S&P Capital IQ

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Kemper Corporation NYSE:KMPR

FQ3 2016 Earnings Call Transcripts

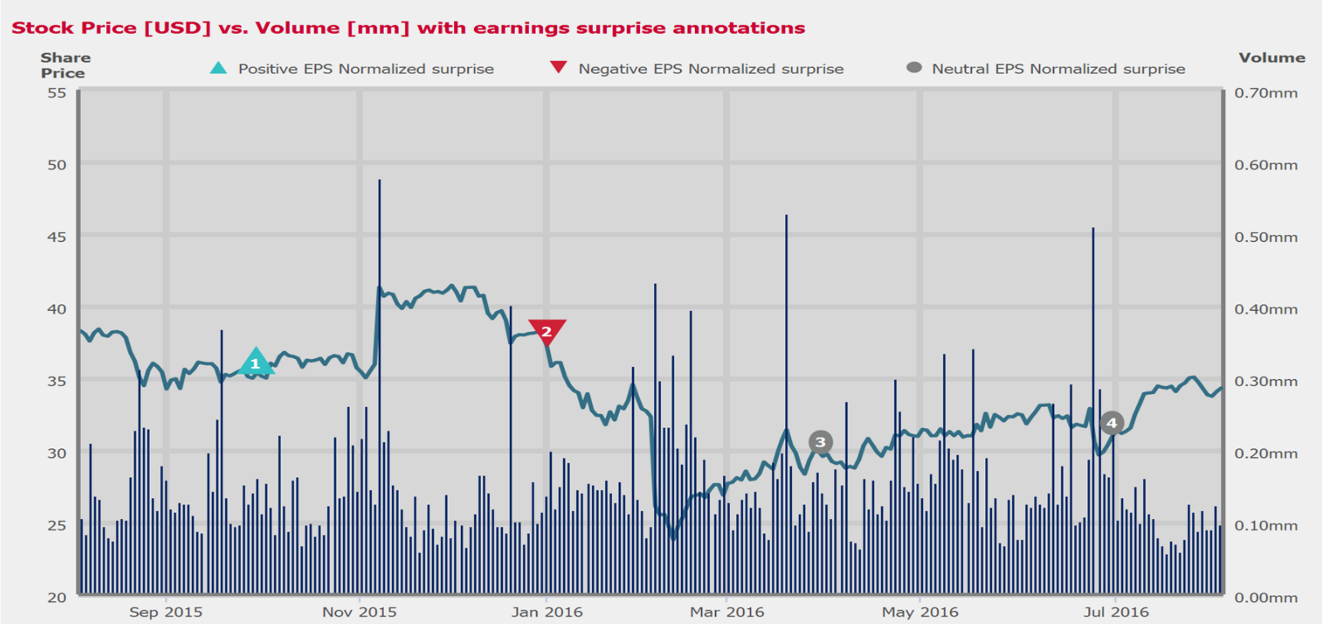
Friday, November 04, 2016 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2016-			-FQ4 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.44)	(0.36)	NM	0.45	0.09	2.16
Revenue (mm)	618.89	637.40	2.99	620.58	2484.85	2519.27

Currency: USD

Consensus as of Nov-04-2016 12:04 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2015	0.56	0.71	26.79 %
FQ4 2015	0.59	0.09	(84.75 %)
FQ1 2016	0.03	(0.01)	NM
FQ2 2016	(0.15)	0.09	NM

Call Participants

EXECUTIVES

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

George D. Dufala
Senior Vice President and President of Property & Casualty Division

Joseph P. Lacher
Chief Executive Officer, President and Director

ANALYSTS

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

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Presentation

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 Joe Lacher, Kemper's President and Chief Executive Officer; followed by Chip Dufala, Kemper's Property & Casualty Division President.

We will make a few opening remarks to provide context around our third quarter results. We will then open up the call for a question-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; Mark Green, Kemper's Life & Health Division President; and Rich Roeske, Kemper's Chief Accounting Officer and Interim Chief Financial Officer.

After the markets closed yesterday, we issued our earnings release 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.

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 2015 Form 10-K filed with the SEC as well as our third quarter 2016 earnings release and Form 10-Q.

This morning's discussion includes non-GAAP financial measures that we believe may be meaningful to investors. In our supplement and earnings release, we 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 third quarter of 2015 unless we state otherwise.

Now I will turn the call over to Joe.

Joseph P. Lacher
Chief Executive Officer, President and Director

Thank you, Diana. Good morning, everybody, and thank you for joining today's call. During the past month, we shared with you our strategic update, and I've had the chance to meet with several of you to discuss your thoughts and questions on our plans for Kemper. These have been engaging discussions, and I've had good questions. We've received positive feedback on the direction we shared in our strategic update. While we know we have a lot of work to do, we're committed to delivering on the plans we laid out. Our goal is to focus intently on our actions and to be candid about our strength and challenges as we drive our business improvements.

Now turning to our results in the quarter. I'll start with a few high-level comments and go through our Life & Health business, and then Chip will do the same for our Property & Casualty business. And then I'll wrap up with comments on investments and capital.

In total for the quarter, we had a $16 million net loss or $0.32 per share, down from net income of $38 million. Our net operating loss totaled $20 million or $0.40 per share, down from $37 million of net operating income. The biggest driver of the change was the $51 million after-tax operating charge we took in our life insurance lines, as we implemented our voluntary outreach efforts using databases such as the Social Security Death Master File. As we mentioned in our strategy call, we're pleased to take these additional proactive steps to help our insurers and their loved ones.

Catastrophes were light in the quarter, totaling $13 million pretax. While this was up from $5 million last year, both years had relatively benign weather losses. As for Hurricane Matthew, in early October, we did not have significant losses. While it's still early, we estimate these losses will total between $5 million and $10 million pretax, which will be included in our fourth quarter results. Interestingly, about 1/3 of the estimated losses were in our life and health businesses related to contents and dwelling coverages there.

Turning to our overall top line. Total Kemper revenues grew 4% to $641 million, with the largest lift coming from Alliance United. Chip will cover the details on our actions and results in that business.

In our Life & Health segment, we had a $29 million net operating loss compared to $24 million of net operating income last year. These results reflect the operating charge from the voluntary outreach efforts I mentioned earlier. Earned premiums were up 1 point, finishing the quarter at $152 million. Excluding the operating charge in the quarter, this business continues to generate capital through stable earnings.

I'll turn the call over to Chip now to discuss our Property & Casualty division results.

George D. Dufala
Senior Vice President and President of Property & Casualty Division

Thank you Joe. Before I go through our Property & Casualty results, I want to touch on an organizational change we are implementing. We are splitting Kemper Personal & Commercial lines into 2 distinct businesses to increase our focus on the specific needs of our markets and customers. Kemper Preferred will serve the standard and preferred home and auto markets. And Kemper Specialty will focus exclusively on the nonstandard auto market in all states other than California. Joe Metz, who has extensive experience in nonstandard auto insurance, will lead the Kemper Specialty business. On an interim basis, I will be leading the Kemper Preferred business and will update you when we fill that important leadership role.

I'm excited to implement these changes, so we can better tailor our products and services to the markets we serve. I'll turn now to our results in the quarter.

In total, the Property & Casualty group reported net operating income of $12 million compared to $21 million last year. 3 primary factors contributed to the decline: 1, Alliance United's performance; 2, catastrophe losses that were low at $11 million pretax, but not as low as last year's $5 million level; and 3, lower levels of favorable prior year reserve development. These 3 factors were partially offset by an improvement in our legacy business' underlying loss ratio as well as our higher net investment income. I'll walk through our major product lines in more detail, starting with nonstandard auto at Alliance United.

Our results continued to be pressured with an underlying combined ratio of 107% in the third quarter. For the first half of the year, Alliance United reported a loss of $20 million. We're starting to see the results of our actions as this quarter improved to a $3 million loss. We're encouraged by the progress as we continue to focus on 4 key areas: elevated frequency levels, a need for increased rates, new business volume and claim staffing levels.

Starting with frequency. Consistent with the nonstandard auto industry, we continue to see elevated frequency levels in California. As a result, we're focused on a number of profit improvement actions, including our second factor, rates. We have implemented 2 rate increases of 7% each on our Millennium product, the first in April and the second one this week. Additionally, we implemented a 7% rate increase on our Gold product in October. We filed for another 7% rate increase on the Gold product, and it's pending approval. We will continue to file for these product rate increases until we achieve rate adequacy, which will take several pricing cycles. In the meantime, we continue to take various underwriting and agency management actions to further improve profitability.

Turning to the third factor, new business volume. New policy counts are down more than 45%, driven by our ongoing underwriting and agency management actions. We will continue to manage new business flow, as we implement needed profitability improvement actions.

Finally, on our fourth key factor, we remain focused on improving our claims operations. We have achieved our targeted increase in our claims adjuster staffing level and are focused on reducing the claims backlog. Since June, we have increased claims staff by a 115 professionals, which takes us to nearly a 50% increase since the beginning of the year. What we are encouraged with recent progress, we have more work to do to reduce the pending claim inventory. In total, we are making progress, but we also acknowledge it will take time for us to achieve acceptable returns on this line.

Now turning to our legacy P&C lines. Our underlying loss ratio improved 2 percentage points to 66.4%. I'll discuss each of our product lines in more detail. In our legacy nonstandard personal auto line, new business was up, primarily in California where the legacy product is profitable. The underlying loss ratio improved 8 percentage points from continued rate, underwriting and agency management actions. This marks the fifth consecutive quarter of sequential improvement in underlying loss results.

In the preferred auto line, written premiums were up $1 million, benefiting from an increase in new business volume and a higher retention ratio, but earned premiums were down $5 million overall largely as a result of the continued run off of the direct business. The underlying loss ratio increased 1 point as rate increases lagged loss trends. We are increasing our rate plan for the year and are pursuing corrective actions for some underperforming agencies.

In home, written premiums were down 3% from a smaller renewal base and the direct runoff, which more than offset improving retention trends. The underlying loss ratio increased 3 points, primarily due to unfavorable development from the first half of the year. We continue to take rate and underwriting actions for the home line. While losses from catastrophe events in the quarter were light, we had 4 points of adverse development on catastrophes from the first half of 2016.

With that, I'll turn the call over to Joe to wrap up our comments on the quarter.

Joseph P. Lacher
Chief Executive Officer, President and Director

Thanks, Chip. Before I review investments, I want to give you one more comment on results. You can see in the Corporate and Other line, results improved $5 million after-tax, primarily from lower pension expenses. In September, we discussed some broad expense reduction initiatives and indicated that some of them were already being executed. This is part of that savings.

Turning to investments. It was a quiet quarter. Our results were good overall, with pretax equivalent book yield up a bit to 5.3%. Net investment income increased $2 million for the quarter with about half the lift coming from a larger investment base and half coming from higher rate. The total return for the quarter was 1%, driven by net investment income.

Now I'll walk through a few of the financial statistics. Book value per share was $40.51 at the end of the quarter, up 4% from year-end, largely from the impact of lower market yields on our fixed maturity portfolio, partially offset by dividends paid. Book value per share, excluding unrealized gains on fixed maturities was $34.27, down 2% from year-end, primarily from dividends paid. Statutory surplus levels in our insurance companies remained strong, and we estimate that we will end the year with risk-based capital ratios of approximately 380% for our Life & Health lines and 325% for our legacy Property & Casualty lines.

Turning to capital. This week, the Board of Directors authorized a dividend of $0.24 per share. We ended the quarter with excess capital estimated more than $200 million. From a liquidity perspective, the parent company held cash and investments of about $310 million, while our $225 million revolver remained undrawn.
With that, we're pleased to turn the call over to the operator to take your questions. Operator?

Question and Answer

Operator

[Operator Instructions] As a reminder, this call is being recorded for replay purposes. [Operator Instructions] And our first question comes from Ryan Byrnes of Janney.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Just Firstly, just want to talk a little bit about the nonstandard book, I guess, the legacy piece. There was some -- again, the underlying loss ratio continues to improve there. We don't talk about it that much. Just want to see what kind of rate that book is getting and where that underlying loss ratio, I guess, is being targeted.

George D. Dufala
Senior Vice President and President of Property & Casualty Division

Ryan, this is Chip Dufala. Thank you for your question today. In the nonstandard auto book, we continue to take low double-digit rate increases there. We are watching that book closely. It's very important to us. We've been watching the frequency and severity trends that the entire industry has been seeing. But all in all, things have been coming along quite nicely for us.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

And any sort of targeted underlying loss ratio that would give you guys the adequate return you're looking for?

George D. Dufala
Senior Vice President and President of Property & Casualty Division

I guess, my answer to that would be no. We continue to make progress. We want to write good, solid profitable business. We want to retain more of that business that we write. And so as we move forward in the weeks and months ahead, we will continue to put a strong solid focus on that line of business.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Okay, great. And then also, I think you guys mentioned you made -- you're looking at the company in kind of 2 segments going forward in the preferred and the nonstandard. Does that mean the reporting will be different going forward, or is it going to remain as is?

Joseph P. Lacher
Chief Executive Officer, President and Director

Ryan, right now, we give you a line level information on that. And over the course of time, we'll take a look to see if we want to do something different. But you can see the nonstandard auto, the standard preferred auto and home, all by component right now.

Ryan J. Byrnes
Janney Montgomery Scott LLC, Research Division

Okay. That's all I had. Actually -- sorry, If I can sneak one more in. I want to make sure this is more of a numbers question. I think you guys noted that this quarter, there were 4 points of, I guess, earlier quarter cat losses in the homeowners line. Did that flow through the cat line or just the underlying loss ratio? Just a quick one.

Joseph P. Lacher
Chief Executive Officer, President and Director

It runs through the cat line.

Operator

[Operator Instructions] Our next question comes from the line of Paul Newsome of Sandler O'Neill.

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

You've made a number of management changes across the Property & Casualty side of the house. I was curious how far those types of changes extend into other areas, particularly the life side of the business, if you have a similar time of management changes that are happening there?

Joseph P. Lacher
Chief Executive Officer, President and Director

I think, Paul, what we're doing overall is starting with a very thoughtful process that says what do we want to be as an organization, where do we want to go strategically, what are going to be our competitive advantages in the marketplace and then making sure we get the right organization set up to deliver those competitive advantages. As we work through each one of these businesses, we'll keep doing that. And some of those changes may come along in any one of those spots, and we'll do it just as part of the ordinary course.

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

Okay. So I mean, is it fair to say that you obviously focus on the Property & Casualty business first and would be moving into the other parts of the business later, or is it...

Joseph P. Lacher
Chief Executive Officer, President and Director

I think we've been focused on all of the business and improving what we're doing overall. I think the Life & Health guys had a pretty heavy focus for the last couple of quarters on the claims enhancement initiatives and are wrestling to the ground the Use Death Master File and have a very heavy focus there. I think they're turning now to take those businesses, where I think we have attractive long-term growth opportunities. They've been historically profitable, but haven't been growing the way we wanted to. And they're going to work hard to figure out how to make that happen. I think we may be a little earlier in that process, given the focus on that Master File issue. And we're going to keep charging.

Operator

And 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 P. Lacher
Chief Executive Officer, President and Director

Well, thank you, guys, for your participation today. We thought it was a relatively quiet quarter on our side of the house, and I guess, you guys did too. We do appreciate your attention and your questions. Just a month ago, 1.5 months ago, we outlined in our strategic update what I believe is a clear roadmap for us. We're going to continue to work through our actions systematically to deliver on improvements. We're implementing our voluntary outreach efforts in our Life & Health segment. We're implementing organizational changes in our legacy Property & Casualty business to deliver focused support to our markets. We're going to continue to navigate the improvements in Alliance United. And we're going to focus overall on profitably growing our business. We'll continue to keep you updated as we work through the action plans we've outlined in our strategic update. And we remain optimistic about the value that we can unlock. Thank you for your continued interest in Kemper, and have a great day.

Operator

And ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation. You may now disconnect.