S&P Global
Market Intelligence

Kemper Corporation NYSE:KMPR

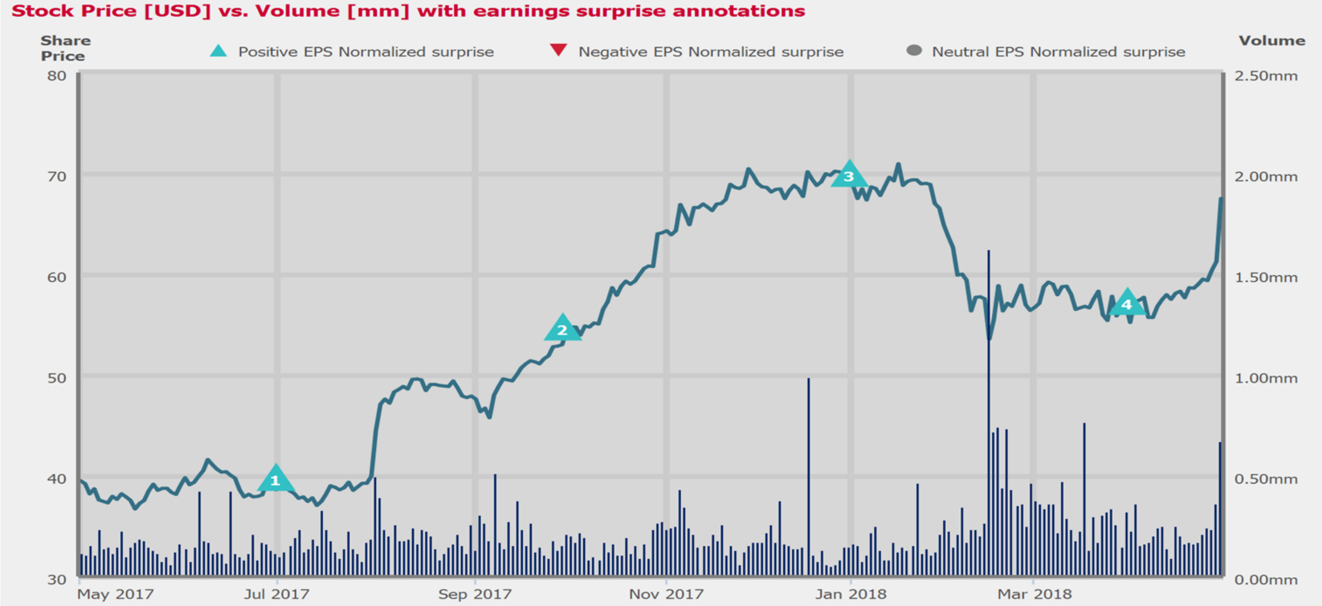
FQ2 2018 Earnings Call Transcripts

Monday, July 30, 2018 8:15 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2018-			-FQ3 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.74	0.70	▲(5.41 %)	1.27	4.00	5.55
Revenue (mm)	706.27	737.70	▲4.45	1127.40	-	4620.00

Currency: USD
Consensus as of Jul-30-2018 2:51 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2017	0.23	0.41	▲1 78.26 %
FQ3 2017	0.28	0.85	▲2 203.57 %
FQ4 2017	0.30	0.60	▲3 100.00 %
FQ1 2018	0.74	1.10	▲4 48.65 %

Table of Contents

Call Participants

EXECUTIVES

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

James J. McKinney
Senior VP & CFO

Joseph Patrick Lacher
President, CEO & Director

Michael A. Marinaccio
Investor Relations

ANALYSTS

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

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Gary Kent Ransom
Dowling & Partners Securities, LLC

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

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

Matthew John Carletti
JMP Securities LLC, Research Division

Presentation

Operator

Good afternoon, ladies and gentlemen, and welcome to Kemper's Second Quarter 2018 Earnings Conference Call. My name is Cole, and I will be your coordinator today. [Operator Instructions] As a reminder, the conference is being recorded for replay purposes.

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

Michael A. Marinaccio
Investor Relations

Thank you, Cole, and good afternoon, everyone, and welcome to Kemper's discussion of our second quarter 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; Duane Sanders, Kemper's Property & Casualty Division President.

We will make a few opening remarks to provide context around our second quarter results and then we will open up the call for a questions-and-answer session. During the interactive portion of the call, our presenters will be joined by John Boschelli, Kemper's Senior Vice President and Chief Investment Officer; and Mark Green, Kemper's Life & Health Division President.

Before the markets opened this morning, we issued our earnings release and published our second quarter earnings presentation, financial supplement and Infinity supplementary financial information. In addition, we filed our 10-Q with the SEC. You will find these documents on the Investors section of our website, kemper.com.

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

This afternoon's discussion includes non-GAAP financial measures that we believe are meaningful to investors. In our financial supplement, presentation and earnings release, we have defined the -- and reconciled non-GAAP financial measures to GAAP, where required, in accordance with SEC rules. And finally, all comparative references will be to the second quarter of 2017, unless otherwise stated.

Now I'll 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. Before I jump into our second quarter results, I'd like to begin by highlighting Kemper's commitment to our strategy of building strength in core businesses, which focus on growing niche and underserved markets. On July 2, we achieved an important milestone in enhancing our position in one of these businesses with the consummation of acquisition of Infinity. This acquisition accelerates our progress towards becoming the premier specialty auto franchise in a niche market through enhanced revenue growth and the addition of a talented team of committed associates. I'd like to welcome the 2,200 Infinity employees that are now part of the Kemper family. We're all stronger together, and I'm proud of how far we've come in becoming a more powerful team.

As you can see from Page 3, Kemper is a national multiline insurer providing specialty auto, preferred home and auto, and basic life, accident and health products and a market capitalization over $5 billion. Our distribution network consists of 2,200 career agents and approximately 30,000 independent agents.

Turning to Page 4. Our long-term perspective remains focused on building Kemper's overall value by leveraging our competitive advantages while building core capabilities in order to maximize the value we deliver to all our stakeholders. Approximately 2 years ago, we set forth a strategy to unlock the embedded value within each of Kemper's businesses. We remained focused on this execution, and we've made significant progress. Our success is evidenced by the quality of leadership we've attracted, the significant turnaround of our specialty auto business and our recent acquisition of Infinity. We've also continued to make great strides in our initiatives to unlock the value within both our Life & Health and preferred home and auto businesses. The diversified revenue stream provided by all of these businesses adds tremendous value to our organization.

Now let's turn to Page 5 and look at some of our second quarter highlights. Overall, we had a strong quarter, reporting net income of $37.6 million or $0.73 per share. Adjusted consolidating net operating earnings per share increased from $0.41 per share to $0.70 per share. Earned premiums increased 13% in the quarter to $658 million, primarily driven by volume growth within our specialty auto business. In the P&C segment, strong top line growth was driven primarily by policy growth in the specialty auto business, which posted a 29% increase in policies-in-force and a 32% increase in earned premiums. In addition to strong growth, the P&C segment's underlined combined ratio improved 2.2 percentage points in the quarter, largely driven by the specialty auto business, which improved by 2 percentage points and contributed a greater percentage of premium to the segment.

Our Life & Health segment continues to provide a stable source of earnings with predictable cash flows. Net operating income increased $6 million in the quarter. Our core investment portfolio continues to be a strength, delivering a consistent income stream. This quarter, we reported net investment income of $78 million. Our balance sheet and capital levels remain strong post our acquisition of Infinity. We currently have approximately $500 million of parent company liquidity, consisting of over $140 million of cash and investments at the holding company, plus borrowings available under the revolving credit agreement and from our subsidiaries. We have over $100 million of excess capital. Despite our recent acquisition of Infinity, our debt-to-capital ratio of approximately 27% is very manageable and is expected to return to the low to mid-20s within the next 12 months.

Lastly, I would point out that we amended and extended our credit agreement, increasing revolver capacity to $300 million. In keeping with our theme of attracting talent, we're excited to have Teresa Canida join the board of directors after having served on Infinity's board for the past 10 years. Her experience and residency in a key South Florida market will provide valuable insight and strength to our team.

With that, I'll hand the call over to Jim to discuss our consolidated financial results in more detail.

James J. McKinney
Senior VP & CFO

Thank you, Joe, and good afternoon. I'll start on Page 6 and review our consolidated second quarter results and then briefly touch on our Life & Health results. Overall, we had a successful quarter. Net income was $37.6 million or $0.73 per share. This is up from $36.6 million or $0.71 per share last year. Adjusted consolidated net operating income was up 74% to $36.5 million or $0.70 per share for the quarter compared to $21 million or $0.41 per share in the prior year.

Earned premiums increased 13% from last year or $76 million in the quarter to $658 million. Our investment portfolio continued to provide us with consistent returns, with a pretax equivalent annualized book yield of 5%, delivering $78 million of net investment income in the quarter. Book value per share, excluding unrealized gains on fixed maturities, ended the quarter at $36.85, up 5% from $35.13 last year.

On the bottom of the slide, you'll note that we continue to profitably grow our P&C policies-in-force while improving both the underlying loss ratio and the expense ratio. In the life business, we are beginning to see an end to the decline in policies-in-force and the face value of the book.

Turning to Page 7. We isolated the key sources of volatility in our earnings. In the highlighted section at the bottom of the page, you can see the underlying operating performance for the quarter. Quarter-over-quarter, we improved underlying performance 58% or $0.48 per share as we remained disciplined in our approach to strategy execution. Overall, we're pleased that our underlying operating performance remains strong, as we seek to optimally manage the risk reward trade-off on each of these sources of volatility.

Our Life & Health division's results are on Page 8 of the presentation. On the top half of the page, you can see the stable revenue trend continued. Earned premiums increased $4 million to $157 million, while net operating income improved to $26 million. This increase was primarily driven by an 11% increase in A&H earned premium, the Life & Health division overall continues to provide stable and diversified earnings with predictable cash flows.

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

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

Thank you, Jim, and good afternoon, everyone. I'll begin with the a discussion on specialty auto on Page 9 of our presentation. We continue to see significant improvement across our entire specialty auto business. Direct written premiums grew by $88 million; our best guess that roughly $30 million came from business entering the marketplace since Access Insurance was forced to seize operations. This highlights the strength of our market position.

Earned premium increased to $308 million for the quarter, up $74 million or 32% over the second quarter of 2017. We estimate that former Access business accounted for roughly $20 million of that increase. The top line growth was primarily fueled by higher volume as policies-in-force increased 29%.

More importantly, this growth was achieved profitably as reflected by the improved underlying combined ratio. Specialty auto's underlying combined ratio improved 2 percentage points over the second quarter of 2017. The business benefited from moderating loss trends, rate actions and increased scale. With the combination of Infinity, specialty auto is expected to further enhance the value we provide to all of our stakeholders.

Moving on to Page 10. Our preferred auto business continues to show improvement. While our underwriting results remain below our target profitability goals, we're seeing improved underwriting results work its way through the book as we benefit from rate increases and moderating loss trends.

Turning your attention to homeowners. The underlying combined ratio was 81.6, about 2 percentage points higher than last year, primarily resulting from the ceded premium for our aggregate cat treaty. Results were also impacted from a one-time TWIA assessment related to Hurricane Harvey. The team remains focused on rate action, claims and underwriting practices to bring this business to an appropriate level of profitability. I'll now turn it back to Jim.

James J. McKinney
Senior VP & CFO

Thank you, Duane. Turning to investments on Page 11, this area continues to be a strength for Kemper. Our portfolio is diversified, highly rated and has performed well over time.

On the bottom left of the page, we've broken out the portfolio by investment type and provided the fixed maturity ratings. The portfolio continues to be conservative in nature, with approximately 80% comprised of fixed maturities and of those, 90% are investment grade.

Looking at the chart in the upper left, you can see our performance over the past 5 quarters. This quarter, we delivered $78 million in net investment income. The core portfolio produced higher net investment income due to growth in the underlying life and specialty books. The alternative investment portfolio generated income of $7 million. Overall, in the second quarter, the portfolio delivered an attractive pretax equivalent annualized book yield of 5%.

Turning to Page 12. We highlight our strong capital and liquidity position. At the end of the second quarter, we had debt-to-total-capitalization ratio of 32% as we prefunded the cash portion of the Infinity acquisition. Post the close of Infinity, we are now at 27%. We expect the debt-to-capital ratio to revert to the low to mid-20s within the next year.

In the chart in the upper left-hand quarter, you can see our parent company liquidity. At quarter-end, we had $709 million in cash and investments and $350 million in borrowings available from our revolver and insurance subs. Again, this is not representative of our current position as we are holding an extra $565 million of cash for the closing of the Infinity transaction. After settling the transaction, we now have $144 million in cash and investments, allowing the HoldCo to serve as a source of strength for our subsidiaries while providing ample annual operating expense coverage.

Looking at the chart in the upper right, you can see our insurance groups remain well capitalized. If you look at the bottom left of the page, you can see that other businesses continue to generate substantial operating cash flows that are expected to grow considerably with the addition of Infinity.

If you will now turn to Page 13, I will provide you with more detail on the economics of the Infinity acquisition. The transaction was funded with 13.2 million shares of Kemper common stock and approximately $565 million of cash consideration. The cash consideration was partially funded by a $250 million term loan and $110 million in borrowings from the FHLB. We fully repaid the FHLB borrowings related to the Infinity acquisition on July 13. When we announced the acquisition in February, based on our 20-day volume weighted-average price, the transaction was valued at $1.4 billion. At the close, given the appreciation in our stock, the ultimate consideration paid was $1.6 billion.

Turning to Page 14. We have decided to share Infinity's second quarter results as they will not be filing a 10-Q this quarter. Additionally, I will point out that we have provided Infinity's supplementary financial information on the Investors section of our website.

Before transferring the call back to Joe, I would like to highlight a couple of items from Infinity's second quarter. Infinity's earned premiums increased to $374 million for the quarter, up $35 million or 10% over the last year from a combination of policy growth and higher average premiums per policy. We estimate that business from Access accounted for roughly $8 million of that increase. At the same time, Infinity experienced a strong uptick in its underwriting profitability. The combined ratio improved by over 8 percentage points as a result of improved loss cost trends in California and Florida, higher average premiums earning in from prior rate increases and the fact that last year's combined ratio was artificially high by 3.6 percentage points as a result of the California premium refunds. 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 results this quarter demonstrate the significant progress we've made on Kemper's transformation and the effective execution of our strategy to date. Specifically, the strong growth and profitability of both our specialty auto businesses further solidifies and validates our thesis for the acquisition of Infinity. We've made tremendous progress in the integration of our organizations and are excited about the power of the combined platform. 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 Greg Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

I have a couple questions for you. First off, I know you've laid a road map out for expense savings as a result of the merger with Infinity, and I was wondering if you could spend a minute and just sort of close the chapter on the first restructuring initiative that you guys launched in 2016 and sort of run through where you initially set your goals and what the final resolution was, especially when we think about the context of I think you initially had said $55 million of cost savings from Infinity by second quarter of 2020.

Joseph Patrick Lacher
President, CEO & Director

Yes, sure, I'll give you a couple of comments and then Jim will tag-team maybe with some more specifics on it, Greg. I think we talked 2 quarters ago, maybe it was 3, I'm going to forget the exact timing, about the initial $50 million to $65 million that we targeted for expense reductions as part of our initial strategic plan, this team's initial strategic plan in September of 2016, and described ourselves as having achieved that earlier than expected and it was baked into the run rate going forward. I don't think we gave you a precise number on where we were but said that's done and that anything that came from the Infinity acquisition was on top of that. We had exceeded that initial goal and the cost savings from the transaction were incremental on top of that but not taking into any account double counting, which I think is what you were trying to target.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Yes, that's exactly what I was looking for.

Joseph Patrick Lacher
President, CEO & Director

We booked the first ones and you get another $55 million.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay, great. Thanks for that color. The Infinity results, I have to go -- I was looking at my model in the context of their combined ratio results and, boy, you have to go back several years to where they were generating combined ratios in the low to mid-90s. Can you talk a little bit about how you're going to -- what you're going to do with that platform from an expansion standpoint? If they're running so profitability in -- I think there was just 4 core states, do you expand -- expect to expand that platform over the next 4 quarters to 8 quarters? Or is that more of a long-term strategic objective for you?

Joseph Patrick Lacher
President, CEO & Director

Greg, what we're going to do is, we're going to take our specialty auto businesses and we're going to pull them together and have them function as one unit. We're not going to think of them long term as a portfolio of competitors inside the company. We'll be bringing those together. There are places where Infinity clearly had a meaningfully stronger platform than Kemper did. As an example, South Florida or all of Florida. So we'll leverage all of Infinity's strength there. There's cases like California where it's more complicated. We had not fully consolidated our Alliance United business into the Kemper business, so we've got a little more work to do with super groups as a start but then to figure out how those pull together. But we will ultimately operate this as one specialty auto franchise and one specialty auto business. We'll push to get on one combined platform and really look to get the benefits of strength and scale from -- by taking the best of both organizations.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. And two final questions, one on the preferred auto, it's still running above $100 million, but it is improving. Can you provide us an update on that market and where -- when do you expect to get to your target margins and the timing of that?

Joseph Patrick Lacher
President, CEO & Director

Yes, we continue to make progress inside of preferred auto. It's not moving as fast as any of us want it to, but it's moving at a reasonable pace, given a variety of items. We've got a lot of states that we're operating in with more modest premium volumes. And we are typically dealing with 12-month policies, not 6-month policies. And I think there's just a general bias in a specialty auto or nonstandard market, it's easier to access and get rates when things go a little sideways because it tends to go a little more sideways more severely. So we fully expected the prefer auto to take a little longer because of that 12-month policy timing and because of the wider spread of states. We're going to continue to march aggressively forward. We are optimistic and continue to get optimistic about that business because we're going to share a claim department across our P&C platforms. The increased scale and the increased strength we're getting from the combination of Infinity and Kemper specialty auto business and the growth we have there will just make that claim department more effective for all of our businesses. So we'll get some extra -- hopefully, some extra lift and maybe accelerant coming off of that.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Perfect. And then on Slide 4, I just was struck by -- at the bottom of it and it's not something that's really changed, but your objective to deliver a low double-digit ROE over time. It feels like with the rate of recovery and improvement that legacy Kemper has been able to realize, coupled with the opportunities at Infinity, that getting to a mid-teens ROE seems more realistic near term given what's going on in the market. And I'm wondering if I'm just missing something or perhaps this needs to be freshened up or -- to reflect the realities of the current market.

Joseph Patrick Lacher
President, CEO & Director

What we're trying to do, Greg, is provide a longer-term ROE target, not a near term one. Near term, it's definitely a terrific marketplace. We don't want it be changing that kind of target just based on whether or not we're in a soft or a hard market. We would look at it and in our view on it was once you get in, particularly in the P&C business, because that's a little bit of what we talking about right now and if we're in a P&C auto business, we believe the best way to build long-term shareholder value is to hit an attractive and appropriate margin for the business and then try to grow that business more significantly over time. We could work to expand margins and that would significantly hurt growth. And we think that near term might look more attractive on the margin basis but long term isn't going to be as good for shareholders or the health of the business, our ability -- or our ability to [dig] and build value long term. We have a portfolio of businesses and they operate at different ROEs, so we're sort of thinking through that as we talk about that target.

Operator

And then next question comes from Matt Carletti from JMP Securities.

Matthew John Carletti
JMP Securities LLC, Research Division

Greg covered a bit of what I had, but I just have a few more kind of numbers questions. First one on the cat aggregate treaty, would that just relate to the legacy Kemper business or will the acquired IPC business become part of that? I realize that home is the biggest exposure there and so there's not as much coming with IPC but just for modeling purposes.

James J. McKinney
Senior VP & CFO

Yes, the cat aggregate treaty is specific to the property business at Kemper, maybe we'd cover again the risk associated with that business.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, great. I guess, next question just on -- you talked a little about the impact that -- the benefit that you thought Access had to the nonstandard book in the quarter. Do you think we're through most of this at that point? Should there be some more in Q3? And I'm thinking that most of those were probably 6-month policies and kind of working their way out or am I thinking about that wrong?

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

No, no, I think you're correct. This is Duane by the way. I would suggest that you're thinking about it right, albeit the consumers that would've -- might have gone down that path in the past are still in the marketplace, so I think you'll continue to see some volume coming our way. But in terms of the initial component, we're pretty much past. I think the order was given in mid-March and they had to have a lot of that out by mid-April and then it was a little bit of a trail. However, I think you'll still see some of that play out in the marketplace over time.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, so it's fair to say probably Q2 is the peak but there should be still some follow through most likely?

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

Yes. I would agree.

Matthew John Carletti
JMP Securities LLC, Research Division

Great. Okay. And then...

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

I'm sorry?

Matthew John Carletti
JMP Securities LLC, Research Division

No, go ahead.

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

I was saying, potentially what that will -- we'll watch the business. We try to monitor any of the cohorts they come through to the extent we can identify which -- what parts of our businesses are coming through Access and with that we'll watch the corresponding loss ratio and the movement.

Joseph Patrick Lacher
President, CEO & Director

We've got a little bit of an expectation -- we've got a little bit of an expectation with that, Matt. There -- that business is coming in geographies and cells that are running a tiny bit hotter for us, so we wouldn't be surprised -- if you're thinking about it from a modeling perspective, we wouldn't be surprised to see the loss ratio get a little pressure from that. We're confident where our margins are. But we do know that, that business has a little bit of a different mix than the business we have to date and it's coming through in a sufficient amount of volume. We think the written premium impact is through, the earned premium will effectively work its way through and there might be a little bit of pressure on the loss ratio.

Matthew John Carletti
JMP Securities LLC, Research Division

Okay, that make sense. And then just last question. Joe, in the past I think you've kind of termed the life business as core or essential to the company. The life has stopped shrinking, the A&H has started growing very nicely, can you just give us an update on kind of the efforts that you've put in place there? And how you see that evolving in coming quarters and years?

Joseph Patrick Lacher
President, CEO & Director

Yes, great question. That business has been one where a lot of what Mark and his team have been doing is focusing on some heavy blocking and tackling. That business had suffered from some very significant underinvestment. And there were -- there's some basic stuff that the organization hadn't been doing and we're tweaking that. It's changing processes and how do we move paper through the system? How do we shift away from paper into doing things electronically? How do we deal with better hiring, training, retention of our sales people? How do we attack lapsed policies and appropriately try to retain them? A lot of small ball baseball. You're doing a lot of the little things better. And as we get more effective in that case -- in those cases, we'll start thinking about maybe doing things a little bigger or a little broader in that process. It may be work in different components of our product or different sales opportunities or different items. I think it took us a little longer than we might have initially guessed in early '16, but we're pleased with the progress we're making inside of both those organizations on building those core capabilities.

Operator

And the next question comes from Jeff Schmitt from William Blair.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Question on the $8.5 million of dealer-related transaction integration costs. What was the nature of those? And what do you expect for that over the next few quarters? Or was that just a one-time expense?

James J. McKinney
Senior VP & CFO

Yes. Thanks, Jeff. Big picture-wise, those are included inside kind of the $70 million in terms of total expenses that we had forecasted in terms of bringing the 2 businesses together. I would think about those as kind of one-time expenses. Some of the items that are kind of inside of that are related to write-offs of essentially technology or stuff like that, that you're not going to use any for. It could be some severance items or other components that are inside there as well as kind of diligence and other cost, which represented kind of a larger component of the front end if you're going back to kind of Q1 with the totality of that number. And so it's really about -- it's those things that you would expect to kind of take place both now and then as we go forward over the next 1.5 years in terms of when we'll kind of reach the end state. And big picture-wise, no change to the total number. It's probably back half if you're trying to model it from just a cash flow standpoint of that. But right now no change in estimates, and we continue to kind of move forward with our initial plan.

Jeffrey Paul Schmitt
William Blair & Company L.L.C., Research Division

Okay. And then the nonstandard auto book, just looking at the top line there, it was [MPW] growth I guess 37% and [PIF] of 29%. And I guess that sort of implies kind of high single-digit rate increases. Is that the right way to think about it? And how does that compare I guess to last couple of quarters?

Joseph Patrick Lacher
President, CEO & Director

Yes, I would say that's probably -- I think, you're close to mid- to single-digit rate change. Some of the other impact running through it, Jeff, is mix. And that has a piece of it. We're sort of doing the calculations -- [vacated] back into it, as Duane was starting to answer. It's probably 2/3 rate oriented, 1/3 mix oriented as a back-of-the-envelope guess. I'm not with a calculator doing that but that's close.

Operator

And the next question comes from Paul Newsome from Sandler O'Neill.

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

I think you've covered a lot, but I just have one question left, which is, I wanted to ask about if there's any update to your thinking about the cost of funds related to the deal when we're thinking about modeling Infinity, given that you've actually now put the funds in place?

Joseph Patrick Lacher
President, CEO & Director

Paul, you're cutting out a little bit, Paul. We heard you saying that -- we updated our thinking on cost of funds, but we were losing you a little bit in the question.

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

I apologize. I'll see if I can talk a little bit louder. I don't know that will help or not. But I'm curious if -- now that you've closed the Infinity deal, if the cost of funds for the transaction has changed materially. It's just a modeling question as we're thinking about Infinity and how it should roll through into the portfolio?

James J. McKinney
Senior VP & CFO

Yes, Paul. Good question. Big picture-wise, they've marginally come down from the expectations that we had included in the S4. I wouldn't suggest it's an overly material number, but they have come down a little bit in terms of what we had modeled the transaction up from a cost of funds perspective.

Operator

And the next question comes from Gary Ranson from Dowling & Partners.

Gary Kent Ransom
Dowling & Partners Securities, LLC

I had a question on -- a couple of times during the opening remarks, you mentioned moderating loss cost and I think you mentioned it on Infinity also that they were seeing better trends. Can you give us a little more detail on what you're seeing in the nonstandard auto book on either frequency and/or severity trends?

Joseph Patrick Lacher
President, CEO & Director

Yes. The question -- or the comments from our part probably come from a little bit of a sense that if you back up 24 months ago, we were getting hammered with loss cost trends. And that's probably a little bit of what's in our heads, particularly California saw the peak of the pain and that's one of our biggest states. So things have moderated from there. I think we would describe loss cost trends as sort of the mid-single-digit, low single-digit sort of a normal type loss cost trend across all of our nonstandard businesses, whether it was Infinity or the different buckets that we took that as a legacy Kemper business in. Similar views across those. Maybe a little bit more of a temperature on the BI side relative than the physical damage. But all-in, low mid-single digit.

Gary Kent Ransom
Dowling & Partners Securities, LLC

Okay. And then on the growth in nonstandard, excluding the impact of Access, there was still very strong growth. I was just wondering if you can give us some idea of the market dynamics that's allowing that strong pace of growth.

Joseph Patrick Lacher
President, CEO & Director

This is a case where I believe the strength of the specialization of both organizations is coming through. We've got a lot of folks who have some pressure on their loss ratios and combined ratios and they're responding to that with rate and underwriting actions and that's causing more business to be in the marketplace. Both of our organizations saw those issues earlier, rectified those issues earlier and are in a more stable position to be ready and receptive in the marketplace to write that business. It's similar to what you're seeing with some other stronger players and stronger names that you consistently see able to deliver that performance, attractive margins and growth while other folks are cleaning up their shops.

Gary Kent Ransom
Dowling & Partners Securities, LLC

You have any reason to think that is going to change in the near future? Or [indiscernible]

Joseph Patrick Lacher
President, CEO & Director

I have every reason to think that it's going to change eventually. This is a cyclical business. I would love it if it stayed this way forever. But I fully expect what will happen is we'll see some element where those loss cost trends start to move a little less benign, and we see folks getting more attractive margins and you see more competitors getting more aggressive and then we'll see that same pressure on margins. And we're going to be disciplined folks trying to target that appropriate margins and appropriate growth to balance that trade-off. I fully expect it to change, I don't see it in the next quarter or 2.

Gary Kent Ransom
Dowling & Partners Securities, LLC

And then just maybe one last question on the integration. Is there -- granted it's only been 3 weeks or whatever, but any update on progress or what you've seen in the initial steps of the integration process? Any surprises or things that were better or worse than you thought?

Joseph Patrick Lacher
President, CEO & Director

I'll start with a couple of thoughts and then invite any of these guys who have other ones to add on. We actually started the integration process at about 10:00 on February 14th. We were setting up integration teams inside of a week of announcing the transaction and doing every piece of work we could. We're obviously weren't dealing with anything with pricing or marketing or customer-facing items, but all of the back office stuff we were working on. So we've got a huge jump on that. And to some degree, for a lot of the folks who were thinking about operational stuff, the closing date was just another day because they were already deep in that process. Generally, I think our commentary would be that we're -- the only thing we're surprised at really is how easily it's been to sort of come to decisions and figure out where we're moving forward. The organizations had similar cultures and similar thought processes on how they approach problems and we've been able to bang through those issues relatively and surprisingly briskly and are very pleased with what we found to date. Every integration and every combination has its share of challenges and speed bumps and items and we'll have all of those to come as we put these things together. But we're very pleased so far with what we're finding and have -- how the teams are working together, how collaborative they are, how quickly we are able to put aside whatever the old uniforms were and put on a new one together to figure out how we really unlock the value of the organization. So we're excited. I think we've confirmed that we think that the synergies we saw are there and are accessible and there's nothing that causes us any angst about being able to unlock those.

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

And Gary, this is Duane. I would echo one thing, not to be repetitive with Joe's comments, but I do believe that the -- what I'll call capability and talent match back and across between the 2 organizations, were kind of hand in glove. Where they -- they had some strengths, certainly were supportive of some of the things that we were doing and they also had some talent coming into the place and -- where we didn't and vice versa. So I think that helps facilitate moving the 2 places together. And so far we're fairly -- we're really pleased with where we are.

Joseph Patrick Lacher
President, CEO & Director

I think what you've got work running through the whole place is that a lot of times you have -- in an acquisition, you have a lot of people hearing footprints and worried about it. With the 2 organizations making the returns they are and with the growth they've got, the whole organization knows we're open for business and are excited about getting some of this internal stuff behind us so we can capitalize on that opportunity and it's exciting to be in that spot.

Gary Kent Ransom
Dowling & Partners Securities, LLC

So it sounds like there's no reason to think any of the -- I guess, there's a variety of synergies, including some longer-terms ones that stretched out into 2022, I think. I don't have them in front of me, but no reason to think any of those changed at this point?

James J. McKinney
Senior VP & CFO

Yes, there's no reason to think that any of those goals have changed from anything that we've forecasted and suggested in the market. To date, all information that we've received is that those items are very achievable, they're within our control and we have very clear line of sight to achieving them. Some of the them are in process right now and others obviously kind of come with time. And then I think relative to kind of the S4 and the positioning that we had there -- I can't remember if it was like Page 263 or 265 or whatever it is -- I think in terms of establishing kind of the base that we had indicated for where we thought profitability of the combined organization and where we thought we'd be stepping into kind of Infinity, I think our assumptions around that have been good. And we feel very comfortable in terms of both the synergy number going forward, the underlying profitability that we were stepping into, if not exceeding that base, as well as essentially the capabilities that we've gained from a talent and team perspective. All of them at this stage are coming together very nicely.

Operator

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

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

You may have already said this, but how much of the cost savings do you expect to drop to the bottom line in '19 versus 2020?

Joseph Patrick Lacher
President, CEO & Director

Yes, thanks, Adam. Good question. The way that we were kind of thinking about it is not necessarily kind of an '18 or a '19 item, but the way that we've kind of forecasted it out is relative from when closing occurred. What we've said and what we continue to believe is true, is that we'll have about half of those fall to the bottom line with -- inside the first year and kind of half in the second year. I would tell you those are probably back-loaded, to some extent, so I wouldn't model it from a linear fashion. But we think we'll achieve the same -- the dollars and the numbers that we've kind of outlined there. So you might think about that in terms of total profitability coming in around $25 million to kind of $30 million with inside that kind of first share.

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

Okay, thanks. And then have you made a decision on a policy management system? And if you have, what's the duration to get that in place?

Joseph Patrick Lacher
President, CEO & Director

We have not made a decision on the policy admin system yet. We're getting reasonably close. The good news is, some of those decisions are apparent, but we'll almost certainly use a third-party vendor. And as we go through that process, we're appropriately taking the opportunity to explore different vendors, recognizing we don't have to do the same thing in our specialty auto business that we do in preferred. And we're looking at capabilities, costs and all the like and working our way through that. We can move briskly on that. Even if we had made a decision already or if it takes us another 3 months or 4 months, it will not have a meaningful impact upon when we would have been trying to put that into the marketplace or what we would do from a cost perspective on the policy admin system.

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

Okay. And also a follow-up. On the integration cost that you're going to incur, I think you mentioned $70 million. Is that just going to be incurred like we've seen in the last 2 quarter, quarter-by-quarter or are you going to bunch that up at one point and take a charge?

James J. McKinney
Senior VP & CFO

Well, the accounting rules will prescribe when we can kind of take the expenses or not. We generally have a pretty good idea of the total expenses and things like that. What I'll commit to you is that we'll be very transparent about those. As you've seen, we've got kind of the [8.3] that has come in today. We'll break them out and make sure that you're kind of aware of them. To the extent that we could take them as a one-time charge, clearly we'd like to do that because it becomes easier from a standpoint of just helping people kind of work through the numbers. It's simpler. We're aware of that. But a lot of these things are accounting-driven and so there'll kind of come out when they come out. What I would model is that number and I'd model them very similar to the kind of revenue as it kind of generally being kind of -- I wouldn't do a linear-like push. You might think of them a little bit back-ended. And I think the $70 million in total that we've given is probably a good estimate in terms of where we're expect to be. And again, you must think about those very similar to the way that we kind of talked about a little bit of the synergies kind of half-and-half kind of with inside those time period. And again, if there's updates, we'll update further as we get into it and get deeper into the process.

Operator

And the next question is a follow-up from Greg Peters from Raymond James.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Two questions. I was wondering if you could comment on the different reserving methodologies, one at Infinity and the other at Kemper or maybe they are very similar. I'm curious about it in the context of how it might affect the numbers for Infinity under the merged entity?

James J. McKinney
Senior VP & CFO

Yes -- no, good question, Greg. I think big picture, I think are you asking are we going to end up -- more likely to have kind of a large purchase accounting change associated with the reserve. I would suggest right now we have relatively kind of similar processes, maybe different ways in terms of processes in terms of how we come out, but a very similar general view in terms of what we're -- from a reserving kind of methodology standpoint. With that in mind, I'm not anticipating any significant kind of change in terms of the overall total reserves one way or another. Now that said, we're still going through the purchase accounting exercise. We're still further diligencing our numbers and obviously there'll be more to come on the opening balance sheet in the third quarter. But right now, I don't see anything material.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Okay. And then just another big picture question. Listening to the larger companies in the auto space and this isn't a new question for you, but there's a lot of emphasis around technology, telematics, applications that can go on cell phones, that can monitor driving behavior, et cetera. And I'm just wondering how you are going to be going through this big restructuring on the one hand and then being able to keep up with what some of your peers are doing on the technology side. On the other hand, I'm wondering if it's too much in the marketplace or maybe you could just talk about your approach to both, because they're both very important to the long-term goals of getting your return on equity and getting an appropriate economic return on capital?

Joseph Patrick Lacher
President, CEO & Director

Yes. Good questions, Greg. And we think about them from a couple of different perspectives. The 2 companies, if you back up 2 years ago, Kemper and Infinity, both of us were struggling with a little bit of a scale challenge. And the ability to make those investments, the ability to deal with the R&D, the ability to engage in some of those items were challenges for the 2 companies. Our ability, now that we're combined, puts us in a meaningfully different position to be able to explore those. And our ability at the margins we're generating and the growth we're generating both gives us an opportunity to think about that differently and if you just project forward, it expands that opportunity because there's going to be a bigger, stronger organization and all of this comes around to the benefits of scale. So we see that as a plus. We also are in a segment of the marketplace in specialty auto where most of those issues impact our segment of the market later. It's just slower for -- from an adoption perspective. It's slower to have an impact in the niches that we've been in. So not having it and being a little behind on that is less of a challenge to us. What we're going to clearly have to do over the course of the next couple of years is play some catch-up on it. That's a disadvantage, because we're playing catch up, but it's also an advantage because we can learn on somebody else's tuition. We can see what worked, what didn't work and focus more on the -- in the spots that are more effective and leverage those. So it's a challenge we're thinking about all the time. It's part of the reason the acquisition makes a lot of sense for us and we'll keep banging away at it.

Charles Gregory Peters
Raymond James & Associates, Inc., Research Division

Thanks for that color, Joe. And just as a follow-up. There's a -- again, during this earnings conference call season, there's a lot of rhetoric around insurtech. And there's a big segment or cohort of insurtech that seems to be focused on distribution and personal lines distribution in particular. I'm wondering how you're viewing these emerging opportunities with new distribution partners or have it -- has it been because they're not really focused on your segment of the market, they're not really relevant. Or maybe they are? Maybe you could provide us some perspective on that?

Joseph Patrick Lacher
President, CEO & Director

Yes. There's thousands of different ideas and everybody's got their get-rich-quick, "I'm going to be the next Facebook" idea in insurtech. Some of them are going to be very effective, some of them are going to be crashes and burns. We're watching those items. We actually do some different things in fintech and insurtech and are engaging with different folks and watching and learning inside of that space, maybe on a more modest scale than other folks are doing but we're engaged in watching out things like plug-and-play and other places. So there's a plus there from a learning perspective. What I guess we'd expect and we're watching -- I'm trying to think of the right analogy. If you back up 15 years ago, the big guys were all spending tons of money building proprietary systems and were all convinced that the proprietary policy admin system what was going to let them kick everybody's rear in the marketplace. And then we found a couple of folks like a Guidewire that came out with a capability that could sell you something out of a box, which all of a sudden let smaller players, ones that were big enough to afford the system, but were small enough to not have made those huge investments in proprietary systems, could all of a sudden leapfrog and in some cases get ahead of where some of those big guys are. We're very much anticipating that some of these insurtech, fintech companies will come up with some bright, thoughtful solutions to some of these things like apps that watch your driving behavior or other items that will let us accelerate and catch up and provide some of that leapfrog capability. So we're actively watching. We're excited about it. We think there's opportunities there. Haven't seen them materialize yet, but they'll be looking for carriers like us that want to be fast followers in that space and we'll be great customers for them or partners for them because some of the big guys won't be as interested. We're sort of in the right slot to matter to them.

Operator

And this concludes the question-and-answer session. I would now like to turn the conference back over to Joe Lacher for any closing remarks.

Joseph Patrick Lacher
President, CEO & Director

Thank you, operator, and thanks to everybody for your time today and your interest in Kemper. We're excited about being a bigger and stronger organization. We're focused on continuing our journey to unlock all of the value inside of this new combined organization. We look forward to updating you again next quarter. Thanks.

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