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Horace Mann Educators Corp. (HMN)

Q2 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Horace Mann Educators' Second 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, VP Investor Relations. Please go ahead.

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you and good morning, everyone. Welcome to Horace Mann's discussion of our second quarter results. Yesterday, we issued our earnings announcement, 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

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them. Actual results may differ materially due to a variety of factors, which are described in our news release and SEC filings.

In our prepared remarks, we use some non-GAAP measures. Reconciliations of these measures to our 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 second quarter core results near breakeven and ahead of the loss we anticipated in our pre-announcement, due to better-than-anticipated segment operating performance. Based on this performance, we made a minor upward revision to our full year core EPS guidance to a range of $2.15 to $2.35. As our preliminary announcement described, the impact on our bottom line from external events was disappointing. We expect 2023 ROE to be in the high single digits as we resume our trajectory towards our goal of a sustainable double digit ROE.

Our operating results clearly benefited from strategic actions we've taken in recent years, while also illustrating the value of diversifying our earnings base with our new worksite division, adding $13.2 million to core earnings in the quarter. Let me cover each of the external challenges individually.

First catastrophe storm activity was outsized. Our losses were nearly double our 10-year average for the second quarter. The second quarter is typically our heaviest catastrophe quarter. It has represented about 50% of our full year catastrophe load since we completed a strategic and multi-faceted shift to reduce our coastal exposures five years ago. However, in this year's second quarter, the Midwest and Plains states experienced unusually high thunderstorm, wind and hail activity. For example, one severe storm that crossed the country in May caused major damage in communities from Texas to Minnesota and Pennsylvania. In light of the breadth and magnitude of the events in the quarter, we do not believe that exposure concentrations were an issue, although our dynamic underwriting and risk mitigation programs monitor this risk closely.

Second, inflation continues to significantly impact the P&C sector. Industry-wide inflation is driving higher physical damage costs due to higher parts pricing and labor rates, as well as claim resolution timing. Injury claims costs are rising because of trends towards more severe accidents and increased utilization of medical treatments. As we've described in recent quarters, we have been proactively adding rate and taking underwriting actions where needed to address rising loss costs.

Our auto rate plan is dynamic through the remainder of 2022 and well into 2023, and we will adjust as needed to address evolving market trends. The current plan reflects rate increases in the high single to low double-digit range in states representing almost 80% of our premiums. Keep in mind, 70% of our auto policies are six-month policies. We are also strengthening auto reserves this quarter, because it became clear that these industry-wide trends are also affecting claims from recent accident years that remain open because of pandemic-related systemic delays.

Like auto, our property pricing strategy is proactive and average premiums have risen almost 8% over last year's second quarter, due largely to inflation adjustments to coverage values. Given that the level of weather activity will support additional rate filings, we expect the overall impact on average premiums rising to the mid-teens over the next 12 to 18 months. Said another way, our property book has been historically profitable and we will adjust our underwriting and pricing as needed to maintain that track record.

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And lastly, weakness in the equity markets led to unfavorable DAC unlocking. Bret will discuss DAC unlocking in detail later in his remarks, but I want to step back briefly to note that we've been positioning the investment portfolio for a rising-rate environment for some time. We expect to benefit substantially over the next several years from the actions the Fed is taking to address inflation and other economic factors behind the equity market volatility.

For example, nearly 20% of our portfolio is floating rate, plus our core portfolio new money rate in the second quarter was 4.8%, up over 140 basis points from a year ago. To bring this back to a high level view, although progress towards our long term goal of a sustained double-digit ROE has been temporarily interrupted by the impact of external events, we remain as committed as ever to taking care of our educator customers and as confident in our long-term outlook.

To achieve our long-term objectives of an expanded market share and accelerated shareholder value, we implemented a multi-year PDI strategy to enhance our product offerings, to strengthen our distribution, and to modernize our infrastructure. Our transformational phase to position ourselves for market growth culminated in the acquisition of Madison National Life in January. 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.

So let me turn to the momentum we continue to see as we implement strategic growth initiatives in each division, beginning with worksite. Core earnings for the worksite segment were up 14% over prior year, and we're seeing continued progress in sales metrics. Second quarter voluntary supplemental sales grew 83% over last year's second quarter, as we steadily moved back towards pre-pandemic levels. The employer-sponsored benefits line, which was added with the acquisition of Madison National this year, contributed $1.3 million in quarterly sales, consistent with our expectations for that business.

As on a side, employer-sponsored sales do fluctuate by quarter with first and third quarters generally stronger than second and fourth, aligning with typical benefit year timing for districts. We expanded our marketing of group supplemental products in the second quarter to further meet the needs of school districts interested in providing more comprehensive benefits to their educators and employees. We remain optimistic about the growth opportunity of this business, particularly as we leverage the complementary geographic and product strengths of the two acquired businesses. And looking further out, we are encouraged by our preliminary work leveraging district relationships across the retail and worksite divisions. It's good to have early reinforcement of our enthusiasm about the future of the Horace Mann Companies

On the retail side of the house, we are seeing steady progress in each of our four strategic growth priorities. First, as we've come out of the pandemic with greater access to educators and growing demand from industry disruption, we are slowly returning to pre-pandemic sales levels. In the auto line, April was the best month for auto sales since the pandemic began. May was similar, even though sales typically start to trail off as the school year winds down. June was even stronger than April and May, with the highest auto sales since fall of 2019. As a multi-line carrier, our relationships with customers often start with an auto policy, but grow to include property insurance, life insurance and savings products. That's why we are leading with auto in geographies where we are priced appropriately.

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The second priority is to execute on accelerating the successful cross-selling of our modoline customers. It's consistently a strength of our agents and bodes particularly well for our overall customer retention. With over 600,000 incoming calls to our customer care center annually, we wanted to make certain those conversations identified and acted on unmet educator needs. Through a structured approach, the level of new sales coming out of these interactions has grown 160% in the first half of this year.

The third priority is to continue to build our digital capabilities to ensure our operations run efficiently and educators connect with us in a manner that they prefer. This year, a lot of the focus is on infrastructure evolution to support the household identification work that will be integral to our multi-channel distribution and growth capabilities going forward.

Finally, and most importantly, we must maintain our distinctive service mindset in every decision and every interaction. We facilitate internal training, discussions and recognition around keeping the educator at the center of everything we do. Of course, there are examples across the business, but the work of our P&C claims team in the second quarter clearly stands out. They delivered prompt, compassionate and reliable service to our customers at each step of the process, storm after storm after storm.

Informing all of these strategies is our ongoing in-depth education market research to better understand the buying propensities and preferences of the nation's nearly 8 million educators, as well as the districts that employ them. We continue to add our education market knowledge and build those learnings into our existing sales processes.

Looking ahead, our agents are excited to engage with educators during the upcoming back-to-school season. Although the environment is dynamic, we are cautiously optimistic about schools being more able to focus on academics with the worst of the pandemic behind us. Likewise, educators have more time to allocate to their personal lives and financial planning. We are seeing positive signs in terms of scheduling events and meetings, utilizing both our traditional in-person strengths and the virtual skills we learned over the past two years.

Throughout our growth journey, driving shareholder value through varying economic cycles remains a priority. As Bret will discuss in more detail, our capital generating capacity remain strong. We continue to return capital to shareholders with annual dividend increases and opportunistic share repurchase. In the first seven months of the year, we used $24 million to repurchase almost 671,000 shares, our highest level of repurchase activity since 2016, which is a testament to our confidence in our strategy. Today, there is over $40 million remaining on the board authorization from May.

In closing, as schools open for the 2022-2023 school year, we will be there to support educators, providing financial education, enrolling new participants in benefit programs, sponsoring classroom projects, and building relationships. This is what we do best, work as a partner to the educational community and help provide solutions to the challenges that educators face every day.

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. External events had a significant impact on our quarter, although earnings came in slightly ahead of our pre-announced range, with the core loss at $0.01 per diluted share. Based on the results, we updated our full-year 2022 core EPS guidance to $2.15 to $2.35 per diluted share. We expect

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2023 ROE to be in the high-single digits as we resume our trajectory toward our goal of a sustainable double-digit ROE. I'll go into more detail on the guidance later in my remarks.

But first, let me run briefly through the results and outlook considerations for each segment. Property & Casualty results were significantly affected by cat losses and inflation, with a segment core loss of $25.4 million. In addition to the initial impacts of our pricing actions, policy counts were relatively flat as new sales strengthened and retentions continued to rise, leading to average written premiums up 1.6% for auto policies and 7.5% for property. Total written premiums were up slightly for the quarter and the rate of increase should continue to improve. We are looking forward to seeing this momentum reflected in total earned premiums later this year or early in 2023.

So let's turn to the key drivers of the second quarter underwriting results. First, catastrophe losses. In line with our July 13th announcement, cat losses were $45.7 million, contributing 31 points to the combined ratio, well above our 10-year average for the second quarter of $26 million and bringing year-to-date cat losses to $53 million. Our losses from 22 events designated as cats by PCS in the quarter, primarily severe thunderstorm, wind and hail events, were concentrated in the Midwest and Plain states. Because of the hail events, auto cat losses contributed about one point more to the loss ratio than last year.

Our updated guidance assumes cat losses for the second half of 2022 will contribute between $20 million and $22 million pre-tax, unchanged from previous guidance. This is in line with our 10-year average for second half cat losses. I would also note that, we did not see outsized cat losses in July.

The second driver is inflation. In line with industry experience, we began addressing higher auto loss severity, driven by inflation in late 2021 and earlier this year. Over recent months, we've also seen additional impacts of other loss cost factors, including the industry trends towards more severe accidents and increased utilization of medical treatments. As Marita noted, we continue to implement rate and other underwriting changes to address these trends. It's worth noting that miles driven are near pre-pandemic levels despite higher gas prices in recent months.

Third, there also has been an effect on settlement of claims from recent accident years that had not been closed, because of pandemic-related systemic delays. In the second quarter, we recognized the effect of the inflationary trends by strengthening prior accident year reserves by $6 million pre-tax.

P&C segment net investment income was $14 million below last year's level as a limited partnership portfolio for this segment swung to breakeven from last year's outsized returns. If we assume our average historic level of LP returns, the P&C segment would have annual LP earnings around $15 million, but as you've seen in the quarterly results, the period-to-period earnings can be volatile. Our guidance for full year core earnings for the P&C segment is $10 million to $14 million as we said in July.

Turning to Life & Retirement, core earnings were up 4.8%, while adjusted core earnings were up 24.4%. The equity market declines led to higher DAC unlocking as well as lower charges and fees on asset based accounts. However, the level of DAC unlocking was lower than we originally anticipated, as there was a partial offset related to the assumption on future separate account fund performance. While the equity market declines are impacting our full year outlook, operationally, both Retirement and Life continue to perform in line with our expectations.

Life sales in the quarter continued at a steady pace, rising sequentially, although slightly below a strong quarter last year. Persistency remained consistent and mortality costs were below last year's second quarter. The net interest spread was 303 bps, up from a year ago, reflecting strong investment returns. The spread in our fixed annuity business is comfortably above our threshold to achieve a double digit return on equity. We also had

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another solid quarter for Retirement Advantage, the fee-based mutual fund platform that we believe creates long-term opportunity for this business segment.

Our updated outlook for the full-year core earnings for the L&R segment are $56 million to $59 million, anticipates the full-year net investment spread will be slightly below the 2021 level of 290 bps. While mortality costs are expected to be consistent with actuarial expectations, the revised outlook also reflects first half DAC unlocking and the effect of equity market declines on charges and fees.

Now, let me turn to Supplemental & Group Benefits segment. You'll recall that Madison National's results were added effective January 1 of this year, which makes some of the comparisons to 2021 performance less useful. Overall, this business is performing well and we are excited about its potential and the earnings diversification it brings.

For the full segment, second quarter premiums and contract charges earned were $69.1 million, of which Madison National's employer-sponsored products represented $37.5 million. Sales of voluntary supplemental products were $2.2 million in the second quarter, an 83% increase over prior year with persistency remaining very strong at 92%. Sales of employer-sponsored products added another $1.3 million, in line with our expectations for the second quarter.

Amortization of intangible assets under purchase accounting reduced core earnings by $3.9 million pre-tax versus $3 million in the second quarter of 2021. Core earnings were up 10% with adjusted core earnings up 14%. Net investment income for this segment reflected the addition of the Madison National portfolio effective January 1. It's been a seamless integration and we've already increased GAAP book yield by more than 200 bps to nearly 4% for this portfolio. And as our CML and LP commitments for this portfolio are funded, we would expect to see that yield rise further.

The pre-tax profit margin for this segment reflects the combination of voluntary and employer sponsored product lines. Our full year outlook 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.

Before I turn to investments, I want to give an update on the new LDTI accounting guidance. As we mentioned at year end, the standard does not change long-term earnings, underlying economics or cash flow. Furthermore, it has no impact on the statutory earnings or the statutory capital we are all required to maintain for regulatory purposes. None of the changes impact our past or future products or product structure or our educator customers either in what they pay us or the amount of claims we ultimately pay to them. However, for the impacted businesses, it does require cash flow assumptions, underlying policy reserves, to be reviewed and updated and those reserves to be revalued using current discount rates.

When we adopt the standard effective January 1, 2023, we will be applying the guidance as of the transition date of 1/1/2021. The transition impact on reported GAAP book value will fall largely in three areas.

First, an increase in the liability for future policy benefits, largely due to changes in discount rate assumptions. Number two, a new benefit liability to be called market risk benefits. And thirdly, the elimination of the shadow DAC equity adjustment. In total, when we make the transition adjustments as of 1/1/2021, shareholders equity will be reduced by $400 million to $500 million. This impact will largely be due to the impact of revaluing reserves using a discount rate assumption relevant for that date. There is no question that we have recouped a material portion of that amount due to the effect of recent interest rate increases and the discount rate.

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Also, after adopting LDTI, we plan to continue to provide an adjusted shareholders' equity that excludes these adjustments as well as unrealized gains. The appendix to our investor presentation includes the table that will appear in the 10-Q we expect to file Monday. It summarizes the areas of impact and is included for your reference. We continue our work on the implementation of LDTI and we'll offer further updates on income impacts later this year.

I've mentioned various aspects of investment performance for the segments, but looking at the consolidated portfolio, net investment income on the managed portfolio was right on track with our expectations. LP returns were 12.6%, a strong return given market volatility and ahead of our historic average annualized returns, which are in the 8% range. However, the comparison to last year is unfavorable because of Q2 2021's outsized returns from LPs of over 30%. We've added some disclosures in the investor presentation and investor supplement to illustrate how the LP portfolio and related earnings are distributed between segments.

The P&C segment has more exposure to the portion of the LP portfolio with equity-like characteristics. So that segment is most likely to see volatility when equity markets are under pressure. The core fixed income portfolio is well-positioned to take advantage of opportunities to add high quality exposure to the portfolio, while still achieving strong new money rates.

We now expect total net investment income from the managed portfolio for the year to be at the low end of the guided range of $310 million to 320 million. This largely reflects lower portfolio balances in the core portfolio, because of elevated cat losses. Due to equity market declines, returns on LP funds are now expected to be below historical average for the second half. When we take all of the factors into consideration, we made a modest upward adjustment in our guidance for 2022 core EPS to $2.15 to $2.35. The release and the presentation contain the guidance for each segment's core earnings that I mentioned in my remarks.

Stepping back, our efforts over the past several years have made Horace Mann a stronger and more diverse organization, able to continue to effectively serve educators, while withstanding external pressures. Our long-term view of our potential remains fundamentally unchanged. We continue to target sustained double-digit ROEs and 10% average annual EPS growth over the long term. We continue to expect to annually generate at least $50 million in excess capital above what we pay in shareholder dividends. While our priority is and will continue to be growth, we are committed to providing strong returns to shareholders.

Since we closed the Madison National transaction at the start of 2022, our repurchase activity has been its highest since 2016. We used $24 million to opportunistically repurchase almost 671,000 shares of stock at an average price of $35.80, supported by a new $50 million authorization from the board in May. We have paid more than $26 million in shareholder dividends, reflecting the 3.2% increase declared by the board in March, and expect to pay approximately another $27 million in cash dividends in the second half of the year.

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.

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QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] And the first question today will be from Meyer Shields from KBW. Please go ahead.

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

Q

Thank you. Good morning.

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

A

Good morning, Meyer.

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

Q

I guess, brief math – sorry. I hope it [indiscernible] (29:31). I think this is a mathematical question, but if we're seeing inflation running sort of hot and we're not quite at rate level to reflect that yet, wouldn't it make sense to anticipate sort of a second half catastrophe loss ratio that's above average rather than in line?

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

A

Yes. Meyer, you mean from a property cat perspective. We do a plan every year looking at 5- and 10-year averages. We look at whether the most recent year has increased that per claim level higher. So we would take into consideration some of the things that we anticipated for increased material costs, for example, an estimation of supply chain for example. So our planning originally, when we put that number together for this coming year, for the full year, would have included many of the trends that you see, to the extent that those trends continue longer, get deeper where there would be a need next year when we do our plan to think about it, sure, but it would be small.

Remember that the second quarter, by far, is our biggest quarter for cats. Obviously, we saw in the second quarter with nearly double what our 10-year average would tell us. But the second quarter tends to be pretty small for us and our numbers reflect that. So to the extent that there was a little bit of creep, it would be on a much smaller number than it would be if it was the first half.

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

A

Yeah. Meyer, this is Bret. Just to add to what Marita just shared. I think in my remarks, talked about our planned cats second half being $20 million to $22 million. So just throwing out a 10% increase, that's a couple million bucks. And I also mentioned in my prepared remarks that we didn't see anything outsized in July.

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

A

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Yeah. And I would to and maybe Mark has comment, but I'll probably steal his thunder, so he won't need to come in. But we are seeing some of the actual cost of materials level off a little bit, i.e. lumber. So it might not be as cliffy as maybe it was in the first half.

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

Q

Okay. No...

[indiscernible] (31:59)

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

A

No. Marita, I think...

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

Q

Go ahead.

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

A

Yeah. I was going to just jump in. This is Mark. I would say that what we're seeing in terms of some of the changes and for example, in things like lumber, gives us perspective that the trend over the second half of the year, the inflationary trend is going to be quite similar to what we had originally thought in our plans when we put forth our original cat plan for the year.

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

Q

Okay. No. That's all very helpful. And thank you. Completely unrelated question, I guess, for Ryan. As we kind of move into a period of higher interest rates, how does that impact the allocation to alternative investment?

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

A

Thanks for the question, Meyer. This is Ryan. Higher interest rates for us, the biggest benefit is on the core portfolio. And as Marita said in her remarks, 20% of that portfolio is floating rate. That's primarily within high-grade AAA, AA CLOs, and commercial mortgage loans. The impact of a 100-basis point move on floaters is about $12 million pre-tax for us.

When I think about how that impacts the limited partnership portfolio allocation, higher interest rates bode well for private credit and we have a sizeable allocation to private credit funds. Those are primarily in the life retirement supplemental and group segments. But as rates reprice, those new originations of loans in those funds will price at a higher rate. To put it in perspective, they typically generate a return in the high-single digits to about 10 for that strategy. And you could see a little bit more of a widening of that improvement in that, if you will, as the rate environment moves up.

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

A

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Yeah. Meyer, this is Bret. I would also add that as of June, we're basically at our 5% allocation to that asset class and that's kind of the level that we're comfortable at that we have talked about. We shared with everyone that the LP allocation would be around 5% of the total portfolio and CMLs would be about 10%, but we're not quite to that level on the CMLs yet. So I just wanted to add that.

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

Q

Okay. That's perfect. Thank you, so much.

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

A

Sure.

Operator: And the next question will come from Gary Ransom with Dowling & Partners. Please go ahead.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yes. Good morning. I wanted to ask about the adverse development in auto. When you told us it was $6 million, I guess I didn't realize until last night that it was really $12 million and $6 million favorable in property. But I was wondering if you could help us understand how that manifested over the course of the second quarter. Obviously, you saw something in the first quarter and then you saw more of it in the second quarter. I wonder if you could describe what you've seen, and maybe particularly note any changes in sub-ro delays that might have contributed on the physical damage side?

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

A

Sure, Gary. This is Bret. Let me start and I would say if Mark, wants to follow with any additional comments. But I think you and others are well aware that we've had a long-standing reputation for maintaining conservative loss reserve levels. That's not a new thing for Horace Mann. And as you said, in the second quarter, we did strengthen the auto BI reserves specifically to the tune of $12 million. And you're right, they were offset by some favorable development in the property line.

And obviously, yes, it was, looking at how things were developing and seeing a trend, and I think we even noted it in our prepared remarks that they were mainly related to probably the vast majority of the last two [ph] accident (36:25) years. 2021 and 2020, where, if you think about it, these were related to open claims that obviously when those were set up, they did not anticipate the inflationary pressures that when we actually go to settle those claims and pay them in the current year, obviously we're coming in heavier than that. And obviously, homeowners, I would say, is a separate issue altogether. No different than in prior years, where I would say reserving on a conservative level, we've had favorable releases through certainly the last five-plus-years in that.

So, we just felt the prudent thing to do, I think you're well aware we set reserves so that we're basically at the upper half of the range. And that strengthening that we did in the second quarter basically let us maintained those same levels. Mark, I don't know if you wanted to anything there?

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

A

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No. I mean, I think, Bret hit on all the key points. I mean, I think part of what we've seen, I think many in the industry you're seeing is, during the pandemic, there was a slowdown in receiving demand packages, where there were attorneys involved and a lot of these older claims that are open have some attorney involvement. And one – now that we're finally starting to see those come through, you're seeing much higher levels of treatment, more increased treatment and things like that. And I think that's why we've kind of had this manifestation of recognizing it, probably start to see it a little bit in the first quarter to some extent, but more so in the second quarter and acknowledging that.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

So, am I correct...

[indiscernible] (38:19)

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

I was going to ask about physical damages. Is there nothing significant on this physical damage side?

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

A

s No. On the physical damage side, when you ask about the [indiscernible] (38:28), obviously that subrogation is a little bit slower, but we are still getting it, but still anticipate getting it and that's not really a factor, and what's that are happening with the reserve development.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Okay. Yeah, it's just interesting because across the industry with all the companies that have reported so far, the differences are a little bit checkered. And even though I understand what you're saying, I don't see it's – it sounds like a universal effect on everybody and yet only some are experiencing it. And – so I don't know, in that context, I don't know, do you have any view of how widespread? What you're seeing, does it seem environmental across the board or is it perhaps coming in certain states or certain regions?

[indiscernible] (39:28)

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

A

Go ahead, Mark.

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

A

I'm sorry, Marita. I was just going to say, I think to an extent it is environmental. When we look at sort of the close rates of some of the key peers in terms of what percentage of their claims are still open, we see pretty similar patterns in this kind of slowdown in the liability side. And so, I have to believe that most of what we're seeing is a macro effect that everybody is experiencing to some extent.

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Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Yeah. Okay. If I could just change the subject to marketing to the teachers, I know the New Year is coming up, and I think you've kind of mentioned that there's a little bit of activity going on. I don't know, maybe it's a little too early to describe everything you're doing, but I just wonder if you have any metrics or anything you could share with us that suggest you're really getting back to normal with the upcoming start to the school year?

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

A

Yeah, absolutely. And we put the remarks in our script to try to give you a little bit of color on that. And I would tell you that when we look at July, July is following a similar pattern and we feel good about the momentum that we're seeing in July as well, is strong. I mean for us, July tends to be a pretty small, quiet month and you can imagine it's vacation time for teachers for sure and maybe for some of our agents as well. But this July, it looks like they may have continued to use some of the things that they learned during the pandemic and they've ramped up their, what I'd say, early back-to-school activity.

And what we're seeing for back-to-school is, like we said in our script, appointments are being made, we keep track of our leads. We keep track of the activity that our agents have. We know where our sales people are pulled in, where we're holding seminars and back-to-school rallies. And all those numbers look quite good as we get back to more pre-pandemic levels on that activity. I mean, we have more opportunity to touch base with our customers than we've had in a long time. So, I would say, all the metrics that we follow are all pointing in a pretty good direction.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

And I guess, when we think about growth rates in those businesses and maybe it's your new sales, I guess I'm trying to think about how this might unfold in the next year and actually into the third and fourth quarter. Just kind of how much growth we can expect and trying to think about what's happening now versus perhaps what was happening a year ago, how much change has actually happened?

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

A

Well, I mean, I'd say a lot of change. I mean, when you think about trying to do what we do in a pandemic environment when schools are, if not closed, certainly distracted, the environment is quite different when the majority of the pandemic-related issues are behind us. Not only is access significantly opened up, but our educators have more time and more interest in engaging with us. They're not as consumed as students being out, students being in, and navigating a hybrid environment.

The world has settled down a little bit for them and for us, so that we can get back to what we would normally be doing this time of year. But even more excited that we can combine it with much of the work that we did during the pandemic that drove efficiency that allowed us to use Zoom, that allowed us to use food trucks in parking lots and all the other things we did. We think there's a magnifying effect by being able to do what we always did historically and combine it with what some really good new tools that we used during the pandemic.

I mean when I look at, take the supplemental sales numbers, it is a worksite product, the worksites that are open and you see those numbers in there. Take our retirement trajectory, retirement looks good. People are having

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conversations engaging in retirement. We're excited about the cross-sell discussions, at least between retail and worksite and the other way around, though momentum seems good.

Gary Kent Ransom
Analyst, Dowling & Partners Securities LLC

Q

Thank you for all of that. That's good commentary.

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

A

You're welcome.

Operator: And the next question will come from John Barnidge from Piper Sandler. Please go ahead.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Thank you, very much. My first question, another life provider, for individual life, reported an actuarial charge and reduced life earnings going forward. It was related to lapse assumptions and a mortality improvement assumption change. Can you maybe talk about lapse assumptions versus experience, and then mortality improvement that's embedded versus assumed versus maybe experience? Thank you.

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

A

Yeah. John, this is Bret. I can start and if Mike wants to chime in. But I believe the life carrier that you're referring to is on a product that we don't even sell or market. So, I think maybe there could be some confusion does that relates to the new accounting pronouncement versus the unique specificity of the product at hand. So, I can't sit here and comment on another company's assumptions. Obviously, we true-up our assumptions on a regular basis. We haven't seen any dramatic changes in our persistency or lapse rates and usually don't, whether we're in a financial crisis. In the past, I think we've commented our customers are sticky when the mass markets aren't. But that's all I can comment on as it relates to Horace Mann.

John Barnidge
Analyst, Piper Sandler & Co.

Q

Bret, I appreciate that clarity around the product mix difference. And maybe a question around the pricing program, touching 80% of auto premiums, I believe. Now that it's – the timeframe is being pushed out, which geographies in that remaining 20% eventually see rate or can you maybe talk about the areas that aren't seeing rate in that 20% ? Thank you, very much.

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

A

Hey, Mark. You can go ahead and take that one.

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

A

Yeah. The most significant area that isn't seeing rate is obviously California. I think there's been a lot published in the last couple of weeks on what's going on there? I would say that we have very recently in the last couple of days, we have made a filing in California for one of our companies that represents about 20% of our premium. We

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anticipate making a filing in the other company within the next several weeks. Obviously, given what's going on in the environment there, we do anticipate that to be a challenge. However, we have the luxury I think, of the partnerships we have through our general agency to be able to place business with other partner carriers when necessary. And if we don't ultimately get the rate that we need, then we may need to restrict some of the new business growth in that particular geography.

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

Yeah. That's right, Mark. This is Marita. I'd also say that we start all this with a profitable book of auto business in California and its educators, right? A homogeneous market niche of educator business appropriately rated, I mean to the extent that over time these trends continue and we're not able to get the rate that we need and others need in the state, we may need to restrict new business growth. We're not at that point. But as Mark said, restriction of new business growth for us would mean that we'd place it with another carrier that might be comfortable writing that business.

We're not at that point. We work really hard. We'll see how this works out. But on the majority of our book, we're getting the rate increases that we need, and we feel good about being able to put the rate in that we need to cover these trends in the majority of the places that we are. And if we need more rate, we'll push more rate.

John Barnidge Q
Analyst, Piper Sandler & Co.

Just to clarify, Mark, you said, you're a rate filing a company in California that represents 20% of premiums. Is that 20% of California premiums you're talking about?

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

Yes, I'm sorry. That's correct, 20% of the California premium. So we have two different underwriting companies in California. One is about 20% of the California premium, the other is 80%. We, within the last few days made the initial filing on the first company and we anticipate a similar filing in the next few weeks in the other company.

John Barnidge Q
Analyst, Piper Sandler & Co.

Great. Thank you, very much. Best of luck.

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

Thank you.

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

Thank you.

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

Appreciate the questions.

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

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

Q

Good morning. I just have follow-up on the pricing question. Approximately how much pro forma premium in the way of price increase in auto and home do you see coming through the pipeline over the next 12 to 18 months?

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

A

Yeah, you can go ahead, Mark.

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

A

Yeah. So, as we said on the auto side, we anticipate rates across that 80% of the market in the high-single digit, low-double digit. A lot will depend on what we get – when and if we get rate in California and how much that will change. And as you think about it, part of what you have to remember is, these are rates that are just going in to the system now or going in over the next couple of quarters.

When we talked originally at the fourth quarter call, we talked about, at that point, a mid-single digit rate increase across auto and at that point we would have expected about half of that premium to earn-in in the latter half of this year and the other half to earn-in in early next year. As we've increased that number that pushes that earnings out a little bit more into the earlier to mid-part of 2023.

On the property side, when you think – we talked about this a little in the script. We have been taking increases through inflation guard, we've taken two increases over the past year that helped our average premiums jump up almost 8%. We had anticipated the combination of rate and inflation to be in the low double digits. But given what we've seen with the continuing rate of inflation and more so on the long-term view of weather and its sort of impact on our overall profitability because we feel good about ex-cat once we address the inflation issues that we really need to take a more aggressive approach on the rate side to address what we've seen with increased weather. And so that's why we anticipate over the next 12 to 18 months, starting to push more towards that mid-teens level of overall premium change on the property side.

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

Q

Okay. Thanks for the color. A lot of the other questions I had were answered. I guess I'm just going to pivot to a broader macro challenge for so many companies is that just with inflation and tight labor market, employee retention has become an issue. So, Marita, maybe you could step back and give us some perspective on not only what's going on internally with the employees in your company, but also within your producer agency channel. Is it – are you still seeing the same retention levels, same producer retention levels that are historical? Or has there been a change, et cetera?

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

A

Yeah. It's a great question. And I know I sound like a broken record when I say insulated but not immune. But I think one of the key attraction and retention points to Horace Mann is our mission, our vision, and our value proposition. People come to Horace Mann and stay at Horace Mann, because we serve one of the most deserved set of customers on the planet and people are attracted to that mission-centric value proposition.

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So, when I look at the stats across our peer set and companies across the US, I'm proud of our retention stats for sure. But we're not immune from the trends that you see out there. People make different choices these days. And what we see is our open position count tends to be a little higher than what we have seen in the past, but our retention is quite strong. And I think we're bucking the tide a little bit in that regard. Our agent retention numbers are also decent. We're excited about our ability to attract new agents to the value proposition.

And recently, I think we mentioned this on the last call as well, our agent recruiting numbers are beginning to trend up. You can imagine how difficult that is during a pandemic-related kind of environment, and we don't see that as much now as we're beginning to see access open up. We're beginning to see our agents hire licensed producers. And those numbers are starting to go back as well. So again, insulated but not immune. Clearly, we see the trends, but I'd stack our retention numbers up against most of what we're hearing and seeing out there in the marketplace.

C. Gregory Peters

Analyst, Raymond James & Associates, Inc.

Q

Got it. Thank you for the detail.

Operator: And thank you. Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Heather Wietzel for any closing remarks.

Heather J. Wietzel

Vice President-Investor Relations, Horace Mann Educators Corp.

Thank you, everyone, for joining us today. If there's any follow-up questions, feel free to reach out. I'll be available obviously today and next week. I also wanted to just let everyone know we will be meeting with investors in conjunction with all five of our covering sell-side firms over the next month or two, so you've got to – if there's anybody you're dealing with, just feel free to reach out, we'll figure something out. I do have to make highlight, however, we will be at the KBW Conference in September along with many of our peers as we all know that's one of the big events. So, look forward to talking to folks and thank you for your time.

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

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