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Assurant, Inc. NYSE:AIZ

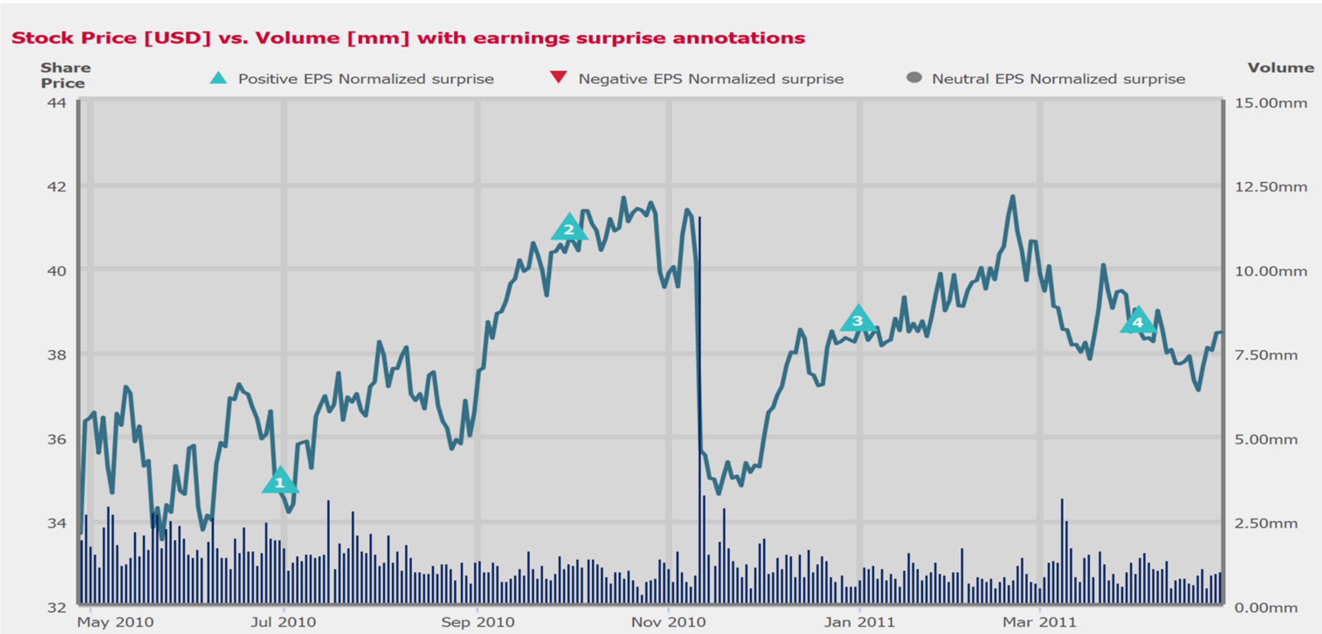
FQ2 2011 Earnings Call Transcripts

Thursday, July 28, 2011 12:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2011-			-FQ3 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.92	0.76	(17.39 %)	1.08	4.70	5.42
Revenue (mm)	2008.38	2062.89	2.71	2003.23	8038.30	8004.42

Currency: USD
Consensus as of Jul-28-2011 9:36 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	1.16	1.35	1 16.38 %
FQ3 2010	1.15	1.27	2 10.43 %
FQ4 2010	0.99	1.08	3 9.09 %
FQ1 2011	1.23	1.37	4 11.38 %

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Call Participants

EXECUTIVES

Christopher John Pagano
Executive VP & Chief Risk Officer

Melissa Kivett

Mike Peninger

Rob Pollock

ANALYSTS

Chris Giovanni
Goldman Sachs

Ed Spehar
Bank of America

Mark Hughes
SunTrust

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Presentation

Operator

Good day. And welcome to the Assurant Second Quarter 2011 Financial Results Conference Call. Today's conference is being recorded. All participants will be in a listen-only mode during the presentation. Later, we will conduct a question-and-answer session. Instructions will be given at that time.

At this time, I would like to turn the conference over to Ms. Melissa Kivett, Senior Vice President, Investor Relations. Please go ahead, Ms. Kivett.

Melissa Kivett

Okay. Thanks, [David]. Welcome to Assurant's second quarter 2011 earnings conference call. Joining me with prepared remarks are Rob Pollock, President and Chief Executive Officer of Assurant; and Mike Peninger, our Chief Financial Officer. Prepared remarks will last about 20 minutes and then we will open the call to questions. Chris Pagano, our Chief Investment Officer and Treasurer, is also here for questions.

Yesterday we issued a news release announcing our second quarter 2011 financial results. The news release, as well as corresponding supplemental financial information is available on our website at assurant.com.

Some of the statements we make during today's calls may contain forward-looking information. Our actual results may differ materially from those projected in the forward-looking statements. Additional information concerning factors that could cause actual results to differ materially from those projected in any forward-looking statements can be found in our 2010 Form 10-K which can be accessed from our website.

The company undertakes no obligation to update or revise any forward-looking statements.

Additionally, this presentation will contain non-GAAP financial measures which we believe are meaningful in evaluating the company's performance. For more detailed disclosures on these non-GAAP measures, the most comparable GAAP measures and a reconciliation of the two, please refer to yesterday's earnings release and the supplementary financial information that's posted on our website at assurant.com.

Now, I'm glad to turn the call over to Rob.

Rob Pollock

Thanks, Melissa, and good morning, everyone. Midway through the year, we are delivering on the commitments we outlined at our 2011 Investor Day. These commitments include profitable growth, reducing expenses and improving ROEs. Here's some examples from the quarter.

Profit improvement continues at Assurant Solutions as we grow our wireless service contract and preneed businesses. At Specialty Property we are increasing loans tracked in our lender-placed business and expanding our offerings to rental property managers.

Our new strategy at Assurant Health is gaining traction as we sell new affordable products to provide consumers access to the healthcare system. We are also demonstrating strong expense management and at Assurant Employee Benefits, sales of voluntary products are gaining momentum, as we help employers provide more benefits for their employees.

Now, I will highlight our progress at each business. I'll begin with Assurant Solutions, results continue to improve. The global economy continues to be a headwind for Assurant Solutions but we are winning new clients. This demonstrates our products and services are meeting customer needs.

We are setting the stage for longer term profitable growth, combined ratios are improving, preneed place sales remain at healthy levels and our sales pipeline is strong for service contracts including wireless.

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New sales help offset the continued run off of Circuit City and the decline in the domestic credit insurance business.

Overall, solutions 2011 earned premiums will be similar to 2010. We expect earned premiums to grow in 2012. We are well-positioned to deliver on our commitment of a double-digit ROE in 2012 with continued improvements expected in the out years.

Moving to Assurant Specialty Property, quarterly results reflect the impact of unprecedented weather-related events. We are helping our customers affected by the severe storms and will continue to do so as they rebuild and repair their properties.

Our business model leverages a sophisticated tracking system that ensures structures are covered for damage. Our strategic focus on aligning with market leaders in mortgage servicing is again paying dividends.

During the quarter, one of our clients at quarter acquired a portfolio of 200,000 loans. We will begin tracking these loans later in 2011, with premium production beginning in 2012. Adjacency growth opportunities look promising. We are building our niche renters business, focused on distribution through property managers.

In June, we acquired SureDeposit, the market leader in rental security deposit alternatives. The SureDeposit product is offered by property managers serving 1.5 million apartments in 4,500 communities. This product is beneficial to both renters and property managers. Early feedback from SureDeposit clients reinforces that there are opportunities to grow revenue with our full product suite. We are pleased that SureDeposit's management team and employees are now part of the Assurant family.

For the remainder of 2011, we expect properties premiums will be consistent with year-to-date results. Earnings will be dependent upon catastrophes, particularly hurricanes.

Next, I'll turn to Assurant Health. Second quarter results reflect continued progress in implementing our strategy, both consumers and distribution partners are recognizing the value and affordability of our health access and supplemental products.

We also improved efficiency in our operations as evidenced by a reduction in quarterly expenses of almost $24 million from a year ago. This is a tremendous accomplishment. It demonstrates our ability to adapt to changing markets.

For the balance of 2011, we must continue to generate sales and drive further expense efficiencies a better customer experience and a simplified business model will help us achieve these goals. We are achieving early success with our redeemed strategy. As a result, we are raising our 2011 net operating income outlook from breakeven to between $15 and $20 million after tax.

Assurant Employee Benefits continues to be challenged by a lack of job creation. This hurts revenue and creates a difficult environment for returning claimants to work. While we are disappointed with overall profit results, we are encouraged by the improvements we are achieving in our dental business.

During the quarter, overall sales increased, led by the growth in our voluntary products. Local and regional brokers are increasingly interested in voluntary products in the aftermath of healthcare reform. We are providing them with marketing and training support to help them generate sales as part of our key broker program, remember the voluntary products are a targeted growth area for benefits. For the remainder of 2011, we expect modest sequential improvement, primarily driven by our dental business at Assurant Employee Benefits.

I'll now turn to corporate matters. During the quarter, we took approximately $160 million in dividends from our operating companies. We continue to exercise discipline in managing our capital. We repurchased 3 million shares of our stock, increased our quarterly dividend by 13% and acquired SureDeposit.

Capital at the end of the quarter was $650 million, including the $250 million buffer for tail event risks. For the full year, we expect operating company dividends will roughly equal our earnings. We believe further

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buybacks are appropriate, given our share price and we expect to continue share repurchases throughout the year.

Now, Mike will walk you through the operating results for each business. Mike?

Mike Peninger

Thanks, Rob. Let's start with Assurant Solutions, where second quarter 2011 net operating income was just under $40 million, a 31% increase versus the second quarter of 2010. Improved underwriting results in Canada, Europe and domestic service contracts drove the year-over-year increase.

Domestic net earned premiums increased in the wireless, retail and automotive channels. These increases were offset by declines from the continued run off of Circuit City and our domestic credit business.

The domestic combined ratio was 96.6% for the quarter due to improved seasonal loss experienced in our wireless business and lower general expenses versus last year. We expect this ratio to move slightly higher in the second half of the year but it should be less than its 98% long-term target for the full year.

Internationally, net earned premiums increased 16% versus the second quarter of 2010, driven by growth in Latin America from both new and existing clients. Premiums and fees were up slightly in Europe as we focus on wireless opportunities.

The international combined ratio decreased 320 basis points from the second quarter of 2010. The improvement was driven by better loss experience in Canada and profitable growth in Latin America. Improved results in Europe due to the pricing actions taken in the U.K. and growth in the rest of the region positively affected the combined ratio as well.

The international results improved despite the increase in new wireless client implementations which temporarily pressure the combined ratio. For 2011, we remain on track for a 200 to 600 basis point improvement in the international combined ratio versus the fourth quarter of 2010.

Preneed's net operating income increased 11% versus the second quarter of 2010. Our partnership with SCI continues to generate strong sales for the business, these sales in excess of $200 million during the quarter led to higher invested assets and a corresponding increase in investment income.

Turning now to Assurant Specialty Property, net operating income was approximately $43 million. This includes nearly $43 million of after tax reportable catastrophe losses versus approximately $5 million of such losses in the same period last year. As a reminder, we define a reportable catastrophe loss as an ISO event that results in a loss of $5 million or more.

The addition of new lender placed clients and loan portfolios during 2010 and an increase in the overall placement rate continued to sustain gross earned premiums in our lender placed business. Second quarter net earned premiums declined slightly due to additional premiums seeded to clients and increased catastrophe reinsurance premiums. Excluding the reportable catastrophe losses, the combined ratio increased for the quarter due primarily to an increase in the frequency of weather-related losses.

During the second quarter, we announced the completion of our catastrophe reinsurance program, although the rates were comparable to last year, we bought additional coverage since our exposure has grown so our reinsurance premiums will be approximately $25 million higher this year, complete details are available on our website.

Turning next to Assurant Health, please remember that current results are not directly comparable to prior year results due to changes in our business model and the premium rebate accruals required under healthcare reform.

Second quarter 2011 net operating income was $5.2 million. The sequentially lower effective tax rate in the second quarter was driven by the improved profit outlook for the year. Higher expected pre-tax profits mean that the new limits on certain tax deductions will have a smaller impact on our effective tax rate.

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Earned premiums for the quarter were $425 million, net of a premium rebate accrual of $17 million. We now estimate that the full year premium rebate liability will be in the $70 to $80 million range.

Delivering on our commitment to reduce expenses was an important driver of results. During the quarter, we cut expenses by 17% or $24 million from a year ago. We've made significant progress in putting Assurant Health on a path to profitability in this challenging environment. Future profitability will be impacted by the pace of our evolving product mix as we modify our business model to serve the needs of consumers.

At Assurant Employee Benefits, net operating income was $8.5 million. The year-over-year decrease was due primarily to less favorable disability and life experience including the previously discussed impact of lowering the reserve discount rate. Improved dental results partially offset the decline. Disability incidence rates remain in line with expectations. However, disability experience in the second quarter continued to reflect lower claimant recovery rates.

Second quarter net earned premiums were down compared to the second quarter of 2010 and we expect full year 2011 premiums to be down as well. The decrease reflects pricing actions on a block of previously assumed disability business and lower prior year sales.

Growth in voluntary and supplemental products improved persistency in our primary book and signs of organic growth are partially offsetting the overall premium decline.

Turning now to corporate matters, as part of our ongoing investment portfolio management activities, the company executed a number of transactions during the quarter that modestly shorten the duration of our portfolio. The tax treatment of some of these transactions allowed us to release a tax valuation allowance associated with deferred tax assets. This increased our net income and book value per share and will add to corporate capital as we file future tax returns.

We were very pleased to announce the SureDeposit acquisition during the second quarter for $45 million. We expect the internal rate of return on this investment to be well in excess of our cost of capital and we have the potential for even higher returns as we market our expanded product offering to our customers and those of SureDeposit.

Annualized net earned premiums for the acquired business are approximately $35 million. In 2011, we expect to earn about $10 million of premiums and fee income since it will take several months to transfer existing business and begin writing new business in our insurance paper.

Approximately $26 million of the purchase price was recorded as intangible assets and the remaining $19 million was allocated to goodwill. The intangible assets will be amortized through our income statement over approximately nine years. We expect the transaction to be accretive to our earnings this year.

As Rob mentioned, during the second quarter we repurchased 3 million shares for $110 million, bringing the total of the first half of 2011 to 7.4 million shares at a cost of $284 million. In the third quarter through July 22nd, we repurchased an additional 512,000 shares for approximately $18 million. We continue to view our share price is undervalued and expect to continue to repurchase shares during the remainder of the year.
And, with that, I'll ask the operator to open the call for questions.

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Question and Answer

Operator

Thank you. (Operator Instructions) And our first question will come from Ed Spehar with Bank of America.

Rob Pollock

Good morning, Ed.

Mike Peninger

Hi, Ed.

Ed Spehar
Bank of America

Good morning. Thank you. Mike, you were going a little bit quick there. I was just wondering if you could sort of go back at Solutions and could you cover again a little bit of some of the drivers in domestic and what you had said?

And then I wanted to ask a question on the dividends that have been taken so far in the year-to-date, from the subsidiaries and how you are thinking about sort of the capital structure debt issuance or anything else in terms of if you happen to find other acquisition opportunities? Thanks.

Mike Peninger

Okay. I'll talk about Solutions and then turn it over to Chris, but what I mentioned, Ed, was that earned premiums are increasing in wireless and retail and domestic. We continue to get nice growth in Latin America and then in terms of the overall premiums you've got the offsetting decline that we've talked about in the past from Circuit City and domestic credit business.

Christopher John Pagano
Executive VP & Chief Risk Officer

And that the improvement, Ed, if you recall, we have been working hard on our risk management efforts in Solutions and so business that they wrote in '09 and '10 was better than earlier years and is now earning off the balance sheet. Okay? So we feel good about that but as Mike pointed out, our target on that is 98.

Mike Peninger

Right. And that's what we believe is kind of our price for levels there. And if we turn -- Chris, do you want to comment a little bit on operating company dividends?

Christopher John Pagano
Executive VP & Chief Risk Officer

Sure. Let me -- maybe start and give you a couple of reconciliations and then I'll talk a little bit more about the outlook and some of the other elements of capital management. But, we started the first -- we ended the first quarter, excuse me, with $585 million of holding company capital in aggregate. We took $160 million of dividends.

We spent or returned about $127 million to shareholders, $17 million in the form of shareholder dividends and then $110 million of repurchases. That leaves you at about 620. Then corporate had some cash in-flows which is really just a reflection of timing differences of about $30 million.

Keep in mind, in the first quarter that cash outflows were about 60. So you are looking at, again, the difference between cash and accruals. That leaves you with the 650 at the end of the second quarter. What's not in there, okay, is the $45 million purchase price of SureDeposit. What we did there was rather

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than take a dividend from Specialty Property from earnings and then send the money back down to buy SureDeposit, Specialty Property just wrote the check out of their first half earnings.

Now, if you think about -- let's talk about first half results and then on a go-forward basis, got about $250 million of net operating income in aggregate for the first half, $160 million of dividends. That leaves 90 of earnings that are still at the segments available for dividends. We spent -- Specialty Property spent $45 million of that. So we got to think about it as the first half earnings that were available for dividends in the second half, about $45 million.

Now, in terms of kind of the outlook and Rob and Mike both mentioned that we are expecting to be in the market, repurchasing shares for the balance of the year, which includes through cat season. We feel very good about the capital position, $400 million of deployable capital, some additional earnings available from the first half, as I mentioned.

On the M&A front, there's nothing imminent and given our process and our rigor around M&A, it's more likely that the deals that will meet our criteria are going to be smaller deals, similar in size to SureDeposit which are not going to affect our ability to buy back shares. So, again -- and on top of that, we've got shares that are very undervalued.

We've got 11 -- we're trading at $11 below book value. So share repurchase is an appropriate use of deployable capital. We expect to be doing that throughout the rest of 2011.

Ed Spehar
Bank of America

I have to follow up because I want you to keep saying all this stuff. But when you talk about the willingness to buy back stock through cat season which is a pretty significant change, I think, for you guys, I mean, is it same kind of, you know, thinking about buybacks in the third quarter the same way you think about buybacks in any other quarter or is there still a little bit different view?

Mike Peninger

Yeah. Well, I think we look every quarter at what's going to happen in the quarter, you know, looking forward, Ed and evaluate what our capital position is relative to what we see going on. Now, Chris and his team did a tremendous amount of work on the Risk Management side to help us better qualify tail event risk, okay.

That was a big part of our Risk Management process over the last of couple years, which has given us a better line of sight on our capital position and understanding of where we sit as we move into things. Other thing I'd point out is our method of buying stock is a 10b5-1 plan and we have flexibility around how we set up and structure that program. Okay?

Ed Spehar
Bank of America

And just one last one, what is the -- what do you consider to be the debt capacity today?

Christopher John Pagano
Executive VP & Chief Risk Officer

Again, it's similar number that we said in the past, $3 million to $350 million of opportunistic debt capacity. We were at just under 18% debt-to-total cap, so it gives us a lot of room there. The other thing on the financial flexibility side and one thing that we're looking at carefully right now is the possibility of extending the maturity of our credit facility. The current facility is due to expire at the end of 2012. We believe we can put another facility in place that goes out to 2015, will just give us a little bit more flexibility on that front as well. The other thing I would point out…

Ed Spehar
Bank of America

Mike…

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Christopher John Pagano
Executive VP & Chief Risk Officer

Sorry, Ed.

Ed Spehar
Bank of America

No, no. I was just -- go ahead.

Christopher John Pagano
Executive VP & Chief Risk Officer

Okay. The question around capital and on a go-forward basis, Rob's point about us re-assessing it every quarter, which we continue to do and I think the way we looked at this quarter is that with $400 million of deployable capital and a share price trading where it is, this is a good time to deploy capital and return it to shareholders via share repurchase.

Ed Spehar
Bank of America

Thank you.

Operator

(Operator Instructions) Our next question comes from Chris Giovanni with Goldman Sachs.

Rob Pollock

Good morning, Chris.

Chris Giovanni
Goldman Sachs

Good morning. Thanks so much. One follow-up just on the capital, I mean, is the cat reinsurance program where you guys bought more coverage maybe giving you guys a little more comfort to purchase shares, maybe earlier than you would have originally expected?

Mike Peninger

Well, I think certainly the ability of our decision to buy the program -- the cat program in two steps allowed us to take advantage of the cat market earlier in the year, which gave us I think more cover or perhaps a better program than we might had we bought it all at once in June. I think the issue around cat and what's going to happen with the reinsurance market on a go-forward basis is really going to be a 2012 event, but the issue around being able to buy back through cat season -- I think is really about having $400 million of capital above and beyond the buffer which is what we set aside to protect us against tail risks such as cat. So again, it's the strong capital position, a good feel for the ability to get earnings out as dividends from the operating segments and a share price that's -- as I said very undervalued.

Chris Giovanni
Goldman Sachs

Okay. And then in the health segment, Rob, you had mentioned sort of $24 million of expense saves to date. Can you talk about, sort of, how much room you have left there? And then also, I know in 1Q you guys expressed some optimism around seeing a sequential improvement in sales and that sort of receded here in 2Q, so can you comment if that's sort of seasonal or is there something else going on there?

Rob Pollock

Sure. Couple of things and then I'll let Mike make some comments as well. But first, Chris, the $24 million is a quarter-over-quarter compared to the 2010 number, all right? And as we outlined last year, we took some expense actions last year to reflect the new environment. We've made changes to our commission

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structures. We are pleased with the progress but we know that more will be required going forward as the models change, because we are just operating off a different model.

The old model was get to the lowest combined ratio you can, the new model is we are operate -- you want to manage that loss ratio to the required level and then you are operating off the difference and that's where our profits have to come from. So we are pleased with the progress we are making. It demonstrates we can adapt as the market changes and we feel quite good about the progress we are making.

Related to the sales side of things, you know, there is a bit of seasonality. I'd also say, though, we are working through adoption by the brokers to the change in the landscape. We are pleased. We're holding seminars on that to get them up-to-speed on that. We're doing integration with our enrollment system. Actually, we've had some very good progress with our supplemental products and attachment rates there. So we feel good about that. Mike?

Mike Peninger

I was just basically going to say the same thing that when you look at our sales, we've got sort of the traditional core products and then we've got the affordable products that we're selling that we think are meeting. So we think we cover the gamut of, sort of, consumer needs out there and we're seeing solid results, as Rob said, in the adoption of our affordable plans that we feel quite good about, actually.

Chris Giovanni
Goldman Sachs

Okay. Thank you and then just one last one. In Specialty Property, have your sort of steady state scenario that you provided at Investor Day, has the time line or any of that changed given, you know, maybe some of the more lackluster, you know, macro and housing data that's come out recently?

Mike Peninger

I'll start and say I think Gene provided a really good outline in the Investor Day at our view on what could happen. Obviously, we had a little pickup in placement rates again during the quarter. I think our belief is still that those will peak sometime this year, but, you know, we acquired clients in 2010. That's helped lift our -- we are quite focused on that gross earned premium number and those have grown some.

We mentioned that we will have another client coming on-board late in the year that will produce next year. That, again, will emulate that track level that Gene's outlined. The big one is obviously is going to be the economy and government policy relating to supporting housing and we don't have a clear line of sight on that, Chris.

Chris Giovanni
Goldman Sachs

Okay. Thank you very much.

Operator

And next we'll hear from Mark Hughes with SunTrust.

Mark Hughes
SunTrust

Thank you. The 200,000 loans that are coming over, are you getting all of the existing premium on that? Are you going to start to billed once they get transferred?

Rob Pollock

We believe that one's going to be a flat cancel, Mark.

Mark Hughes
SunTrust

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Okay. So you would get all the premium in that case?

Rob Pollock

Yeah. What that means is that beginning in the first quarter, we will get the premium on the policies that exist today and then new placements will be ours as well.

Mark Hughes
SunTrust

Nice. The gross written premium in Solutions is quite strong. You talked about the wireless retail, automotive. Were there new relationships there that helped give you a nice boost? How sustainable is that momentum as we look at the next few quarters?

Rob Pollock

Yeah. We feel that Solutions is developing some good momentum and that some of the growth is coming from our Lowe's relationship, Mark, and that one, remember, is top line but heavily reinsured, so not all of that drops through to the bottom. And we kind of provided that outlook for this year. The earned premiums will be leveled despite the credit and Circuit City declines, but we should see net earned premium growth next year.

I think if you can look on the balance sheet a little bit at the unearned premium within Solutions and that's growing, again, as Mike pointed out, the Lowe's account is heavily reinsured right now. But we are working hard to figure out how we can add additional value to that account. But Solutions is definitely finding some opportunities out there we feel, like that momentum is starting, so that's good.

Mark Hughes
SunTrust

Right. And then any regulatory updates on the Specialty Property side, anything you see that has changed?

Rob Pollock

No. Again, we think we have a very compliant program. We think that we are operating within all the rules. We are really not a party to any of the discussions that are going on with the state AGs and the servicers, but obviously, we look forward to resolution of the issue because we think that it's certainly something that is weighing on us.

Mark Hughes
SunTrust

Thank you.

Operator

And our final question will come from Ed Spehar with Bank of America.

Ed Spehar
Bank of America

My question was answered. Thanks.

Rob Pollock

Sure.

Operator
And this concludes Assurant's second quarter 2011 call. Please note that a replay will be available as of 11 a.m. You may now disconnect.

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