S&P Capital IQ

CONTENTS

Kemper Corporation NYSE:KMPR

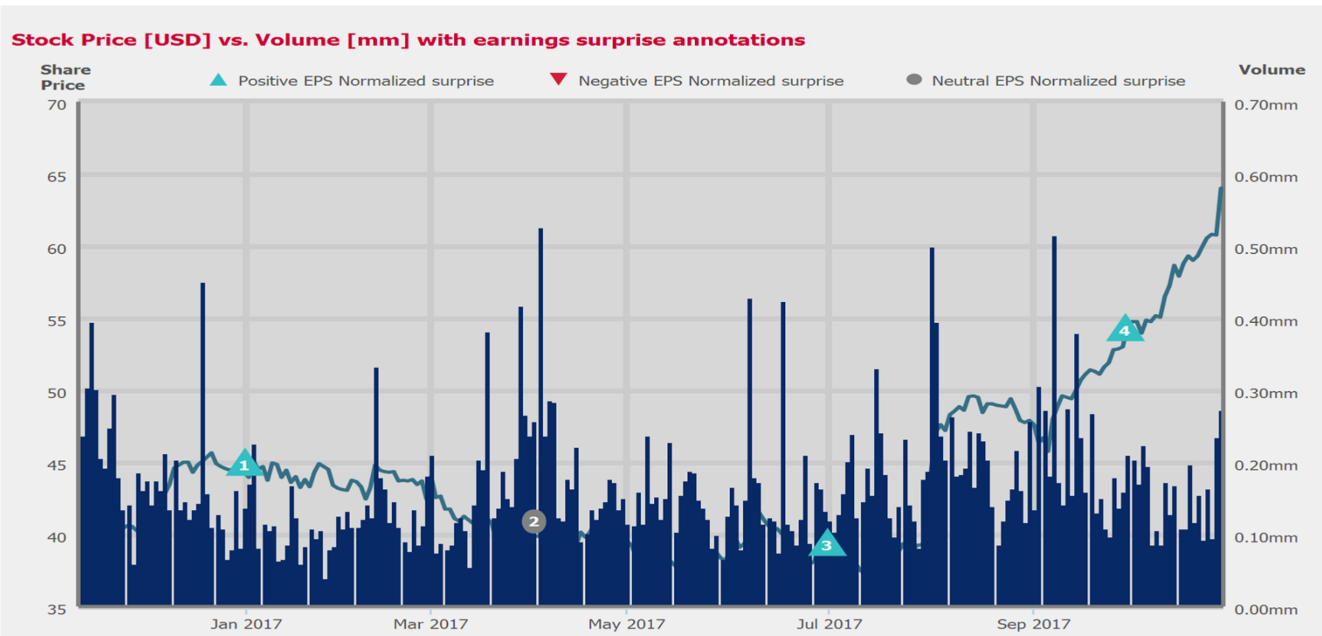
FQ4 2017 Earnings Call Transcripts

Wednesday, February 14, 2018 1:30 PM GMT

S&P Capital IQ Estimates

	-FQ4 2017-			-FQ1 2018-	-FY 2017-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.30	0.60	▲100.00	0.67	1.50	1.78
Revenue (mm)	669.80	689.60	▲2.96	693.70	2731.20	2681.20

Currency: USD
Consensus as of Feb-06-2018 6:35 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2016	0.42	0.56	▲1 33.33 %
FQ1 2017	(0.17)	(0.08)	NM
FQ2 2017	0.23	0.41	▲2 78.26 %
FQ3 2017	0.28	0.85	▲3 203.57 %

Call Participants

EXECUTIVES

James J. McKinney
Senior VP & CFO

Joseph Patrick Lacher
President, CEO & Director

Todd Barton

ANALYSTS

Carl-Harry Doirin
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Christopher Campbell
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Gary Kent Ransom
Dowling & Partners Securities, LLC

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to Kemper's Fourth Quarter 2017 Earnings Conference Call. My name is Chad, and I will be your coordinator today. [Operator Instructions] As a reminder, the conference is being recorded for replay purposes.

I would now like to introduce your host for today's conference, Todd Barton, Kemper's Assistant Vice President of Investor Relations. Mr. Barton, you may begin.

Todd Barton

Thank you, Chad. Good morning, everyone, and welcome to Kemper's discussion of our fourth quarter and full year 2017 results. This morning, you will hear from Joe Lacher, Kemper's President and Chief Executive Officer; and Jim McKinney, Kemper's Senior Vice President and Chief Financial Officer.

We will make a few opening remarks to provide context around our fourth quarter results. And then we will go through the details of our planned acquisition of Infinity Property & Casualty before opening up the call for a questions-and-answer session.

During the interactive portion of the call, our presenters will be joined by John Boschelli, Kemper's Senior Vice President and Chief Investment Officer; and Mark Green, Kemper's Life & Health Division President.

After the markets closed yesterday, we issued our earnings release and published our fourth quarter earnings and acquisition presentation as well as our financial supplement. In addition, we filed our Form 10-K with the SEC. You can find these documents on the Investor section of our website, kemper.com.

Our discussion today may contain forward-looking statements. Our actual results may differ materially from these statements. For information on potential risks associated with relying on forward-looking statements, please refer to our 2017 Form 10-K as well as our fourth quarter 2017 earnings release.

This morning's discussion includes non-GAAP financial measures that we believe are meaningful to investors. In our financial supplement, presentation and earnings release, we have defined and reconciled non-GAAP financial measures to GAAP where required in accordance with SEC rules. And finally, all comparative references will be to the fourth quarter of 2016 unless we state otherwise.

Now I will turn the call over to Joe.

Joseph Patrick Lacher
President, CEO & Director

Thank you, Todd. Good morning, everyone, and thank you for joining us on the call today. To the Infinity employees that are listening, I just want to let you know how excited Jim, Glenn and I are about our companies becoming one team. Looking forward to meeting many of you over the next few days. We see tremendous opportunities for our future, and we're looking forward to realizing those together.

Before discussing our transaction, we want to share some commentary on our standalone fourth quarter and full year 2017. Kemper had a strong fourth quarter and a transformational year. We restored Alliance United to profitability, which set the stage for building a premier nonstandard auto franchise. Additionally, we made tangible progress improving our Life & Health division. We stabilized our premium base and improved our operating capabilities, all while maintaining an efficient cost structure and consistent earnings.

Before Jim walks you through our quarterly and annual results, I will discuss some of the highlights, which are on Page 4 of the presentation. We had a strong earnings year with significant increases in GAAP, EPS and adjusted net operating EPS for both the quarter and the full year. Earned premiums increased 8% in the quarter and 6% in the year, driven by policy growth and premium rate increases in the nonstandard auto business. Net investment income increased 3% in the quarter and 10% in the year, driven by continued performance in our core investment portfolio and outperformance from the alternative investment portfolio. Total revenues were nearly $700 million in the quarter and $2.7 billion for the year, the highest annual amount since 2009.

In addition to the strong growth in the P&C Division, we also significantly improved underlying performance. The P&C division's underlying combined ratio improved 6.3 points in the quarter and 5.5 percentage points in the year, largely driven by the nonstandard auto business. Our preferred auto and home business improved as well, but there's still more improvement needed until the business reaches target profitability. Our team remains committed, and we continue to implement claims, rating and other underwriting actions.

Our Life & Health division continues to be a stable source of earnings with strong and predictable cash flows. Excluding last year's charge to increase our voluntary outreach efforts, net income increased $2 million in the quarter and $10 million for the year.

Our balance sheet and capital levels remained strong with nearly $200 million of cash and investments at the holding company plus borrowings available under the revolving credit agreement from the subsidiaries. We have approximately $580 million of parent company liquidity, and our operating companies continue to be capitalized at levels that exceed our rating requirements, and our debt-to-capital ratio improved to a very manageable 21.9% at year-end.

I'm excited that Duane Sanders has joined the organization earlier this year as our President of the P&C division. Duane is a proven leader with more than 30 years of P&C experience in numerous executive roles. He is an excellent addition to our leadership team and will provide great insights as we continue to grow our business and build long-term value. We have a lot going on in this quarter, but I don't want you to miss the next point. On our last couple calls, we discussed purchasing reinsurance to reduce volatility to higher frequency, lower severity catastrophes. I'm pleased that we have successfully secured an aggregate catastrophe reinsurance treaty for 2018. The new program provides $50 million of coverage, in excess of $60 million and covers our preferred homeowners business for all perils except named storms and earthquakes.

And last, we recognized a $7.4 million benefit from tax reform.

With that, I'll hand it over to Jim to discuss our financial results.

James J. McKinney
Senior VP & CFO

Thanks, Joe, and good morning, everyone. Now let's turn to Page 5 and look at our fourth quarter and full year results. Overall, we had a strong quarter and year. Net income was $37 million or $0.71 per share for the quarter bringing net income for the year to $121 million or $2.23 per share. This is up $31 million or $0.60 in the fourth quarter of 2016 and $16.8 million or $0.33 for the full year. Net operating income was $31 million or $0.60 per share for the quarter and $93 million or $1.78 for the year compared to $29 million or $0.56 in the quarter and $12 million or $0.25 for the year.

Results for 2016 included a $51 million after-tax charge, which is $0.98 per share, related to our voluntary Life & Health outreach efforts. Excluding that charge, the full year net operating income increased $30 million or $0.55 per share.

Earned premiums increased $45 million in the quarter and $130 million in the year. Our investment portfolio continued to outperform expectations, delivering $83 million of net investment income in the quarter and $327 million in the year.

Book value per share, excluding unrealized gains on fixed maturities, which was impacted by tax reform, ended the year at $35.57, up 2% from $35 last year.

On the bottom of the slide, you can see that we grew our P&C policies in force, while improving both the underlying loss ratio and the expense ratio.

Turning to Page 6. We isolated the key sources of volatility in our earnings. In the highlighted section at the bottom of the page, you can see the underlying operating performance for the quarter and the year. Quarter-over-quarter, we improved underlying performance 53% or $0.33 per share. This is down slightly from the third quarter of 2017, primarily from the seasonality we normally incur in the fourth quarter in our P&C businesses. For the year, our underlying operating performance improved 65% or $1.40 per share to $3.54.

Overall, we are pleased that our underlying operating performance is headed in the right direction, and we are focused on reducing the sources of volatility in our earnings, particularly catastrophes. As Joe mentioned, we secured an aggregate catastrophe reinsurance treaty, which should help mitigate the impact of high-frequency, low-severity catastrophes.

With that, I'll turn the call back to Joe to talk about our planned acquisition of Infinity Property & Casualty.

Joseph Patrick Lacher
President, CEO & Director

Thanks, Jim. Turning to Slide 8. Yesterday, we announced that we entered into an agreement to acquire 100% of the stock of Infinity, a leading specialty auto insurer. We're extremely excited about this highly strategic transaction, both within nonstandard auto business but also more broadly at Kemper. With a strong growth in earnings momentum in both our businesses, we believe this is the right time for the combination of our 2 companies. As we've discussed on previous calls, we've been on a multiphase journey to unlock embedded value within Kemper. We made meaningful progress within each of our businesses, but it's in our nonstandard auto business that we've realized the most significant improvement. This business is generating an industry-leading profitable growth. Last year, we reported $53 million of net income, an underlying combined ratio of 94.7% and a 19% increase in premium. The acquisition of Infinity should accelerate our progress towards becoming the premier nonstandard auto franchise, one that consistently delivers exceptional value for consumers and at the same time strong financial results. Within nonstandard auto, we're creating a focused and scaled player in a traditionally niche segment. Given our complementary footprint, this transaction will allow Kemper to reach a broader customer base and will strengthen our relationships with our agencies. From a Kemper corporate perspective, a larger nonstandard auto business further enhances our overall brand and customer value proposition. And additionally, we expect to benefit from financial flexibility and capital generation provided from increased and more diversified earnings sources across our business segments.

Before we go into the details of the transaction and key investment highlights, I'd like to spend the moment on who Infinity is on Slide 9. Infinity is a leading nonstandard auto player focused on high-growth, urban markets across the U.S. Infinity generated $1.4 billion of earned premiums in 2017, with the bulk coming from 15 key urban zones across 4 key states: California, Florida, Texas and Arizona. Infinity has built a low-cost and efficient operating platform that leverages data and analytics, coupled with a specialized claims function. We intend to integrate these capabilities across our P&C businesses to generate improved underwriting results going forward.

As you can see on the chart at the bottom right of Page 9, Infinity has consistently written profitable business and reported a 95.2% combined ratio in 2017. Strong results like these didn't just happen. It's a direct impact of Infinity's high-quality leadership team and focus strategy. Throughout this process, I had the opportunity to work with the Infinity team, and I'm very excited about the capabilities of this business, and more importantly this team will bring to Kemper.

On Page 10, Jim will discuss the transaction details.

James J. McKinney
Senior VP & CFO

Kemper will acquire 100% of the shares of Infinity for a total price of $129 per share or $1.4 billion in aggregate value. The aggregate consideration paid to Infinity shareholders will consist of $51.60 per share in cash and 1.2019 Kemper shares for each Infinity share. This is based on the 20-day volume weighted average price of Kemper stock as of February 12, 2018, which is $64.40. From this point, the number of shares Kemper will deliver to Infinity is fixed, so the ultimate transaction value will float with the Kemper's stock price. Based on Monday's closing price of $57.75, this would imply a transaction value of approximately $1.3 billion or $121 a share. The pro forma ownership of the combined company is expected to be approximately 80% existing Kemper shareholders and 20% Infinity shareholders. We have structured the transaction to preserve financial flexibility, which will support future growth initiatives of the combined company. As noted above, approximately 60% of the aggregate purchase price will be funded with Kemper shares issued to directly Infinity shareholders. In addition, they will receive approximately $570 million in cash funded with internal resources available to Kemper. The transaction will be subject to applicable regulatory and shareholder approvals, and we anticipate the transaction will close in the third quarter of 2018. Also, we intend to add a Director from Infinity to our board, which will expand our board to 11 Directors.

Now I hand it back to Joe to discuss some of the key strategic highlights on Page 11.

Joseph Patrick Lacher
President, CEO & Director

Thanks, Jim. Through this financially compelling and structured transaction, the combination of our 2 nonstandard auto brands will focus on serving a niche segment that has not been the focus of the major auto writers, build an organization with best-in-class analytic capabilities and operational excellence, create a nonstandard auto insurer with meaningful scale which will translate to better products and services for our customers and enhance Infinity's strong brand and capabilities among urban and Hispanic customers by offering Kemper products to Infinity's customer base.

On Page 12, we highlight the strength of the combined company. Based on 2016 net written premiums, the transaction creates the 14th largest personal auto writer. Most of the top 15 auto writers are focusing on standard and preferred insurance. However, our focus will be in the nonstandard auto segment, which is fragmented today. Risk collection, claims effectiveness and the ability to provide a differentiated and value-oriented product are key to being successful in this business. To do so requires commitment and scale, which we will have. When we look at the market, we believe there is an opportunity for the new Kemper to become the industry leader. The increased scale and focus will allow us to offer a valuable service to niche segments. It will also give us the ability to spread fixed costs across our business and will differentiate us from other small and nonstandard auto writers who may not be able to justify incremental investments in product, pricing and claim capabilities.

Following the transaction, Kemper will be better positioned to attract and retain key talent and become an employer of choice within the nonstandard auto industry, tailor our products with the specialized needs of nonstandard customers which will increase retention, improve analytical capabilities with increased data and skill sets, increase claim efficiencies and effectiveness, offer more competitively priced products due to the increased scale and efficiencies and strengthen relationships with our agents and expand customer reach.

On Page 13, we underscore Infinity's strong brand and capabilities within growth markets. Roughly, 98% of Infinity's nonstandard auto premiums are generated in 4 key states, all of which have grown faster in the U.S. population in total over the past 5 years. In addition to focusing on these 4 states, Infinity has developed capabilities to provide specialized products and services to the Hispanic community, which is growing faster than the overall population in those states. We will remain committed to serving this customer base, which is one of the fastest-growing demographics within the U.S., growing 3x faster than the overall population. Kemper's nonstandard auto business is currently focused in California and Texas. And therefore, 95% of the combined companies' nonstandard auto premiums are focused on high-growth segments, creating a compelling platform for future growth. By concentrating on these growing niche segments, Infinity has been able to cost-effectively provide a product that meets the specialized needs of their core customer and strengthen their brand and reputation to this demographic. They are the personal auto insurance industry leader in serving the Hispanic community by providing bilingual contract and servicing capabilities. In fact, 100% of Infinity's sales representatives and 85% of their customer service representatives are bilingual.

In September of 2016, we refined Kemper's strategy to focus on consumer-related businesses with niche opportunities. Infinity, with its unique capabilities and core demographics, fits directly within this strategy.

On Page 14, we emphasize the pro forma of the business mix of the combined company compared to our current footprint. Infinity's current geographic footprint complements ours well. The acquisition increases both our personal and commercial auto volume, while providing us with significant scale in Florida and Texas which are fast-growing and attractive markets. Our 3 unique businesses provide stable and diversified sources of cash flow, enable greater capital efficiency and the opportunity for an enhanced investment returns.

With the combination of Infinity and Kemper, we believe we are bringing together 2 complementary organizations. We talk about this on Page 15. We have similar philosophies on delivering valuable products at reasonable cost. As we move forward with our integration plan, our intention is to focus on keeping the best of each organization. Both have built strong product and claim capabilities, low-cost processes and have a proven growth track record. Infinity's focus on its core urban and Hispanic customer base has allowed it to become a leader within this segment and build a brand that customers recognize, value and trust. Kemper brings a stable and more diversified earnings stream and a strong in-house investment capability. This enables the combined company to be more capital efficient and provides an opportunity to enhance Infinity's investment portfolio returns.

With this transaction, we believe 1 plus 1 is more than 2. Our increased scale yields stronger core claim and product capabilities, the ability to retain and attract top talent and the ability to make optimal investments in products, service and technology and the ability to better absorb fixed costs.

Now I'll turn the call back over to Jim on Page 16 to go over key financial elements of the transaction.

James J. McKinney
Senior VP & CFO

The addition of Infinity is highly strategic and accelerates the momentum we've generated at Kemper since the new management team joined. The transaction is financially compelling and will result in meaningful synergies that translate into significant value. Combined, Kemper will have $3.7 billion of earned premiums, an increase of 58% from 2017. Within nonstandard, we will more than double to $2.2 billion of premiums. In year 1, we expect the transaction to be cash flow accretive, excluding one-time and deal-related expenses. In year 2, the transaction is expected to be greater than 10% accretive to EPS. Given the tremendous earnings accretion from this transaction, we project our tangible book value per share earn back in approximately 2 years. The transaction is structured with a modest amount of short-term debt that will raise our pro forma debt-to-capital ratio to approximately 26%. The increased earnings from the companies should result in reducing this ratio to current levels within a year of the transaction close. We have performed a ground-up analysis of both companies cost structures and areas for potential synergies, and have estimated $55 million of fully phased-in pretax cost savings, which we expect to realize within 24 months. Additionally, there is potential for incremental investment yield as we transition the investment responsibilities to our team and reposition Infinity's current portfolio. This adds an estimated benefit between $5 million and $10 million. Restructuring charges are anticipated to be roughly $70 million, which is 1.3x our fully phased-in cost savings. Altogether, we're excited about this opportunity and believe this transaction represents a significant opportunity to create value for shareholders.

On Page 17, we feature the operating and capital metrics of the combined organization. The key takeaway from this slide is the combined company's earning power as demonstrated by underlying operating income of roughly $270 million in 2017. Further, both companies are positioned for continued profitable growth based on their underlying combined ratios.

With that, I will turn it back to Joe.

Joseph Patrick Lacher
President, CEO & Director

Thanks, Jim. As you can see, we're very excited about the progress we've made at Kemper in the last couple of years, and we're ahead of our commitments. I believe that the acquisition of Infinity accelerates Kemper's strategic journey.
With that, operator, we'll turn the call over to questions.

Question and Answer

Operator

[Operator Instructions] The first question will come from Greg Peters with Raymond Jones.

Carl-Harry Doirin
Raymond James & Associates, Inc., Research Division

This is actually Carl Doirin for Greg Peters. Happy to know that you guys kept at least some of the cash to buy new microphones this quarter.

Joseph Patrick Lacher
President, CEO & Director

Yes, that's not the only we bought this quarter, but microphones are on the list.

Carl-Harry Doirin
Raymond James & Associates, Inc., Research Division

Well, the first question is, if you could perhaps walk us through the acquisition process and whether or not if there are any breakup fees? And the second question would be in terms of the concentration in the state, do you see any issues with the regulators?

Joseph Patrick Lacher
President, CEO & Director

So help me understand, Carl, I know what you mean on breakup fees and other items. When you're poking at the acquisition process, what are you looking for there to make sure I understand the question?

Carl-Harry Doirin
Raymond James & Associates, Inc., Research Division

Sort of the sale process, whether it was shopped or anything we should know?

Joseph Patrick Lacher
President, CEO & Director

Okay, got it. And we will tag team this. I'll do the first and third and let Jim take the middle. This is a transaction that makes very strong strategic sense. I think as we looked at the marketplace and looked at competitors and carriers that made sense for us to be working with, and Infinity came to the top of the list all the time. And I think very much without totally speaking for them, they had a similar view. Jim Gober, Infinity's past CEO and current Executive Chairman, and Glen Godwin and I have had opportunities to cross paths at a number of different industry events. Through those, we ended up engaging in conversations. And I think, ultimately, concluded that this was a unique combination that provided exceptional value to both sets of shareholders in a way that we could pursue those conversations directly and that's what we did. Jim do you want to cover your opinion?

James J. McKinney
Senior VP & CFO

I'd be happy to. In terms of the questions as it relates to kind of the breakup fees, there's a 3.5% breakup fee associated with the transaction and there's an additional 1.5% that covers transaction costs or other things from that perspective.

Joseph Patrick Lacher
President, CEO & Director

Relative to regulatory approvals, we've got the normal array of regulatory approvals you would expect, given where our insurance companies are domiciled. We don't expect any extraordinarily high regulatory challenges related to this. We're dealing with California, Ohio, Texas and Florida and Indiana, I'm forgetting the company domiciled in Indiana it's been a lot of business there. And we think the scale of the company is strong and powerful and important, but we think it will pass all regulatory muster with a very reasonable engagement with the regulators.

Carl-Harry Doirin
Raymond James & Associates, Inc., Research Division

Okay. Sounds good. And if I could sneak one last question in. Have you had any conversation with, I guess, most importantly the California regulators in terms of any action related to the tax reform when it comes to pricing?

Joseph Patrick Lacher
President, CEO & Director

We are constantly in conversation with the California Insurance Department on all of our pricing, rating, regulatory processes. They had a very explicitly defined process for defining rate need and looking at those items. And we've gone through that. There has not been a particular conversation that suggested it's perhaps been out in the press that a rate rollback is required. And I think if you looked at our detailed filings and going through the regulatory process the way California has defined it, one would not be warranted. But there hasn't been a specific request to us around the Commissioner's comments.

Operator

The next question will come from Gary Ransom with Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

You mentioned during your prepared remarks about products that might improve retention. And I usually think about nonstandard auto is not retaining very well, more of a churning business. I wonder if you can just add a little bit more about what you were -- what you meant there?

Joseph Patrick Lacher
President, CEO & Director

Sure. And there is a couple of things underneath that, Gary. First, the core product by itself with any customer base, if you better understand the customers' needs and you're more appropriately adept at managing those, you increase the retention. Now in nonstandard that maybe taking it from a low number to a slightly less low number, but that's better. Part of that becomes how you deal with billing transactions, how you deal if somebody lapsed, how you can manage the reinstatement process. Do you have bilingual call centers versus just bilingual advertising? Do you engage culturally with the customer in a way that helps them feel like what many times for people is a painful transaction dealing with insurance that it's less painful. We believe a lots of those capabilities can be helpful and drive up retention, and just being better at what we do, as a group, helps that. Additionally, there are cases where nonstandard customers are asking for a renters policy. In some cases, Infinity has been experimenting with offering some more modest amounts of life insurance, simple life insurance products that might cover the outstanding car loan or other items around that, and we have the capacity to manufacture the products that they've been experimenting within those fashions. So as opposed to just collecting a commission on it, we'd be part of the entire transaction there. And that's in the early stages from their side, it remains to be seen how we get that and make that work, but we are excited about having perhaps, first and foremost, the ability to do a better job with the core product that customers want and need and how they experience it, and second with potentially expanding the offerings, if that proves to bear fruit.

Gary Kent Ransom
Dowling & Partners Securities, LLC

That's very helpful. Another thing on taxes, and I'm just trying to ask whether the reduced tax rate helped this deal along a little bit, just in the sense of cash on cash returns are probably a little bit better with the new law? And maybe I'm stretching if that has anything to do with your decision, but I just wanted to ask the question.

Joseph Patrick Lacher
President, CEO & Director

Thanks, Gary. The way that I would look at it is the Tax Reform Act has really kind of a very short-term benefit, I think, both to us and from an industry perspective. My expectation is that kind of ROE hurdles inside the market haven't necessarily changed. As a result, I would expect kind of the additional benefits from Tax Reform to fall back into kind of pricing that will essentially kind of enhance the value that customers provided. Generally speaking, when I think about this, I think it's about less than 18 months before those items are kind of fully baked in. I know in terms of the way that we kind of think about and have modeled things internally for the process that we go. We took a similar view to that approach and, obviously, incrementally have kind of baked that in, in terms of what we expect to happen from a market perspective.

Relative to the transaction, overall, I think all of us are excited about corporate tax reform and more enthusiastic that as some might say, America is fully open for business. When we look at this transaction, it makes very, very strong strategic sense in either tax environment. It's a good logical deal for customers, for shareholders, for employees, and we are marching ahead either direction.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Great. And then if I can just ask one more on reserves. I realize reserves are short of short tail for the auto business, so maybe there's not a whole lot of adjustment. But just looking at the processes of how you do reserves, is there a lot -- is there much difference between the 2 companies?

Joseph Patrick Lacher
President, CEO & Director

There's a high degree of consistency. These are auto reserving items. So a fairly high degree of consistency. There's always some nuance, particularly as an actuary you'll appreciate the subtlety of those nuances where most of us won't. But I think there is a high degree of consistency. That was about 7 years of question for you guys.

Operator

The next question will be from Paul Newsome with Sandler O'Neill.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

I will try to keep it to 6 years. Could you talk about kind of the timing and maybe location and mechanics of some of the cost cuts that you are looking to get out of the 2 operations?

James J. McKinney
Senior VP & CFO

Yes, happy to, Paul. I mean, starting with timing, I would expect that roughly -- we talked about the $55 million kind of being built in, kind of fully -- or baked in fully within 2 years. My expectation in terms of kind of thinking about that and modeling it is, I would expect about $20 million inside the first 12 months. You should not think about that on kind of a straight line path. You should think about that incrementally building throughout the year. Similarly, I would suggest that we'll bake in and realize about $55 million to $60 million of benefits in year 2, from that perspective. And then going forward, what we've talked about is an additional kind of $12 million to kind of $15 million that we believe will be further earn in over kind of years 3 and 4, related kind of to the idiosyncratic elements that are unique to kind of this business and how you kind of bring system and other elements together and just the timing that, that takes from that perspective.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

Maybe could you also talk about the overlap just from an operational perspective. Some of these are, obviously, geographically very specific?

Joseph Patrick Lacher
President, CEO & Director

What you're trying to get at Paul. I want to make sure I understand.

Jon Paul Newsome
Sandler O'Neill + Partners, L.P., Research Division

For example, my understanding is that your original business had -- sort of very concentrated business is in Los Angeles and then -- or the California businesses. How much is the Infinity's overlap with those operations? Will they essentially still continue to run standalone? Or will there be actually integration within the businesses themselves?

Joseph Patrick Lacher
President, CEO & Director

Yes, whilst -- I think I get what you're going at and let me -- if I miss, push me back in the right direction. From a field perspective, we're going to look to integrate these businesses as briskly as we can, recognize we got to get to regulatory approvals, then we've got insurance businesses on different systems platforms and different product forms, and we're going to deal with renewals. So we got the normal array of things that slow the industry. But we'll move those close and combined as briskly as we can. From a field location perspective, a lot of those costs are variable costs. They're claim representatives. They're call center people. And both of us strive to have a relatively flat organization in the field. So we'll get synergies, but it will be, in many cases, technology synergies or overhead area synergies. A lot of those field components will be actually a help to have the organizations combined because we can bring greater strength and greater specialization, but it's less about standings and shares leaving field organizations, then it is improved execution and capability and scale in those geographies. Right now, where in a particular geography, we might have to have a claim adjustor who has to drive X amount of distance between claims. If we increase the scale there, that drive time goes down. You get efficiencies and plusses out of that. To the extent that results in staffing efficiencies, normal attrition picks that up, and we'll just replace people at a slower pace. Did I get what you're looking for, Paul?

Operator

The next question will be from Bob Glasspiegel with Janney.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

I'd like to just circle back to Slide 9 where you're going to have California at 53% of the product mix. I share your views that the investment world is taking this regulatory concern about that state and overblowing it. But how do you feel about -- is it a good thing to be that big in California? Over time, do you wanted to be bigger or smaller? And where are the respective companies in a combined ratio run rate in those states, assume both profitable?

Joseph Patrick Lacher
President, CEO & Director

Yes, so we got a couple of questions in there. One of the things we find attractive as we think about niche markets, and we think about places to compete. One of the things we mean what we talk about that is environments where you've got limited or less focused competition, sometimes where the competitors are scared to play, sometimes places where it's a difficult marketplace to compete in and specialization, increased knowledge, increased sophistication becomes an advantage. That comes to us when we deal with nonstandard auto in general. California is a big market, it's a big nonstandard auto market, it's a complex market, it provides disincentives to other carriers to move there. And if you don't have the focus and the knowledge of how to compete there, you're going to risk getting your head handed to you. We have size and scale and intimate knowledge and great experience, both in the state and inside of the market segment. We think that's actually an advantage, and one that puts us in a better spot to optimize that challenging market. Both companies right now are profitable. They're at what you would reasonably think, without giving you a specific numbers, would be very reasonable and attractive nonstandard auto combined ratios. They're not just barely profitable. They're hitting on all cylinders. And at the size they are for both of us to be generating the growth we are generating, they got to be growing and they are. As we think about where nonstandard auto business is, where the population in the U.S. is growing and where the Hispanic population is growing, we think a meaningful competitive advantage by knowing these markets and having scaling them and being in a place where there's less -- it's less attractive for competitors to come in and the population is growing there, that's like an ideal spot for us to be in, so we like it. Would I like to be bigger other places? Sure. But that's not at the expense of California. That's just the fact that we like to be bigger and more substantial and have a more diversified earnings stream because that would be good.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

Are you sure your positions on that -- if I could parse your sort of answers before you're profitable in California, you're going to be more profitable as a result of the tax rate. You said that over time, you're going to pass through -- the industry is going to pass through positives. Is there a scenario where you might be cutting rates in California and still be very profitable when your competitors are raising rates, and this is a good thing, not a bad thing?

Joseph Patrick Lacher
President, CEO & Director

Let's parse that a little bit more finely. I didn't say we were wildly profitable in California when we're going to get much more wildly profitable with taxes. We're making a reasonable return. You know as well as anybody in this industry, there's a regular loss trend and loss inflation. So as that loss trend and loss inflation is creeping in, you're getting pressure all the time on an upward trajectory that's deteriorating profitability. You'll get a tailwind that's helping it with tax reform. So it doesn't take long for those 2 lines to cross even without making a rate change on that process. So some of what Jim's describing is, if you just take a normal expected loss trend and run it through over 18 months, you eat heavily into a tax law change quickly. Do I hope that we are profitable and in a position to capitalize and grow, while our competitors are still having to increase their rates? I sure do. I think that's what's been happening over the last 18 months, and I hope it continues. I hope we continue to deliver more attractive products and prices and better value for consumers and can capitalize on our expertise.

James J. McKinney
Senior VP & CFO

To avoid confusion on that, we want to make sure that we earn a fair margin for what we're doing, but we're not looking to necessarily optimize margin. We want to make sure that we create real value for consumers for this that we're doing the right things by them. And then making sure that we're then empowered from shareholders by earning a fair margin to continue that. The goal once you've got an appropriate margin right should be to grow as fast as you possibly can and serve as many people as you can. And we think our model, in this combination, essentially helps with that. We think tax reform and other items that we're talking about kind of bleed in and essentially enable you from a margin to hopefully position you to grow faster, if you're thinking about it from that perspective. And so we're excited about it from that perspective, but I would not be looking at it as an item that is expected to dramatically change the margins that these businesses have earned over a period of time. We're not trying to maximize margin. We're trying to maximize EPS growth, book value per share growth and shareholder value growth, and that's getting a fair return and fair margin and then growing as much as we appropriately can.

Robert Ray Glasspiegel
Janney Montgomery Scott LLC, Research Division

If I could just throw in one last question. As you dug into Infinity, where do you see them as stronger than you, whether it's claims systems, underwriting talent? Obviously, you like the California niche and the Hispanic focus. Is there something else about Infinity that jumped out at you as being supergood relative to where you may be?

Joseph Patrick Lacher
President, CEO & Director

There is a number of things on both sides that are strong and powerful. I'll pick the one that I would say, and maybe it'll weave its way into 2 or 3 as I describe it. The company has done a terrific job having a clear focused mission on being in the niche segment of urban and Hispanic consumers and in building their entire process around it. The entire organization knows it and understands it. They work collaboratively. And they don't just talk about it from a marketing brochure or having a market department run a few ads. It goes top to bottom in terms of how they build it. Bilingual front-line claim reps, bilingual service people, engaging in the Hispanic communities, recognizing that while some of us may say the word Hispanic and that shows everybody who speaks Spanish into one bucket. There are many different areas of the Hispanic community and recognizing those differences and how they vary, from say, Miami to Houston to LA, are meaningfully different. Their thoughtfulness of how to really understand the customer and their needs and their wants and build their entire process around that is really exceptional, and it's a good reminder to all of us that if you build your business around what the customer wants and needs, you can earn a fair return and significantly grow. And you earn the -- the customers understand that brand, they understand the value and they understand the trust and they believe in the quality, it is truly exceptional. I don't know if I got to 2 or 3 things, but sort of wrapped them together. For us, this stuff is insurance geeky stuff.

Operator

[Operator Instructions] The next question will be from Christopher Campbell with KBW.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Just a number -- first, just a numbers question on the deal. Will the all stock or cash selections be based on the 1.2019 and $51.60 subject to the pro rate? And will the mix -- and will that mix itself the 1.20 or the 1.2 and then the $51.60, will that be an election option?

James J. McKinney
Senior VP & CFO

Well, I'm not -- it was a little hard to hear you coming across, but high-level, yes. The numbers that I described essentially are the numbers that, let's assume, you either picked all stock or all cash and we hit the caps on those relative to elections, those are the numbers that folks would be prorated to.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Got it. And are you thinking more of the beginning of 3Q or the end of 3Q for the actual closing?

Joseph Patrick Lacher
President, CEO & Director

We'd love to tell you. The issue here is we got to work through our regulatory approval processes. And as briskly as we move through those, we'll move to closing. There is no guarantees on it. We don't anticipate a huge set of problems on that. There's nothing that's, obviously, there. We'll try to shorten it as much as possible. But the best we can to tell you, Chris, is think third quarter.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Got it. Very helpful. And on just you bringing the 2 organizations together, what are you assuming in terms of just to the cannibalization of the premium, so agents may not want to put business both with

Kemper or there might be a concentration issue. What are you kind of -- what are your numbers assume in terms of premium leakage?

Joseph Patrick Lacher
President, CEO & Director

We've gone through a fairly deep analysis on this as deep as you can without recognizing competitive needs. We went through some diligence and looked at an agent level. We had a third-party do it for us, so we weren't -- neither side got the per agent in detail, but got sort of a concentration analysis. And there is very few spots where the overlap is so concentrated that we looked at it and said, there's a real obvious issue. I have done a lot of transactions where we've seen that. What we have is bigger scale with a lot of agencies, but not crazy big scale with a few. And I think that it'll be much bigger for both of us, given the size, books that some of the competitors who are #12 through #1 above us from an auto perspective has. In my experience, I don't see this being a huge item. We've modeled in some premium loss as a result, but I don't think it's going to, at the end of the day, be an issue where a lot of agents are saying, "Boy, I'm too worried about having too much nonstandard auto business with these guys." Usually, what they do at that level is say, who has got the right product and the right price, let's get it placed. There are generally a lower retention levels for those customers, so they're a little less sensitive to that concentration, and they could be making and adjusting their moves in the market daily, weekly, monthly. They're more sensitive towards the competitive dynamic. And we're very comfortable that near-term, we'll have a a little bit of noise, longer-term, we're going to be a much more competitive and robust player.

Christopher Campbell
Keefe, Bruyette, & Woods, Inc., Research Division

Right. And then just one final one. I know Infinity was expanding its distribution reach in like places like Georgia and Atlanta. So is that on hold now that Kemper's acquiring it? Or is that -- or are you kind of thinking even broader geographic distribution or expansion?

Joseph Patrick Lacher
President, CEO & Director

Both companies are going to kind of continue to operate independently and as competitors in the marketplace until we close. So I won't be able to comment on what they're doing pre-closing. Those are going to be things they're going to march forward. I would expect that they're going to continue with those because they're very enthusiastic and seeing as a market opportunity for doing that. And I think we've got a common view. When we look at the marketplace, if we find attractive nonstandard auto markets that are growing customer bases and our skill sets can come to bear, we're going to look to expand and do that. We think the combined organization actually has the ability to absorb that type of expansion more easily than either one of us would have on our own.

Operator

Ladies and gentlemen, this concludes our question-and-answer session. I would like to turn the conference back over to Joe Lacher for any closing remarks.

Joseph Patrick Lacher
President, CEO & Director

We had a lot of information today. Thank you all for joining the call and for your interest. As we said a couple of times, we are very pleased with the success that Kemper on its own has had in the last couple of years of attacking and achieving the results in our strategic plan. We believe we're ahead of the commitments we made there, and we're excited to move to, what we might have described at that time, Phase III in one of our businesses and moving forward strategically growing the organization. We're excited for this Infinity transaction, and very much look forward to a more powerful organization on the balls of our feet moving forward and growing the organization. So thank you for your time and interest. And we look forward to talking to you soon.

Operator

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