S&P Capital IQ

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Kemper Corporation NYSE:KMPR

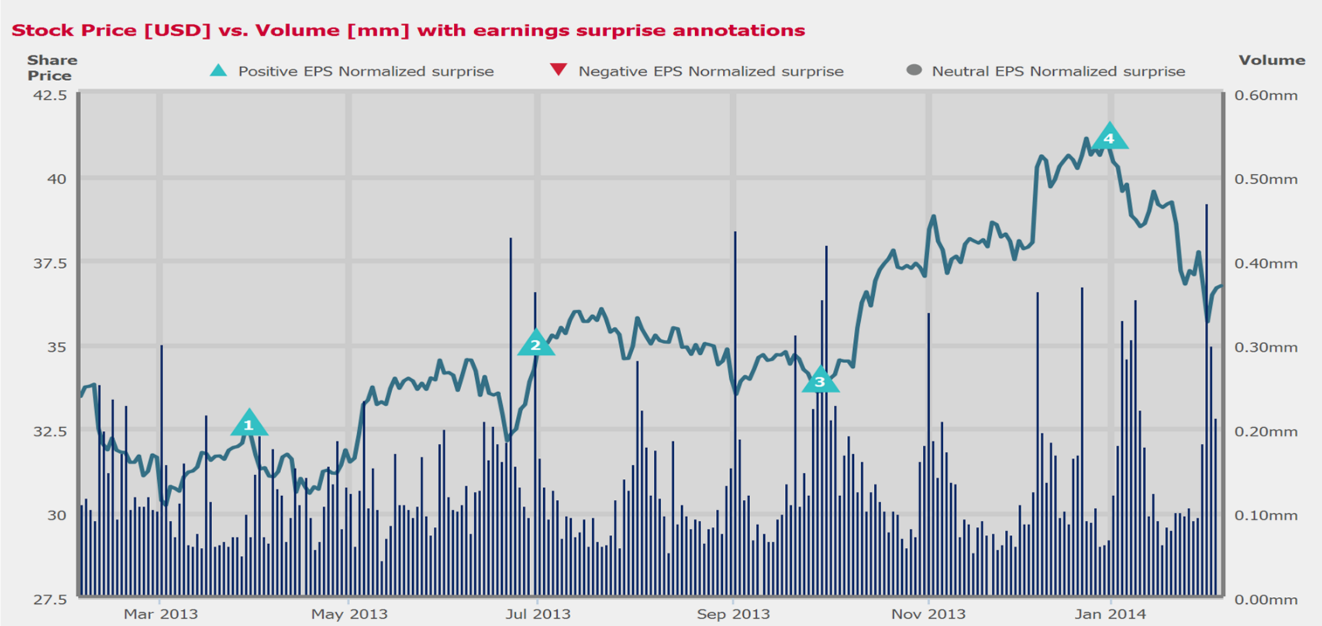
FQ1 2014 Earnings Call Transcripts

Friday, May 09, 2014 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ1 2014-			-FQ2 2014-	-FY 2014-	-FY 2015-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.65	0.56	▼(13.85 %)	0.55	2.48	2.81
Revenue (mm)	566.92	548.70	▼(3.21 %)	565.98	2254.81	2252.12

Currency: USD
Consensus as of May-09-2014 6:10 AM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ1 2013	0.52	1.00	▲1 92.31 %
FQ2 2013	0.27	0.55	▲2 103.70 %
FQ3 2013	0.40	0.69	▲3 72.50 %
FQ4 2013	0.60	0.83	▲4 38.33 %

Call Participants

EXECUTIVES

Denise Idell Lynch
Former Property & Casualty Group Executive

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

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

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

Frank Joseph Sodaro
Former Senior Advisor

ANALYSTS

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to Kemper's First Quarter 2014 Earnings Conference Call. My name is Nova, and I will be your coordinator for today. [Operator Instructions] As a reminder, this conference is being recorded for replay purposes. I would now like to introduce your host for today's conference, Ms. Diana Hickert-Hill, Vice President, Investor Relations and Corporate Identity. Ms. Hickert-Hill, you may begin.

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

Thank you, operator. Good morning, everyone, and thank you for joining us. This morning, you will hear from 3 of our business executives, starting with Don Southwell, Kemper's Chairman, President and Chief Executive Officer; followed by Denise Lynch, Kemper's Property & Casualty Group Executive; and Frank Sodaro, Kemper's Senior Vice President and Chief Financial Officer. We will make a few opening remarks to provide context around our first quarter results. We will then open up the call for a question-and-answer session. During this interactive portion of the call, our presenters will be joined by John Boschelli, Kemper's Vice President and Chief Investment Officer; and Ed Konar, Kemper's Life and Health Group Executive.

After the market's close yesterday, we issued our press release and financial supplement. In addition, we have filed our Form 10-Q with the SEC, and you can find these documents on the Investors section of our website, kemper.com. Please note that our discussion today may contain forward-looking statements. Our actual results may differ materially from these statements. For information on potential risks associated with relying on forward-looking statements, please refer to our Form 10-K filed with the SEC on February 14, 2014, as well as our first quarter 2014 Form 10-Q and earnings release.

This morning's discussion includes non-GAAP financial measures that we believe may be meaningful to investors. In our supplement and earnings release, we have defined and reconciled non-GAAP financial measures to GAAP, where required, in accordance with SEC rules. And finally, all comparative references will be to the first quarter 2013, unless we state otherwise.

Now I will turn the call over to Don Southwell.

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

Thank you, Diana. Good morning, everyone, and thanks for your interest in Kemper. Today, I'll discuss our overall results for the quarter, including a few specifics on the Life and Health segment and on our investment performance. Denise will provide more insight on our Property & Casualty segment results. Frank will review details on our financials, capital and liquidity. And I'll finish up with some closing comments before we go into the question-and-answer period.

We'll start with the total view. We made progress in some areas and were challenged in others. We delivered $35 million in net income in the quarter, which was down from $58 million. Net operating income was $32 million versus $42 million, a decline of $10 million. We'll go into the details shortly, but keep in mind that we expect to see some quarter-to-quarter earnings volatility as we navigate our path to improved profitability.

Our Property & Casualty segment realigned its businesses and continued to make progress on its profit improvement actions, despite a difficult quarter. Denise will provide more information in a moment.

Turning to our Life and Health segment. Earnings were up 4% in the quarter, delivering $22 million in net operating income. For the Kemper Home Service Companies, benefits returned to a more normal level after picking up in the first quarter of 2013.

The Life and Health segment continued its expansion efforts related to our 3 new growth initiatives. The first is our Kemper Senior Solutions business, which offers life and home health care products through independent agents and brokers. The second is our Kemper Benefits business, which offers voluntary work-site supplemental health products through employers to their employees. And Kemper Dental offers dental products to employees of small businesses. We remain pleased with the market interest to-date in these new businesses.

Turning now to investments. The portfolio delivered another quarter of good results. Net investment income was down from last year when our equity method investments performed exceptionally well. This year, they were more normal. From a total return standpoint, it was an outstanding quarter, as we were rewarded for staying fully invested in the market. Due to the continued challenging interest rate environment, recently we have been putting a majority of our new money in lower investment-grade municipal and corporate bonds, along with private higher-yielding investments. However, we do not expect a material change in our overall noninvestment grade fixed income allocation.

Now I'll turn the call over to Denise.

Denise Idell Lynch
Former Property & Casualty Group Executive

Thanks, Don. Before I walk through the results, I'd like to discuss the recent changes we made to the Property & Casualty organization, since they affect how we report our results.

In mid-March, we implemented a realignment of the former Preferred, Specialty and Direct businesses into one Property & Casualty segment. The new Property & Casualty segment allows us to share best practices, where appropriate, invest in new capabilities and offset some of the expense ratio pressure from earned premium decline. I'm pleased to report that we have received consistently positive feedback from our agents regarding our new structure.

Our agents recognize the opportunity this realignment presents for them and for us by extending access to our full suite of products through cross-appointing where appropriate. In fact, more than 200 cross appointment opportunities are in the pipeline as a result of this realignment.

The realignment is allowing us to double our Predictive Analytics team to support our Kemper personal and commercial lines business. We've also formalized our project management team, created a new strategy function and invested in an organizational effectiveness team. We are looking forward to benefiting from the opportunities the new realignment rates for our Property & Casualty segment.

Turning to results for the quarter. We delivered net operating income of $14 million in the quarter, down from $29 million. We have several areas of progress, particularly an improved rate adequacy and the performance of our direct-to-consumer book during the run-off phase. Nonetheless, the catastrophe and noncatastrophe weather losses and premium decline made this a disappointing quarter.

The top line was pressured as we delivered $304 million in net written premium, down from $345 million. While softening market conditions and the effect of our deliberate actions to reduce catastrophe exposures reduced volatility from non-catastrophe whether, increased package writings and improve the overall quality of the book of business resulted in lower new sales volume and retention.

We are focused on improving both new sales and retention throughout 2014 by: one, engaging existing agents to increase new business sales; two, increasing new business through appointing new agents and cross-appointing agents with both preferred and nonstandard product access, where appropriate; three, increasing hit ratio and price adequacy through improved rate segmentation; and 4, improving the agent experience as they write new and renewal business with us.

Turning to profitability. The combined ratio of 99.5% was up 3.7 points. The decline in earned premiums contributed to the expense ratio increasing by 2 points, despite lower overall expenses on a year-over-year basis. The loss and LAE ratio was up 1.7 points, largely from increased catastrophe losses. The underlying loss and LAE ratio was relatively flat as higher-than-normal large losses and weather-related losses were offset by higher average earned premiums.

Looking at personal auto in more detail, our net written premiums -- premiums written were $208 million and earned premium were $216 million. Personal auto experienced a higher level of favorable development, primarily from the previous accident year. The underlying loss and LAE ratio improved just above 0.5 points, with average earned premium increasing 5%.

Our recent personal auto loss trends are mostly consistent with the industry. In the last year, bodily injury frequencies have declined, favorable to the industry, while bodily injury severities have increased, consistent with industry. Property damage and collision loss costs have escalated, consistent with industry trends. In the aggregate, pure premium trends are increasing by low-single digits.

In commercial auto, net premium written were $14 million. The underlying loss and LAE ratio deteriorated 7 points, primarily from a higher frequency in all coverages, except bodily injury. This remains an area of focus as we improve underlying profitability in this line of business.

In homeowners, net premiums written was $71 million. Homeowners experienced an increase in catastrophes and a lower level of favorable reserve development. The underlying loss and LAE ratio deteriorated 1 point, primarily from an increase in losses from large buyers. While not a good quarter for homeowners, we are pleased with the continued progress we are making through disciplined underwriting actions and improved average earned premium, which is up 12.3%.

Looking at our overall performance, there are areas of good progress and issues to address. We feel good about: one, our continued progress toward underwriting this quality, price adequacy and average earned premium increases; two, the second of the Property & Casualty segment -- excuse me, the realignment of the Property & Casualty segment; and three, the effectiveness of the run-off of the direct-to-consumer book.

We are acting with focus and urgency to improve new business production and retention, while not compromising our commitment to improve profitability. While we expect continued pressure on the topline, we anticipate premiums to stabilize later in the year.

Overall, the changes we are implementing our refinements to drive improvement in P&C performance over time, and we look forward to our realigned organization, bringing increased value and efficiency to the agents and policyholders we serve.

Now I'll turn the call over to over to Frank.

Frank Joseph Sodaro
Former Senior Advisor

Thanks, Denise, and good morning, everyone. Today, I'll cover Kemper's overall first quarter performance, capital and parent company liquidity. We delivered net income of $35 million or $0.63 per diluted share, compared to $58 million or $1 per diluted share. Results included $4 million of after-tax net investment gains in the current quarter, compared to $16 million.

Our net operating income was $32 million or $0.56 per share for the quarter, compared to $42 million or $0.72 per share. Total revenues were $555 million for the quarter, a decrease of $61 million, due to lower Property & Casualty earned premiums, fewer net investment gains and lower net investment income.

Earned premiums declined $32 million, with nearly all the decrease stemming from personal auto. Our Property & Casualty earned premiums decrease was more than we expected, and we are implementing the actions to improve performance.

Consolidated pretax net investment income was $71 million in the quarter, a decrease of $10 million, driven by lower equity method investment income and lower yields. Equity method investments earned $4 million, compared to $9 million, which was better than expected last year.

The first quarter annualized pretax equivalent book yield on average invested assets was 5%, down about 85 basis points from last year. Our pretax equivalent average investment grade fixed maturity reinvestment rate increased about 45 basis points sequentially to about 4.5%.

Now I'll discuss the financial results of each of our businesses, starting with Property & Casualty. The Property & Casualty Insurance segment reported net operating income of $14 million for the quarter, down from $29 million last year. Overall, our Property & Casualty combined ratio increased nearly 4 points to 99.5% for the quarter due to higher catastrophe and weather-related losses.

The underlying loss and LAE ratio was essentially flat at 71.4%, as improvement in personal auto offset increases in commercial auto, homeowners and other personal insurance. Insurance expenses, as a percentage of earned premiums, increased 2 points to 27.8%, driven by the lower premium base.

The Property & Casualty segment benefited from $15 million of favorable reserve development in the quarter, up $2 million. Total catastrophe losses were $16 million, up $7 million. Earned premiums were $322 million in the quarter, down $30 million as a lower number of auto policies and force was partially offset by higher overall premium rates. The continuing run-off of our direct-to-consumer book was approximately 25% of the drop in earned premium. In total, Property & Casualty premium retention was 77.5% compared to 80.6%.

I will shift now to the Life and Health segment. Net operating income was $22 million in the quarter, an increase of $1 million from last year. Earned premiums and net investment income decreased slightly in the quarter to $155 million and $50 million, respectively. Total expenses were down $2 million, pretax, as lower home service agent commissions and real [ph] cost were partially offset by higher start-up cost related to our new growth initiatives.

I will now cover book value, capital and parent company liquidity. Book value per share was $38.71 at the end of the quarter, up 5% or $1.85 from year end, driven primarily by the impact of lower market yields on the value of our fixed maturity portfolio. Book value per share, excluding unrealized gains on fixed maturities, was $35.13, up 2% from year end.

Statutory surplus levels in our insurance companies remain strong, and we estimate that we will end the year with risk-based capital ratios of approximately 415% for our Life and Health group and 360% for our Property & Casualty group.

On May 1, the Property & Casualty group paid a dividend of $100 million to the holding company, its first dividend in more than 2 years. The excess capital position of our P&C companies was largely attributed to improved results and lower levels of premium, including the direct-to-consumer run-off. We expect to continue to build excess capital in our P&C operations throughout the year; however, we are not expecting the P&C segment to pay any additional dividends in 2014. The plan for the Life and Health Group to pay a dividend of about $80 million in the second half of the year.

Turning to liquidity. In the first quarter, Kemper issued a $150 million of 40-year subordinated hybrid debt with a 7.375% coupon. We anticipate using the net proceeds for working capital and general corporate purposes, including retirement of a portion of the company's debt.

Given our capital needs at this time, we anticipate retiring our $250 million outstanding debt at its November 15 maturity, with parent company cash, as we look to reduce our overall debt outstanding closer to historic levels over the long term.

At the end of the quarter, the parent company held cash and investments of about $255 million, and our $225 million revolving credit line remained undrawn.

And now, I'll turn the call back over to Don.

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

Thank you, Frank and Denise. As you just heard, our capital position strengthened even further. Our long-term capital deployment priorities continued to include: one, funding profitable organic growth; two, strategic acquisitions; and three, returning capital to shareholders, both through share repurchases and dividends. We remain focused on achieving improved profitability. While we are selectively funding organic growth in some areas. In total, premium revenues are expected to decline in 2014. So our organic growth will not use capital this year.

Regarding acquisitions, we routinely evaluate opportunities and are keeping some powder dry. On returning capital to shareholders, we maintained our competitive dividend and continued to repurchase shares when the volume and price met our 10b5-1 plan criteria. In the first quarter, we repurchased $8 million worth of common stock.

Given the recent debt offering, the dividend from the Property & Casualty segment and the softer new business, we have a higher level of capital and cash impairment than we typically hold. This creates flexibility, but it also creates challenges to the denominator of the ROE.

The path we've outlined to achieve a double-digit ROE has 4 main elements: one, continued improvement in our Property & Casualty combined ratio; two, normalized catastrophe losses; three, increases in interest rates consistent with the Federal Reserve baseline scenario; and four, full deployment of available capital.

Our first quarter Property & Casualty results alter our expected trajectory somewhat. However, we are confident that our Property & Casualty results will improve. Catastrophes will be a volatile but manageable risk. Interest rates dropped in the quarter, but we expect that interest rates will rise. Effectively deploying our capital when the right opportunities arise will be critical.

It's possible that achieving a double-digit ROE run rate could be delayed beyond the fourth quarter of next year, but we still have a good shot at hitting that target. We remain committed to delivering, and we are optimistic about our long-term prospects.
With that, I'll turn the call back over to the operator, so we may take your questions. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Steven Schwartz of Raymond James.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Frank, can we start off with Capital a little bit? I got a little bit lost. How much is at the holding company now?

Frank Joseph Sodaro
Former Senior Advisor

There's $255 million of cash and short-term investments at the holding company right now. That does not include the $100 million dividend that was paid on May 1 from P&C.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay, so -- okay, that was important. I didn't get that. And then did that include -- that included the debt offering?

Frank Joseph Sodaro
Former Senior Advisor

Yes.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay. So that's what I want to make sure there. Okay, included debt offering. Okay. And then onto some other things, if I may. Reinsurance changes this year, did that have any effect on premiums earned this quarter? I know that it did have a big effect on 2013.

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

Steven, I think our reinsurance buy was about $10 million less [indiscernible] and the prior year. We'll check on that number. But I think that's close. So if you look at the quarter -- hold on just a sec. Reinsurance buy was $5.3 million decrease. We took advantage of some of the rate reduction to buy a little more. So net premium earned would, you take about a 1/4 of that, it shouldn't be any impact on the quarter.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay, so not that big of a deal. Okay. And then the premium growth slowing in 2014, there was that comment. That was a reference just to P&C. I guess I'm kind of wondering when you might think that the new efforts of Reserve National dental [ph], the brokerage might actually show up in the top line?

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

Steven, let me ask Ed Konar to give us his views on that.

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

Steve, some of those businesses are pretty new. The most -- the one that's been around the longest is senior solutions, which is selling life insurance and home health care health insurance. And that business is generating -- I think it's sold approximately $16 million of annualized premium to-date. Sales are still going pretty well. The Kemper benefits division is more in its infancy, and I think there's a few million dollars of annualized premium on the book. But that's ramping up as we go. And the Kemper Dental is pretty small at this point. So the 2014 impact of all those businesses together, probably in the $20 million earned premium range.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Okay, great. And then, Frank, one more, if I may. Would you have an estimate -- I don't know if you guys do this or not, but would you have an estimate for RBC for the life companies for the end of the quarter?

Frank Joseph Sodaro
Former Senior Advisor

I have the end-of-the-year projection at $415 million. I don't have the end-of-the-quarter estimate handy right now. We ended the year at about $430 million on the Life side.

Operator

[Operator Instructions] And I'm showing no further questions in the queue. I'll turn program back to management for closing remarks.

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

Thank you, operator. I do have just a few closing remarks. In the first quarter, we did make progress in some areas, and we were challenged in others. Our Life and Health segment had a solid performance. Our Property & Casualty segment made improvements in some areas and is implementing actions to deliver the overall results that we seek. And our investment portfolio had another good quarter. We do remain committed to delivering shareholder returns, the kind of shareholder returns that we all seek.

Thank you for your time this morning. We'll update you again on our next call.

Operator
Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a wonderful day.