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Horace Mann Educators Corp. (HMN)

Q1 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Horace Mann Educators' First Quarter 2022 Investor Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Heather Wietzel, Vice President 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 first quarter results. Yesterday, we issued our earnings release, investor supplement and investor presentation. Copies are available on the Investors page of our website.

Marita Zuraitis, President and Chief Executive Officer; and Bret Conklin, Executive Vice President and Chief Financial Officer, will give the formal remarks on today's call. With us for Q&A, we have Matt Sharpe on Supplemental & Group Benefits; Mark Desrochers on Property & Casualty; Mike Weckenbrock on Life & Retirement; and Ryan Greenier on Investments.

Before turning it over to Marita, I want to note that our presentation today includes forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not guarantees of future performance.

These forward-looking statements are based on management's current expectations, and we assume no obligation to update them. Actual results may differ materially due to a variety of factors which are described in our news release and SEC filings. In our prepared remarks, we use some non-GAAP measures. Reconciliations of these measures to the most comparable GAAP measures are available in our news release.

I'll now turn the call over to Marita.

Marita Zuraitis

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

Thanks, Heather, and good morning, everyone. Last night, we reported first quarter core earnings of \$0.64, a decrease from prior year. While external events affected our bottom-line, we are pleased with the sales momentum we continue to see.

In fact, April was the strongest sales month we've had for P&C products since the beginning of the pandemic, and supplemental product sales were double last April. We're also pleased to have Madison National fully on board and working with us to fulfill our long-term objectives of a sustained double-digit return on equity and a larger education market share.

Today, I'll first briefly touch on the quarterly results, which Bret will discuss in more detail later in the call. Then, I'll talk about how our commitment to educators and our stakeholders continues to inform our strategic vision. And I'll summarize the work we are doing to realize our long-term objectives.

For the quarter, Life & Retirement and Supplemental & Group Benefits segments had steady performance and annuity contract deposits were up 6%. Our total net investment income was up 3%, and the current higher interest rate environment bodes well for our portfolio going forward.

Our Auto combined ratio improved 6.6 points in the first quarter of 2022, over the fourth quarter of 2021. However, in-line with the broader industry, our property and casualty earnings continue to be affected by inflation, particularly for auto parts and labor costs. The impact of inflation was most pronounced in March, but our early read of April appears more consistent with January and February.

Despite the impact on our near term P&C earnings, we remain confident in the profitability and opportunity for the Auto line over the long term. This confidence stems from our Auto position pre-pandemic, our strategic pricing choices during the pandemic, and our longstanding approach for customer cross-sell and retention, simply put, we are focused on offering a fair price for our loyal customers through varied market conditions, we want to keep and cross-sell our Auto customers.

If you recall, between 2017 and 2019, we undertook an Auto pricing and underwriting initiative to improve profitability which resulted in a 7-point improvement in our underlying Auto loss ratio. Throughout the pandemic, we chose not to lower rates under the assumption that Auto frequency would return to "normal" sooner rather than later.

As Auto loss trends returned to more historic levels over the course of 2021, we began the process of adding rate where needed to address rising severity. With inflation accelerating, we have updated our rate plan and filing

schedule to move ahead with higher single-digit to low-double-digit rate increases in most states. We will continue to evaluate loss cost trends throughout the year, taking rate and underwriting actions as needed.

Minimizing the impact to our educator customers remains a priority. We have equipped our agency force with tools and resources to have conversations with our customers on the current industry environment and our agents see more opportunities to quote Auto to our educator client base. We do expect the ongoing inflationary pressure on Auto loss cost to have an impact on our full-year results.

With that said, we now expect our 2022 core EPS to be at the lower-end of our \$3.45 to \$3.65 range. We continue to expect 10% average annual EPS growth and sustained double-digit ROEs in 2023 and beyond.

Turning to the long-term outlook under our new divisional structure, we are working in tandem to serve educators however they receive their insurance and financial solutions. Whether educators are receiving benefits through work, buying solutions from a trusted local advisor, or using our convenient direct channels, Horace Mann can help them achieve life-long financial success.

It's a mission that is especially relevant this week, which is Teacher Appreciation Week. Our employees and agents are offering their heartfelt thanks to the educators who made a difference in their lives and in communities across the country were recognizing the educators who are dedicated to making sure each and every student is supported and given the opportunity to reach their full potential.

A natural extension of this commitment to our educator customers is a desire to have a positive impact on all our stakeholder groups. We do this through integration of ESG factors into both our day-to-day operations as well as long term planning. We recently updated our corporate social responsibility reporting, which includes a commitment to cut our absolute Scope 1 and Scope 2 carbon emissions in half by 2030 and achieve net zero carbon emissions by 2050.

We've already reduced our emissions by about a third since 2019 through initiatives like installation of a more efficient HVAC system and more than 500 solar panels at our Springfield, Illinois headquarters.

We also undertook an updated materiality assessment to ensure our direction remains aligned with the priorities of our stakeholder groups. In late 2021 and early 2022, we solicited feedback on the ESG topics of most importance to investors, employees, agents, customers, community leaders and company leadership.

What we found was that while issues like business ethics and data security remain, top priorities across stakeholder groups, human capital topics such as diversity, equity and inclusion and employee development grew in importance since our last stakeholder engagement survey. We will take this stakeholder input into account as we continuously update our long-term ESG plan.

It is against this backdrop that we enter the leadership phase of Horace Mann's growth journey. In our foundational phase, we implemented a multi-year strategy that included enhancing our product offerings, strengthening our distribution and modernizing our infrastructure.

In our transformational phase, we added capabilities and scale with our acquisitions and improved our overall profitability through the improvement in our underlying Auto loss ratio and by re-insuring a legacy annuity block. During the pandemic, we virtualized our sales processes and invested in agency support to enable agents to reach educators wherever they were.

Our two goals remain unchanged. First, capturing an expanded education market share, there is substantial opportunity within the K-through-12 educator space of 7.5 million individuals. Slide 17 in our investor presentation breaks down how we are thinking about our short and long-term opportunities here. We consider our retail and voluntary supplemental customers as a natural cross-sell space for us. We have proven effective cross-sell processes in place for this group.

With our newest customers in the worksite space, we have the opportunity over the next several years to test and learn how to cross-sell individual insurance and financial services products to educators reached through employer-sponsored products.

Looking through a wider lens beyond Horace Mann customers, we have relationships with roughly 1 million educator households. This includes participants in our Student Loan Solutions program, which helps educators take advantage of the Federal Public Service Loan Forgiveness program. Broader still, we have engaged with far more educators through financial wellness workshops, social media, previous quotes and more.

With nearly 80 years of history in the educator space, we know a lot about our nation's educators. But we have yet to fully understand the buying propensities and preferences of those 7.5 million individual educators, as well as the districts that employ them. We're currently undertaking even more in-depth research into the education market to better understand educator demographics around financial service needs, further refined sales processes, and maximize cross-sell opportunities.

Second, we remain committed to accelerating shareholder value through a sustained double-digit return on equity. This year and beyond, we expect to generate \$50 million in excess capital annually, while our first priority for excess capital remains supporting profitable growth, which further drive shareholder value. We continue to return capital to shareholders through dividend increases and share repurchases. In March, our board of directors approved a 3% increase in the annual dividend. This is the 14th consecutive year we've increased the dividend.

In closing, we're excited about the future as one company supporting educators in achieving life-long financial success through both individual insurance and financial solutions and employer-sponsored group coverages. Thank you.

And with that, I'll turn the call over to Bret.

Bret A. Conklin

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

Thanks, Marita. And good morning, everyone. As Marita noted, Horace Mann reported core EPS of \$0.64 below last year because of inflation and other factors affecting P&C results. The value of the revenue and earnings diversification we've accomplished in recent years was demonstrated with steady results in both our Life & Retirement and Supplemental & Group Benefits segments. The results of newly acquired Madison National are included in the Worksite Supplemental & Group Benefits Segment. And as Marita said, this business is performing within management's expectation.

One technical note, starting this quarter, we've added adjusted core earnings and tangible book value to our materials along with related ROE calculations. We are defining adjusted as core earnings, excluding DAC unlocking and amortization of intangible assets, both non-cash items. We believe these metrics are useful when evaluating our capacity for capital generation.

Also, I'll touch on our full-year EPS guidance later in my remarks. But first, let me run briefly through the results and outlook considerations for each segment.

As expected, P&C net written premiums were slightly below last year's first quarter. The benefit of stronger retention is being somewhat offset by new business volumes that remain below historical levels due to the lingering effects of the pandemic on sales. Segment earnings reflected a year-over-year decline in underwriting income as well as lower first quarter net investment income due to the performance of the limited partnership funds allocated to this segments' portfolio.

Looking at Auto and Property results separately, the change in the Auto loss ratio primarily reflected the anticipated increase in frequency toward pre-pandemic levels. Over the past year, miles driven, has steadily moved closer to pre-pandemic levels and the impact of that change comes as no surprise. Similar to others in the industry, we are also seeing higher Auto loss severity due to inflation which was the other factor in the increase in the Auto loss ratio.

As we've said, Horace Mann is well-prepared to leverage the disruptions underway in the Auto market. And we believe the 3-point improvement in Auto retention since last year's first quarter is one sign that we're on the right track.

As Marita noted, we had achieved our targeted Auto profitability prior to the pandemic and did not respond to its early stages with rate decreases to gain market share, a strategy used by direct marketers. Instead, we remain committed to our long-term strategic approach of providing our policyholders with a fair price over the life of their policy. Further, auto average premiums are level with last year and pandemic-related mileage changes have stabilized.

With inflationary pressures raising costs associated with claims, our Auto rate plan now includes rate increases in the high-single to low-double-digit range in states representing almost 80% of our premiums.

For property, the first quarter underlying loss ratio was strong at 52.3%, although higher than last year's first quarter due to elevated fire losses. There is no pattern or trend to report and as noted in the past, this line can be lumpy on a quarterly basis.

The increase in the underlying loss ratio was partially offset by cat losses below last year's level, with the property combined ratio at 92.3%. Household retention has risen 2.1 points for property, even as average premiums have risen 5% due to inflation adjustments to cover values made in recent months. We expect renewal pricing increases should move closer to high single-digits over the course of the year.

Briefly on the P&C segment outlook. As we look to the remainder of 2022, we will be continuing to file and implement our rate plan for Auto and to monitor coverage values and rate needs in property. We expect to see those actions influence underwriting profitability over the course of the year. In the combined Life & Retirement segment, core earnings were up 3.5%, with total benefits and expenses unchanged. Adjusted core earnings, which excludes DAC unlocking, were up 26.1%.

Both the Retirement and Life businesses continue to perform in-line with the trends we saw during 2021. Retirement net annuity contract deposits rose 5.9% over last year's first quarter, with total cash value persistency strong at 94.3%. We continue to see how our solutions for augmenting Retirement savings remain a core need for educators and how Retirement products are an important entree into districts in this environment.

The net interest spread was 286 bps up from a year ago, reflecting strong investment returns. The spread on our fixed annuity business is comfortably above our threshold to achieve a double-digit ROE in this business. We had another quarter of progress with retirement advantage where contracts in force increased to about 16,000. Retirement advantage is the fee-based mutual fund platform that we believe creates long-term potential for this business segment.

Life sales continued at a steady pace, albeit slightly below a year ago, and persistency remained consistent. Mortality costs were below last year's first quarter.

Our outlook for the L&R segment continues to anticipate higher net investment income with the spreads remaining near the 2021 levels and mortality consistent with actuarial expectations.

Now, let me turn to the new Supplemental & Group Benefit segment. This segment combines the results from the Supplemental segment we created when we acquired NTA in 2019 with the results from Madison National. Madison National's results were added effective January 1 of this year, which makes some of the comparisons to 2021 performance less meaningful.

For the full segment, first quarter premiums and contract charges earned were \$69.9 million, of which the new employer sponsored products represented \$39.8 million. Total sales for the segment were \$3.7 million. Sales of voluntary products were \$1.4 million in the first quarter, a 40% increase over prior year with persistency remaining very strong at 92.1%.

Sales of employer-sponsored products added another \$2.3 million in-line with our expectation for Madison National's first quarter as part of Horace Mann.

Amortization of intangible assets under purchase accounting reduced core earnings by \$3.9 million pre-tax versus \$2.9 million pre-tax in the first quarter of 2021. Therefore, core earnings were down slightly, with adjusted core earnings up 4.4%.

Net investment income for this segment reflected the addition of the Madison National portfolio effective January 1. We expect to see investment yield improve for this segment over the remainder of this year and into 2023 as we optimize that portfolio.

The pre-tax profit margin declined because of the addition of the newly acquired employer-sponsored products, which are expected to generate a lower margin than voluntary products. In the first quarter, total benefits also reflected normal seasonality for the employer-sponsored products. The benefit ratio for the voluntary products continues to reflect some benefit of changes in policyholder behavior due to the pandemic.

Our full-year outlook for the Supplemental & Group Benefits segment assumes claims utilization will move closer to pre-pandemic levels, leading to full-year benefit ratios of about 35% for voluntary products and about 50% for employer paid products. Amortization of intangible assets is expected to be approximately \$13 million or \$0.30 per share after tax for the year.

Turning to investments, total net investment income on the managed portfolio was up almost 3% to \$73 million, with total net investment income up 2.5%. The increase in net investment income on the managed portfolio was partially due to a higher contribution from our commercial mortgage loan fund portfolio.

The return on our limited partnership portfolio of 7.69% was below the record-setting returns we saw last year, but still a strong return given market volatility. The traditional fixed income portfolio had a yield of 4.26% in the first quarter compared with 4.16% a year ago. With the increase in interest rates, we continue to find good opportunities to add high quality corporate exposure into the portfolio at rates north of 4%. The core new money rate was 4.04% in the first quarter. And based on current market conditions, we continue to anticipate it will remain above 4% for the year in light of the current outlook for interest rate increases.

Our allocation to commercial mortgage loan and limited partnership funds are expected 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. Overall, we expect these strategies will combine to generate high-single-digit annual returns on average over time.

As we look to the full-year, we continue to expect net investment income from the managed portfolio will be in-line with 2021 with underlying assumption that limited partnership portfolio returns are closer to our historical average for the full-year after last year's outperformance. And that's a good segue to our expectation that 2022 core EPS is more likely to be at the lower end of the guidance range of \$3.45 to \$3.65 we provided when we announced year-end 2021 results.

This view was largely due to the impact of inflation on the near-term Auto results, although it's also influenced by the potential impact of market volatility on DAC unlocking. Our long-term view of our potential remains fundamentally unchanged. We continue to target 10% average annual EPS growth and sustained double-digit ROEs driven by our profitable growth beginning in 2023.

Every day, we see the values 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. Further, we continue to see Horace Mann generating at least \$50 million in excess capital each year, and that's in addition to the more than \$50 million we already pay in cash dividends. Beyond supporting growth opportunities, we have several ways we can use capital to enhance shareholder value, in particular, opportunistic share repurchases. 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, operator. We're ready for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] At this time, we will pause momentarily to assemble our roster. And our first question will come from Gary Ransom with Dowling & Partners. Please go ahead.

Gary Kent Ransom

Analyst, Dowling & Partners Securities LLC

Q

Good morning. I wanted to ask about loss trends a little bit more. I wonder if you could just give us a sense of the typical type of car, the educators own. Are they more new cars with lots of technology where chip shortages are involved? Are they older cars? I don't know. I'm just wondering if you could give us a sense of how your mix might be different in any way from others.

Marita Zuraitis

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

A

Probably makes sense, Gary. I'll turn it over to our resident expert. Mark, do you want to take that?

Mark Richard Desrochers

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

A

Yeah. Sure. Gary, I mean, our book is probably typically a little bit older than the average, for the fleet across the country in general. So not anything significant in terms of the impact of high-priced cars or anything like that or lots of newer cars. But I still think that we're certainly not immune from some of the trends in terms of overall used car pricing, the labor shortage issues, any issues around parts being available. That has a broad impact even if our fleet is slightly older than the country-wide fleet.

Gary Kent Ransom

Analyst, Dowling & Partners Securities LLC

Q

Can you clarify what you were talking about when you said March was a little bit higher and then January, February and April were more similar.

Mark Richard Desrochers

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

A

Yeah.

Gary Kent Ransom

Analyst, Dowling & Partners Securities LLC

Q

What was the difference there?

Mark Richard Desrochers

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

A

Yeah. So, look at March, what we were seeing, it as an unusual up-tick in what I would say is more severe accidents so that, you have the impact of inflation driving up the severity. But we also saw higher impact losses that we would associate with longer trips being taken during March that we speculated and associated with people traveling during spring break.

And our early view when we look at April kind of confirms that this appears to be an anomaly and April looks more like we would expect.

Gary Kent Ransom

Analyst, Dowling & Partners Securities LLC

Q

Right. Okay. Then over on the liability side, is there anything going on in the social inflation that's evident to you or attorney rep or anything like that?

Mark Richard Desrochers

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

A

Yeah, I mean, I do think we are seeing more increased social inflation, as courts open up, there there's definitely been an up-tick in both attorney representation and I think the aggressiveness, some of those attorneys in terms of going after settlements.

So, I think that we like the rest of the industry, we're starting to see some of that return to what we might have saw at the latter end of time just before the pandemic kicked in.

Gary Kent Ransom

Analyst, Dowling & Partners Securities LLC

Q

And just one other question on this topic. I – what has basically happened when you look at used cars, you had a couple of step functions up in summer of last year and kind of the fall of last year, and things have kind of leveled out. Are you actually seeing a leveling in the sense of sequential, even though it's up year-over-year by a substantial amount? Are we – are things flattening out at this point?

Mark Richard Desrochers

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

A

Yeah. I mean, we are starting to see a little bit of that flattening out. I think like others are seeing. But I think there was another period of time maybe in the fall where we saw that for a short period and then it – it spiked again. So, I am cautious – cautiously optimistic that, that will continue to see it kind of level out and start to normalize a little bit. But, yeah, we're certainly seeing those same kinds of trends.

Gary Kent Ransom

Analyst, Dowling & Partners Securities LLC

Q

All right. Thank you. And I'd kind of like to ask a different subject for Marita. You mentioned in your prepared remarks about studying what the educator market is doing, how they're thinking, and how to cross-sell. What – have you learned anything or is there any way you can describe how your customer views the Horace Mann brand in any – the dimension across products or the dimension across service? I don't know, if you could share anything, that'd be helpful in understanding what's going on out there.

Marita Zuraitis

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

A

Yeah. Gary, I really appreciate your thoughtful questions. First in Auto and then the one you just asked on strategy. I do feel compelled on the Auto strategy question to go back a little bit. And I think I probably said it over and over again in the script with a lot of words, but I think it's important. We did the hard work to set a solid profitability foundation in Auto. And that's really working out quite well for us. We'll react to these trends as we are

now appropriately and we'll ensure ongoing solid results in our Auto segment as we always had. And I appreciate Mark's answers. I think he gets this well and we're lucky to have his expertise here in our company and that serves us well.

On the strategy question, we tried in the investor deck on page 17 to begin to give you a glimpse into the answer to that question. I think it's remarkable that we actually closed on Madison National in this quarter, and you're asking that question, and that does say a lot about us.

We – just like NTA before it spent an awful lot of time with these people, we're in the same space. NTA was 80% educators, MNL was 80% educators. So, we have learned a lot even before the close. So, for us, beginning to show you how we think about our total addressable market and working up. At the top of that page, there is, obvious cross-sell opportunities between our Retail products, our Retail segment, P&C and L&R, with individual supplemental products. And we're seeing that today.

When you look at April, the first sign of us being able to have a little more access, the world start to open up a little bit, we're seeing that momentum in our sales numbers across the board. It's early. There's still noise in the system. It's still a hard world out there for all of us. But we're very encouraged by the signs we see in April where we can get out there and take advantage of the natural cross-sell that we see in these businesses.

There are places where the relationships were on one side of the house and we're leveraging them on the other and vice versa. We showed you a map where we could begin to show you where we have strength in these businesses, where we can simply leverage the relationships that we have in our educator segment, in a known set of customers for these individual entities coming together. We feel great about that.

The learnings that we're also talking about is on the worksite side that might not be as natural, that might not be as obvious, but we still think it's there. We are learning also on the worksite side that the superintendents and business officials that are making these decisions have a brand affinity to Horace Mann, they know who we are. We've spent a lot of time talking about donors [ph] choose (33:35) and bringing dollars to their schools. We are introducing student loan capabilities that help their educators.

Our strategy has been about helping educators attract educators, keep educators and help educators retire soundly. And by doing that, I think we've really built our reputation. And we're invited in and we're able to solve more problems in that addressable market.

So, 2017 was kind of a start to show you how we're thinking about it. And there are numbers around this and we're gaining the numbers. And the hope is over time, just like we do with everything we do, is to be able to give you more transparency on the buckets.

If you look at page 8 where we've always talked very openly about the stages of our journey, in that fix and bill stage, we told you what we were going to do. It was about PDI. We needed to build products, we needed to strengthen distribution, we needed to modernize our infrastructure and we've been clear about what we did in that phase.

In the transformational stage, we added capability. We built scale. Now, we're going to be just as transparent in that growth phase, we've showed you the levers. We've told you what it's going to take to do it. And we're going to be transparent in showing you the success we have in each one of those levers.

Probably a longer answer than you expected to that question. But we're pretty passionate and pretty – we've got a lot of energy around what we're learning and what we plan to do around executing around it.

Gary Kent Ransom

Analyst, Dowling & Partners Securities LLC

Q

No. That was terrific. I appreciate it, Marita. Thank you very much.

Marita Zuraitis

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

A

You're welcome.

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

Matthew J. Carletti

Analyst, JMP Securities LLC

Q

Hey, thanks, good morning. I just wanted to follow on, Gary's last question there – actually, it was what I was going to ask. But – okay, actually to dig in a little deeper there. I mean, I'm looking at page 22 in your slide deck and it's clear that, at least at a state level, there's a lot of overlap between Madison National's footprint and kind of the core P&C, Life & Retirement businesses at Horace Mann.

If we were to dive-in deeper into a lot of those darker blue states, at like a school district level, is there a lot of overlap at that level or are they – or is more of it kind of Madison National has the school district that maybe legacy Horace Mann doesn't have a lot of access into? I'm just trying to get an idea of how much kind of overlap already exists there versus potential opportunity related to your comments on your brand affinity and name recognition to kind of open a door and maybe get you in there on the other side?

Marita Zuraitis

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

A

You know, what's – yeah, and we can certainly provide. You know that we give you the tip of the iceberg, and then, we give you more and more data over time to support it. And because – again I want to remind everyone that, this transaction did take place in the quarter, so, we're giving you an early read here. But for us, when we – it's all across the board.

We have some places where we have very strong presence in a given state with long-standing agencies and good penetration like we have talked about before with P&C and LNR. And many of those states, we also have both an MNL and an NTA relationship, and you can see that. Then, there's other places, where maybe from a Horace Mann traditional perspective, we didn't have a strong presence.

And lo and behold, NTA does or Madison National does. So, the dissection of we can double-down in places where we've got the triple whammy and everybody has a very strong relationship and we can leverage those. But then we also have the benefit of the entrance in places with either starting with an NTA relationship, and we've already seen that over the course over the last year, year-and-a-half. And now with MNL we can start with them an MNL relationship where maybe we did not have an NTA or Horace Mann relationship.

So, for me, it really is about all these things coming together, all with a homogeneous understanding of our niche in the educator space. So it is about that dissection. It's about several different ways to go about this and starting with your strength and leveraging the ultimate cross-sell.

And I don't know if you have anything to add to that, Matt. Matt Sharpe's been front and center in the integration, first acquisition and integration of NTA, and then where we are with MNL. I don't know if you have any color to add on top of that, Matt. If you don't, it's okay, but I wanted to give you the opportunity to comment.

Matthew P. Sharpe

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

A

Yeah. Sure, Marita. Thanks for the opportunity. And, Matt, thanks for the question. There's one other thing I just wanted to clarify or just go a little bit deeper on. When you look at the maps on the top of page 22, you're looking at two different distribution models. The left-hand side is the worksite model where we're selling individuals from the bottom up. And on the right-hand side, you're dealing with the top-down sales process using independent benefit consultants that are coming in to the districts.

So whether they line up or not, the two approaches are different and they can live in the same environment together. And the key is being able to integrate those two sales models so that we can maximize our ability to sell on the ground through the worksite sales environment, as well as maximize the number of districts that we get that are employer-sponsored and give us a much broader access to the district that can then be leveraged by the retail side of the house for all our traditional products.

Matthew J. Carletti

Analyst, JMP Securities LLC

Q

Great. Thank you. That's great color. My next question is kind of unrelated to Madison National in particular, but Marita, you – in your press release and in your comments, you provided some statistics on a few of the businesses for production in April that was encouraging.

Can you give us a sense of – we did see the quarter numbers when you report Q1, but how did kind of that production go kind of January, February, March across the quarter? I'm just trying to get a feel for if it kind of built across the quarter or if you are seeing or if it kind of just – April just kind of sprung up a little more and each month within the quarter kind of look more like the average in Q1.

Marita Zuraitis

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

A

Yeah. It's really been pretty gradual and pretty sequential until April. So basically, the way I think about it is if you remember our pre-pandemic numbers, that first quarter of – they're all running together 2019 or 2020? 2020. Okay. Yeah. Too many years. But the first quarter of 2020, we saw some pretty good momentum in that first quarter from a growth perspective. And then through the pandemic, obviously, with the ebbs and flows of closures and masks and distraction in our teacher market, it was a tough slog from a sales perspective. I think we navigated it quite well and concentrated on what we could concentrate on, getting ready, ramping up, doing a lot of the internal work that we certainly did.

And over the course of the last five, six months, really seeing a nice gradual uptick, pretty sequential across the board. And then when we look at April, it looks very different. And that makes some sense. You had variance in certain things occurring during the first quarter that made it sometimes a little more difficult as things were opening and closing.

But, clearly, in April, the world changed a bit. And I think our agents clearly combined what they learned during the pandemic and want to keep that going. From an ease of dealing with customers in a more virtual way but also

had the added benefit of being a little more connected live and in-person with those educators. And we saw that in April.

I think as it relates to individual supplemental sales, where those things tend to be more in-person, more enrollment-related, more getting back to the additive effect of doing those things the way they're normally done pretty much across the industry, we saw a really nice ramp up with individual supplemental sales in April as well.

And from a retirement standpoint where our customers have been engaged in retirement discussions for obvious reasons throughout the pandemic, that was really more consistent throughout the pandemic. And we're happy to see that it's continuing because we took the opportunity to remind them how important it is, and did a lot of work around retirement planning, financial literacy. And I think Mike and his team did a really good job doubling down on making sure we were having those conversations and that momentum continues.

Matthew J. Carletti

Analyst, JMP Securities LLC

Great and thank you very much for the answers. Very helpful.

Q

Marita Zuraitis

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

Thank you.

A

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

C. Gregory Peters

Analyst, Raymond James & Associates, Inc.

Hey. Good morning, everyone. Hey, I – most of my questions have been answered. So, I'd like to focus in on the comment in your segment outlook around market volatility. And it's two part. I realize it's not relevant to all the products in Life & Retirement, Supplemental & Group, but I'm curious about the impact of market volatility on sales, if there is any.

Q

And then the second piece or the second part of the question would be just, if you can provide us any sort of benchmarks about what the volatility means to DAC unlocking now that Madison National's part of your footprint and there is obviously in the marketplace increased volatility, so any color there would be helpful?

Bret A. Conklin

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

Sure. Greg, this is Bret. Good question. Certainly, we did see some of the volatility that we're referring to show up in the first quarter. We did record about just a little bit over \$2.5 million of negative DAC unlocking. Obviously, that is confined, if you will, to our Life & Retirement segment, which is now combined for the first time in this quarter. But specifically, it relates to our variable annuities and the largest factor, if you will, that comes in the fold is usually the market performance, which is you're comparing the actual performance of the underlying mutual funds to our underlying assumption in the profits.

A

So obviously, the markets were down, specifically the S&P 500, I believe, was down about 5% plus in the first quarter. Obviously, we would assume it's embedded in our critical accounting estimates in our Q or Ks where we would typically assume a 8% return. So, the delta between the two for the quarter resulted in that negative unlocking. Obviously, the equity markets continued to go down in the month of April.

So, we're just signaling that as the markets go down, we will have some additional negative unlocking to report so that it really doesn't relate to sales per se with respect to that. But obviously, rates going up as they have do help us with respect to the investment yields on the portfolio. And certainly, we're seeing, as we highlighted in my comments for the quarter, what our new money rate was. It was hovering above our plan of [ph] 3.50% (46:03). I think the actual results for the quarter were just slightly above 4%.

And the money we're putting to work, certainly in April and May, are even higher than that. So that does bode well for net investment income. But really my comment and the talking points of the volatility and it was in the release was solely related to the DAC unlocking in the Life & Retirement segment.

Marita Zuraitis

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

A

Bret, that's well said. I'd add one thing to that and that is we're an educator company and the complexity is we have a P&C segment, we have a Life & Retirement segment, and we have a Supplemental & Group Benefits segment. And the complicating factor in there is on any given quarter, whether it's DAC unlocking, whether it's auto trends, whether it's cat, whatever it is, there could be something that would affect one of those individual pieces that you are right to ask about, we are right to talk about, but the value of this company is the sum of its parts. And what I look at as I look at the trajectory of our increased shareholder return, our total return over a long period of time, and the ability to really build and grow this company over a long period of time, and not the quarter-over-quarter discussions on some of the smaller pieces.

I like the way that line looks. I like the earnings power that we've built in this company and we're building it for the long haul. But on any given quarter, because we have the sum of the parts, there will be a piece that you will ask about and we will talk about. Those pieces are important. We need to manage them and we do. But we are focused on growing our market share in this segment and doing it profitably for the long haul.

C. Gregory Peters

Analyst, Raymond James & Associates, Inc.

Q

Your messages make sense, Marita, but I just want to just clarify, is it – if in the answer, I think you said 5% decline in the market, and \$2.5 million DAC. And I realize it's a non-cash issue, is that sort of a good benchmark to use in terms of ratios or am I [ph] just not getting (48:18)...

Bret A. Conklin

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

A

Yeah. I guess the – no, I think you're getting warm. If you – as I referred to earlier, I think in our – I don't have it in front of me in our 10-K, I want to say for every 100 bps difference between our underlying assumption, the actual results, it's about \$300,000 to \$400,000 pre-tax. So obviously if we're assuming 8% for the year, that's assuming a positive 2%, the markets were negative 5%, 7 times \$400,000 – between \$300,000 and \$400,000 kind of gets you to that \$2.5 million number. So hopefully that helps. But we do disclose that in our critical accounting estimates with the sensitivities for the bigger pieces of the assumptions.

C. Gregory Peters

Analyst, Raymond James & Associates, Inc.

Q

Makes complete sense. Thank you for the answer.

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

A

Sure.

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

A

Thanks for the question.

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

John Barnidge*Analyst, Piper Sandler & Co.*

Q

Thank you very much. Can you maybe talk about your floating rate portfolio, whether re-priced completely in 1Q 2022 and the upside we should be expecting prospectively from that? Thank you.

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

A

Sure, John. This is Ryan. Thanks for the question. So I'll start with our core fixed income portfolio. It was nearly all fixed rate which is aligned with our liability driven investment strategy. That's focused on book yield. So a rising rate environment certainly helps with the about – we put about \$1 billion to work on an annual basis.

So Bret alluded to the new money yields but just to put some color around it, we're putting money to work about 50 basis points higher than our current portfolio yields. We're hitting 4.50%, 4.75% at this point in time and I'm encouraged by that. And like I said we put about \$1 billion to work in that fixed income portfolio.

But specifically to your question on floating rate, we do have a commercial mortgage loan portfolio that is almost entirely floating rate tied to LIBOR or SOFR, depending on when the loan was originated. And so obviously, we will see an income lift there as we move through a higher rate environment. Our longer term target for that portfolio is 10% of the total portfolio which would be about, say, \$600 million, \$700 million but where we sit today and we've got \$430 million in the ground funded. We've talked about our expectations there of a mid single-digit return but with the re-pricing in rates, I think you can comfortably move that up to about 6% at this point in time for that portfolio.

And, finally, I will touch on we do run an FHLB spread lending program. We take predominantly floating rate advances and invest in very high quality CLO floating rates securities. But we're matched, it's floating-to-floating. So, the opportunity there really is spread. So, while the portfolio is – the floating rate component of that portfolio is meaningful, really the return profile was spread based. So to put a finer point on it, the CML exposure is where we're going to see a pickup.

One other comment before I turn it over back to you. The CML portfolio was in our Life & Retirement and Supplemental & Group Benefits segments. We've talked a little bit about our investment strategy of where we deploy limited partnership and commercial mortgage loan investments, and we focused on capital efficiency. And so, from a statutory RBC charge perspective, it's more efficient to put them in L&R and Supplemental & Group.

Now I will say more of the P&C, LP exposure is more equity sensitive. So you're going to see more volatility in the P&C net investment income line during periods of equity market volatility and you saw that this quarter. So I just want to put a finer point on that for you.

John Barnidge

Analyst, Piper Sandler & Co.

Q

Thanks, Ryan. I appreciate that. My follow-up question is I'm looking at slide 14 of the supplement – talking about the Supplemental & Group Benefits voluntary products. I see the benefit ratio actually declined year-over-year. And so I was curious if you could talk maybe about the claims utilization trends in the quarter and whether we should think of that product having hit normalized exiting the quarter? Thank you very much.

Marita Zuraitis

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

A

Yeah. I mean, I can start with that and then I can turn it over to Matt. But I think it's important to remember what we told you about the difference between those two businesses and how they run from a benefits ratio perspective. So as it relates to both NTA and MNL, it is different. The MNL benefits ratio does tend to run higher and we've shared those numbers with you.

So when you look at the division on a blended basis, you'll see that blended number, but we have provided a lot of disclosure before. The deal closed in the first quarter and certainly as we go on, those benefit ratios just for us in the industry are different and for the group business it is higher than the individual business. But I don't know if you have any more color to put on that, Matt.

Matthew P. Sharpe

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

A

Yeah. Sure, Marita. I'm happy to. So if you look at the benefits ratio, I'll talk about it from both perspectives, both the individual product and the group perspective. So in the individual product, we saw a little bit higher benefit ratio – a little bit higher benefit payment on the short term disability. And that's mostly seasonality, which is similar to the way that seasonality works in the group business. There might also be some deferred procedures that are part of that elevation that we saw in the quarter, which resulted in some increased utilization on the individual short term DI block, which is not a surprise given the fact that there may have been deferred procedures embedded within it. So that is as expected or at least not a surprise.

On the group side, the long term disability claims were slightly elevated, but it was consistent with the historical seasonality that we've seen. There's also a little noise in that number because of PGAAP and potentially a little from claims backlog. But overall, it's performing the way we would have expected it to perform overall. So I don't know if that – if you had any follow up to that, John, or if that answered your question.

John Barnidge

Analyst, Piper Sandler & Co.

Q

No, that was helpful. I mean, my follow-up really is persistency in the voluntary products, improved 60 basis points year-over-year, I know persistency in the voluntary business is something not you but other participants have actually seen pressure as the labor market has become more competitive and people have left. So, can you maybe touch there on the improvement of the persistency year-over-year which is great to see?

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

A

Yeah. So, the persistency on the individual products, you're correct. It continues to improve. I don't know that I have an exact explanation for why the persistency is continuing to perform other than we see a similar persistency trend in the group business. And I think it is unique to the segment that we serve. We've got very strong persistency both in the individual and on the group side.

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

A

Yeah, I do think Matt, that's very well...

John Barnidge*Analyst, Piper Sandler & Co.*

Q

Thank you very much.

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

A

...no, very well said. I think it's another place where insulated but not immune where our market segment does help us. And that stickiness has been pretty consistent over the years when we go back and historically look at both NTA and MNL's trends. And I think Matt's right. The work that we did, this has really come out pretty much as expected.

Operator: Our next question will come from Meyer Shields with KBW. Please go ahead.

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

Q

Great. Thanks. Good morning, all. Two, I think, very quick questions.

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

A

Hi, Meyer.

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

Q

Good morning. I guess this is for Ryan, as we see interest rates rise, does that impact the planned allocation to alternatives or should we expect that to stay constant?

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

A

Good morning. Thank you for the question. We take a longer term view of the investment portfolio and we balance a number of considerations. Obviously, rates are one of them, but capital efficiency, risk parameters, and at the end of the day, it's a liability driven investment strategy. Our longer term targets are about a 5% allocation to the limited partnership bucket. But remember, Meyer, when I talk about limited partnerships, it's a variety of different strategies there.

Two-thirds of them are fixed income like with lower volatility in returns. And so, a higher rate environment in general will impact in a positive way the returns that we get out of those. And like I said, about a third of them are equity sensitive. We've been pushing a little bit more into real estate equity as of late. It's a nice hedge against inflation. We like the dynamics of the US real estate markets. And so that's an area where current market environment and events have shifted our allocation somewhat. But longer term allocation targets are generally within an acceptable range. But that 5% target is probably right.

I will comment on the core fixed income portfolio. The rise in rates allows us to invest up in credit quality. We're actually marginally – we're putting money to work at a marginally higher credit quality position today than say where we were a couple of quarters ago. And so that dynamic is nice to be able to put into the portfolio.

Meyer Shields

Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. No, that's very helpful. And maybe a broader question, I guess, for Marita. It seems clear to me that the trajectory of rate increases in P&C is going to catch up with losses. Should we understand from the comment you made about April sales that you're comfortable growing at current rates with expected retention, renewal retention holding up simply because that's where the entire market is going.

Marita Zuraitis

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

A

Yeah, I think it's a great question because it's one that we ask ourselves every day and monitor every day. When you have this many states in a portfolio, you obviously have many states that are at or beating our hurdle rate from a loss perspective. And we're very pleased it planned to see the growth in those places. So, when you're growing in the right places, it's actually a double-whammy, right. It helps your top line perspective for all the reasons why we want that too, but it also helps the bottom line from a mix perspective.

So we've been very thoughtful. And I think a lot of this emanates from all that really good basic blocking and tackling to understand and improve our profitability that we undertook in the last phase of this journey. So we know very well where we're at rate adequate.

And one of the benefits and we talk about this a lot of our approach is by having the Horace Mann general agency and by leveraging other companies who have a price point or believe their price point is where they want to set it to write business. If ours isn't, we can rely on those strong third-party relationships we have for them to grow the auto. And we do a lot of back and forth there.

So the combination of those things make me feel really good about where we're getting the growth, how we're getting the growth, the cross-sell numbers with that growth. Trust me, in places where we feel we need more rate and are filing more rate, we have not put our pedal on the metal. We are all underwriters at our core, understand this well, and have all the levers we need not to have to do it.

And we talked about this a lot. I mean, we are not a market share grab company. We didn't lower rates to gain market share and then have a bigger gap between what we need and what we have. As a matter of fact, we got out of places that we thought were systemically flawed or harder to do auto business for us it's probably the best example. So, we've done a lot of work to make sure that we can grow where it makes sense to grow, when it makes sense to grow. I think it's a great question. We look at that all the time.

Meyer Shields

Analyst, Keefe, Bruyette & Woods, Inc.

No. That's very helpful clarification. Thank you so much.



Marita Zuraitis

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

You're welcome.



Operator: That's all the time we have for questions. I would like to turn the conference back to Heather Wietzel for any closing remarks.

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you and thank you, everyone, for joining us today. I know we'll be speaking with many of you over the coming weeks and look forward to those conversations. And, of course, if you have any detailed questions you want to follow-up on, feel free to reach out. I'm available in particular next week now that earnings season is winding down. So thank you.

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

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