S&P Global
Market Intelligence

Assurant, Inc. NYSE:AIZ

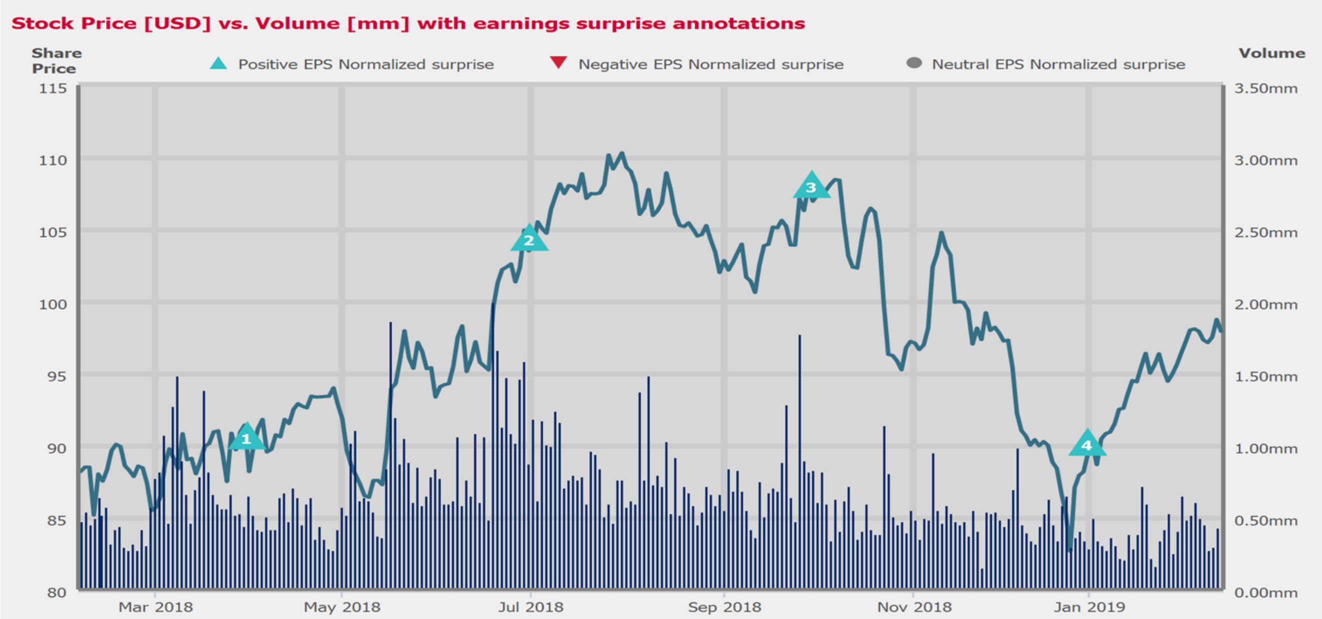
FQ4 2018 Earnings Call Transcripts

Wednesday, February 13, 2019 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ4 2018-			-FQ1 2019-	-FY 2018-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	0.42	0.77	▲83.33	1.98	5.54	5.80
Revenue (mm)	2249.00	2317.00	▲3.02	2312.39	7988.05	8057.60

Currency: USD
Consensus as of Feb-13-2019 6:58 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ1 2018	1.89	2.00	▲1 5.82 %
FQ2 2018	1.75	2.13	▲2 21.71 %
FQ3 2018	1.01	1.06	▲3 4.95 %
FQ4 2018	0.42	0.77	▲4 83.33 %

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Call Participants

EXECUTIVES

Alan B. Colberg
President, CEO & Director

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Suzanne Shepherd
Vice President of Investor Relations

ANALYSTS

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

John Matthew Nadel
UBS Investment Bank, Research Division

Kai Pan
Morgan Stanley, Research Division

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Presentation

Operator

Welcome to Assurant's Fourth Quarter and Full Year 2018 Earnings Conference Call and Webcast. [Operator Instructions]

It is now my pleasure to turn the floor over to Suzanne Shepherd, Senior Vice President of Investor Relations. You may begin.

Suzanne Shepherd
Vice President of Investor Relations

Thank you, Christina, and good morning, everyone. We look forward to discussing our fourth quarter and full year 2018 results with you today. Joining me for Assurant's conference call are Alan Colberg, our President and Chief Executive Officer; and Richard Dziadzio, our Chief Financial Officer.

Yesterday, after the market closed, we issued a news release announcing our results for the fourth quarter and full year 2018. The release and corresponding financial supplement are available on assurant.com. We'll start today's call with brief remarks from Alan and Richard before moving into a Q&A session.

Some of the statements made today may be forward-looking. Forward-looking statements are subject to risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by these statements. Additional information regarding these factors can be found in yesterday's earnings release as well as in our SEC reports.

During today's call, we will refer to non-GAAP financial measures which we believe are important in evaluating the company's performance. For more details on these measures, the most comparable GAAP measures and a reconciliation of the 2, please refer to yesterday's news release and financial supplement available on assurant.com.

I will now turn the call over to Alan.

Alan B. Colberg
President, CEO & Director

Thanks, Suzanne, and good morning, everyone. We are pleased with our performance in 2018. We successfully delivered on our financial commitments to shareholders while also investing to ensure a stronger Assurant for the future.

For the full year 2018, we grew net operating income, excluding reportable catastrophes, by 25%, at the high end of our outlook for the year. This was driven by a lower effective tax rate, by acquisition of The Warranty Group and organic growth in targeted areas. Operating earnings per diluted share, excluding catastrophes, grew 16%, at a lower rate than net operating income, given the 10 million share issuance related to our acquisition of The Warranty Group.

We are also pleased by the ongoing cash flow generation of our specialty businesses, which contribute $740 million of dividends to the holding company. As a result, we issued 3 million fewer shares to finance our TWG acquisition and returned $266 million to shareholders through buybacks and common stock dividends. This year through February 8, we returned another $22 million to shareholders as we continue to view our stock as attractively priced.

We also remain confident in the cash flow generation of our businesses. Last November, we increased our common stock dividend by 7%, representing the 15th increase since becoming a public company. More importantly, in 2018, we took steps to sustain outperformance and profitable growth long term. We further strengthened our leading franchises within Connected Living, Global Automotive and multifamily housing. We did this by broadening our distribution, expanding client partnerships, introducing new and differentiated offerings and acquiring TWG. At the same time, we managed lender-placed declines and supported policyholders in the aftermath of natural catastrophes.

Let me now share some 2018 highlights for each of our operating segments. Global Lifestyle's earnings grew by 20% organically as we strengthened our market position with innovative, full-service offerings well beyond insurance. We are pleased with our progress thus far integrating TWG. We've successfully managed the transition of client relationships with minimal disruption. As we complete our integration later this year, we expect to further capitalize on our leading position with our Global Automotive products and services. In addition, through year-end 2018, we realized $14 million in after-tax operating synergies. On a run-rate basis, we now have in place more than half of the $60 million pretax target expected by the end of 2019.

Within Connected Living, we added new partnerships in the fast-growing cable MSO market while also expanding our relationships with leading OEMs and mobile carriers. Most recently, we launched a device protection program with Visible, Verizon's all-digital prepaid mobile carrier. This program provides device protection, including accidental damage, loss and theft as well as mechanical breakdown following the manufacturer's warranty. It also includes Pocket Geek, our self-diagnostic platform to help consumers optimize device performance and safeguard personal information. As of year-end, we now protect over 46 million covered devices worldwide, with a growing portion leveraging our premium tech support and self-diagnostic tools.

Global Automotive continued to perform well in 2018 with nearly 16% revenue growth, excluding contributions from TWG. Our combined Global Automotive business benefited from prior year's strong sales with third-party administrators, dealer networks, national accounts as well as leading global OEMs. We now protect 48 million vehicles.

In addition, we are working closely with our partners to develop innovative offerings that reflect the evolution of the automotive market. Most recently, this includes launching Pocket Drive by Assurant, a plug-in vehicle device that empowers auto dealers and customers to benefit from vehicle data and mobile conductivity. This technology-based connected car platform will provide consumers with proactive maintenance alerts, diagnostic warnings, roadside assistance and other features. We believe innovative offerings such as Pocket Drive will further expand our vehicle protection product suite beyond insurance and deliver significant value to our partners and end consumers.

2018 represented another year of elevated catastrophe activity in Global Housing, with hurricanes in the Mid-Atlantic and Southeast as well as the California wildfires. This resulted in $170 million of net after-tax cat losses for Assurant. As part of our January placement, we substantially lowered our per event retention from 2018, further reducing our earnings exposure to natural catastrophes. While this will result in higher cost, primarily in lender-placed, we believe lowering our cat exposure will help us generate more predictable earnings over time.

2018 net operating income for Global Housing, excluding catastrophes, increased 10% year-over-year. The segment benefited from tax reform and growth in multifamily housing and our portfolio of Specialty Property offerings.

In multifamily housing, we now provide an expanded suite of offerings. This includes a tracking system to ensure continuous renters' protection and an integrated billing platform for property management companies and their renters. We also invested in creating an even more seamless digital experience for our customers, which we believe will enable us to sustain profitable growth in the future. In lender-placed, we also recently secured another multiyear contract renewal with 1 of our top 5 largest clients, helping to solidify our leading position in this business.

Moving to Global Preneed. With $58 million of net operating income, the segment continues to be a steady contributor of earnings and cash flow for Assurant. In 2018, we strengthened our client relationships with a multiyear SCI Canada renewal and expanded our distribution with new partnerships. We also added new offerings for the senior lifestyle market, including ancillary products like executor care to assist in the death notification and estate planning process. This should support continued strong returns and cash flow in the future.

Throughout 2019 and beyond, we will continue to invest in capabilities and offerings that will better support consumers' connected lifestyles, leveraging our deep expertise within the mobile, auto and home value chains. And as we do so, we will also look to leverage global talent and scale more effectively to support profitable growth. Our recent success in the Japanese mobile market is a great example of this. We also see additional opportunities to drive even greater efficiency and deliver a superior customer experience as we deploy new technologies such as artificial intelligence across our portfolio. We believe these initiatives, among others, will support continued profitable growth this year.

Based on current market conditions, we expect 2019 operating earnings per diluted share, excluding catastrophe losses, to increase 6% to 10% year-over-year, reflecting continued double-digit earnings expansion. This range takes into account incremental reinsurance cost to reduce our cat exposure, lowering our EPS outlook by 2 percentage points. The 2019 share count will include the full year impact of the TWG 10 million share issuance. It also assumes that the preferred shares will be dilutive and added to our share count compared to the anti-dilutive approach in 2018. 2019 earnings will reflect full year contributions from TWG, including an additional $25 million to $30 million of after-tax operating synergies.

We also expect modest profitable growth driven in Connected Living, multifamily housing and Global Automotive. This will be partially offset by continued investments in key capabilities to support growth and declines in the legacy credit business within Global Financial Services. Our outlook also includes the impact of approximately $40 million pretax of acquisition-related intangible amortization, including TWG. Overall, cash flow generation is expected to remain strong with segment earnings roughly equaling segment dividends. We will update our view of long-term financial metrics and targets at our upcoming March 14 Investor Day.

Overall, we are pleased with our performance this year. We remain confident in our ability to continue to expand earnings and cash flow long term. We believe our attractive business portfolio, combined with a scalable operating structure, will produce more diversified, predictable earnings. This should allow us to continue to invest in our business and return excess capital through buybacks and common stock dividends.

I'll now turn the call over to Richard to review our fourth quarter 2018 results and our 2019 outlook in greater detail. Richard?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Thank you, Alan, and good morning, everyone. Let's start with Global Housing. The segment reported a net operating loss of $12 million for the fourth quarter, driven by $95 million of reportable cat losses related to Hurricane Michael and the November California wildfires.

Excluding these cat losses and a lower effective tax rate, earnings decreased $25 million. This was driven by 3 main factors. First, consistent with others across the industry, we experienced higher noncat claims primarily from increased severity of water damage and weather in our lender-placed business. This compared to abnormally low noncat loss experience in the prior period. Second, lender-placed continue to decline as was reflected in both the lower placement rate and REO volumes. And third, we recorded additional reinsurance premiums in the quarter to account for our full year catastrophe exposure. This had a $6 million after-tax impact on earnings. The decline was partially offset by continued growth in multifamily housing and additional investment income from both real estate joint venture partnerships and other related fund investments.

Looking at top line performance, revenues for the segment declined by $61 million, reflecting the August sale of mortgage solutions. Excluding mortgage solutions, revenue was flat as growth in small commercial property products and multifamily housing offset the reduction in lender-placed premiums.

As Alan noted, we have placed 2/3 of our 2019 Catastrophe Reinsurance Program. And as part of this placement, we have substantially lowered our per event retention from $120 million to $80 million pretax. We believe this change will further protect the earnings and cash flows of the company during an active cat year. For example, if we were to recast 2017 cat season using this new $80 million retention, we would have recognized around $80 million more of pretax earnings. We also secured additional multiyear coverage at fixed pricing that will help to reduce the annual variation in cost.

For Global Housing in 2019, we expect to reverse prior trends and return to earnings growth, driven by continued expansion of our Specialty Property offerings. This includes areas such as multifamily housing, where we expect to further increase our penetration of the PMC channel as we leverage digital capabilities to improve the customer experience. We also expect lender-placed earnings to stabilize. While the incremental reinsurance cost will lower results in this business, we will continue to take further actions to manage risk and lower expenses, including our work to streamline our operating platform. Overall, we believe this segment is positioned for long-term profitable growth with significant upside should the economically soften. Also, the segment should continue to generate strong cash flows and maintain superior operating returns.

Moving to Global Lifestyle. The segment reported earnings at $98 million for the fourth quarter, a $55 million increase year-over-year. Excluding a $9.3 million client recoverable, TWG accounted for $35.4 million of the increase. This is net of $2 million of after-tax intangible amortization and includes $8 million of realized operating synergies. A lower effective tax rate for Global Lifestyle accounted for another $7 million of the increase. Excluding these items, results increased primarily due to organic growth in mobile, including continued expansion in Asia Pacific. We also benefited from higher mobile trade-in volumes and greater utilization of our premium tech support services. Similar to housing, lifestyle also recorded greater real estate investment income in the quarter.

Revenue was up $708 million in the fourth quarter, primarily driven by the acquisition of TWG and continued growth in the North American auto dealer channel. Excluding TWG, revenue increased by $62 million, driven by continued organic growth from mobile programs launched during the past 2 years and vehicle protection programs sold through third-party administrators. Revenue growth was partially offset by unfavorable currency movements.

Looking at Global Lifestyle's outlook for 2019, we expect continued growth in net operating income. This will be driven by 3 main factors: First, a full year's contribution from TWG compared to 7 months of earnings in 2018; second, an incremental $25 million to $30 million, after tax, of synergies from the acquisition; and third, modest organic growth within Connected Living and Global Automotive. Our outlook reflects additional investments to strengthen our offerings across Global Lifestyle and the integration of TWG. We also expect new program launches and recent client renewals to result in continued profitable growth, albeit at lower margins. In addition, we continue to manage the anticipated declines in our legacy credit business within Financial Services and focus on repositioning our embedded card benefits in the banking sector, where we have already seen some initial success.

Next, let's move to Global Preneed. The segment recorded $16 million of net operating income in the fourth quarter, up $12 million year-over-year. The increase includes a $3 million benefit from tax rate change, with the remaining amount due to the absence of an asset write-down in the prior year period. In addition, we recorded higher investment income from both real estate gains and increased yields. Revenue in pre-need was up 5%, driven by growth in the U.S. and Canada. Face sales increased 3% from continued traction in Final Need.

In 2019, we expect pre-need earnings to be roughly flat, given a very strong 2018. We will continue to manage expenses closely and look to grow long term from new and existing clients and adjacent product offerings.

At Corporate, the net operating loss was $27.5 million, a decrease of $1.6 million. This was due to the absence of a workforce reduction charge in the fourth quarter of 2017 and higher real estate investment income, which was partially offset by the adverse impact of the U.S. tax rate change. For 2019, we expect full year Corporate net operating loss to be similar to 2018, even as we continue to grow.

Turning to capital. We ended the year with $473 million in total company capital or about $223 million of deployable capital after adjusting for a risk buffer of $250 million. Dividends from Global Housing, Lifestyle and Preneed to the holding company totaled $122 million in the fourth quarter, including $75 million from

TWG. We also received $31 million in cash related to the sale of one of our health legal entities, Time Insurance Company.

During the quarter, we repurchased $49 million of shares and paid $42 million in shareholder dividends, $37 million related to our common stock and $5 million related to our preferred stock.

In 2019, we expect segment dividends from our operating segments to provide ongoing flexibility to invest in our businesses and return capital to shareholders, subject to market conditions. Our current plans also include setting aside capital for the potential purchase of Iké Asistencia.

In conclusion, we're pleased with our strong results for the fourth quarter and for the full year 2018, which provide a solid foundation to drive continued growth into 2019.
And with that, operator, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is coming from Kai Pan from Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

So my first question on the cat side. The new program you have there, you mentioned would reduce your pretax cat in 2017 by $80 million. What would impact on 2018, the $170 million?

Alan B. Colberg
President, CEO & Director

Yes, so Kai, the answer for '18 would be about $15 million pretax. But let me give a little context on what we're trying to do with the new reinsurance program. So as we've looked at it, as we've talked about over the last few years, this company is transforming and is becoming much less cat-exposed through the growth in areas like Connected Living, the acquisition of The Warranty Group. And as we thought about '19, you look at the severity of the storm seasons the last couple of years, what we're really trying to protect against is another severe storm season. And so the way we thought about the additional reinsurance was, yes, in a no-cat year, it's a cost. In a typical cat year, it's about a wash. And then in a severe cat year like we had in 2017, we would have a significant amount of additional cash that we could use to benefit our shareholders. So that's how we thought about it and it's a journey that we will continue on as we continue to transform this company to be much less cat-volatile.

Kai Pan
Morgan Stanley, Research Division

Okay. I guess the difference between 2017 and '18 may be 2018 have more frequency of events, less severity than 2017, so you would not as -- benefit as much. So would you also consider additional aggregate cover?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes, Kai. It's Richard. I think it definitely was something that we looked at as we went into the end of last year and beginning of this year. We went out to the market, and obviously, looking at our exposure, frequency events and what we're expecting in a kind of an average year and extreme year. And our conclusion was that buying down retention to $80 million excess from $120 million was the best purchase for us. But we will continue as we go forward to look at all options that are out there.

Kai Pan
Morgan Stanley, Research Division

Okay. Is the $80 million pretax cat loss is still your cat loss assumption going forward?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

No. What I was saying in terms of the $80 million is we brought down our retention, so it's excess $80 million in terms of -- instead of being excess $120 million. But as Alan mentioned in his remarks, on an average year, it's basically a push overall for the average loss or load that we would have in our plan.

Kai Pan
Morgan Stanley, Research Division

Okay, that's great. Let me shift gear to the underlying growth in the Global Lifestyle segment. What's underlying growth -- premium growth in both auto as well as Connected Living in the fourth quarter?

And just wondering, is there a slowing down there? Because your forecast for the organic growth in this segment that you mentioned is modest organic growth in 2019.

Alan B. Colberg
President, CEO & Director

Yes. So if you look at 2018, I think we're very pleased with the growth in Connected Living broadly. If you look at Q4, I think we were up 7%, excluding The Warranty Group. If you look at full -- this is revenue. If you look at full year '18, we were up 9%, and that's with the headwinds of unfavorable FX in Latin America. So we feel good about the growth. The challenge when we get to earnings is we are ramping multiple new programs and investing. And so in the short term, you don't see as much of that flowing through to earnings as you do flowing through to revenue, but it dramatically strengthens Connected Living for the longer term.

Kai Pan
Morgan Stanley, Research Division

Okay, last one, if I may. Do you have any updates or -- with AppleCare+ as well as a potential merger between T-Mobile and Sprint?

Alan B. Colberg
President, CEO & Director

We generally don't go into a lot of detail on how specific clients are performing, but I think we're very pleased with our broad relationship with Apple, not just in the U.S., but in other markets around the world. And then again relative to a potential merger in the market, we have a long-standing track record of innovation and creating value for our clients. And that, I think, positions us well.

Operator

Our next question comes from John Nadel from UBS.

John Matthew Nadel
UBS Investment Bank, Research Division

So just to square the circle here on the combined ratio for the catastrophe impact. So over a long period of time, I think is -- I think back on Assurant, I think the more normal or typical catastrophe-type load for the lender-placed business was something like 4 point or 5 points. On the combined ratio, it sounds like the buydown of the retention is maybe going to save you 1 point to 1.5 points. Is that the right way to think about that on -- in terms of the typical or normal cat load going forward?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

John, Richard. I mean, I think the way we look at it, I think overall, the amount of the cost of the reinsurance that you had is generally correct. I think as we look at it kind of on an average year, in our NOI, it'll be a push. On our NOI, it will be a push. So that's with cats, obviously. Without cats, it's just a cost. So on an average year, it would be a push would be the way to look at it. But in a year like 2017, where there were some extreme events: Harvey, Irma, Maria, et cetera, yes, that would be an $80 million pretax earnings for us. So that would be a significant change in the earnings profile. And it is another thing that allows us to continue to say profitable growth in the future. Other parts of the businesses have grown, particularly with TWG, so the part of our business that is cat risk is much less already. And then with this additional insurance that we've bought, it's even less so.

Alan B. Colberg
President, CEO & Director

Yes. And John, what I would add -- John, let me just add one thing to clarify. So if you think about our cat load in a average year, what we now expect, given the size of our program, given the reinsurance tower, would be $65 million posttax. That is our specialty cat load. And what Richard was saying is if we had a typical year, our NOI with cat with the new program would be basically unchanged versus what it would have been with the old program. But we're far better off as a company and for our shareholders if we have a severe storm season, as Richard highlighted, we would have had substantially more cash to use in 2017 and 2018.

John Matthew Nadel
UBS Investment Bank, Research Division

Yes, I think this is very responsive. You guys have heard that less volatility in earnings, better -- likely better valuation over the long term, so I'm a fan. The -- Alan, just wanted to talk about it. I think if I understand this correctly, I think you've got 3 separate cost-savings programs that are going on sort of simultaneously and unrelated to each other. The first you laid out a few years ago was designed to drive that $100 million of gross saves over a multiyear period of time. The second one is the migration to a single platform in the lender-placed business. And the third, of course, TWG. You've given us the update on TWG and it sounds like everything's well on track there. Can you just give us an update on the prior 2?

Alan B. Colberg
President, CEO & Director

Yes, so on the first one, which is our long-term target to have $100 million of gross expense saves in our G&A, we are fairly far along with that. And where you can see the benefit is if you look at our Corporate loss, for example, over 2017 and 2018, if you normalize for the tax rate change, is flat. And we've given an outlook a flat again for 2019 despite strong revenue growth for the company. And in total, if you think about that $100 million, we estimate we're about $75 million complete of the $100 million. So we'll continue to work on it, but you're seeing the benefit flowing through the P&L by the ability to grow the company, invest and have a flat Corporate loss. In terms of our single platform in housing, last year was really about getting the first clients installed and proving out the value capture, which we've now done. As we head into '19 and '20, it's going to be a series of conversions of our clients one by one. It'll take time to really affect the ratios that we see and get us to our long-term target there, but we really believe that this differentiates our client experience, our consumer expense -- experience and really strengthens our market position in lender-placed.

John Matthew Nadel
UBS Investment Bank, Research Division

But so following up on that last one and then I'll requeue. The -- I think your long-term targeted expense ratio for the risk businesses in housing was 42 to 44, is that still intact? And approximately when do you think you get into that range? Is that dependent on completing this migration?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes, John, you're accurate in terms of what we had said in the past in terms of the longer-term expense ratio. We're in the process, obviously, of getting ready to update the market on, I would say, all the metrics that are important for us as we go forward during Investor Day on March 14. So that -- I'd assume that, that will be part of it, an update on housing and lender-placed, specifically.

Operator

Our next question comes from Mark Hughes from SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Could you -- I just want to make sure I'm clear on how you're treating amortization for the guidance for 29 (sic) [2019]. I think you said it excludes $40 million of amortization. Is that to say it's more of a cash EPS guidance?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

We're basically just calling out the amount of amortization that we have in this year. So it's included in all the numbers. We've included all the numbers, but we know it's important to the market to get a better read on sort of the cash we're generating because we do generate a lot of cash, as you've seen. As Alan said in his remarks, we're still expecting, going forward, with the operating earnings from the segments to equal the dividends that we can upstream. So that's just a number that we think that the market will find interesting.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Okay. Any updated thoughts on perhaps providing guidance on more of a cash basis?

Alan B. Colberg
President, CEO & Director

As Richard said a minute ago, Mark, at Investor Day, we will be updating all the metrics we think are important. So let's hold that till Investor Day in about a month.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Okay. On the lifestyle, when you mentioned the modest organic, I think you've said you're ramping up new programs, that's having an impact on margin. Are we to think of this that the modest organic is net operating income growth, but then the top line growth would be faster?

Alan B. Colberg
President, CEO & Director

Yes. When we talk about modest organic growth, we're talking about net operating income. The important thing longer term in lifestyle has been that expansion of our programs and clients. And we're now up to, what, 46 million subscribers from the low 30s 2 years ago. So that flows through revenue more quickly than it flows through P&L, just given that the programs have to build over time.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And Richard, you had mentioned a $7 million item, I think, in Global Lifestyle. What was that again?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

It was a $9 million item. I think you're talking...

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Oh, it was a $9 million.

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

The client -- it's a client recoverable. So every year, just the nature of the business, basically changes in client contracts. And we had one that was a little bit larger. So we wanted to call it out specifically just so as you model and as the market models and goes forward, it wouldn't take the aggregate amount and kind of extrapolate that. So that's why we called it out specifically.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And then a final question. You had referred to -- I think in talking about the vehicle, expand the product suite beyond insurance. Is that something meaningful we should think about?

Alan B. Colberg
President, CEO & Director

Yes, I think it's very early days for automotive. If you think about it prior to The Warranty Group acquisition, we did not have the direct-to-dealer distribution to really drive innovation in the market the way we have in mobile. So what we've done in mobile over the last few years is create a road map that has taken us far beyond insurance in delivering a really superior consumer ownership experience. We are launching the same roadmap for auto. Now it's very early, it will be a net investment for us in 2019 as we grow that. But longer term, we see the same potential to really broaden far beyond insurance and auto as we've done in mobile.

Operator

Our next question comes from Christopher Campbell from KBW.

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

I guess my first question is just kind of on the share repurchases. I mean, they were fairly low in 4Q, and I was just surprised you didn't purchase more with the weakness. I guess, was this cat-driven or blackout-driven, because maybe you guys can't repurchase during that time frame?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Well, I mean, we were -- I would sort of -- I would sort of rewind to the year. I mean, originally, we had given an indication to the market that we would be purchasing nothing in 2018, given the acquisition of TWG. We got through the second half of the year and felt a lot better about where we were in terms of the market, including the cats, so we entered the market toward the end of the year. We ended up purchasing another $49 million in the fourth quarter; that brought our total annual purchase to about $130 million. So well ahead of what we thought we would do during the year. And I think, again, that sort of underscores the strength of the company. We do, do these repurchases in terms of 10b5-1, so we do them over a period of time. And that's really what you're seeing in the beginning of January here as well, as we're still in -- as we remained in the market as you've seen in our comments.

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

Okay, got it. And I think you guys had mentioned in the script, potentially using some of the capital to, I guess, close an acquisition. I guess, just how would that impact share repurchases just as we're thinking about for the year?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes, I think we've basically -- in our statements and talked about the potential acquisition of Iké Asistencia, which would be sort of the larger thing on the docket. We purchased the first 40% for about $115 million a few years ago. There's a potential acquisition of the remainder of that as the year goes on. So we've kind of put those funds aside already, reflected that in our capital assumptions. And again, I'd say, we are in the market, as you've seen, purchasing. So that's kind of accounted for, I would say.

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

Got it. And so those funds for the Iké Asistencia one, those would be included in what you have in the excess capital, I think, which is the...

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes...

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

So that would be in the $223 million right now?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes, that's right. Well, in the $473 million total deployable capital; as we start the year, that's within that. But I would also say, I mean, we generate cash kind of every day, every month. So as we go forward in the year, that's taken into -- it's taken into account, sorry. It's taken into account already within that projection. It's not $473 million minus that amount. It's taken into account within that amount. So sorry about that. Just to be [specific].

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

Okay, got it. Got it. It's very helpful. And I guess just switching to Global Housing. I guess, just you've had elevated cats in the property book. And then, obviously, you're purchasing more reinsurance, so you probably want to get that baked into pricing. I guess, just how are you thinking about your taking rate in the LPI book in 2019 versus your loss cost? And I mean, is there any potential for higher rates to help offset some of the PIP decline?

Alan B. Colberg
President, CEO & Director

Yes, so maybe I'll step back just a bit in housing. Housing really overall is at an inflection point. If you think about the last few years, we've been dealing with steady revenue declines, and obviously, the corresponding declines in profitability. We have turned the corner in housing, and we've now said for '19, we expect growth. That's overall -- that assumes continued modest placement rate declines in lender-placed. Assuming the housing market doesn't weaken, that will continue. But through a combination of expense actions we've taken, through ordinary course relationships now at the regulators, we have gotten LPI stable with upside if we do have any weakening of the housing environment. And then housing overall is now positioned to grow, so we feel very good about where we are with housing. Obviously, we're dealing with elevated noncat loss, as the whole industry is, and that will work its way into pricing over time for the industry.

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

Okay, got it. And then just looking at -- I mean, just looking at the concentration of that book, if I go, like, back to the first quarter of '17, you got about 22% in kind of southern coastal regions. Now it's about 25%. And I guess, obviously, you had to buy down the retentions. But I mean, is there an opportunity to buy them down even further? I mean, I guess, just how did you guys get to the $80 million retention and giving up 2% EPS growth? I guess, just what was kind of the calculus behind that for you on a cost/benefit basis?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Well, you're exactly right. We looked at it, I would say, a lot of combinations and permutations around what we could buy in the market, including, as we talked about earlier, even ag insurance. And it really is a question at the end of the day of total risk appetite and cost/benefit of these things. So as we looked at it, we thought we would take a major step, and you'll see going down from $120 million of retention to $80 million of retention is a huge step. I wouldn't even start to forecast where we'll go in the future with that, but I think we kind of put the cursor exactly on the place where we want to be for '19.

Alan B. Colberg
President, CEO & Director

Yes. And Chris, on the coastal exposure, we've always had coastal exposure, given our business model. And it hasn't really changed in any meaningful way over time. It moves around a percent or 2, but long term, it's what we've always had, and it hasn't really changed.

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

Okay, got it. And then just one final one on lifestyle. I guess, where are you seeing the most growth in, like, mobile, extended warranty and automotive? I mean, what are kind of the growth areas in those lines?

Alan B. Colberg
President, CEO & Director

So in mobile, the growth is coming really from several different things. One, we are adding new clients. So we've talked in the last few quarters about KDDI in Japan is a new client. We've now gotten our first meaningful program with Verizon. We've added Apple in the U.S. So we're getting a lot of growth from new programs. Those programs generally take 2 years to 3 years to reach maturity as people buy and replace phones. We're also getting a lot of growth from new services. And then over the last couple of years, we've rolled out Pocket Geek, which is our onboard platform for the consumer experience. And more importantly now, we're rolling out premium tech support, which is the really complicated customer care. That's creating new growth drivers within our existing client base. So lots of different things are driving the very strong growth in mobile. And then if you look at auto, the -- that business is a little different in that what flows through the P&L this year, a significant portion of it was based on sales in the past. So we've had very strong sales the last few years, and that's beginning to show through in '19 and '20. But where the growth is going to come from for us, now we're adding more services beyond what we're doing with the traditional vehicle service contracts. So we see good momentum in auto as well.

Operator

Our next question comes from Kai Pan from Morgan Stanley.

Kai Pan
Morgan Stanley, Research Division

This is larger-picture question. Back in 2016 Investor Day, you laid out 3 financial objective: Grow net operating income long term, 15%-plus EPS growth and ROE expanding to 15%-plus. But if you look at the last couple of years, you already have been -- in normalized cat environment, probably running around the 10%-ish. And in a recent A.M. Best article, you mentioned that ROE is an important measure but is becoming less so for our business. Could you just elaborate on the ROE objective? Are you going away from that and more focusing on earning growth, EPS growth going forward?

Alan B. Colberg
President, CEO & Director

Yes, so let me -- I'll comment on the 3 metrics from 2016 and then partially answer your question, and we'll fully answer it in Investor Day in a month. So we laid out 3 long-term important metrics. One was to grow earnings, and that was very significant because we were dealing with lender-placed declines, we were dealing with the exit of health and benefits. And the very positive news is we've returned to growing earnings. In fact, we've given outlook for 2019 that we're going to have double-digit earnings growth. So we feel that one has been delivered, and that's really driven both in housing and lifestyle. Second, we laid out an EPS growth target of 15%. We've delivered about 13% on average over the last 3 years, so close. And we feel pretty good about how well we've done on EPS. Then ROE, we obviously made a decision in the middle to deploy capital to buy The Warranty Group, which obviously added a lot of capital into the company but fundamentally changed our position in the auto market, which gives us a much better franchise to go with the mobile business we already have. So as we think about it, we have much higher quality of earnings now than we had 3 years ago. In terms of ROE, for us, we use it as a discipline in making investing decisions, an important discipline. But as our mix continues to evolve and shift, it is not as relevant. But we'll talk more about that at Investor Day.

Operator

Our next question comes from John Nadel from UBS.

John Matthew Nadel
UBS Investment Bank, Research Division

We may as well go to the top of the hour, right? The -- Richard, I wanted to follow up on a question from earlier. Without necessarily telling us how much you have earmarked for the buy-in of the remaining stake of Iké, and I know that's still subject to a put-call option, but -- so it's not a given. But is that already reflected in the $473 million of parent company cash or the $223 million ex the $250 million buffer? Or should we think about the cash that you would use for that buy-in as a drawdown on the $223 million?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes, okay. So 2 parts to your question, John, and you phrased it accurately, as usual. In terms of the acquisition, we have a call put; they're options, both parties. So we have the option to buy, they have the option to put. That stars later in the first half of the year. So again, we don't know exactly what's going to happen as we go forward in the year, and we'll keep everyone up to date as those events unwind. So that's the first point. Second point is, yes, we did pay about $115 million for the 40% interest. Can't speculate on what the rest of the 60% interest is, but that probably gives you some level of overall magnitude. Just in terms of the funds, to be specific, we -- I would say you'll see that the level of cash that we have at the end of the year is probably relatively high at $473 million. So we've taken into account that we have this purchase coming in the future. And so we will be purchasing it as we go forward out of that $473 million, I would say. So...

John Matthew Nadel
UBS Investment Bank, Research Division

Out of the -- okay. Yes. So that $473 million is gross?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes. So we've taken it into account in the numbers and the capital projections and what we're thinking of in repurchases for the year.

Alan B. Colberg
President, CEO & Director

And John, I would just elevate from the specific to -- point to what our long-term track record is around capital deployment. We have a business that, whatever we earn in the segments on average, we're able to get to the holding company. And over 15 years, we have consistently used that as the #1 thing to return capital to shareholders through buyback and dividends. So forget short-term things that are going on. That is our long-term philosophy and nothing has changed with that.

John Matthew Nadel
UBS Investment Bank, Research Division

Yes, absolutely. And then just a follow-up on investment income as well. Richard, obviously, real estate JV income is lumpy and it's very difficult to predict, if not impossible. But if we strip that out of your total investment income for the fourth quarter, would you characterize the underlying level of investment income as sort of a reasonable way to think about a run rate? It looks like it was pretty good and maybe it's just benefiting from rates being higher in a shorter-duration portfolio turning over a little bit more quickly. Can you just comment on that?

Alan B. Colberg
President, CEO & Director

Yes John, let me start and then I'll turn over to Richard. The way to think about real estate, which is lumpy, is it's just an alternative asset class within our investment portfolio. So we've made a decision to take some of our investment portfolio and invest in real estate projects. That is, it shows up in a lumpy way, but it does show up consistently over time. So we don't think about stripping it out the way you described it. But I understand where you're going. So Richard, you want to talk about what's the underlying rate before you add back in something on real estate?

Richard Steven Dziadzio
Executive VP, CFO & Treasurer

Yes, I think if you look at the kind of the average rates that we've been posting during the previous quarters, that gives you a good indication of the overall yield. I mean, yields have moved a little bit, but obviously, they went up and kind of now back down in the markets. The other thing that you have coming in, in the total investment income is when we put -- we added TWG to the portfolio. So obviously, that boosts the aggregate amount that we have coming through. So I wouldn't factor in any sort of quantum steps or leaps in it. It's sort of a natural progression of the portfolio. And as Alan said it and as you in your question said, real estate income is lumpy. And in 2019 (sic) [2018], we kind of had most of it in the fourth quarter here.

John Matthew Nadel
UBS Investment Bank, Research Division

Yes, yes. I'm not dismissing the real estate income. I -- it's very real, it's just -- it's much more difficult to predict it. And then last one is, Alan, and maybe this is more about sort of looking into the March 14 Investor Day. But I think one of the things investors struggle with is trying to model the revenue and margin contribution from the differing businesses within Global Lifestyle, the trade-in business, let's say, versus the mobile service contract versus the warranty business on the auto side. So you mentioned trade-in volumes were up on a year-over-year basis. I know you don't split out that piece of revenues, but can -- maybe you help us understand that a bit more. How much were trade-in volumes up? How much of revenues comes from that business? Maybe how do we gauge the contribution from the steady increases in covered devices and covered automobiles, those sorts of things. And maybe it's more of around your deliverable on March 14, but any color you can provide would be helpful.

Alan B. Colberg
President, CEO & Director

Yes, John, first of all, I understand the challenges that you all have to work through in trying to understand lifestyle. The thing we always have to balance is our competitors generally are either private or are not disclosing any information about what they're doing. And so it's a balance. And we are committed, as you've seen over the last few years, to provide as much transparency as we can, and we will continue to do that. Specifically, in trade-in volumes in Q4, what's really happening is we're adding new programs and we have more subscribers. So even in a market where smartphone sales were sluggish to down, we're growing trade-ins because of our increasing number of programs and subscribers.

Operator

Our last question is coming from Mark Hughes from SunTrust.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

You had mentioned how, in the vehicle business, your revenue is driven by sales you've made in prior years. The unearned premium in the Global Lifestyle segment, it sits at about $14 billion. Could you say how much of that normally would flow through the P&L in terms of revenue for you? Is some portion of that presumably shared off with your partners, your clients, and so therefore doesn't actually flow through your P&L? Am I thinking about that properly? And if that's the case, how much of that would you expect on your income statement in the future?

Richard Steven Dziadzio

Executive VP, CFO & Treasurer

Yes, Mark, it's Richard back. So I guess the $14 billion, I think part of it is a reflection of the acquisition with TWG. And during the acquisition, we really talked about showing -- aligning them with our accounting and going from -- going to an accounting that's what we call gross accounting. So the premiums that are paid by the customer come in total to our balance sheet, and then the distribution cost claims are paid out. So as you've kind of stated, I guess, implicitly, not all of that -- those unearned premiums are kind of for us, per se. They will all flow through the income statements and P&Ls, but a part of them will go through to distribution payments, commissions, claims, et cetera. So it'll be a part of that. I think the best thing I would do in terms of giving you guidance on that would be really to look at the kind of the growth trends that we have in the net earned premium that we're showing and the revenues in the auto section and be growing those. It's probably the best indicator as opposed to trying to get into the UPR in what piece because that's a fairly complex piece. And we can...

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Yes, understood. I guess I'm trying to get a basic understanding of your global vehicle net earned premium fees and others this last quarter was $670 million, but you're sitting on an unearned premium balance of [$14 billion]. And so I'm just trying to do kind of the simple math of how much backlog do you have sitting on your balance sheet. How many, presumably, years worth of revenue is reflected there? That -- as opposed to what's the near-term growth rate, anything like that. I'm just trying to get a feel for the magnitude, what that implies for future visibility.

Alan B. Colberg
President, CEO & Director

Yes. So Mark, if you're willing, let's defer that to Investor Day, where we plan to talk a lot more about how to think about the auto business going forward. The important takeaway, though, is we have a lot of embedded earnings on the balance sheet in auto, which is one of the reasons we have a lot of confidence about how the business is going to grow in the coming years.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

Right, and I think we understand that -- I'll take your point to wait on that. But it's -- how much embedded revenue is sitting there, how much is yours versus your partner, that's the question. Appreciate your answer on that. One other question was the -- you had mentioned, in lender-placed insurance, some of the underlying losses were higher and others were experiencing that, and part of what will help that is rate hikes. Do you have any kind of assumption or visibility on what rate hikes you might anticipate over the next year or 2 within the lender-placed piece?

Alan B. Colberg
President, CEO & Director

What I would say on that is we're in a good position with the various states at this point. Our discussions with them are based on the facts of the situation. And we're warranted, based on our experience, we're able to work with them on rates. So I think we feel good about it. It's ordinary course, it's an annual process with most states, that's how we think about it.

Mark Douglas Hughes
SunTrust Robinson Humphrey, Inc., Research Division

And you wouldn't care to venture, mid-single digits, upper single digits?

Alan B. Colberg
President, CEO & Director

No, we would not.

All right. Well, thank you, everyone, for participating in today's call. We're very pleased with our performance in 2018 and looking forward to another strong year in 2019. Our Investor Day on March 14 is coming up soon, and we'll share our long-term vision, strategy and we'll go deeper on the key metrics and the way to think about our various businesses. In the meantime, please reach out to Suzanne Shepherd and Sean Moshier with any follow-up questions. Thanks, everyone.

Operator

Thank you. This does conclude today's teleconference. Please disconnect your lines at this time, and have a wonderful day.