S&P Capital IQ

CONTENTS

Kemper Corporation NYSE:KMPR

FQ4 2013 Earnings Call Transcripts

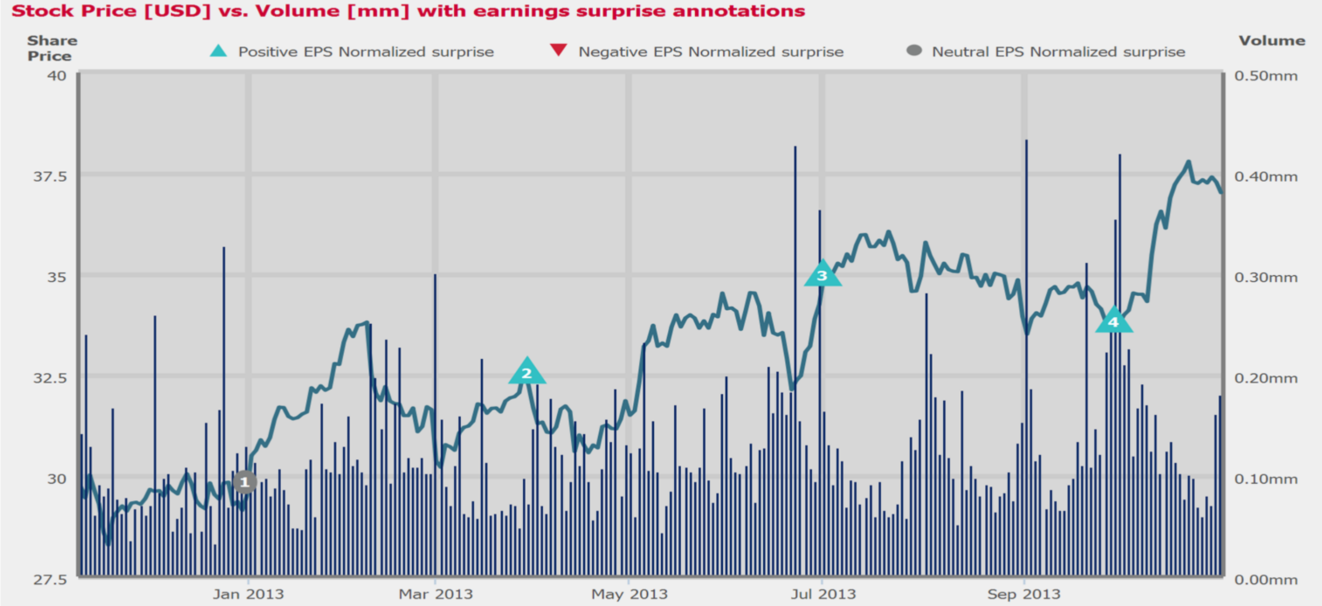
Friday, February 07, 2014 4:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2013-			-FQ1 2014-	-FY 2013-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.60	0.83	▲38.33	0.68	2.57	2.78
Revenue (mm)	577.80	586.00	▲1.42	573.34	2346.30	2426.50

Currency: USD
Consensus as of Feb-07-2014 6:25 AM GMT

Stock Price [USD] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2012	0.06	(0.06)	NM
FQ1 2013	0.52	1.00	▲1 92.31 %
FQ2 2013	0.27	0.55	▲2 103.70 %
FQ3 2013	0.40	0.69	▲3 72.50 %

Call Participants

EXECUTIVES

Diana J. Hickert-Hill
Vice President of Investor Relations & Corporate Identity

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Edward J. Konar
Former Vice President and Life & Health Group Executive

Frank Joseph Sodaro
Former Senior Advisor

ANALYSTS

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

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

Matthew John Carletti
JMP Securities LLC, Research Division

Miranda Davidson

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to Kemper's Fourth Quarter 2013 Earnings Conference Call. My name is Jonathan, and I will be your coordinator today. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes. I would now like to introduce your host for today's conference, Ms. Diana Hickert-Hill, Vice President, Investor Relations and Corporate Identity. Ms. Hickert-Hill, you may begin.

Diana J. Hickert-Hill
Vice President of Investor Relations & Corporate Identity

Thank you, operator. Good morning, everyone, and thank you for joining us. This morning, you will hear from 2 of our business executives starting with Don Southwell, Kemper's Chairman, President and Chief Executive Officer; followed by Frank Sodaro, Kemper's Senior Vice President and Chief Financial Officer. We will make a few opening remarks to provide context around our fourth quarter results. We will then open up the call for a question-and-answer session. During this interactive portion of the call, our presenters will be joined by John Boschelli, Kemper's Vice President and Chief Investment Officer; and Ed Konar, Kemper's Life and Health Group Executive.

After the markets closed yesterday, we issued our press release and financial supplement. You can find these documents on the Investor Section of our website, kemper.com. Please note that 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 Form 10-K and 10-Q report filed with the SEC as well as our fourth quarter 2013 earnings release. We plan to file our 2013 Form 10-K on or about February 14, 2014. This morning's discussion includes non-GAAP financial measures that we believe may be meaningful to investors. In our supplement 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 fourth quarter 2012, unless we state otherwise.

Now I will turn the call over to Don.

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Thank you, Diana. Good morning, everyone, and thanks for your interest in Kemper.

Today, I'll discuss our overall results for the quarter and the year, and Frank will review details on our financial results, capital and liquidity, then I'll wrap up. Before we start on the commentary, I want to mention that Denise Lynch, our Property & Casualty Group Executive, has a schedule conflict, so I'll be covering P&C results in addition to the Life and Health group results.

Fortunately, those of you who will be participating in the 2014 Association of Insurance and Financial Analysts or AIFA conference in 3 weeks, will have an opportunity to see Denise in person as she will be a member of the P&C Personal Lines panel. Denise and Frank will also be participating in Kemper's one-on-one meeting to that conference.

Now let's turn to our results. In total, we are very pleased with our progress in the fourth quarter, as well as for the full year. We are earned $55 million in net income in the quarter and $218 million in net income for the year. We finished the year with an ROE of more than 10%. Like others in the P&C industry, we benefited from low catastrophe levels and favorable development. But we also made significant tangible progress in our run rate. We had a very good year. I feel great about our team's results, and we are well-positioned for continued improvement in profitability.

Our Property & Casualty group delivered another quarter of substantial improvement. We achieved our goal to reduce the groups underlying combined ratio by 3 to 5 points in the year, delivering a 4-point reduction in total. As Denise mentioned in past calls, we focused intently on long-term profitability even at the expense of top line in the short term. While our underlying performance significantly improved, we still have work to do. We continue to focus on aggressive actions, such as rate increases, improved underwriting discipline and product line management.

4 key P&C highlights this quarter include: first, the total group's combined ratio improved 20 points to 95%; the underlying combined ratio also improved by nearly 5 points to 98%, with each of our segments contributing to this improvement. Second, weather remained less active in the quarter with catastrophe losses significantly below the levels we saw in 2012. Third, we're making progress with the actions to improve pricing, product management and analytic capabilities, and we will continue to focus on these areas. Accordingly, the Property & Casualty group continued its strategic reduction of the earned premiums, shrinking 5% overall in the year. And fourth, the direct run off continues to go very well.

Now I'll walk through a few more detailed comments on our product lines. We continue to optimize our business mix to drive improved performance. For example, our Package Plus product, the premier offering for the Kemper Preferred segment made up 67% of all new Preferred sales in the quarter and 61% for the year. The homeowners line continued to show improvement. We achieved a 14% filed rate increase in 2013, up from our original 10% plan. We have another year or 2 of increases to achieve full rate adequacy, and we think the market will support this. This remains a priority as we continue to implement appropriate actions to improve and sustain the performance of the homeowners' book of business.

Auto progressed as well, but more slowly than did homeowners. We continue to take aggressive actions to improve auto profitability in both preferred and specialty.

Kemper Direct outperformed once again, as we continue to wind down the direct-to-consumer business.

Direct benefited from low cat losses, the elimination of marketing expenses and continued favorable development. The tendency of season business to perform better, coupled with significant rate increases led to the underlying combined ratio improving 19 points year-to-date. We're very pleased with the results this team has delivered, and I believe they will continue to manage Kemper Direct's underlying loss ratio at about these levels, but fixed expenses will put some upward pressure on the expense ratio.

So to summarize the Property & Casualty group, we're pleased with our progress in many areas, and we are focused on delivering further improvement. We are targeting a 2- to 4-point improvement in the P&C group's underlying combined ratio in 2014. We expect this improvement to have some impact on our top line, although premium reduction should moderate as the year progresses.

Written premium increases in preferred and specialty should mostly offset the run-off in direct. Earned premiums will, of course, lag written premiums.

Turning now to Life and Health. Earnings were up 2% in the quarter. Last quarter, we told you we expected the Life and Health segment earnings in the second half of 2013 to be at about the same levels as the second half of 2012. We exceeded that forecast by $4 million and delivered $89 million in earnings in total for 2013. Overall, our total life insurance premiums grew with the Reserve National business feeling the growth.

Life insurance premium to the Kemper home service companies were fairly stable. Our Reserve National business continues its expansion strategy and supplemental products, with both new and existing distribution channels. As we have seen in recent quarters, expenses are up somewhat with more people and more commissions supporting our diversified model. But we're pleased with the market interest. The team remains agile as national health care evolves. It's still early and we're keeping a close eye on the team's plans and progress, but we like what we see so far.

Turning now to investments. The portfolio delivered another quarter of solid results, mainly from higher returns on equity method investments. Our LPs and LLCs tend to do well over time, but are subject to some volatility. The performance of these assets drove the overall portfolio performance. We continue to anticipate a rising interest rate environment in the year despite January's decline. Now I'll turn the call over to Frank.

Frank Joseph Sodaro
Former Senior Advisor

Thanks, Don, and good morning, everyone. Today, I'll cover Kemper's fourth quarter 2013 performance and parent company capital and liquidity. As Don mentioned, overall we capped of another very strong year with another solid quarter. We delivered net income of $55 million or $0.99 per diluted share, up from $2 million or $0.03 per diluted share. Results included $9 million of after-tax net investment gains in the current quarter compared to $2 million last year.

For the full year, net income was $218 million or $3.80 per diluted share, more than double the $103 million or $1.74 per share we earned last year. Our net operating income was $46 million for the quarter compared to net operating loss of $3 million last year. For the year, net operating income was $159 million, up from $54 million last year. Total revenues were $586 million for the quarter, a decrease of $11 million due to lower earned premiums offset by higher net investment gains and higher net investment income.

On a full year basis, revenues were just over $2.425 billion, down $36 million from 2012, driven by lower earned premiums offset by higher net investment gains and higher net investment income. The earned premiums declined -- the earned premium decline were in line with our expectations and mainly as a result of profitability improvement actions we took across our P&C businesses.

Consolidated net investment income was $77 million in the quarter, an increase of $4 million driven by higher equity method investment income. These investments -- these investments earned $7 million in the quarter compared to $2 million last year. Excluding these equity method investments, net investment income decreased slightly due to lower yields, offset by higher average investment base. The fourth quarter annualized pretax equivalent book yield on average invested assets was 5.5%, up about 10 basis points.

Our average investment rate fixed maturity reinvested rate increased about 90 basis points sequentially to just over 4%, although the amount reinvested was lower.

Net investment income for the year was $315 million, up from $296 million in 2012 and largely the result of higher returns on our equity method limited liability investments. The year-to-date pretax equivalent book yield on average invested assets was 5.7%, up about 15 basis points from 2012. We are pleased that the reinvestment rates have increased, but they still remain below the book yield on our existing portfolio.

Now I'll discuss the financial results of each of our businesses starting with P&C. Kemper Preferred reported net operating income of $23 million for the quarter, up from a net operating loss of $20 million last year. Overall Preferred's combined ratio improved 28 points to 91.5% for the quarter due to lower catastrophe losses, improved underlying loss results and the impact of net favorable reserve development, partially offset by higher expenses. The underlying loss ratio improved almost 8 points, primarily as a result of the higher average earned premiums outpacing loss cost for homeowners and auto.

Insurance expenses increased primarily from higher employee cost. For the year, Preferred's underlying combined ratio was 95%, improving from 97% in 2012 as improvements in homeowners and other personal insurance lines offset a slight deterioration in our auto underlying loss ratio. As Don mentioned, we continue to take aggressive actions to improve the performance of the auto line. While the average earned rate increase was 4.5%, this is the fourth quarter in which the pure premium have increased mid-single digits, largely driven by higher severity in bodily injury.

We continue to work on price adequacy with improved price segmentation and filed rate increases, which were about 9% for 2013. Preferred's net written premiums were $193 million in the quarter, which was about $20 million lower than last year. And net earned premiums were $216 million in the quarter, down $8 million. The drops in written and earned premium were driven by a lower level of auto policies, partially offset by higher overall premium rates. In total, premium retention was 85%.

On a full year basis, net written premiums decreased 5% and full year net earned premiums were about flat with 2012.

Now turning to Kemper Specialty. We reported net operating income of $1 million for the fourth quarter, up from a net operating loss of $3 million last year. The combined ratio in Kemper Specialty improved almost 5 points to 105%. The underlying combined ratio improved to 1 point this quarter due to the favorable impact of our rate in underlying actions, even with the headwinds of 5 points of adverse development from the first 3 quarters of the current year.

The full year 2013 underlying combined ratio improved 2 points to 103%.

Specialties net written premiums were $85 million in the quarter compared to $95 million last year and net earned premiums were $95 million compared to $103 million last year. Overall, premium retention was 66%. These results are driven by rate actions we implemented, which contributed to a decline of 17% in total segment policies in force.

For the year, net written premiums decreased 8% to $383 million and net earned premiums decreased 6% to $393 million.

Now I'll turn to Kemper Direct. In the quarter, we reported net operating income of $6 million, up from $2 million last year with an 82% combined ratio this year compared to a 103% last year. The underlying combined ratio improved almost 8 points to 103%, driven by lower expenses and 2 points of improvement in the underlying loss ratio. The expense ratio improvement was primarily from lower employee compensation and lower restructuring charges.

Kemper Direct net earned premiums were $28 million for the quarter, down from $37 million and in line with our expectations.

Auto and Home average earned premium rates increased in the quarter by 6% and 11%, respectively, but were more than offset by lower volume. Going forward, we expect direct-to-consumer portion of this business to continue to decline at roughly the same pace as 2013, in line with the reduction in premium and the run off reserves -- of reserves, we currently allocate roughly $135 million of capital to Kemper Direct.

Shifting to the Life and Health segment. Net operating income overall was $25 million and $89 million for the quarter and year, respectively, compared to $24 million and $91 million in 2012. Earned premiums decreased slightly to $157 million in the quarter to $633 million for the year. Net investment income was flat for the quarter, but increased $4 million after tax for the year, partially from higher return and equity method investments.

For the quarter, the Life business incurred higher start-up cost related to Reserve National's new distribution initiatives but these expenses were offset by lower home service agent commissions. Finally, I'll discuss book value, capital and parent company liquidity.

Book value per share was $36.86 at the end of the quarter, up $1 from the third quarter but down slightly from prior year end. The impact of higher interest rates on our fixed maturity portfolio was a drag for both the quarter and the year. Book value per share, excluding unrealized gains on fixed maturities, was $34.49, up more than $1.50 from the third quarter and up close to $4 from prior year end.

Statutory surplus levels in the insurance companies remain strong, and we estimate that we will end the year with risk based capital ratios of approximately 440% for our Life and Health group and 360% for our Property & Casualty group. We estimate that our insurance companies will have a maximum ordinary dividend capacity of about $215 million in 2014, comprised of $80 million from Life and Health and $135 million from P&C. We expect both groups to pay dividends to the parent company 2014, but we have not determined the levels at this point.

Turning to liquidity. In the fourth quarter, Kemper's subsidiaries, United and Trinity, became members of the Federal Home Loan Bank of Chicago and Dallas, respectively. In connection with this, we reduced our revolving line of credit to $225 million from $325 million. These number shifts gave United and Trinity access to cost efficient sources of liquidity and consequently, reduced the need for larger credit lines at the parent company level. At the end of 2013, the parent company held cash and investments of about $160 million and our $225 million revolving credit line remained undrawn. And now, I'll turn the call back over to Don.

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Thank you, Frank. As you've just heard, our capital position remains strong. Our long-term capital deployment priorities continue to include: first, funding profitable organic growth; second, strategic acquisitions; and third, returning capital to shareholders, both through share repurchases and dividends. We are achieving profitability and remain committed to further improvement. While we are selectively funding organic growth in some areas, in total, premium revenues are expected to remain flat to declining in 2014, so organic growth will not use capital this year. As results improved, we are more open to acquisitions and we intend to keep powder dry for opportunities. We have maintained our competitive dividend and continue to buy back shares opportunistically. In the fourth quarter, we repurchased $15 million worth of common stock, bringing our 2013 total to 3 million shares repurchased for just over $100 million.

In 2013, we communicated our goal to achieve a double-digit ROE by the end of 2015 on a run-rate basis. And we outlined a path that had 4 main elements: one, continued improvement in our P&C combined ratio; 2, full deployment of available capital; 3, increases in interest rates consistent with the Federal Reserve base line scenario; and 4, normalized catastrophe losses.
While we hit a double-digit ROE in 2013 some of the profits where of a nonrecurring nature, so we do not consider our goal to be achieved. Nonetheless, our actions and results to date are consistent with our plans to achieve double digits by the end of 2015. We do expect some volatility along the way. External factors, such as cats and interest rates affect ROE. And importantly, we will meet opportunities to fully deploy our capital. Regardless, we like our business model and our team's commitment to delivering results. So in closing, we had another very good quarter and a very good year. Our underlying performance continues to improve. Our actions are aligned to drive further progress, and we outlined a few milestones for you on this call. We are committed to delivering and we are optimistic about our prospects. With that, I'll turn the call back over to the operator so we may take your questions. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Miranda Davidson from Raymond James.

Miranda Davidson

Everything looked pretty good this quarter and pretty straightforward. So I though I would just revisit the Direct run-off. Is there any more color you'd like to add on the running off of the direct-to-consumer part? Or the investing back in the affinity book? And as things continue to improve, does that make selling the unit any more attractive?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Miranda, thanks for your comments and there isn't lot more color to add to run direct. It's not something that we see that we would put on a block. It's performing well. I guess the only color I would add is that the amount of development we had this year was pretty significant. And certainly wouldn't want you to build that in your models going forward.

Operator

Our next question comes from the line of Adam Klauber from William Blair.

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

How is the -- in the Preferred segment, how is the standard loss ratio accident year, ex cats, this quarter versus the last couple of quarters?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

You want to repeat that question, Adam? I didn't...

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

Sure. I was looking for the auto, the core auto loss ratio in the Preferred business for the quarter versus what it was in the first 9 months?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Frank, you have that available?

Frank Joseph Sodaro
Former Senior Advisor

I could take a shot at this. So auto on Preferred, we have an underlying loss ratio improvement of about 2.5 points, and that's on lower frequency, offset a little bit by higher severity. As far as compared to prior quarters, I don't have that handy.

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

Okay, okay. Do you know if it's -- was it -- the 2.5 is good, do you know if it was running lower than was earlier in the year .

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

We'll have to get back to you on that, Adam. We can give you a call and get you that info..

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

Also could you talk about a competitive trends in the standard auto market? And what's going on in the last 6 months? Have they heated up or is it sort of status quo where we're at before?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

I would say it's probably heated up a little bit. Certainly, what's going on with Travelers and Quantum is -- the jury's still out on where that's going to head but before are starting to make noises about growth and adequacy. I guess we haven't seen it quite so much in the marketplace as we've heard the noise about it, though.

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

Okay. That's good. And then the last question. It looked like for the quarter, the loss ratio especially moved up. What drove that increase?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Frank, you want to take a crack at that?

Frank Joseph Sodaro
Former Senior Advisor

Sure. So for the quarter, the loss ratio for special -- I'll break it down into 2 pieces -- the underlying loss on personal lines and the personal private passenger auto, was really about flat on an underlying basis. Commercial had actually a better underlying loss ratio than prior fourth quarter going from a 92.4% down to a 78%. So I know there was some noise on specialty lines for the -- because we had some inter-year development. And this is kind of a hard thing to walk through but if you want me to take a quick shot at this I can, and I'll walk from some of the numbers we've given. Starting with an underlying combined ratio, specialty overall had an improvement of about 1 point. In the current year, there was some adverse developments from the first 3 quarters of about 5 points. And if you were to look at last year, there was a similar phenomenon last year where the first 3 quarters had 3.5 points of adverse development. So on a modified basis, the underlying combined ratio actually improved about 2.5 points. So included in that, then, to get to a loss perspective, the expenses were up about a point. So all said and done, there was about a 3.5 point improvement on a modified basis for the underlying loss ratio. You might have to look at the transcripts to follow that.

Operator

Our next question comes from the line of Paul Newsome from Sandler O'Neill.

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

I was hoping to maybe move away from the Property and Casualty business and maybe revisit the [indiscernible] -- I just have 2 questions, both focused on Life. The first question is, if we take out the changes in interest rates and look at measurements like policy-in-force growth, total insurance value, is the Life Insurance business growing or not? And then I guess the second question is, relatedly, under what scenarios can we see higher earnings on the -- in the Life Insurance business?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

I'm going to ask Ed to follow up my initial commentary. But in terms of growth, this quarter, we did see some growth in the Life Insurance business that was driven by growth in some of the new distribution efforts at Reserve Nationals. So typically, we have had a very modest decline in premiums in this business as it's a relatively mature business. Ed, you want to take a crack at rounding out that answer?

Edward J. Konar
Former Vice President and Life & Health Group Executive

I think you got the main points. Our traditional Home Service business is kind of in a modest shrink mode, but actually pretty stable the last few years. Over on the Reserve National side, we've got some different distribution initiatives underway and the first of those sells primarily final expense, Life insurance to senior citizens. That's what's kind of fueling most of the Life Insurance growth this year, and probably into the near-term future.

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Were there other elements to that question we missed?

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

I mean, is there a scenario where the business -- where the earnings go up?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Sure. Earnings have been growing in that business over recent years, and then there is a headwind with the climbing interest rates. So as interest rates climb back up, our reinvestment rate, even at today's rates, is lower than our portfolio rate. So they have to go up more before we start adding investment income. But we could potentially grow the profits in other ways and Ed wants to tell you about that.

Edward J. Konar
Former Vice President and Life & Health Group Executive

I guess what I would add to that is over the last 2 years, we have taken 2 rate increases. We took one in the spring of 2012 and we took another one, the 1st of this year. And we took rate increases of roughly 5%, which when we calculate that back to what its equivalent is in terms of investment income, a 5% rate increase on a premium we charge our policy holders, is worth about 100 basis points lower investment income over the life of the policy. So over the last 2 years, we've kind of built in a lower expectation from investment income.

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

And the only thing I'll add to that just -- is that unlike Property & Casualty, new business pricing is on new policies only and in force products aren't affected by those rate increases that Ed talk about so it's come a little more slowly.

Operator

Our next question comes from the line of Matt Carletti from JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Just a couple of questions. The first one on the kind of reiterating the guidance and saying a double-digit ROE on a run-rate basis by the end of 2015. I was hoping you could clarify that a little. When you say on a run-rate basis, is that x kind of one-timers, full year '15 you expect to be in the double-digit range? Or is it that kind of by the time we get to the end of '15, say, the latter part of the year if you annualize the quarterly results, we should be on pace for a double-digit ROE?

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

It's the latter.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, and then -- the only other question I had is some companies have given some color around January, kind of non-cat weather, the winter storms, particularly in the South. Are you able to give us any guidance in terms of what you've seen so far in your book? That would be helpful.

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Sure. We've got some preliminary reserves set up for those winter storms and it's not material or we would have put something out on it. But most of our losses are freeze-related and homeowners-related. But it's certainly a noticeable uptick because of that, but it's nothing unusual for us.

Operator

[Operator Instructions] And this does conclude the question-and-answer session of today's program. I'd like to hand the program over to Don Southwell for closing comments.

Donald G. Southwell
Former Chairman, Chief Executive Officer and President

Thank you, operator. I do have just a few closing comments. 2013 was a very good year, a banner year. I'm proud of the progress that our teams are making. And while we know we have more to do, this was another strong quarter and a great year for Kemper. So I want to say thank you to the Kemper team, including our agents who helped deliver these terrific results.

We remain committed to fulfilling our promises to our customers and to delivering shareholder returns, the kind of returns we all seek. So thank you for your time this morning, we look forward to updating you on our progress, again at our next call.

Operator
Thank you. Ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.