S&P Global
Market Intelligence

Kemper Corporation NYSE:KMPR

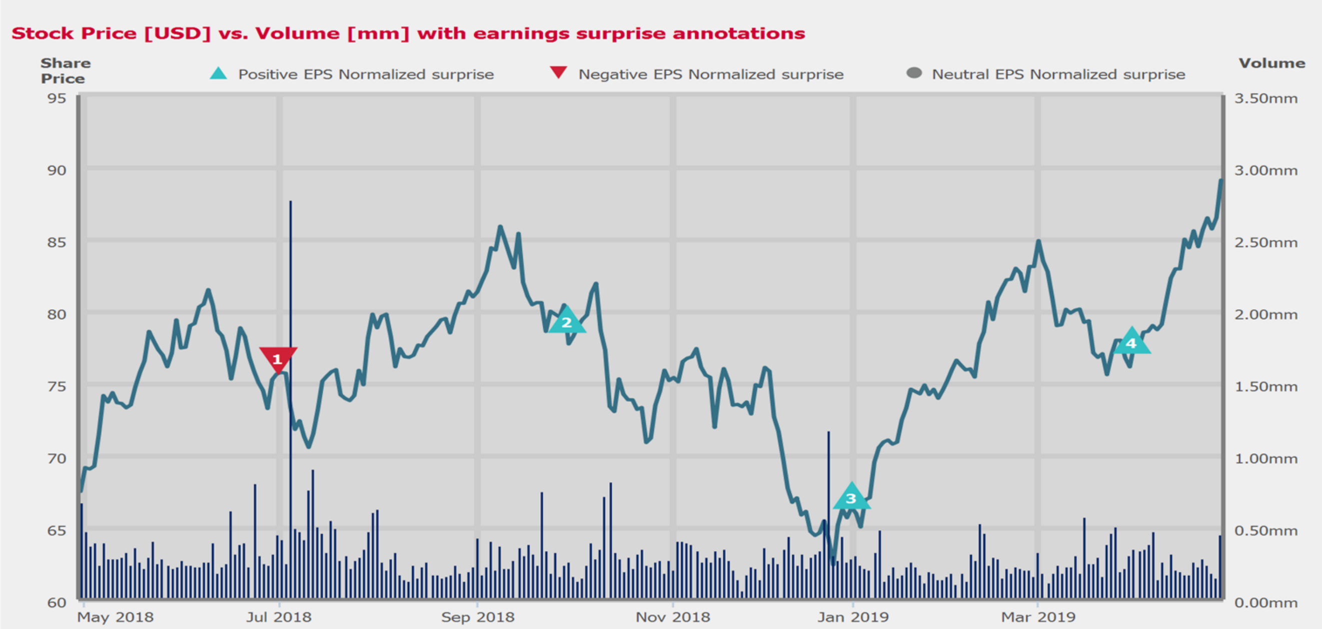
FQ1 2019 Earnings Call Transcripts

Monday, April 29, 2019 8:15 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2019-			-FQ2 2019-	-FY 2019-	-FY 2020-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.38	1.50	▲8.70	1.25	5.45	6.13
Revenue (mm)	1162.33	1159.40	▼(0.25 %)	1190.53	4808.67	5123.40

Currency: USD
Consensus as of Apr-29-2019 7:55 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2018	0.74	0.70	▼1 (5.41 %)
FQ3 2018	1.29	1.59	▲2 23.26 %
FQ4 2018	0.78	0.91	▲3 15.19 %
FQ1 2019	1.38	1.50	▲4 8.70 %

Table of Contents

Call Participants

EXECUTIVES

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

James J. McKinney
Executive VP & CFO

Joseph Patrick Lacher
President, CEO & Director

Michael A. Marinaccio
Investor Relations

ANALYSTS

Adam Klauber
William Blair & Company L.L.C., Research Division

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

Gary Kent Ransom
Dowling & Partners Securities, LLC

Jon Paul Newsome

Matthew John Carletti
JMP Securities LLC, Research Division

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to Kemper's First Quarter 2019 Earnings Conference Call. My name is Andrew, and I will be your coordinator today. [Operator Instructions] As a reminder, the conference call is being recorded for replay purposes.

I would now like to introduce your host for today's conference call, Michael Marinaccio, Kemper's Vice President of Corporate Development and Investor Relations. Mr. Marinaccio, you may begin.

Michael A. Marinaccio
Investor Relations

Thank you, Andrew. Good afternoon, everyone, and welcome to Kemper's discussion of our first quarter 2019 results. This afternoon, you'll hear from Joe Lacher, Kemper's President and Chief Executive Officer; Jim McKinney, Kemper Senior Vice President and Chief Financial Officer; and Duane Sanders, Kemper senior Vice President and the Property & Casualty Division President. We'll make a few opening remarks to provide context around our first quarter results and then we'll open 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 Senior Vice President and Chief Investment Officer; and Mark Green, Kemper Senior Vice President and Life & Health Division President.

Before the markets opened this morning, we issued our earnings release and published our first quarter earnings presentation and financial supplement. In addition, we filed our Form 10-Q with the SEC. You can find these documents on the Investors 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 2018 Form 10-K as well as our first quarter 2019 Form 10-Q and earnings release.

This afternoon's discussion also include non-GAAP financial measures that we believe are meaningful to investors. One such measure that I want to highlight is, again, is as adjusted for acquisition. It is clearly important to understand our reported results, including the impact of -- Infinity acquisition had to Kemper overall. However, investors have also expressed an interest in understanding the underlying organic performance of the combined businesses.

Since our reported financials don't include Infinity's historical information prior to the closing of the acquisition and our current results include the impact of purchase accounting, the underlying trends are not easily visible. In an effort to provide insight into the underlying performance, we also provide our financial as adjusted for the acquisition. This removes the impact of purchase accounting and includes historical Infinity information to more easily provide a meaningful year-over-year comparison.

In our financial supplement, presentation and earnings release, we have defined and reconciled all the non-GAAP financial measures to GAAP where required in accordance with SEC rules. You can find each of these documents in the Investors section of our website at kemper.com.

Finally, all comparative references will be to corresponding 2018 period unless otherwise stated.

I'll now turn the call over to Joe.

Joseph Patrick Lacher
President, CEO & Director

Thank you, Mike. Good afternoon, everyone, and thank you for joining us on today's call.

We're pleased to announce that we delivered another quarter of strong performance. The intrinsic value of our business continues to grow. We remain committed to our portfolio of specialized businesses which focus on growing niche and underserved markets. The superior growth we're delivering shows that our customers see and appreciate the value we're creating for them. Our strong earnings and financial outperformance combined with this growth demonstrates the value we're creating for our shareholders. Our strong balance sheet reinforces our ability to continue to deliver on our promises into the future. All of this fueled by an increasingly dynamic culture where employees are learning, growing and delivering great results.

On Page 5, we're pleased to report that we have exceeded or are ahead of schedule on every financial target we announced at the time of the Infinity transaction and via the S-4. Written premiums are more than $150 million above those targets. Our yield enhancement is 20% above the high end of the range. Our debt-to-capital ratio is below 22%, earlier than projected. Last quarter, we raised our cost savings target to $70 million to $75 million, and approximately 60% of that revised number has been realized. We have a mid-teens operating earnings accretion. And part way through year 1, we are already exceeding our ROE and ROATCE year 2 targets. Probably the most significant statistic is the tangible book value earnback. It's accretive after 3 quarters. That's less than 1/2 the 2 years initially projected. And don't forget, that measurement has no but-fors. It includes integration costs, the improving quality of the balance sheet and the core underlying profitability of the business. It's all-inclusive. The acquisition has been and continues to be an out-of-the-park financial success.

Now let's turn to Page 6 and review the highlights of the first quarter. Overall, we generated double-digit organic growth and significant margin improvement while maintaining a strong balance sheet. We continue to create shareholder value as demonstrated by our 28% increase in book value per share and 30% increase in book value per share excluding unrealized gains in our fixed maturities.

Looking at our return on average equity excluding unrealized gains on our fixed maturities, we produced an 11.4% return. We're pleased with the significant improvement this represents from historical performance.

As stated, we delivered strong improvement in the underlying fundamentals of our business. Earnings per share increased 130% to $2.35 per share, while adjusted consolidated net operating net income per share increased 36% to $1.50. Earned premiums grew 76% on a reported basis, 12% on an as-adjusted basis and 15% as adjusted within our Specialty P&C segment.

In addition to 15% growth, we achieved significant improvement in our Specialty P&C segment's operating performance. The underlying combined ratio improved almost 2 points to 91.7% as reported and 260 basis points to 92.1% on an as-adjusted basis.

Both the Preferred P&C and the Life & Health segments continue to demonstrate improvement. The Preferred P&C segment's underlying combined ratio remained in the mid-90s while managing down a catastrophe exposure. The Life & Health segment's benefits ratio remained within a normal range of volatility, while expenses returned to normalized historical levels.

From a financial strength standpoint, we maintained over $600 million of available and contingent liquidity. This coupled with our strong debt-to-capital ratio of 21.5% provides us with significant financial flexibility.

I'll briefly mention one more item before I hand the call over to Jim. On April 25, we received an additional $20 million payment from CSC in connection with the judgment in the software dispute. The remaining balance of this award is currently on appeal.

And with that, I'll hand it over to Jim to discuss our consolidated quarterly financial results in more detail.

James J. McKinney
Executive VP & CFO

Thank you, Joe, and good afternoon to everyone on the call. Let's turn to Page 7 to discuss the first quarter financial results.

As Joe mentioned, we had a great start to the year. We generated strong top line growth while growing profits and returns. Earned premiums increased to $1.1 billion. On an as-reported basis, this represents a 76% increase over the prior year quarter, driven by organic growth from each of our businesses and our acquisition of Infinity. On an as-adjusted basis, earned premiums increased 12%, the result of a 10% increase in policies in force within our Specialty P&C business segment and a mixture of rate and volume increases from both the Preferred P&C and the Life & Health segments.

Turning our focus to net income. Organic growth, ongoing improvements and underwriting performance and our Infinity acquisition led to robust growth in net income, net income per share and adjusted consolidating net operating income per share. Net income for the quarter totaled $155 million, up $101 million from the prior year quarter. Net income per share on a reported basis increased from $1.02 to $2.35. On an adjusted basis, net income per share increased 105% to $2.32. Adjusted consolidated net operating income per share on a reported basis increased from $1.10 to $1.50. On an as-adjusted basis, adjusted consolidated net operating income per share increased 18% to $1.46. These results led to strong growth in book value per share and book value per share excluding unrealized gains on fixed maturities.

Moving on to Page 8. Here, we isolate the key sources of volatility in our earnings. Adjusting for

[Audio Gap]

underlying operating performance improved 43% or $0.44 per share for the quarter. This improvement is driven by continued strong growth in underwriting margin expansion within our Specialty P&C segment, steady profits from our Life & Health division and our continued efforts to reposition the Preferred P&C franchise.

With that, I'll now turn the call over to Duane to discuss the results of our P&C segments.

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

Thank you, Jim, and good afternoon, everyone. Earlier, Joe hit on the fact that the Infinity acquisition is achieving or exceeding all financial targets, which is a credit to both organizations and an outcome from harmonizing the operations, focusing on what's important, leveraging key capabilities and a consistent effort to becoming one. These efforts, along with many others, has yielded us a successful first quarter.

Now turning to Page 9, I'll discuss our Specialty P&C Insurance segment. As with the prior 2 quarters, I will review this business on an as-adjusted basis, including Infinity results in all prior periods.

Earned premiums increased to $729 million for the quarter, up 15% over the first quarter of 2018. The top line growth was primarily fueled by the value our products provide to policyholders, resulting in higher premium volume as policies in force increased 10%. This continued double-digit growth demonstrates Kemper's leading competitive position within the specialty auto market.

Not only have we generated strong growth and meaningful market share gains, we simultaneously produced an improving underlying combined ratio. The segment's underlying combined ratio decreased over 2.5 points for the quarter due to an improving loss ratio and scale benefits resulting from continued volume increases. We remain focused on further strengthening our capabilities, delivering value to our customers and generating disciplined profitable growth.

On Page 10, you will see the results of our Preferred P&C Insurance segment. Earned premiums increased to $186 million for the quarter, up 5% over the first quarter of 2018, largely a result of the continued expansion of our new auto product, which provides improved segmentation. The underlying combined ratio increase for the quarter was related to our Homeowners' business driven by some above-normal large loss activity.

The Preferred Auto business continues to show improvement. Policies in force grew up -- grew by over 5% for the quarter due to the product expansion. Underwriting results improved as demonstrated by over a 0.5 point improvement in the underlying loss ratio and an expense ratio relativity in line with that of the first quarter of 2018. We remain focused on further improving this business through additional product and claims management to bring results to our target profitability goals.

Turning your attention to the Homeowners and Others business. The underlying combined ratio was just under 90%, about 2.5% points higher than last year, primarily as a result of an abnormal number of large losses as mentioned earlier. Our policies in force decreased about 5%, not unexpected as we continued to diversify our catastrophe exposure through pricing and underwriting actions. Long term, our position on this business has not changed, and we still expect to bring it to appropriate profitability through rate, product and claims actions.

I'll now turn the call back to Jim.

James J. McKinney
Executive VP & CFO

Thank you, Duane. Our Life & Health division's results are on Page 11 of the presentation. The team's continued focus on agency management and process improvement resulted in earned premium growth of over 3%. In the fourth quarter of 2018, we had an increase in incurred expenses and noted at the time that the majority were related to onetime items tied to volume and non-run rate business investments expected to enhance long-term profitability. This quarter, the level of insurance expense returned back in line with our historical trend. In addition, the benefit expense ratio remained within a normal range of volatility versus the elevated level experienced during the first quarter of 2018 due to the severe flu season.

Turning to investments on Page 12. Our portfolio remains diversified and highly rated as demonstrated on the bottom-left of the page. Looking at the chart in the upper left, you can see the investment performance over the past 5 quarters. This quarter, we delivered $83 million in net investment income. The core portfolio produced higher net investment income largely due to the addition of Infinity's investment portfolio. The alternative investment portfolio generated a loss of $1 million, mainly the result of the underperformance of 3 funds. We consider this an episodic event that is not indicative of a broader market theme or a portfolio underwriting deficiency. Overall, the portfolio delivered a pretax equivalent annualized book yield of 4.2%. This is down from 5% due to the asset mix shift driven by the addition of Infinity and the previously discussed decrease in alternative net investment income.

On Page 13, we highlight our strong capital and liquidity position. In the first quarter, operating cash flows increased $15 million to $89 million compared to the first quarter of last year. The increase was a result of increased scale and discipline, operational and financial management.

Turning our attention to the chart in the upper-right of Page 13. You can see that all of our insurance groups remain well capitalized. In the upper left-hand corner chart, we present our parent company liquidity. At quarter end, we had substantial financial flexibility with $119 million in cash and investments and $490 million in borrowings available from our revolver and our subsidiaries. Finally, our debt-to-capital ratio was 21.5%, providing us with significant financial flexibility.

On page 14, I would like to quickly touch on our operating leverage program. This program provides us access to collateralized advances which we can, in turn, invest in high-quality assets to enhance net investment income on a risk-adjusted basis. In addition, it enhances our ability to deploy float and take advantage of market inefficiencies. When utilized in this fashion, the borrowings would not be classified as debt from either an accounting or rating agency standpoint and, therefore, would not impact our debt-to-capital ratio, reduce borrowing capacity, change our fixed cost structure or impact our working capital. Overall, this provides further evidence that we are disciplined operators looking for every opportunity to create value for our shareholders, customers and employees.

With that, I'll turn the call back to Joe for some closing comments.

Joseph Patrick Lacher
President, CEO & Director

Thanks, Jim. In conclusion, this quarter's strong operating results continue to demonstrate the power of our platform and the great progress we're making on building the strength of our franchise. Our team's collective effort and dedication resulted in another quarter of top-tier premium growth and profitability in our Specialty Auto business with consistently stable earnings in our Life & Health businesses and improving results in our Preferred P&C lines.

We remain committed to strengthening our core capabilities, maintaining our specialized market focus and delivering outstanding value for our customers and our shareholders.
And with that, I'll turn the call back over to the operator to take your questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from Matthew Carletti of JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

I just have a few questions. In Specialty P&C, the margins have improved quite substantially. At this point, would you view these as kind of a 92% underlying combined ratio as target margins and so you'd look to maximize growth at that level? Or do you think that the run rate profitability of that segment could be improved from here?

Joseph Patrick Lacher
President, CEO & Director

Yes, Matt. We -- it's Joe. Thanks for the question. We don't provide targets. We do indicate that we're targeting a low-teens ROE. I think it would be hard to do math on a 92% and come to the -- and not come to the conclusion that, that was better than low double-digit ROE. And maybe I said low teens. I mean low double-digit ROE. It would be hard to come to the conclusion that it wasn't exceeding that.

Trying to project where it goes over the next quarter or 2, we're going to try to avoid doing that. I think we're at a point where if you did that math and concluded we were better than that low double-digit ROE, we would be looking to grow as much as we can. And that's all going to become a function of local market issues and what our competition's doing and how we're sitting. But at a 92%, we're definitely looking for more growth rather than margin expansion.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, great. And then shifting to Preferred, kind of a similar question. Without giving a target, how should we think about that in terms of where the improvement could go and kind of the time line by which you think you could achieve whatever the target margins for that segment might be? And would you expect that, when everything's running how you want it there, kind of the targeted return on capital for that business is similar to Specialty? Or would you expect that Specialty is a higher-return business?

Joseph Patrick Lacher
President, CEO & Director

So let me give you a couple of thoughts, and then Jim and Duane can jump in and add if they want or if I'm missing something. First, and we've talked about this before, margin improves generally slower than Specialty Auto. You typically have 12-month policies. Regulators tend to be a little more sensitive to rate and underwriting changes and action changes in those businesses. They -- typically, when you have a temperature in Specialty Auto, there's a perception that the customer caused the problem so the business tends to be a little more responsive. Each of the businesses, whether it's Specialty Auto, Preferred Auto or Preferred Home, has a different amount of required capital. As Jim said, they've got different hurdles there in terms of what they're doing. The -- if you were point back and maybe look at Schedule P and look at the triangles and sort of the underlying numbers, you'd see a slow and steady improvement on this underlying business. There's been some cat volatility in Homeowners, but you'd see a very reasonable profit improvement over the last 3 or 4 years inside of that business. I think there's still some work to do there, but the Auto's getting close. The Homeowners has a little bit further to go.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, great. And then just 1 more question kind of away from the operating -- oh, go ahead.

James J. McKinney
Executive VP & CFO

Matt, I would just add to Joe's comments. You can further kind of take a look at some of the triangles that are available from a Preferred standpoint for the Personal Insurance standpoint. I think what you'll see is if you go back to 2016 and prior, the totality of the position that we stepped into at that point in time was roughly 10 points worse than where we were at or where we had projected at that point in time. You can see that both from the pay development as well as kind of the incurreds that have come through from there. And so as we've been forecasting and making our adjustments both from a rate and mix, you're seeing what appears on the surface to be relatively flat. But in reality, we've improved the underlying profitability of that business by over 10 points today, and we continue to kind of make meaningful progress against that. And as you've seen in can see from those triangles both in terms of the Schedule P that Joe is referencing as well as the triangles available in the K, if you look at the recent years, if anything, you've seen a slight favorable development there.

Joseph Patrick Lacher
President, CEO & Director

The hole is deeper than we thought it was.

Matthew John Carletti
JMP Securities LLC, Research Division

Got you. And then lastly, a quick one. Just, yes, you put in the appendix kind of an update on the 2019 reinsurance program. Could you just help us ballpark kind of both the cap program and the aggregate program, kind of how pricing changed and how we should think that flowing through the model?

James J. McKinney
Executive VP & CFO

Yes. I mean big-picture-wise, the cap pricing changed in a nonmaterial way. You're going to see maybe a couple of million dollars in totality from a premium perspective that will come out over the year. In general, it's a pretty favorable place for us to be.

Operator

The next question comes from Gary Ransom of Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I had a question on the opportunities for growth. And I guess I'm thinking that the environment is a little bit more stable in terms of pricing now. And that, that -- compared to where we were for the last 2 or 3 years, that might mean that a little less shopping going on. And I was wondering if you could just help me understand how that might be changing or whether that makes it more challenging to grow or whether there's other things going on that I'm missing there.

Joseph Patrick Lacher
President, CEO & Director

So Duane and I will tag team this one. I assume you're principally, Gary, talking about the P&C business and maybe the Specialty Auto, most principally.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Yes, I'm probably talking about Specialty Auto mostly. Yes.

Joseph Patrick Lacher
President, CEO & Director

Okay. We're still seeing fairly attractive growth in there. It's down from what we saw last year, which was really, really high. Now it's just great. But we're finding our products are competitive. And there's a regular set of shopping that goes on with Specialty Auto customers partly because they tend to have just a higher premium outlay, in general, so they're a little more price-sensitive. And then we're exploring opportunities not just in 1 or 2 urban zones, but we're also looking to expand the business.

Duane Allen Sanders

Executive VP and President of Property & Casualty Division

Yes. This is Duane. Gary, I would echo Joe's comments. And by and large, the nature of those insurers have a tendency to kind of price shop regardless of where they are even though you might find it to be more stable. And with the competitive pressures and competition making changes, there is some movement out there, and so that alone will get them -- put them back in the marketplace. And then to Joe's point, where we are kind of spreading our reach into other areas allows us to continue to try to gain share in different geographies.

Joseph Patrick Lacher
President, CEO & Director

We might expect there to be pressure. The premise of your question, Gary, I think was that if people aren't being disruptive with rate action, there won't be as many shoppers. We actually -- we worry more about the growth if we start to see people being disruptive by having a sale. And that will cause some temporary contraction, and then usually that results in them jacking their prices up later on when they realize it was a sale and it was ill-advised.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Right. Do you see it at all on the Preferred side? Is that different in that market?

Joseph Patrick Lacher
President, CEO & Director

I -- again, we can tag on this one. I've always seen it a little bit different in the Preferred side of the house. We've got a more modest-sized book there, and we're in some specialized geographies and working with our package program, so we don't see quite as much volatility there. I'm not sure if you're looking for comment more broadly across the entire market.

Gary Kent Ransom
Dowling & Partners Securities, LLC

No, that's fine. I think that the Specialty comment is most helpful. Maybe a way of saying it is there's not -- there's always a lot of churn going on, no inertia of people sitting back and...

Joseph Patrick Lacher
President, CEO & Director

You see more churn in a preferred market when somebody's -- when it's a hard or a soft market, you tend to see prices moving and it triggering more shopping behavior in the Preferred environment. There's generally a high degree of shopping behavior in the specialty market all the time.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Oh, yes. Okay. That's helpful. Just on another subject too, I'm thinking back you've talked about claims leakage a little bit as you brought the 2 companies together. And I think you have made a lot of progress and maybe you've tightened that all up, but I just wondered if you could tell us where you stand in that whole claims process. Is everything where you want it to be with the joining of the 2 companies?

Joseph Patrick Lacher
President, CEO & Director

Yes. Gary, I think what we were describing was that when you put 2 organizations together and you've got 2 different hiring processes, 2 different -- possibly say, different career paths, 2 different training processes, how supervisors spans their control, 2 different systems, I mean all of the nitty-gritty stuff with how claim departments operate, when you're putting those together for some period of time, people, in addition to serving the customers and dealing with individual claims, some part of the bandwidth of the organization is spent figuring out how to combine those. Typically, when that happens, you would expect that there might be some increase in claim leakage. We're always doing a great job of serving our customers. We're always doing a great job paying what we owe. Sometimes, if a car winds up sitting in a body shop 1 day longer and there's more storage fee or there's another day of rental expense so there's operational items that might occur that might push those dollars up little bit, they occur.

I don't know if we know exactly whether we pulled that merger-related leakage out. I know we've got pretty attractive combined ratios right now. I know we will look to make sure that's fully out over the next 12 months. And I know when you combine it with the, effectively, the margin question that Matt was asking, we would expect that to the extent that there is something there, we would be thinking about that in terms of the pricing be more competitive rather than seeing intentionally margins getting better.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Right.

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

And the only other thing, Gary, that I would say is, to all the things that Joe mentioned, is you've also got -- when you bring the organizations together, you have process, procedures and, I'll call, vendor relationships, and those vastly vary. And so when you harmonize those, you just -- it takes a little time to work through those. And as we continue to do that, then we'll -- as Joe says, we look at paying what we owe and doing it to the best of our ability, most efficient and effective way possible. And to the extent we can continue to work that process, we will.

Joseph Patrick Lacher
President, CEO & Director

We don't anticipate being on one claim system, Duane, until end of the year. And if we're not on 1 claim system until the end of the year, we can't be under, surely, 1 set of processes. Our hope would be that once we're on 1 system and 1 set of processes, we can actually advance the ball a little further. But that's going to be a 2020 prospect just from the

[Audio Gap]

I mean, we would have described to you all before when we talk about the systems coming together.

Operator

The next question comes from Paul Newsome of Sandler O'Neill.

Jon Paul Newsome

Congrats on the quarter. Just almost a follow-up, and I apologize if you've touched this. I missed it. I had to jump off real quick. But wanted to know if there was anything unusual in the reserve development that showed up this quarter? It looked like it was a little bit more favorable than I expected, not a bad thing. But just is there anything in there that would be different or abnormal this quarter?

James J. McKinney
Executive VP & CFO

Yes, no differences Paul, this is Jim, in terms of our -- the methodology or the application that we're applying. Nothing significant stands out. Just continues to be favorable underlying trends within the business. And the net result of that was favorable development during the quarter.

Operator

[Operator Instructions] The next question comes from Adam Klauber of William Blair.

Adam Klauber
William Blair & Company L.L.C., Research Division

As far as capital usage, I know you like organic and if there are deals out there, you like to do those also. But with leverage coming down, if the first 2 don't pop up, do buybacks become a consideration this year?

Joseph Patrick Lacher
President, CEO & Director

Yes, Adam. And I'm going to go back to -- I know you started the question this way, but I'm going to go back to it this way. Our first priority is to focus on growing this business. We think we've done a nice job building a model that does a good job for customers and shareholders. Our first priority is going to be organic growth. When there are opportunities out there like the Infinity acquisition or something similar, we'll explore those. And when we don't, over a foreseeable time horizon, don't have the opportunity to grow the business, we will look at ways to explore returning capital to shareholders. I think we've talked about there's a variety of ways we can do that, and we'll sort of regularly look at what's the most appropriate and efficient and opportunistic way to do that to get the best return for the shareholders in that return.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And as far as I think you mentioned there were a couple alternative investments that didn't do great during the quarter. Could you add some extra color on that? And do you -- and I think maybe you said it's probably one-off so you don't expect that to recur in the next couple of quarters?

James J. McKinney
Executive VP & CFO

Yes. Thanks, Adam. This is Jim. That's exactly right. We look at them as being more related to episodic events. The reason for that is you get a little bit more volatility when you have end-of-life investments. You have a quarter, like the fourth quarter, where the volatility within the market and other changes some of the discount rates associated with some of those end-of-life investments, and then that result is kind of a change or a short-term to medium-term or permanent change in terms of how those assets will change or trade. Not something more indicative of the broader portfolio. Really, just the reality of where we're at on a couple of end-of-life assets and their impact in terms of the totality of our alternative investment income for the quarter.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And then could you give us some color on that operating leverage program? Just give us an idea what that is. And I don't know if you can -- is that going to start bumping up investment income in the near term?

James J. McKinney
Executive VP & CFO

So Adam, you came in and out with your question or at least in terms of what we heard so I'm going to try to answer the question the best that I can. And if I haven't, just let me know and we'll try to dive deeper. I would look at the operating leverage program that we've initiated or initiated in greater detail here in the quarter as something that I would not expect to have a material impact on our future earnings or our strategy in terms of what we're doing from a business perspective. The result of what we have deployed so far potentially increases run rate income by $1 million to $2 million. That's not something that I would otherwise normally highlight from a run rate perspective other than it's a larger item when you look at the balance sheet that looks a little wonky if you don't have context to it.

In terms of the strategy pieces that it gives us, it helps create efficiency. You have timing elements that come in from a float perspective, and you obviously have differences in terms of when the assets are available. By having this program, it gives us some additional capability to appropriately match those timing differences and to take advantage of that. So I think it'll have a small incremental increase in the overall margin of the company as we go forward. And the big opportunity that I think is there is just further matching of assets and liabilities as we continue to kind of move forward in the business.

Adam Klauber
William Blair & Company L.L.C., Research Division

Okay. And then as far as the Auto business, I mean, the loss ratio was very good. Could you talk about, from a seasonality, what -- which quarters do you think will have -- typically for your book to business, have a better versus loss -- worse ratio?

Duane Allen Sanders
Executive VP and President of Property & Casualty Division

Yes. Adam, this is Duane. If you look historically -- actually, if you look at the industry, it's normally fourth quarter miles driven and weather will create potentially some run on that. If I look at our book, make it -- maybe it's geography, things of that nature. And the pick we'll use is an annual pick, but by and large, if you just look at industry, you'll probably find that to be at the end of the year.

Operator

The next question comes from Christopher Campbell...

James J. McKinney
Executive VP & CFO

Adam, just -- if I could just add a little bit of color on that. Big picture, last quarter, I think you asked the question in terms of what would be a reasonable proxy to begin to think about how to estimate it, I'd point you back to the answers that we gave last quarter for that. If you look at the kind of a 4- or 5-quarter average and applied a little bit of trending to the most recent, I think you'll get a pretty close approximation to kind of the underlying trends and what we're seeing, which again, as Duane highlighted, is included in the annual pick that we have and to put out there at this time. But I think those 2 things will merge pretty close and give you a reasonable bandwidth in order to project underlying income for the company.

Operator

The next question comes from Christopher Campbell of KBW.

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

My first question is on the reserve releases. I guess that's the most that we've seen since at least 2014. So I guess what accident years and lines are you seeing the redundancies emerging in?

Joseph Patrick Lacher
President, CEO & Director

So a couple of thoughts for you, Chris, and Jim and I will tag team this one. I'm not sure it was the biggest in that time period, but maybe I'll offer a thought. At some point is where -- when we're thinking about our loss picks, we're always looking at the -- picking management's best estimate by definition. But in any given point in time, we look at when there's periods of either greater disruption or less disruption. And we did have some period of time between some fairly high growth and some other items that were somewhat disruptive to the organization that might have caused us to think about this with a little wider arrow bar, and as time evolves, that tightens up a little bit. So I wouldn't immediately start seeing this as a, as Jim mentioned earlier, a fundamental change in how we're doing things. There's just some level of timing issue around pieces of it.

James J. McKinney
Executive VP & CFO

Yes. No, I would agree, this is Jim, with Joe's comments there. In terms of some of the specifics we're looking at, we've seen in a little bit of pressure, maybe $1 million, $1.5 million, when we look at unfavorable development from the accident years of 2016 and prior, and then we've seen favorable development relative to the loss picks both from a '17 perspective and an '18 on a macro point of view. No change relative to our overall reserving principles, the macro process that we run. Just more -- we continue to see favorable underlying developing -- or case incurred trends across the business, and that's reflected in the results in terms of where we came out this year for the quarter.

In terms of a relevant data point, this is similar to what you might have seen from a reserve -- favorable development in the first quarter of 2017. I think you'll find those numbers are close. They have no correlation relative to what we're doing, but this is not a number that's unusual for our company to potentially have from a trend perspective.

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

Okay, got it. And then just kind of building on that last question. So what is the current spread that you guys have between your rates and loss cost for the 2 Auto businesses?

Joseph Patrick Lacher
President, CEO & Director

That's not a stat we typically give, Chris. We don't provide those components. I'm trying to figure out how I can help you with what you're doing -- with what you're trying to -- because so I'm assuming you're trying to connect those to try to project a loss ratio or a combined ratio?

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

Yes. The idea was, yes, like to kind of see what the trends would be, just underlying with the businesses on the core loss ratio. So I guess, do you guys have like a loss cost inflation, like I don't know, like 3% to 4% or 5% to 6%, something like that? And like, if we look at the rate filings, we could kind of get an idea like, okay, their normalized loss cost inflation is x percent, and then we're seeing these rate increases...

Joseph Patrick Lacher
President, CEO & Director

So I'm going to give you maybe a more complicated answer than you're looking for, Chris, and you can help me help you. Over the long term, auto loss cost inflation tends to run at a 3% to 4% range. When you go to any individual line, when you're dealing with collision or bodily injury, you can periodically see them outsized on that. You can -- if you're talking about total inflation, that would also include frequency so there's frequency pops. If you're just talking about ex frequency, just severity, you get a slightly different answer.

If you're trying to project what you're going to see as a net impact to our profit margins, I'm going to point you back to the fact that we say we target a low double-digit ROE, and after that, we look to grow as much as we can. So what our folks would be doing in any given state and any given line and any given rate filing is they would look inside of that particular spot and say, what are the profit margins looking like there? What are they seeing with loss trends in that environment, frequency and severity? How much of that do they think is environmental versus what do they think might be the reaction of something we're doing inside of our claim department? What do they think is going to happen over the course of the next 12 months? And then we'll put all of that together to think through what should we be doing from a rate perspective to March going forward.

We have fairly strong combined ratios right now. We've talked about that a little bit already. Our general bias would be that if we were seeing -- we would be trying to find a way to grow the business at those combined ratios.

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

Got it. And are you seeing any difference between like, I mean, after you look at some of like the inflation series that the government tracks and things like that? It looks like there is like starting to be an uptick in some of like more the maintenance repair and kind of more PD collision type of loss cost. I mean, are you seeing like a big difference between that? Because I would think it'd be mostly underweight PD and kind of more overweight liability loss cost. Is that like a good way to think of the way your book would be tilted towards those inflation drivers?

Joseph Patrick Lacher
President, CEO & Director

We end up -- on our Specialty Auto business, we'll sell a higher percentage of liability-only policies than you would in a typical preferred book. A typical preferred book would be full coverage. What ends up being liability-only though is let's say I buy a policy that's liability-only, I'm not covering my vehicle. But if I crash into you and it's my fault, we're still repairing your vehicle and any bodily injury. So a liability-only policy has both physical damage and bodily injury payments associated with it. It's just not repairing my car. It's repairing of yours and any bodily injury you have. So we're still getting some metal and some flesh that's running through these.

So we look at all of those external trend and pieces of information and we take those in as environmental components. We're also looking at what we're seeing locally, and more granularly, our product management team, we'd be pressing them very much at a local point of view around that. It's a tactical issue.

Christopher Campbell

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

Okay, great. That's very helpful. And then just kind of a numbers question. Maybe this one's for Jim. I was looking at the net investment income. Why was -- the dividends on equity security, that looked like it spiked in 4Q. It was like $6.6 million last quarter, and then it was only $2.3 million this quarter. And like, this number looks more like what the prior data points would be. Did anything special happen last quarter with that?

James J. McKinney
Executive VP & CFO

No, nothing special. I mean it's -- we have a reasonably sized book. We have continued to diversify even our alternative investments books in terms of the timing from their place, not a real material change in the types but just in terms of how they're layered. I think what you're pointing to, and the way I would think about that, Chris, is being more episodic to that moment than any kind of general trend that I would take away.

Big picture, I think if you look over the business for the last several years, you'll see from a percent standpoint, we're relatively in line with our historical holdings, and I would continue to expect similar-type returns going forward, market-dependent, of course. But no real change here in terms of our investment philosophy, underlying investment returns over time and how we think those are going to play out.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Joseph Lacher for any closing remarks.

Joseph Patrick Lacher
President, CEO & Director

Thanks, Operator, and thanks to everybody on the call for your time today and for your interest in Kemper. We look forward to being with you in the next quarter. Thanks a lot.

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