. Yesterday, we issued our earnings release, investor supplement and investor presentation, all of which 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 Q&A, we have Matt Sharpe on Supplemental & Group Benefits; Mark Desrochers on Property & Casualty; and Mike Weckenbrock on Life & Retirement; plus 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-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 also 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, Horace Mann reported fourth quarter core earnings of $0.97 and full year 2021 core earnings of $3.59 per diluted share. This marks our second consecutive year of record earnings and core return on equity of over 10%. It also positions us well for strong results in 2022 and achievement of our longer term targets of 10% average annual EPS growth and sustained double-digit ROEs.

Today, I will briefly discuss our 2021 results, which Bret will cover in more detail. He will also discuss our commitment to accelerating shareholder value creation as we continue to execute on our strategic road map, which is driving significantly greater earnings power for the company.

Since 2018, we have more than doubled our expectations for capital generation to $50 million in 2022 and beyond. While our first priority for excess capital remains supporting profitable growth, which further drives shareholder value, we will continue to utilize our share repurchase program and continue our track record of annual shareholder dividend increases.

I want to focus the majority of my remarks on the steps we're taking to achieve our targets, as well as comment on how this aligns with the strategy we executed to bring us to where we are today, positioned to be the company of choice to help all educators protect what they have today and prepare for a successful tomorrow.

In the fourth quarter, all segments finished ahead of expectations, reflecting our solid underlying performance, as well as strong net investment income due to the very strong returns on our limited partnership portfolio. Across the board, the results illustrate the value of our multiyear focus on products, distribution, and infrastructure to better serve the education market. In particular, we continue to be very pleased with the results of our retirement segment, where annuity sales increased 5% over prior year.

Throughout the COVID-19 pandemic, our educator customers remained keenly focused on preparing for the future. As we continue to introduce new districts and households to our retirement products suite, we gained more opportunities to introduce our individual insurance products to new educators.

As we have expected for more than a year, auto loss costs returned to pre-pandemic levels. For the P&C industry, this hasn't been so much an issue of if, as an issue of when. Combined with inflation-driven factors as expected, this led to an auto loss ratio above the unusually low level of last year. Bret will give more details on our 2022 rate plan, but we're confident we will remain competitive with fair pricing for our education market while addressing the inflationary pressure. Despite the higher auto loss ratio, as well as catastrophe loss costs about double last year's fourth quarter, our P&C business was profitable in the quarter.

For the year, catastrophe losses were about even with 2020, with both years running ahead of our 10 year average. We continue to see growth momentum in the supplemental business with another quarter of sequential sales growth. We also continue to see temporary changes in policyholder behavior related to the pandemic.

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Now, let me spend a little time talking about Horace Mann's long-term view now that Madison National Life is officially on board. I'd like to welcome any Madison National employees on the line to the company. We are excited to be working together as one team serving the education market. We worked side by side with Madison's team in the months leading up to the close to ensure a smooth initial integration, which we've seen with all hands on deck for the first month and a lot of enthusiasm for what we can accomplish together. The beauty of bringing together two such similar companies, mission-centric with decades of experience in the education market, is that neither of us have to change who we are. We can simply build a stronger company together.

With this strengthened value proposition, Horace Mann remains focused on helping educators achieve lifelong financial success and evolving to meet the needs of the education marketplace. We continue to be guided in our day-to-day operations by our commitment to educators and desires to have a positive impact on all of our stakeholder groups. This commitment is the core strength that will enable our company to grow and serve more educators with distinction.

To achieve our long-term objectives of an expanded market share and accelerated shareholder value, we implemented a multiyear PDI strategy to enhance our product offerings, strengthen our distribution and modernize our infrastructure. Our transformational phase to position ourselves for market growth culminated with the acquisition of Madison National. And as a result, we now have the capability to provide educators with the products they need, whether purchased individually or through their employer.

Under the Horace Mann umbrella, we have aligned our operations into two focused divisions, retail and worksite, to maximize our potential to respond to the needs of educators and school districts. The retail division is largely our legacy lines of business. We built the work site business through the NTA and Madison National acquisitions, giving us the capabilities to provide voluntary and employer paid benefits, which dramatically expands our growth opportunities.

To briefly revisit what that means, there are roughly 7.5 million K through 12 educators in our core market, and the demand for educators grows steadily each year. After the addition of Madison National, Horace Mann is serving roughly 1 million households through either individual or worksite solutions. Historically, the customer base has been around 80% educators. The opportunity is substantial, and we know this market better than anyone else.

Our solutions and programs are tailored to meet educator needs at each stage of their lives. What motivates us is the understanding that educators are incredibly deserving of dedicated solutions and support. A clear example of this is our student loan solutions program, which helps educators take advantage of the Federal Public Service Loan Forgiveness Program. Despite degree requirements on par with many private sector jobs, educators take home lower salaries than other professions with similar prerequisites.

Many educators forego higher paying private sector jobs because they have a passion for what they do. They choose the profession because it's a calling, because they want to make a difference. Even before COVID-19, educator attrition was high. Over the past two years, the job has become undeniably more difficult as educators took on the roles of frontline workers during the global pandemic.

The concern of educator burnout is widespread and is magnifying staffing concerns among school district administrators. School districts looking to attract and retain highly qualified educators are often unable to do much in terms of salaries, which are often dependent on state and local budgets. One area they can provide more value

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to educators is in workplace benefits that increasingly resemble those in the private sector with employer paid and voluntary life, disability and supplemental insurance coverage. That's the need from a work site perspective.

Across the education market, we are serving a homogeneous market with similar characteristics, buying habits and risk factors. They appreciate individualized guidance and education, which we provide through programs like financial wellness workshops and student loan solutions. They are conservative, responsible savers and risk-averse, which leads them to retirement products like the annuities and mutual fund products Horace Mann offers. They are loyal, which results in higher policyholder retention in personal lines, and Horace Mann's customer retention increases the more products a customer has.

By bringing Horace Mann and Madison National together and building on the progress from bringing NTA on board several years ago, we have the products, distribution and infrastructure to take care of educators' protection and savings needs, however they receive coverage, whether they buy it themselves, receive it through their employer or both.

It's also worth noting that our supplemental group and retail businesses have strong and complementary presence in different geographies, which sets the stage for leveraging existing district and educator relationships for cross-sell. In the foundation phase of our strategy, we defined our key initiatives, such as improving our auto loss ratio, and delivered the results we had described. We are similarly working on key initiatives to deliver profitable growth in 2022 and beyond.

The first is to cross-sell more customers. The more solutions we can provide to meet educator needs, the higher our policyholder retention. This is the true value of our multiline model, being able to help solve all of our customer needs for insurance and financial solutions by building a lifelong relationship with our clients. Now more than ever, we have more ways to do that.

That brings us to our second initiative, which is to take advantage of current industry dynamics to leverage auto as a source of new households. Historically, many of our new customers came to Horace Mann through the garage, although this dynamic shifted during the pandemic. Educators focused more on savings products and less on reevaluating their current protection products. We were not surprised that shopping for auto was not their priority at that point. And we see the potential for educators to now start thinking about auto and other protection products.

Before I turn to the other initiatives, I want to pause briefly to revisit our strategy and approach for personal lines. Horace Mann has long focused on offering a fair auto price over the life of a customer relationship. The educators who buy are very loyal as our retention rates demonstrate and they often become package customers, not just of homeowners, but potentially also buyers of savings products. We believe our relationship approach to bundling contributes to our long-term track record of strong retention and cross-sell metrics.

Another area of focus is maximizing our work site opportunity. We want to expand Madison National's reach with employer paid products now concentrated in the Midwest into Horace Mann's national footprint, particularly into the Southern markets where NTA had developed a strong presence. We'll complement that with efforts to expand the supplemental reach with voluntary products into Madison National's Midwestern geographies. Reaching new districts and introducing them to the Horace Mann companies will lead to further cross-sell opportunities for our retail products.

To support our growth plans, we must continue to build on our digital capabilities to ensure our operations run efficiently and educators connect with us in the manner they prefer. Finally, we must maintain our distinctive

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service mindset in every decision and every interaction. Horace Mann has been successful because we put our educator customers at the center of everything we do and we can only continue to be successful if we evolve with our customers' changing needs and preferences. In today's environment, this effort will continue to set us apart.

Looking ahead for 2022, we expect EPS will be in the range of $3.45 to $3.65, with ROE near 10%. Our guidance has net investment income in line with 2021, factoring in limited partnership returns closer to historic averages after a stellar performance in 2021. The guidance also includes at least $0.15 from newly-acquired Madison National Life's current business activity as well as initial contributions of strategic growth initiatives that will drive results in 2023 and beyond when we are targeting average annual EPS growth of 10%.

Before I turn the call over to Bret, I want to note an additional example of how we live our commitment to our stakeholders every day. For the fourth year in a row, Horace Mann has been named to the Bloomberg Gender-Equality Index, which recognizes corporate commitment to transparency in gender reporting and advancing women's equality. The reference index measures gender equality across five pillars: female leadership and talent pipeline; equal pay and gender pay parity; inclusive culture; sexual harassment policies; and pro-women brand.

Being included in this index for the fourth consecutive year underscores Horace Mann's commitment to building and maintaining an inclusive corporate culture where every employee feels heard, respected and appreciated. We aim to build on this progress in 2022 by continuing to diversify our workforce to make sure we fully understand and represent the education market we so proudly serve.

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.

Thank you, Marita, and good morning, everyone. As Marita noted, Horace Mann reported record core EPS as well as core ROE above 10% for the second consecutive year. Fourth quarter 2021 core EPS was $0.97, significantly above the top end of our guidance for the quarter.

Every segment exceeded our expectations, largely reflecting strong net investment income growth, driven by the performance of our limited partnership portfolio. More importantly, the value of the revenue and earnings diversification we've accomplished in recent years was clearly demonstrated as we achieved these results even while the auto loss ratio returns to pre-pandemic levels, which wasn't a surprise to us and shouldn't be a surprise to anyone else based on the resumption of more normal driving patterns across the country.

In a moment, I'll talk more about our outlook with Madison National as part of Horace Mann. But, first, let me run briefly through the highlights of 2021. 2021 Property & Casualty premiums were $608 million. Retention remains strong, although new business volume continues below historical levels. Underlying segment results for the year were impacted by auto loss frequency returning to near pre-pandemic levels as miles driven has increased. Further, severity is elevated for both auto and property.

Nonetheless, with a healthy contribution from investment income, P&C core earnings were strong. For the fourth quarter, P&C segment earnings were $15 million and our combined ratio was 99.9%, a solid result considering cat losses were almost double last year's fourth quarter.

Our retention rose 2.5 percentage points for auto policies and 1.5 percentage points for property in 2021. In auto, the fourth quarter underlying loss ratio was 79.3%, an increase of 11.9 points compared with the prior year quarter when loss activity was unusually low due to the pandemic. Auto loss levels increased mainly due to miles

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driven and claims frequency effectively returning to near pre-pandemic levels, as well as higher loss severity related to inflation. As we've said before, Horace Mann is well prepared to leverage disruptions in the auto market.

First, our loss ratio going into the pandemic was at the profitability levels we had targeted. Second, we did not respond to the early stages of the pandemic with rate decreases to gain market share, a strategy used by direct marketers. Instead, as Marita described, we remain committed to our long-term strategic approach of providing our policyholders with a fair price over the life of their policy. In the current environment, we are seeking rate to address the higher cost associated with claims. As a result, our auto rate plan for 2022 sees rate increases in the 6.5% to 7% range in states representing about 75% of our premiums.

In property, the fourth quarter underlying loss ratio improved by 4.8 points from the prior year quarter to 37.3% despite higher severity due to labor and material cost increases. In addition, we continue to make certain insured values are keeping pace with inflation. The combined impact of the rate increases and inflation-driven coverage changes is expected to lead to average premiums rising in the high single digit to low double-digit range over the course of 2022.

Turning to supplemental, full year core earnings were $46 million, up 7% over the prior year, as net investment income rose 39%. Over the course of the year, we experienced favorable trends in reserves and through temporary changes in policyholder behavior due to the pandemic. For the fourth quarter, the segment contributed $31 million in premiums and $12 million to core earnings, with margins remaining better than our longer term expectations.

Supplemental sales were $2.2 million in the fourth quarter, the highest quarterly sales performance since the pandemic began. Sales for 2020 included one pre-pandemic quarter. Although we are still not back to those levels, we expect to see steady progress over the coming quarters.

Premium persistency remains strong, improving 2 points in the quarter to 92.5%, a testament to the value educators place on these coverages, with about 278,000 policies in force. In the life segment, sales continued their steady pace and persistency remained consistent throughout the year. Core earnings for both the full year and the fourth quarter were ahead of last year as strong net investment income offset elevated mortality costs.

For the retirement segment, annuity contract deposits were up 5% for the year, while segment core earnings, excluding DAC unlocking, rose 90%. Full year earnings benefited from higher net investment income, which resulted in an increase in the net interest spread to 290 bps from 212 bps in 2020, largely due to strong returns on the limited partnership portfolio. Further, contract charges earned rose 30%, largely due to strong equity market performance. Core earnings ex-DAC unlocking were up 45% in the fourth quarter, reflecting the continued strong net interest margin.

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, and retirement products are proving first to be an important entree into districts in this environment; and second, a great introduction of Horace Mann to district employees and educators. Over time, this will provide new cross-sell opportunities we can leverage as the external environment improves.

While still a small part of the total, we are also beginning to see measurable progress in the number of Retirement Advantage contracts in force with another solid quarter, bringing the end of year total to 15,000, up 15% over prior year. Retirement Advantage is the fee-based mutual fund platform that we believe represents long-term value for this business segment.

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Turning to investments, total net investment income on the managed portfolio was up more than 23% to $321 million for the year, with total net investment income up 18%. The increase in net investment income on the managed portfolio was due to the contribution of our limited partnership portfolio. We're allocating these alternative strategies to generate a higher income contribution than could be generated through traditional fixed income investment in today's markets without any meaningful shift in the risk profile of the overall portfolio. This approach proved its value in 2021, with returns running ahead of our historical levels due to the relative strength of equity valuations, which resulted in strong private equity and venture capital returns.

Our other strategies, such as private credit, infrastructure and real estate, also posted solid performance. And our commercial mortgage loan fund portfolio continues to perform as expected. Overall, we expect these strategies will combine to generate high single-digit annual returns on average over time. The traditional fixed income portfolio had a pre-tax yield of 4.27% in 2021, compared with 4.2% a year ago. Fourth quarter purchase activity continued to focus on sectors and issuers with more attractive relative value, such as BBB corporate and high yield credit. The core new money rate was 3.83% in the fourth quarter of 2021.

Before I turn to our outlook, we funded the Madison National acquisition, which closed on January 1 as we had planned, with cash on hand and additional borrowings on our revolving credit facility. We drew on the line at the end of December. So at year-end, total debt was $502.6 million, with $249 million outstanding on the line of credit. The debt-to-cap ratio, excluding net unrealized investment gains, is 24.9%, which aligns with levels appropriate for our current financial strength ratings.

Further, RBCs at year end were all in line with our targets for the subsidiaries. Corporate expenses ran a bit above our normal run rate in the fourth quarter because of costs associated with the Madison National acquisition. In 2022, corporate expense will reflect the higher interest expense associated with the additional borrowings.

During the fourth quarter, we repurchased almost 100,000 shares for a total of approximately $3.5 million and more than 50,000 shares since the first of this year for approximately $2 million. We have about $13 million remaining on the current repurchase authorization. And that's an ideal segue for what we see for 2022 and beyond.

As Marita discussed, we expect the leadership phase of our journey will show the value of the strategies we have been implementing for a number of years to make Horace Mann an even stronger and more diverse organization, better able to serve educators while also providing solid returns to shareholders. Out of that strength, we see Horace Mann generating at least $50 million in excess capital each year.

Beyond supporting growth opportunities, we have several levers to further enhance shareholder value, in particular, share repurchase. Further, we expect to maintain our track record of 13 years of annual increases in our cash dividend, which is currently generating a yield above 3%.

As we stated in the news release, we expect 2022 EPS in the range of $3.45 to $3.65, with ROE near 10%. That expectation includes at least $0.15 for Madison's current business activity, as well as initial contributions of strategic growth initiatives that will drive results in 2023 and beyond. Further, it anticipates limited partnership portfolio returns closer to our historical averages and net investment income in line with 2021 totaling approximately $310 million to $320 million.

Looking at business performance, we will report financial results in three operating segments in 2022: Property & Casualty, Life & Retirement, and Supplemental & Group Benefits. Our guidance is based on that new structure.

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Property & Casualty 2022 core earnings are expected to be in the range of $44 million to $48 million. In 2022, we're planning for an underlying auto loss ratio, slightly higher than the 2021 level as auto frequency remains near pre-pandemic levels, with inflation driving higher severity in both auto and property lines. Guidance reflects a cat loss assumption of approximately 9.5 points on the combined ratio in line with the 10-year average. The longer term P&C combined ratio target remains at 95% to 96%. We are planning for net investment income to be lower in this segment as it benefited from strong limited partnership returns in 2021.

Life & Retirement segment 2022 core earnings are expected to be in the range of $74 million to $77 million. In this segment, we're planning for net investment income to be up slightly, maintaining the net interest spread near the 2021 level. Our guidance reflects mortality returning to actuarial expectations, given our focused niche of educators and their high vaccination rates.

Supplemental & Group Benefits segment 2022 core earnings are expected to be in the range of $47 million to $50 million. This segment will include our current supplemental business, as well as Madison National and a small group life block from our legacy life segment. Our plans anticipate claims utilization for supplemental and disability products to return to near pre-pandemic levels, leading to a benefit ratio about 35% for voluntary products and about 50% for employer-paid products. As a result of the Madison National transaction, 2022 total amortization of intangible assets is expected to increase by $0.08 to $0.12 per share over 2021.

Looking even further ahead, I want to share an update on where we stand with our work on the accounting standards update 2018-12 for targeted improvements to the accounting for long-duration contracts. Last year, we began the assessment of how this standard would impact our legacy Life & Retirement business. That process is well underway but not complete. Now that we've completed the Madison National transaction, we've been working on the assessment of our Supplemental & Group Benefits businesses, although the impact here is likely be minimal due to the nature of their liabilities.

Broadly, although the standard does not change long-term earnings, underlying economics, cash flows or statutory accounting, it does require cash flow assumptions, underlying reserves for the impacted businesses to be reviewed and updated at least annually. There is widespread agreement that when the standard is adopted in 2023, the industry will be using lower interest rates than were used in existing assumptions, which is expected to result in initial AOCI adjustments that lower book value. The initial earnings impact is more complex to develop with many product-specific factors to consider. Similar to most affected companies, we expect to be able to offer more details by midyear.

In closing, we're very pleased with 2021 results. We're also confident that we will be building from the success as we move forward. 2022 EPS is expected to be in the range of $3.45 to $3.65, including the contribution from Madison's current business activity as well as initial contributions of the strategic growth initiatives that drive results in 2023 and beyond. We have strengthened Horace Mann's value proposition for the education market. And this sets the stage for significant profitable growth over the long term to generate value for all of our stakeholders, which is reflected in our long-term targets, 10% average annual EPS growth and a continuation of the double-digit ROEs we have delivered for the past several years.

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're ready for questions.

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QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] The first question is from Gary Ransom of Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes. Good morning. I wanted to focus on the rate versus loss trend in personal auto. Obviously, severity happens immediately and rates happen over time. So, your guidance of a slightly worse loss ratio probably has a lot more front-end loaded in 2022. I just wondered if you could talk a little bit about what you're seeing on severity and sort of the timing of the corrective actions.

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

A

Yeah. Gary, thanks for your question. Very thoughtful and as usual, part of the answer is embedded right there in the question. Before I turn it over to Mark on the specifics, I want to go back just a little bit and remind everyone of our focus on building a company with a sustained long-term, double-digit ROE. And one of the key levers of that ROE improvement was our auto loss ratio improvement. And we did the hard work, which included reduction of PIF in some difficult places like Florida and Colorado and broader underwriting action that shrunk auto units. But it put us in a better position.

So, to give you a plug, your Dowling IBNR number 49, not that I read it, compared loss ratio improvement among the auto players and noted that Horace Mann had strong improvement compared to our peers. Of course, folks are starting to drive again. Of course, the lack of rate appropriately over the last few years in the industry would begin to catch up and we're not that far off from where we said we would be and where we thought we would be.

Let me turn it over to Mark with some of the specifics regarding severity. Mark?

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

A

Yes. First, I think it would be good to give some context to our auto results. When I look at the full year and the quarter, results were actually fairly consistent with our expectations. I think as we noted in some prior calls, we expected the loss cost to return to pre-pandemic levels by the end of 2021 or early 2022. Clearly, we're at that point. If we look at the underlying loss costs in Q4, they are about low-single digits above where we were in 2019 before the pandemic.

However, without the pandemic, with normal inflation, we would have expected loss costs to be up probably mid-single digits over the prior two years. But clearly, I think the components of how we got to this point are a bit different than we expected.

The overall accident frequency does remain somewhat lower than pre-pandemic levels, which I would attribute to two things. One, we still see some continued changes in driving patterns that haven't returned completely to normal from pre-pandemic patterns. And second, as Marita pointed out, a lot of the effort that we put into improving our book of business leading up to the pandemic, we're starting to kind of realize some of that, some of the actions we've taken. As she noted, Florida is an example where our share of our PIF countrywide was about –

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reached a high of nearly 7% of our PIF being in Florida. And now today, we're down to just about 1%. So those kind of actions have driven some additional frequency improvement that was a little bit harder to see, I think, during the pandemic.

But as you appropriately pointed out, Gary, offsetting that, clearly, we've seen the same kind of severity trends that many in the industry are seeing, inflationary-driven factors, whether it be increased pricing on used cars, supply chain issues, labor cost and such. So we're definitely seeing that. We do expect the inflationary pressures to continue into 2022. And as Bret mentioned, we're taking some rate actions to address those. We're in the process of filing and implementing rate increases in over 30 states, representing about 75% of the premium, with rate increases ranging between 5% and 10%, averaging in that 6.5% to 7.5% range, as Bret mentioned within those states. However, even with 70% of our policies being six-month policies, it's going to take some time for that rate to earn in. And as you point out, the severity inflation is here today. The rate will earn in a little bit later, and therefore, we do expect some margin compression throughout 2022. And as you pointed out, yes, it will be definitely more front-end loaded as the rate earnings starts to accelerate towards the back half of the year.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

I just wanted to make sure I heard it correctly. You said 70% of your policies are six-month policies.

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

A

Six months. That's correct.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. Great, thank you.

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

A

And just two quick clarifications or additions to that, Mark. Thank you for that detail. All that is included in our guidance, so we're contemplating that. And it would be remiss of me not to say you got to remember our educator niche, insulated but not immune. That doesn't change. So the risk characteristics, the driving habits, the predictability, everything that comes with that educator niche is there, but they're not immune from some of the broader trends that we see. So I just wanted to add those two points, Gary.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Right, okay. There are other things that you can potentially do that are beyond rate. And most of what I hear from other companies, they're talking about an independent agency system. So that's one set of actions that are nonrate you could do. With your distribution, on the one hand, maybe there are – it limits what you can do to some extent. But on the other hand, maybe you can have a more coordinated action. I just wonder whether your distribution system helps you in any way to put in additional changes, whether it's getting a rate on tiering, somehow getting less new business, kind of underwriting a little bit better. Any comments there would be helpful.

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

A

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Yeah. Gary, I'll turn it over to Mark, if he has any specifics, in a minute. But what I would say is we control our distribution, right? We set the levers. We set the underwriting, and we control those yes and no decisions. We control the geographies and the levers that we pull in those geographies. So I do believe we have a lot more control over that distribution. And in addition to that, we also leverage through third-party vendors, when it might not be appropriate for Horace Mann to take that risk or price that particular account. And that allows us to continue to do our full value proposition and be present almost everywhere.

We have some smaller states that maybe over time, it doesn't make sense for us to be the paper in those states. And you may see us take some action in places when it doesn't make sense. We have Massachusetts, where we clearly decided not to manufacture our own auto and to leverage another company in that regard. We use Progressive for non-standards, so that we don't have to be in the world of trying to price nonstandard business. So we have a lot more control over our distribution and a lot more flexibility in what we accept, when we accept it and how we price it.

I don't know, if you have anything to add to that, Mark.

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

A

Yeah. I think you hit it on all the right points, Marita. The only thing I would add to it is that if I'm an independent agency environment and I'm taking a lot of rate or I'm pushing underwriting actions to reunderwrite or do premium pursuit-type actions, in an independent agency environment, that agent quite often will just move the business to another company. One of the advantages I think in our distribution system is that our agents need to work with us to keep that business and keep that customer, and I think that does give us an advantage when we do need to take action to improve the overall profitability profile.

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

A

The other point is where we put agents, right? We have complete control over that. We're not adding new agents in Florida. And as a matter of fact, the good, strong agents we have in Florida are focusing on retirement and supplemental, and that's been extremely helpful to our bottom line. So we also have control over where we put them and how many we have. It's a good lever to have.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

All right, thank you very much. That's good color.

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

A

Thank you, Gary.

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

A

Thanks.

Operator: The next question is from Greg Peters of Raymond James. Please go ahead.

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

Q

Good morning, and thank you for getting me into the queue this quarter. I wanted to step back and have you give us an update on the expense structure of the organization. We hear so many other companies commenting on how they're trying to through technology transformation and other initiatives improve the expense ratio component of their operations. And clearly, the acquisition will help to leverage your expense structure. But I was looking for further color as we think about the outlook for expenses, not only just in Property & Casualty, but the other businesses and how you're thinking about it for this year and next year.

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

A

Yeah. Greg, this is Bret Conklin. A very, very well-stated question. I guess, as it relates to expenses in general, with you tracking us, I think we do a very good job of managing our expenses. And if you go back to our journey, if you will, in addition to improving the auto profitability that Marita mentioned a little and responded to Gary, we also couple of years back had an initiative to, if you will, rightsize our expenses and took out about $30 million over a couple year period. And as you mentioned, yes, we have done some additional acquisitions and there will be additional expenses that come from adding Madison National. And obviously, we do target ratios as a percentage of revenues.

And one of the things that we have planned for 2022 is we're always going to have some strategic spend in our budget. And as, I think, Marita had in her prepared remarks, obviously, we do want to spend strategically in the areas of auto growth, cross-sell digital capabilities. We still are completing our full modernization of P&C, i.e. Guidewire. And also, Mike Weckenbrock and his team are undertaking some life modernization as well. But all the while, while keeping that under control, if you will, I would say I hope we always have a certain amount of strategic spend every year. It might be different strategic spend. But obviously, with growth, we can absorb some.

So yes, we'll – I think we've talked about Madison National. It's just bolted on in our 2022 plan numbers from premium, expenses, et cetera. We'll look at making the most efficient use of the consolidated entity. But I think you'll see that the expenses, yes, we are going to spend a little bit more strategically certainly in the growth area.

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

A

Yeah. Bret, very, very well said. One thing to add is I'm actually very proud of our expense work and the discipline we've had on expenses. When I think about the transformational stage of our journey, I think about three acquisitions and all the expenses that come with those acquisitions absorbed. I think about a reinsurance transaction that could have potentially put some pressure on ratios. I think about the strategic investments that Bret talked about, all funded for rather than coming out to the Street and saying, here's what it's going to cost and expect X percent increase in our expenses. We kind of did it in the normal course of our strategy, and I'm proud about that. And I think we've been pretty transparent on our expense picture, on our spend, and the value of those spends. So thanks for the question.

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

Q

That's good color. The second question I had, pivoting to your guidance on investment income. I was looking at, I think, it's slide – page 30, if I'm correct, where you folks do the returns on the LP portfolio in 2021 and you suggested it's going to return to normal. How do we look at, say, the market volatility on a year-to-date basis and

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sort of factor that into our assumptions? Are we going to see some increased volatility on a quarterly basis because of this as we've mapped out 2022? Or just give us some added perspective. That was my last question.

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

Sure. This is Ryan Greenier. Thanks for the question. We model our – in guidance, we model our returns for the limited partnership portfolio very similar to how we think about P&C catastrophes. We take historical average just given the inherent lumpiness, if you will, of the third of the portfolio that is more equity sensitive. So that number is in the mid-8% range for the limited partnership portfolio. When you speak of volatility, most of our outperformance in 2021 came from private equity and venture capital strategies, which, obviously, those returns are highly correlated to the equity market.

When I think about that third of the overall portfolio, that is more volatile, that is probably the largest driver, Greg, and to a lesser extent, high yield spreads. But when we think about it, we will, as we move through the year, when we provide guidance updates, we bake in outperformance or underperformance in the LP portfolio, but we always use a forward-looking assumption that reflects our historic average performance.

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

Got it. Thanks for the color.

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

Sure.

Operator: The next question is from Meyer Shields of KBW. Please go ahead.

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

Thanks. I was hoping for an update on agent retention in terms of whether the great resignation or the, I guess, legitimate questions of the stresses on educators. Is that having an impact on the ability to attract and retain agents?

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

Yeah. Thanks for the question. It's certainly been a very volatile year for – or two years almost now for our agents. But I think that in some strange way, it's increased their resolve. It's reminded them of why they do what they do. It's allowed them to make an even bigger impact in the lives of the educators. And I think they jumped into this environment, as they usually do, with both feet.

What we saw in 2021 quarter over quarter over quarter, we're pretty consistent almost to the numbers, steady numbers, agency count, throughout the year. Certainly, in this world, you see retirements that maybe you didn't expect. We didn't see as many as we actually expected when you think about the great retirement, the great resignation, the great rotation, regardless of the label people are putting on it. What we're seeing is maybe in our own way, this mission-driven cause-centric world that we live in as a company has really given people purpose and really bound them to what we do as an organization and we've seen our numbers hold.

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We also said on the last call that we felt good about our recruiting efforts. Those are continuing. We did focus on the integration of NTA agents, getting them to know Horace Mann, our other products, potential cross-sell down the road, concentrating on learning and building with Madison National's distribution partners. So, we had plenty to do, but our overall EA plan has remained probably more steady than we would have anticipated.

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

Q

Okay. That's fantastic. Also, earlier, Marita, you mentioned that you use Progressive as your nonstandard underwriter and I think you've communicated that in the past. What's the impact to Horace Mann when Progressive temporarily doesn't want to grow because of its own concerns about rate adequacy?

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

A

Yeah. I mean it is a great question. We don't just have Progressive in the Horace Mann general agency. We have other options. But there are times where you would say to an educator, you truly have a nonstandard risk and we're not a nonstandard company. Our agents have relationships locally with other agencies that might be able to help that customer out, but we don't ever feel compelled to take that on. And there's plenty of other things we're doing with that customer, right? We're having student loan discussions. We're having DonorsChoose discussions. We're doing financial wellness. And sometimes, we're just not the right place for the auto. But we don't get extra pressure.

And we haven't really found a lot of cases where Progressive wouldn't be there. They would normally have a price point that would be appropriate, because you've got to remember, there's nonstandard and then there's educator nonstandard. And I would say that Progressive is happy with our loss ratio and happy with our book of business. And for the most part, they want whatever we'd be willing to send their way. It's been a good relationship.

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

Q

Okay. Perfect. Thank you so much.

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

A

You're welcome.

Operator: The next question is from John Barnidge of Piper Sandler. Please go ahead.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you. I wanted to go back to your comment in the guidance about 35% loss ratio for voluntary products and 50% for employer-paid products. Can you maybe talk about the mix between those two different products so we can maybe arrive at a blended number?

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

A

Matt, do you want to take that?

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Matthew P. Sharpe
Executive Vice President-Supplemental & Group Benefits & Corporate Strategy, Horace Mann Educators Corp.

A

Sure, happy to. Thanks for the question, John. In 2021, roughly half of the new sales came from each one of those products. Looking forward to 2022, that mix is likely to change a little heavier towards the individual product versus the group product. But the other thing to note between the two products is both of those products are priced for a double-digit ROE and what you're seeing in the difference between those loss ratios is just the product structure and the distribution methodology that happens between those two products.

John Barnidge
Analyst, Piper Sandler & Co.

Q

That's very helpful. Thank you very much. And then, maybe sticking with supplemental, if we think about the commentary around continued supplemental sales improvement, can you maybe talk about what the assumed sales growth is in legacy supplemental for the contribution from Madison National for 2022? Thank you for the answers.

Matthew P. Sharpe
Executive Vice President-Supplemental & Group Benefits & Corporate Strategy, Horace Mann Educators Corp.

A

Yeah. I'll be happy to answer that question, if it's okay, Marita?

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

A

Absolutely.

Matthew P. Sharpe
Executive Vice President-Supplemental & Group Benefits & Corporate Strategy, Horace Mann Educators Corp.

A

Yeah. As you look forward to sales in 2022, we're eager to return back to the pre-COVID levels. It looks like momentum is on our side and public sentiment appears to be on our side in terms of keeping the school buildings open. As long as the school buildings remain open and our access starts to improve, I would expect the individual product sales to continue to progress back towards the pre-pandemic levels. Whether we reach the pre-pandemic levels by the end of this year is yet to be seen. Only time will be able to tell, but we're optimistic that we'll be making significant progress back towards that number.

On the Madison National side, we don't have any numbers this quarter because they weren't part of the company in the last quarter. But as you look forward, they're not an individual sales environment. They're a corporate sales environment, meaning they sell from the top of the district down and their employer-paid benefits. So they're not really impacted as significantly as we were impacted due to the lack of access to the district buildings on an individual basis.

John Barnidge
Analyst, Piper Sandler & Co.

Q

That's very helpful. Thank you very much. Best of luck.

Matthew P. Sharpe
Executive Vice President-Supplemental & Group Benefits & Corporate Strategy, Horace Mann Educators Corp.

A

Thank you, John.

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Marita Zuraitis

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

A

Thanks, John.

Operator: This concludes our question-and-answer session. I would like to turn the conference 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 to everyone soon. Feel free to reach out if you have additional questions. I would point out, we are at this point planning to attend in person both the AIFA and Raymond James conferences, and it will be a great chance to catch up with people again in person for the first time in a few years. So reach out for questions. Otherwise, have a great day, and thank you.

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

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