S&P Global
Market Intelligence

# Kemper Corporation NYSE:KMPR

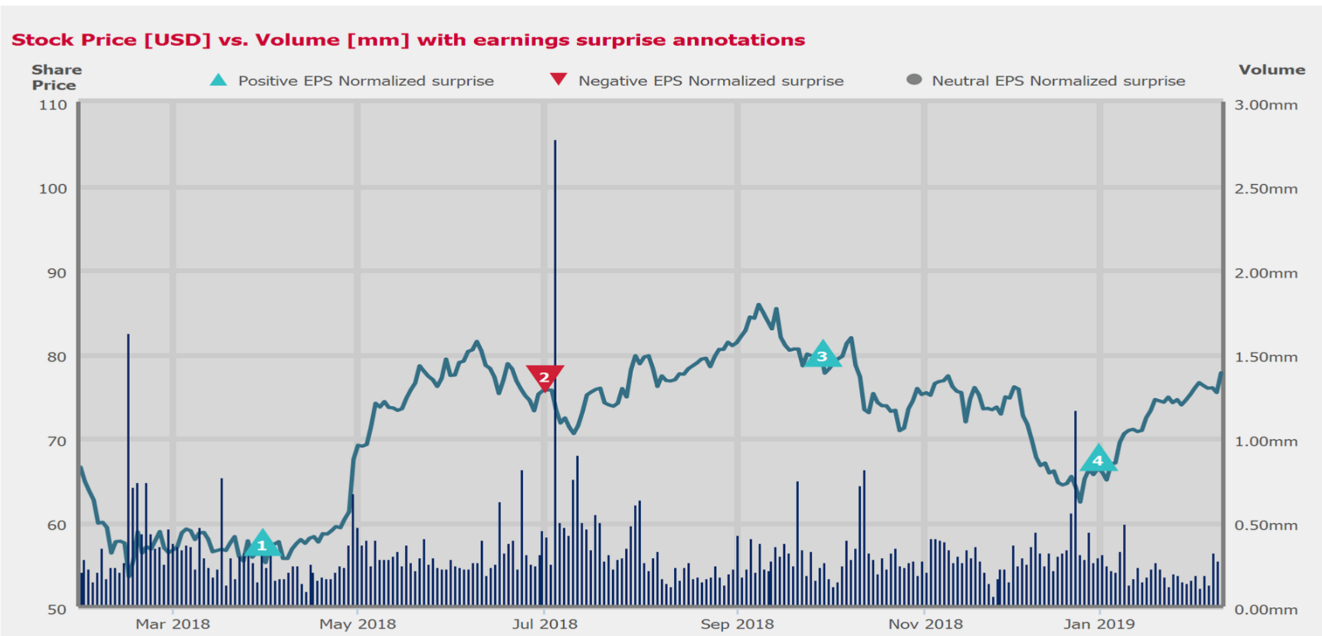
# FQ4 2018 Earnings Call Transcripts

## Monday, February 11, 2019 9:15 PM GMT

## S&P Global Market Intelligence Estimates

| | -FQ4 2018- | | | -FQ1 2019- | -FY 2018- | |
|---|---|---|---|---|---|---|
| | CONSENSUS | ACTUAL | SURPRISE | CONSENSUS | CONSENSUS | ACTUAL |
| **EPS Normalized** | 0.78 | 0.91 | ▲15.19 | 1.43 | 4.14 | 4.37 |
| **Revenue (mm)** | 1152.35 | 1156.90 | ▲0.39 | - | 3782.75 | 3767.50 |

Currency: USD
Consensus as of Feb-11-2019 3:18 PM GMT




**- EPS NORMALIZED -**

| | CONSENSUS | ACTUAL | SURPRISE |
|---|---|---|---|
| **FQ1 2018** | 0.74 | 1.10 | ▲1 48.65 % |
| **FQ2 2018** | 0.74 | 0.70 | ▼2 (5.41 %) |
| **FQ3 2018** | 1.29 | 1.59 | ▲3 23.26 % |
| **FQ4 2018** | 0.78 | 0.91 | ▲4 15.19 % |

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# Call Participants

### EXECUTIVES

**Duane A. Sanders**
*Senior VP and President of Property & Casualty Division*

**James J. McKinney**
*Senior VP & CFO*

**John Michael Boschelli**
*Senior VP & Chief Investment Officer*

**Joseph Patrick Lacher**
*President, CEO & Director*

**Michael A. Marinaccio**
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### ANALYSTS

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

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

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

**Marcos Costa Holanda**
*Raymond James & Associates, Inc., Research Division*

**Samir Khare**
*Capital Returns Management, LLC*

# Presentation

**Operator**

Good afternoon, ladies and gentlemen, and welcome to Kemper's Fourth Quarter 2018 Earnings Conference Call. My name is Andrea, 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, Andrea. Good afternoon, everyone, and welcome to Kemper's discussion of our fourth quarter and year-end 2018 results. This afternoon, you'll hear from Joe Lacher, Kemper's President and Chief Executive Officer; Jim McKinney, Kemper's Senior Vice President and Chief Financial Officer; and Duane Sanders, Kemper's Senior Vice President and the Property & Casualty Division President. We'll make a few opening remarks, provide context around our fourth quarter and year-end results, and then we will 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; and Mark Green, Kemper's Senior Vice President and Life & Health Division President.

Before the markets opened this morning, we issued our earnings release and published our fourth quarter earnings presentation and financial supplement. We intend to file our Form 10-K with the SEC on or about February 14. You can find these documents on the Investors section of our website at kemper.com.

Our discussion today may contain forward-looking statements. Our actual results may differ materially from these statements. For information on potential risks associated with relying on forward-looking statements, please refer to our 2017 Form 10-K as well as our 2018 Form 10-K once filed and our fourth quarter 2018 earnings release.

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

Since our reported financials do not 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 display our financials as adjusted for acquisition. This view 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 on the Investors section of our website, kemper.com.

Finally, all comparative references will be to corresponding 2017 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 the call. Pleased to report we had a good quarter and even better year. We've made strong progress and looking forward to sharing the highlights of our accomplishments with you. But before we do that, I'd like to take a moment to say a few words about some recent changes to our board.

About 2 weeks ago, we announced that Tom Goldstein resigned from our Board. We're saddened to share that Tom lost his courageous battle with cancer and passed away last week. Tom had served on Kemper's Board since August 2016 and made numerous meaningful contributions. I'm blessed to have known and worked with Tom for nearly a decade. He was a truly great person, friend and role model. We're honored to have had the opportunity to be associated with him. Our thoughts are with his family. His advice, insight and wise counsel will be missed.

Second, last week, after nearly 2 decades of service, Doug Geoga announced his intention to retire from the board at the end of his current term in May. Doug felt very strongly that he wanted to be a bridge for the new senior management team. His experience, wisdom and guidance have been enormously helpful in our journey to turn around Kemper. We're in a strong spot, and our commitment to excellence is running through the organization. Given that, Doug felt that after 2 decades of service, the time was right for him to retire. His leadership and contributions are too numerous to list. I want to thank him for his great partnership, his friendship and his service to Kemper over the years. We are all better for it.

Now turning back to Kemper. Pages 3 and 4 remind everyone who we are, a specialized, multiline insurer focused on growing underserved, niche markets where we can deliver outstanding value and results for our customers and our shareholders. We have a strong portfolio of businesses in Specialty auto, Preferred home and auto, and basic life and supplemental health and accident products. These businesses interact collectively, strengthening each other and providing capital diversification benefits. Our Specialty auto business continues to deliver very significant, profitable growth and our personal insurance and Life & Health businesses provide diversified sources of earnings and liquidity.

I'd like to remind everybody that we told you back -- what we told you back in 2016. We outlined our 3-phase strategy to unlock embedded value in the company. I'm not sure we used the word turnaround, but that's clearly what was needed. We were on a path to transform the company. We worked hard to execute on the initiatives we outlined, to establish a clear strategic focus, to build core capabilities, to deliver value for our customers and to produce strong, reliable financial results for our shareholders. Broadly, Phase 1 and 2 are complete. We're unmistakably in pursuit of Phase 3. While we will always have something that we are reworking or improving, we're focused on sustainable, profitable growth.

Turning to Page 5, I'd like to review our highlights for 2018. In short, we increased earnings; improved returns; grew the business, both organically and inorganically; and enhanced our core capabilities. Strength and consistency in our leadership team is an asset for Kemper, and the contributions of the team are driving solid execution and meaningful progress on our plan.

The Specialty P&C insurance segment is more than twice the size it was a year ago. We organically posted double-digit profit -- double-digit growth and policies in force with low-90s combined ratios. The Infinity acquisition further strengthened this business as a premier franchise.

Additionally, we continue to remain strong capital and liquidity positions with highly rated insurance subsidiaries. We'll continue to build on our core capabilities to grow a strong franchise and deliver sustained value.

On Page 6, defined an update on our integration of Infinity, another proof point on our progress. We are both achieving integration milestones faster than planned and exceeding financial targets. We generated mid-single-digit year 1 operating earning accretion, excluding VOBA, and are ahead of schedule on our ROE improvement. We projected a 2-year tangible book value earn-back and are about 2 quarters ahead of schedule. Our synergy realization is also currently ahead of schedule.

When we announced the transaction last February, we stated we would achieve cost savings of $55 million and a yield enhancement from repositioning of the Infinity investment portfolio of an additional $5 million to $10 million. The portfolio repositioning is successfully completed. At this time, we are increasing our second quarter 2020 run rate target for cost savings to $70 million to $75 million.

Now let's turn our attention to Page 7 and review the highlights for the fourth quarter. Overall, we continue to create shareholder value as demonstrated by our 15% increase in book value per share. If you remove the unrealized gains on our fixed maturities, our book value per share increased 28%. Looking at our return on average equity under the same 2 methodologies, we've produced a 7.7% and an 8.3% return, respectively, significant improvements from historical performance.

Our net income for the quarter was $7 million, inclusive of $60 million after-tax, unfavorable change in fair value of equity and convertible securities. Our adjusted consolidated net operating income per share, 52% to $0.91 per share. Earned premiums grew 76% on a reported basis and 12% on an as-adjusted basis with 16% within our Specialty P&C segment. We continue to see improvement in our Specialty P&C insurance segment's operating performance. The underlying combined ratio improved 110 basis points to 94.5% as reported and 230 basis points to 90.9% on an as-adjusted basis. The Preferred and Life & Health segment saw some pressure on the underlying performance, which Duane and Jim will touch on a little later in the presentation.

When we announced the Infinity acquisition, we said we would return our debt-to-capital ratio to a normalized level by the second quarter of 2019. In the fourth quarter, we repaid $215 million of our bank loan, thereby reducing our debt-to-capital ratio to 23%. We maintain our $640 million (sic) [ $540 million ] of available and contingent liquidity, which provides significant financial flexibility.

There are 2 additional items I want to touch on before I hand the call over to Jim. First, the aggregate catastrophe reinsurance program was put in place in 2018 to reduce exposure to larger-than-normal numbers of high-frequency, low-severity catastrophes. It delivers value by reducing required capital because it reduces earnings volatility. While we believe it is a value-creating trade in any year, the visibility of its impact on earnings was clear in 2018. And second, last week, the Board of Directors increased our quarterly dividend 4%. This was our first increase since 2011. It further demonstrates our confidence in our platform over the long term and our belief that we are substantially through our turnaround.

With that, I'll hand it over to Jim to discuss our consolidated quarterly and full year financial results in more detail.

**James J. McKinney**
*Senior VP & CFO*

Thank you, Joe, and good afternoon to everyone on the call. Let's turn to Page 8 to discuss the fourth quarter financial results.

Income for the fourth quarter was $7 million, down from $37 million in the prior year. The decrease in fourth quarter net income was largely due to increased investment market volatility that created a $60 million after-tax change in the clear value of our equity and convertible securities. Since the end of 2018, this component of our portfolio has recovered over 40% of the change in value experienced in the fourth quarter.

From an operating standpoint, we had a strong quarter. Earned premiums increased to $1.1 billion. On an as-reported basis, this represents a 76% increase over the prior year quarter, largely due to our acquisition of Infinity and accelerated growth in Specialty auto. On an as-adjusted basis, earned premiums increased 12%, mainly due to organic growth in Specialty auto, reflecting a 13% increase in policies in force.

Adjusted consolidated net operating income per share on a reported basis increased from $0.60 to $0.91. On an as-adjusted basis, adjusted consolidated net operating income per share increased 76% to $1.23 per share. The increase in these measures is primarily due to improved performance within our Specialty and Preferred segments.

Turning to Page 9, you will find 2018 full year results. As discussed earlier, 2018 was a transformational year for us, and our results demonstrate that fact. Net income increased 57% to $190 million, or $3.22 per share as reported or 79% to $298 million, or $4.55 per share as adjusted. Adjusted consolidated net operating income increased 179% to $258 million or $4.37 per share as reported, or 175% to $376 million or $5.73 per share as adjusted. Earned premiums increased 44% for the year to $3.4 billion as reported, or 11% on an as-adjusted basis, primarily driven by volume growth within our Specialty auto business.

Moving to Page 10. Here, we isolate the key sources of volatility in our earnings. When adjusted for these sources of volatility, our underlying operating performance improved 46% or $0.44 per share for the quarter. This improvement is largely driven by strong growth in underwriting margin expansion within our Specialty P&C insurance segment. We are pleased with these results, but not satisfied, and look forward to further improving our operating income and book value per share.

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

**Duane A. Sanders**
*Senior VP and President of Property & Casualty Division*

Thank you, Jim, and good afternoon, everyone. Let me expand a little on the integration and the benefits we are realizing. In claims, the combination of our teams and platforms delivered increased scale and capabilities, leading to enhanced effectiveness and execution. Specifically, we've seen improvements in processing and response times and overall customer service across our P&C platform. Increased scale has also improved our ability to recruit, train and retain claim employees, favorably impacting productivity.

We are beginning to see early stages of benefits and efficiencies within the product management function. Our increased scale has resulted in more insightful data and deeper analytics, improving our best practices and better informing our product, pricing, positioning and go-to-market execution.

Related to our core systems, the integration efforts are well underway to design a more effective platform to manage the full life cycle. We've selected our policy admin, claim and billing platforms that will enable us to realize efficiencies, gain flexibility and provide better data. We've made great progress on our plans and are focused on accelerating deployment.

We are also pleased with how well the integration of our people and the alignment of our cultures have resulted in stronger talent, capabilities and leadership. Now I'll begin with a discussion on our Specialty P&C insurance segment on Page 11. I will discuss this business on an as-adjusted basis, including Infinity results in all prior periods. Earned premiums increased to $718 million for the quarter, up 16% over the fourth quarter of 2017. For the year, earned premiums also increased 16% to $2.8 billion. The top line growth was primarily fueled by higher volume as policies in force increased 13%, providing further evidence of Kemper's leading competitive position within the Specialty auto market.

Importantly, while we generate strong growth and meaningful market share gains, we also produced and improved our underlying combined ratio. The segment's underlying combined ratio decreased a couple of points for the quarter and about 3 points for the year. The business generated attractive returns due to rate and product management actions as well as increased scale.

On Page 12, you will see the results of our Preferred P&C insurance segment. Earned premiums increased to $189 million for the quarter, up 4% over the fourth quarter of 2017. For the year, earned premiums remained relatively flat at $731 million. The underlying combined ratio increased for both the quarter and full year related to investments in capabilities that should provide meaningful future benefits.

The Preferred auto business continued to show improvement. Policies in force grew by 5% for the quarter, while improving underwriting results as demonstrated by almost-2-points improvement in the underwriting loss ratio. This was offset by just over 2-point increase in the expense ratio, partially due to the investments we made in the business, which we expect to provide long-term benefits.

We're planning for the future and have focused on further improving this business through more robust product and claims management to bring results to our target profitability goals.

Turning your attention to our homeowners and other business, the underlying combined ratio of 79%, about 9 percentage points higher than last year, and policies in force decreased 5%. We're currently reducing our catastrophe exposure through policy count, pricing and underwriting actions. Long term, we expect to bring this business to appropriate profitability levels through rate, product rollout and claims actions.

I'll now turn the call back to Jim.

**James J. McKinney**
*Senior VP & CFO*

Thank you, Duane. Our Life & Health division's results are on Page 13 of the presentation. Results for the quarter were mixed. The team continue to make good progress on sales and platform initiatives. This resulted in a modest uptick in earned premium and an increase in expenses. About $2 million of the expense's increase is related to onetime items. Most of the remaining increase in expenses tied to volume and non-run-rate business investments expected to enhance long-term profitability that are expensed on as-incurred basis. In addition, the group experienced an increase in the frequency of claims that elevated benefit expense in comparison to the prior year quarter.

Turning to investments on Page 14. Our portfolio remains diversified and highly rated, as demonstrated on the bottom left of the page. Looking at the chart on the upper left, you can see the investment performance over the past 5 quarters. This quarter, we delivered $91 million in net investment income. The core portfolio produced higher net investment income, primarily due to the addition of Infinity's investment portfolio. The alternative investment portfolio generated income of $7 million.

Overall, in the fourth quarter, the portfolio delivered an attractive pretax equivalent annualized book yield of 4.6%. This is down from 5.4% last year, primarily due to an increase in alternative performance and the mix shift resulting from the addition of Infinity's portfolio.

On Page 15, we highlight our strong capital and liquidity position. In 2018, operating cash flows increased about $300 million to $540 million. 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 15. You can see that all of our insurance groups remain well-capitalized. In the chart in the upper left-hand corner, you can see our parent company liquidity. At quarter-end, we had substantial financial flexibility with $101 million in cash and investments and $540 million in borrowings available from our revolver and subsidiaries.

Last, in line with the commitment we made in February 2018 when we announced the Infinity acquisition, we have returned our debt-to-capital ratio to a normalized level. At quarter-end, our debt-to-capital ratio was 23%.

On Page 15 (sic) [ Page 16 ], I would like to quickly touch on our reinsurance programs. Over the years, we have maintained a catastrophe reinsurance program to protect us against low-frequency, high-severity catastrophes. Our program for 2019 provides us with 95% coverage against $225 million of losses arising from a single event in excess of our $50 million retention. In addition, we renewed the homeowners aggregate catastrophe reinsurance program we initiated in 2018 to protect us from high-frequency, low-severity catastrophes. After 500,000 per event retentions, this program covers us for $50 million in losses above our $60 million retention level.

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

**Joseph Patrick Lacher**
*President, CEO & Director*

Thanks, Jim. So to wrap up, the strong operating results this quarter and for 2018 are further evidence of the significant progress we've made on our transformation. The Infinity acquisition and its successful integration and the refresh of our brand are additional milestones in that journey. The investments we've made in our franchise resulted in record-setting sales and premium growth in our Specialty auto business with consistently stable results in our Life & Health businesses and improving results in our Preferred auto and home lines.

As we move into 2019, we will continue to build our competitive advantages. We'll maintain our specialized focus to deliver outstanding value and results for our customers and our shareholders and will leverage the quality of both our Specialty auto and personal insurance businesses. We'll use the strength of our data and analytics to enhance product management. We'll leverage our increasing scale to deploy improved claims, delivery capabilities to better serve our customers and allow us to be more competitive. We'll make improvements in our operational and product capabilities in our Life & Health businesses to advance our sales and distribution capabilities. We continue to focus on effective execution of our strategy and fully realizing the benefits of our diversified platform.

And now I'll turn the call back over to the operator to take questions.

# Question and Answer

**Operator**

[Operator Instructions] And our first question comes from Paul Newsome of Sandler O'Neill.

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

I wanted to ask about a couple of -- actually, it looks like the nonshared business is going pretty well. I actually wanted to see if the change and sort of fix is going to be mainly on the Preferred business? Or are you looking at other places as well, that -- sort of incremental things that we think should be changed or will be changed?

**Joseph Patrick Lacher**
*President, CEO & Director*

Are, Paul, you referring to my general comment that there's always something we're reworking or fixing?

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

Yes.

**Joseph Patrick Lacher**
*President, CEO & Director*

I think that's probably a general comment that's going to go on forever. There's -- if we ever get to a point where we tell you everything's humming great and there's not something we can improve on, it's time for us to be replaced. There's always something inside an organization that can be improved or an opportunity to enhance and keep working. Now our Preferred auto and home business is not running where we'd like it to be. That is clearly a spot where we've got improved returns, and we're going to continue working on that. I think we're going to see clear benefits that come from the stronger Specialty auto business, the scale and strength that we had there from a claim perspective, that same claim department services our entire P&C business, so that's an example of where the acquisition will help the entire organization. And we are continuing to march forward on the profitability enhancements we've got in that space. And we're also focused inside of our Life & Health business. As we mentioned, I'm thinking about operational and product capabilities that will let us continue to grow that franchise. And those have been they're slow going, they take a while to work their way through to an income statement given how life accounting works, but we believe they'll pay dividends over the long term.

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

And then, separately, I wanted to ask about the alternative investments and/or just investments in general. What sort of impact did the last crazy December month have on the returns? And I can't recall if you report things with lag or not? Or -- every company does it a little differently.

**James J. McKinney**
*Senior VP & CFO*

Yes, I know. Thanks, Paul, good question. The results that you're seeing, the market was generally down about -- I think if you look at the S&P, about 14%. If you're looking at our portfolio in terms of the equity in the convertible securities, it was down around 10%. Most of that occurred in December. We don't generally report with any type of lag to our results. So that is updated through year-end. As I indicated on -- with my opening comments, one other point that I would suggest or point you to is that since the end of the year, we have recovered in excess of 40% of the value decrease that we experienced in the fourth quarter and most of that obviously in December.

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

Great.

**John Michael Boschelli**
*Senior VP & Chief Investment Officer*

And Paul, this is -- Paul, this is John Boschelli, just to add a little color to that. On the alternatives side of the portfolio, there -- they come through on different various lags. So majority of the portfolio is on a quarter lag. With that said, the -- most of -- as you know, most of our alternative portfolio is debt-centric. So we do expect some volatility from the downturn in December. But again, most of our underlying investments have contractual cash flows. And so -- just to add a little extra color there.

**Joseph Patrick Lacher**
*President, CEO & Director*

So we're giving you a little bit of an answer, some on equity-type items and some that also went through the alternate that have debt component.

**Operator**

Our next question comes from Marcos Holanda of Raymond James.

**Marcos Costa Holanda**
*Raymond James & Associates, Inc., Research Division*

So my first question is on the Specialty auto and on the PIF growth number reported. I think that was 13%. So I was just wondering, as we look into 2019 and with most carriers now being at/or close to being rate adequate, how should we be thinking about PIF growth here over the next year or 2?

**Joseph Patrick Lacher**
*President, CEO & Director*

Yes, Marcos, it's a good question. And a couple of thoughts. One, I'm going to remind everybody that we don't do forward-looking PIF projections or provide guidance there. I can give you a general commentary on sort of what I've seen and would expect broadly across the marketplace. Like what we've seen for a while is folks who are improving their profitability and trying to get themselves to a rate adequate position, we've had the good fortune of being a particularly strong carrier in the Specialty auto space, have had very attractive margins for some time and have been able to very significantly grow our business while folks are getting their house in order. We had very strong margins. We're going to be focused on doing everything and anything we can to profitably grow this business. I can't tell you if at some point somebody in the marketplace is going to start doing something silly. What I can tell you is that we start with a very strong business franchise. And we believe, regardless of what happens, we'll be in a position to do better in hard or soft markets than some of those less-focused or less-capable players.

**Marcos Costa Holanda**
*Raymond James & Associates, Inc., Research Division*

That's fair, that's fair. And then just as a follow-up. I was just curious if you could touch on what primarily drives a divergent underlying margins in the Preferred auto, in the Specialty auto? Is this severity only? Or are there are also different frequency trends in those segments?

**Joseph Patrick Lacher**
*President, CEO & Director*

Yes, I think the issue on Specialty auto and Preferred auto, you get customer differences there. You also get different competitor sets. And for us, as well, we often have different geographies that we're dealing with. So you get a little bit of all of those. In general, Specialty auto customers tend to have higher frequencies. They get into accidents more often. In our case, we tend to have more of those customers in urban areas. And regardless of whether you're a Specialty or a Preferred customer, you tend to get in more accidents in urban areas than you would in suburban or rural areas just because of the higher traffic patterns. You also get very much a different competitor set. That's one of the reasons we are so attracted to the Specialty auto segment. We are a fairly large, fairly sophisticated player there, and are one of the largest in that space so that we believe that gives us a competitive advantage in that area. Where in the Preferred segment, you get a lot -- in fact, the majority of the carriers in the industry are participating there. So it really is a combination of all of those things that causes the difference.

**Operator**

Our next question comes from Adam Klauber of William Blair.

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

A couple of different questions. I know you mentioned it, Joe, but could you recap the cost savings and investment synergies. What were you at originally and where are you at today?

**Joseph Patrick Lacher**
*President, CEO & Director*

Sure. We had originally suggested $55 million for cost synergies. And the first 2 years, we had suggested that there would be potentially $10 million to $15 million more on system savings in the out years beyond those 2 years. And we had suggested $5 million to $10 million from the portfolio -- shifting the Infinity portfolio into the Kemper portfolio. We have successfully completed that portfolio repositioning and are inside of that range. We are updating the $55 million first 2-year cost savings to $70 million to $75 million. And we are not changing the systems' cost savings that we were expecting in the 2 years following that.

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

Okay. Then when we look at your Specialty Property, Casualty (sic) [ Property & Casualty ], the underlying combined for the quarter was at 90.9%. That's better than the last several quarters. Should we be looking more at an average or are the last 2, 3 quarters, not -- sorry, I'm not asking for future, but should we think about it more as an average? Or are the last 2, 3 quarters more indicative of what that business can do?

**James J. McKinney**
*Senior VP & CFO*

Great question. I think the right way to think about that is probably more about in average over the last kind of 4 or 5 quarters. You may put a little bit of emphasis on your last 2. But I think in average, in totality is probably the best way to get the clearest deal.

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

Okay.

**Joseph Patrick Lacher**
*President, CEO & Director*

The question really comes and I'll add a thought or 2 on it. We believe the best way for us to be building long-term shareholder value is to hit a fair return, that hits a return that matches our ROE targets and then to grow the business. If we were given, as an example, an opportunity to take a 92 combined ratio and try to improve it or take a 92 combined ratio in auto and let it deteriorate slightly and grow the business. We would think that the better long-term value answer would be the latter, not the former. That's not in any way trying to pick a target or a bogey for combined ratios, it's just using it as an example. So if you're asking what's the right jumping off point for projections, the average of the last 4 quarters might be the same. If you're asking, how do you project next quarters? I might use a shorterterm measurement. If you're asking what to look for over the next year or 2, 3 years or asking how we think about the business, I'd give you a slightly different answer. So I'm trying to give you a little bit of all of them.

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

Okay, that helps, Joe. And then as far as frequency of the auto lines, we've seen the industry data, which is a little lagging, fast track and some of the other big companies are showing negative frequency trend. Is that consistent with what you're seeing also?

**Duane A. Sanders**
*Senior VP and President of Property & Casualty Division*

Yes, this is Duane. So I would think it's -- we're not too dissimilar from industry, now that varies certainly at the state and by -- on -- in mix level. But what we're seeing in there, we're comfortable with, and we're not necessarily, largely out of pattern.

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

Okay. And then as far as your PIF growth in Specialty. Obviously, very strong. Is that more across your business? Is it weighted more towards Florida, California, Texas? Is any -- are any one of the territories jumping out?

**Joseph Patrick Lacher**
*President, CEO & Director*

We always get -- it depends on how tight you get the geographies inside that. We're seeing PIF growth across all of our states, California and Texas for the year have been a little higher. It -- it's -- depends on the length of time of the period you're looking to. We're actually growing broadly across all our big states and look to be expanding that. California, Texas, Arizona, we're seeing increases in Florida. There's -- it's not as if one's growing and the rest are shrinking. I guess that's the answer.

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

Okay, yes, that's helpful. And then, on the Life & Health, the benefit ratio was up. I think you mentioned that. Was that more of the year-end true-up? Was that -- is there something unusual going on in the book that caused that?

**James J. McKinney**
*Senior VP & CFO*

Something cut out off from our end, at least, I apologize, on the first part of the question.

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

Sure. As far as the Life & Health benefit ratio moving up for the quarter, was that more of a year-end true-up? Was there something unusual you saw in the book of business?

**James J. McKinney**
*Senior VP & CFO*

No, nothing unusual. And generally, with this business, you'll kind of see a quarter or 2 throughout the year where you might get a little bit of a frequency delta from what's normal. It's a very small change when we talk about the frequency delta. It's like 0.1, 0.2. But on a large book of business, that can have several million dollars of impact. We've seen, over the last 2 or 3 years, a really slight increase. But overall, nothing here that you should note that really changes the long-term trend within the business or the long-term earnings expectations of the business. Remains in line with what we've historically articulated, which is kind of that $85 million to $95 million on an after-tax basis. And again, the business as a whole performed that way for the year and really no change to that story.

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

Okay. And then of course...

**Joseph Patrick Lacher**
*President, CEO & Director*

Let me go back for one second and then -- and add one more thought on the growth question. The -- if you look over the whole year, the -- Florida's actually been down for us on a fairly significant basis. I was adding -- my thought process, thinking about what we've seen in the very recent short term of it turning around from that perspective. If you're looking for the whole piece, Florida's been backwards for us for a big chunk of the time period.

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

Okay, okay. So then as far as the integration goes, I guess, 2 questions. One, I think you said you picked a policy admin system. Can you let us know what you're going forward with? And then, two, how's retention been among the field or marketing force at IPCC?

**Joseph Patrick Lacher**
*President, CEO & Director*

So from a -- on the system's side, we've -- we're partnering with Guidewire across all those particular disciplines, whether that's the claim, the billing or the policy admin. I'm sorry. And then in terms of the -- we've been really fortunate with the integration as we indicated. And the folks that -- as we blended the 2 together and actually started becoming or acting more like one, we've been able to maintain the bulk of the folks or those folks that have what -- just market-facing, agent-facing. And we're doing a pretty good job on that front, harmonizing our agency channel in how we go to market. So we're in really good shape on that. There's been no notable unintended retention issues.

**Operator**

Our next question comes from Christopher Campbell of KBW.

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

I guess, just great trends, congrats on the quarter. And my question just being why -- my first one's really a high-level question on kind of the overall strategy now that the integration is proceeding, you guys are doing better than expectations, kind of raising the estimates. And I just kind of go back to Slide 4, the earnings deck where you mentioned focusing on consumer-related businesses to target niche markets, have limited competition and unique expertise. And I definitely see that in the Specialty auto and even the Life & Health, but I don't know if I quite see how the Preferred lines fit into that overall strategy. So I guess, just could you kind of walk us through like how Preferred -- how you guys can be uniquely differentiated in that market? And then if you weren't able to do that, would you guys consider strategic options for that business?

**Joseph Patrick Lacher**
*President, CEO & Director*

Yes, Chris, good question, and one we've talked about a couple of times. The issue there, and we clearly see that point. We had a couple of thoughts on it. One, we do a particularly good job inside of that space with a packaged auto and home capability, and we see leveraging that and leveraging our homeowners capability as being the spot that will be ultimately, a differentiator in that space. That's where we're focused on building our capabilities, that's what we'll look to do inside of that space. And our nearterm plan would be the same regardless of how we approach this. If we thought that we couldn't be strategically effective, the first thing we do is improve the performance and capability underlying business, that's the same thing we're doing as we're building this homeowner's capability and looking to strengthen and leverage it. So we see there being a real niche for that, a real opportunity, are heavily focused on it, and we'll think through that. And if we get out 2 years, who knows what happens in that process. We're always thoughtful about what the right way to strategically advance the organization, do the right thing for shareholders. We'll cross that bridge if we get to it.

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

Great, that's very helpful. And then just -- I had one more question. And I'm thinking back to December, like you guys and some of the other life ones were like with the latent cycle concerns, anyone with the life business was getting hit pretty hard. So I understand the Life & Health side for you guys should be fairly recession-resistant given you have a low-dollar, whole-life policies and why people are buying them. But I'm just trying to think, would it -- with the nonstandard piece of that, just in terms of higher claims frequency, lower premiums, I mean, how sensitive would that be to a recession? And I'm just thinking about to Infinity's book, by backing away, they have like an 11% premium decline. But I think in 2009, it was 8%. Not quite sure what the legacy Kemper numbers were, but I guess just how should we think about -- like in a potential recession, how -- like what would be like the economics of the nonstandard business or the Specialty auto business?

**Joseph Patrick Lacher**
*President, CEO & Director*

Okay. So you -- I want to make sure I'm going the right direction. You shifted your questions, focusing on the Specialty auto or nonstandard.

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

Yes, the Specialty auto, [ nonstandard ]. I'm just trying to think is that -- yes, it's like so the Life & Health is probably pretty recession-resistant, so there shouldn't be like too much of a negative impact. You guys don't have a lot of like credit risk in that book. But on the Specialty auto, I'm thinking that book might be more recession-sensitive than a typical standard auto book would be.

**Joseph Patrick Lacher**
*President, CEO & Director*

You got a couple of things that go on across auto books, Chris, through economic cycles. One of the things you get might be folks worried about more fraud. And one of the nice pieces about our particular business is that's one of the things we're exceptionally attuned at investigating and finding. That's one of the reasons you need to be an expert in Specialty auto, and then the standard preferred guys moving into the space. They get their head handed to them, it's because they're not quite as fraud sensitive. So we have that as a positive, but you might see that. What you also tend to see is a reduction in miles driven when you see a reduction in employment. You saw the converse of that as we started to move out of the recession, you start to see economic growth. You heard most carriers talk about an uptick in frequency. And part of the conversation there was an increase in miles driven as more people were employed. You see the opposite end of that when you go to the other direction. So to the extent there might be some uptick in severity or fraud, you also get a downtick in frequency because of those miles driven. You're going to see what any particular individual cycle or any individual particular environment does, but my experience has been you get offsetting forces.

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

Got it. And then just on premium growth, would you guys see typically like higher price sensitivity just given your target market like during recession?

**Joseph Patrick Lacher**
*President, CEO & Director*

Again, I'm not sure how our group gets higher price sensitivity. They tend to be fairly price-sensitive to begin with as a segment. This part of the business, part of the whole auto world tends to run lower retention because people are very price-sensitive. There might be, but again, it's not something that's historically baked a lot into models from a carrier side.

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

Okay, got it. And then...

**James J. McKinney**
*Senior VP & CFO*

I would also highlight that when you think about our business, especially when you're looking at the Specialty auto, we tend to have a very attractive cost proposition that allows us to maintain a very attractive policy price while earning fair returns for our shareholders. I think that number generally would stand up irregardless of what economic time period it is. And I think that's one of the things that when you're comparing, you're trying to figure out competitive advantages or changes in terms of how a business might operate, it's what's their underlying unit cost to be able to provide an appropriate service. And from that perspective, I think we compare pretty favorably.

**Operator**

[Operator Instructions] And our next question will come from Samir Khare of Capital Returns Management.

**Samir Khare**
*Capital Returns Management, LLC*

I -- the last 2 years have been pretty tough for homeowners and insurers in California, and regulators and other stakeholders are watching things quite closely, also becoming quite critical of certain aspects of insurer's operations. So what effect do you think these pressures might have on California auto carriers, either on production or how you handle claims, late approval process or other things?

**Joseph Patrick Lacher**
*President, CEO & Director*

Yes, our experience is that California is always a challenging market. They're a thoughtful insurance department. They run different rules than most other states across the country. In auto, they have different rating rules than anywhere else in the country. So there's already a fairly heightened degree of sensitivity inside of that space. I wouldn't expect that, that would become less heightened as a result. But they're also a thoughtful group. They recognize the difference between auto, homeowners, workers' comp and the like. A lot of what's going on inside of the homeowners' space is the result of a lot of loss activity, which is a real opportunity that the insurance industries had to respond to consumer need, but there is a connection with losses and lost cost and pricing. And I've always found California to be rational about understanding that and recognize that will eventually work its way back into pricing or underwriting at some point.

**Samir Khare**
*Capital Returns Management, LLC*

Okay. And I guess, maybe in conjunction with that explanation, there's news stories that are talking about capacity issues for homeowners in high-risk areas. Do you have any thoughts on how that might affect your business? Is it an opportunity or a threat to your business?

**Joseph Patrick Lacher**
*President, CEO & Director*

Yes, I saw similar stories in the last couple of days. I think that what you see there is sort of the connection with the earlier part of the answer to my question. It's -- I'm not commenting on us at this point, but I'm making a general comment as a long-term industry veteran. If you didn't think that you were getting an adequate price for the risk you were taking, you wouldn't be looking to add more risks in that process, and that would cause a capacity challenge in the marketplace, which puts pressure on the marketplace to allow prices to go up or coverage to get curtailed. That's what sort of makes the healthy marketplace function. I think what you're seeing now is a lot of carriers tightened that capacity because they're not happy with the -- where they believe their pricing is. I'm not commenting on any of their individual components. But I can see that, that would likely be happening and that will work its way out. We'll go through and make our own evaluation of what we believe our rate adequacy is and our coverage offerings and our ability to appropriately underwrite risks. And where we believe we have a meaningful advantage, we will operate accordingly. And where we believe that we're not priced where we needed to be or we need to have more underwriting deployed, we'll pull back. That will be very much a local geography.

**Samir Khare**
*Capital Returns Management, LLC*

Okay, great. And just on that, any anticipated changes on your auto book as it relates to changing prices and exposures on the homeowners?

**Joseph Patrick Lacher**
*President, CEO & Director*

We're not really thinking -- we're not connecting those 2 thought processes. We'll manage the pricing and the profitability of those independently, and we need to as we work through that department of insurance in particular.

**Operator**

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

**Joseph Patrick Lacher**
*President, CEO & Director*

Thank you, operator, and thanks, everybody, for your time today and your interest in Kemper. We look forward to updating you again next quarter. Have a great day.

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