HORACE MANN EDUCATORS CORP /DE/
Form 10-Q
August 09, 2005
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2005

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 1-10890

HORACE MANN EDUCATORS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**37-0911756**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1 Horace Mann Plaza, Springfield, Illinois 62715-0001

(Address of principal executive offices, including Zip Code)

Registrant s Telephone Number, Including Area Code: 217-789-2500

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

As of July 29, 2005, 42,926,628 shares of Common Stock, par value $0.001 per share, were outstanding, net of 17,503,371 shares of treasury stock.

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HORACE MANN EDUCATORS CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders

Horace Mann Educators Corporation:

We have reviewed the accompanying consolidated balance sheet of Horace Mann Educators Corporation and subsidiaries (the Company) as of June 30, 2005, and the related consolidated statements of operations and comprehensive income for the three-month and six-month periods ended June 30, 2005 and 2004, and the related consolidated statements of changes in shareholders equity and cash flows for the six-month periods ended June 30, 2005 and 2004. These consolidated financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2004, and the related consolidated statements of operations, changes in shareholders equity and comprehensive income, and cash flows for the year then ended (not presented herein); and in our report dated March 31, 2005, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2004, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it was derived.

/s/ KPMG LLP

KPMG LLP

Chicago, Illinois

August 9, 2005

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED BALANCE SHEETS

(Dollars in thousands)

	June 30, 2005 (Unaudited)	December 31, 2004
ASSETS		
Investments		
Fixed maturities, available for sale, at fair value (amortized cost, 2005, $3,533,208; 2004, $3,399,254)	$ 3,685,609	$ 3,541,255
Short-term and other investments	130,242	115,835
Short-term investments, loaned securities collateral	301,088	142
Total investments	4,116,939	3,657,232
Accrued investment income and premiums receivable	96,927	104,530
Deferred policy acquisition costs	215,964	209,576
Goodwill	47,396	47,396
Value of acquired insurance in force	18,587	21,522
Other assets	66,400	76,883
Variable annuity assets	1,261,967	1,254,763
Total assets	$ 5,824,180	$ 5,371,902
LIABILITIES AND SHAREHOLDERS EQUITY		
Policy liabilities		
Fixed annuity contract liabilities	$ 1,752,940	$ 1,688,075
Interest-sensitive life contract liabilities	606,115	593,694
Unpaid claims and claim expenses	341,226	342,445
Future policy benefits	180,221	181,648
Unearned premiums	194,952	204,706
Total policy liabilities	3,075,454	3,010,568
Other policyholder funds	146,049	142,634
Liability for securities lending agreements	290,427	
Other liabilities	224,983	218,011
Short-term debt		25,000
Long-term debt	190,872	144,720
Variable annuity liabilities	1,261,967	1,254,763
Total liabilities	5,189,752	4,795,696
Preferred stock, $0.001 par value, authorized 1,000,000 shares; none issued		
Common stock, $0.001 par value, authorized 75,000,000 shares; issued, 2005, 60,397,449; 2004, 60,350,014	60	60
Additional paid-in capital	343,946	343,178
Retained earnings	545,797	494,665
Accumulated other comprehensive income (loss), net of taxes:		
Net unrealized gains on fixed maturities and equity securities	92,194	85,872
Minimum pension liability adjustment	(14,992)	(14,992)
Treasury stock, at cost, 17,503,371 shares	(332,577)	(332,577)

Total shareholders equity	634,428	576,206
Total liabilities and shareholders equity	$ 5,824,180	$ 5,371,902

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (UNAUDITED)

(Dollars in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Revenues				
Insurance premiums and contract charges earned	$ 168,202	$ 169,097	$ 336,520	$ 336,660
Net investment income	48,449	46,877	96,009	95,473
Net realized investment gains (losses)	4,300	(811)	9,050	4,471
Total revenues	220,951	215,163	441,579	436,604
Benefits, losses and expenses				
Benefits, claims and settlement expenses	94,969	106,973	197,973	218,428
Interest credited	28,614	26,876	56,694	53,283
Policy acquisition expenses amortized	18,887	17,404	37,168	33,783
Operating expenses	30,653	34,524	60,943	68,131
Amortization of intangible assets	1,316	1,128	3,088	2,454
Interest expense	2,555	1,695	4,328	3,375
Total benefits, losses and expenses	176,994	188,600	360,194	379,454
Income before income taxes	43,957	26,563	81,385	57,150
Income tax expense	10,450	7,626	21,230	16,522
Net income	$ 33,507	$ 18,937	$ 60,155	$ 40,628
Net income per share				
Basic	$ 0.78	$ 0.44	$ 1.40	$ 0.95
Diluted	$ 0.72	$ 0.41	$ 1.29	$ 0.89
Weighted average number of shares and equivalent shares (in thousands)				
Basic	42,886	42,732	42,876	42,727
Diluted	47,832	47,311	47,769	47,294
Comprehensive income (loss)				
Net income	$ 33,507	$ 18,937	$ 60,155	$ 40,628
Other comprehensive income (loss), net of taxes:				
Change in net unrealized gains on fixed maturities and equity securities	47,313	(17,276)	6,322	(58,267)
Change in minimum pension liability adjustment				
Other comprehensive income (loss)	47,313	(17,276)	6,322	(58,267)

Total	$ 80,820	$ 1,661	$ 66,477	$ (17,639)

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY (UNAUDITED)

(Dollars in thousands, except per share data)

	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Common stock		
Beginning balance	$ 60	$ 60
Options exercised, 2005, 46,674 shares; 2004, 17,502 shares		
Conversion of Director Stock Plan units, 2005, 761 shares; 2004, 20,511 shares		
Ending balance	60	60
Additional paid-in capital		
Beginning balance	343,178	342,306
Options exercised and conversion of Director Stock Plan units	768	665
Catastrophe-linked equity put option premium		(1,125)
Ending balance	343,946	341,846
Retained earnings		
Beginning balance	494,665	456,330
Net income	60,155	40,628
Cash dividends, $0.21 per share	(9,023)	(8,981)
Ending balance	545,797	487,977
Accumulated other comprehensive income (loss), net of taxes:		
Beginning balance	70,880	64,356
Change in net unrealized gains on fixed maturities and equity securities	6,322	(58,267)
Change in minimum pension liability adjustment		
Ending balance	77,202	6,089
Treasury stock, at cost		
Beginning and ending balance, 2005 and 2004, 17,503,371 shares	(332,577)	(332,577)
Shareholders equity at end of period	$ 634,428	$ 503,395

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(Dollars in thousands)

	Six Months Ended June 30,	
	2005	**2004**
Cash flows - operating activities		
Premiums collected	$ 343,387	$ 348,855
Policyholder benefits paid	(209,172)	(218,651)
Policy acquisition and other operating expenses paid	(114,667)	(103,923)
Federal income taxes recovered (paid)	1,096	(3,933)
Investment income collected	95,588	94,408
Interest expense paid	(4,098)	(2,937)
Other	1,329	863
Net cash provided by operating activities	113,463	114,682
Cash flows - investing activities		
Fixed maturities		
Purchases	(565,174)	(764,228)
Sales	295,710	431,027
Maturities	142,179	166,010
Net cash provided by (used in) short-term and other investments	(24,963)	8,582
Net cash used in investing activities	(152,248)	(158,609)
Cash flows - financing activities		
Dividends paid to shareholders	(9,023)	(8,981)
Principal repayments on Bank Credit Facility	(25,000)	
Exercise of stock options	750	665
Catastrophe-linked equity put option premium		(1,125)
Proceeds from issuance of Senior Notes due 2015	74,245	
Repurchase of Senior Notes due 2006	(29,077)	
Annuity contracts, variable and fixed		
Deposits	159,473	170,027
Benefits and withdrawals	(60,767)	(46,497)
Net transfer to variable annuity assets	(61,202)	(61,570)
Net decrease in life policy account balances	(2,248)	(2,364)
Change in bank overdrafts	(8,366)	(6,228)
Net cash provided by financing activities	38,785	43,927
Net increase (decrease) in cash		
Cash at beginning of period		
Cash at end of period	$	$

See accompanying Notes to Consolidated Financial Statements.

See accompanying Report of Independent Registered Public Accounting Firm.

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HORACE MANN EDUCATORS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

June 30, 2005 and 2004

(Dollars in thousands, except per share data)

Note 1 - Basis of Presentation

The accompanying unaudited consolidated financial statements of Horace Mann Educators Corporation (HMEC ; and together with its subsidiaries, the Company or Horace Mann) have been prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) and with the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The Company believes that these financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly the Company s consolidated financial position as of June 30, 2005, the consolidated results of operations and comprehensive income for the three and six months ended June 30, 2005 and the consolidated changes in shareholders equity and cash flows for the six months ended June 30, 2005 and 2004. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The subsidiaries of HMEC market and underwrite tax-qualified retirement annuities and private passenger automobile, homeowners, and life insurance products, primarily to educators and other employees of public schools and their families. The Company s principal operating subsidiaries are Horace Mann Life Insurance Company, Horace Mann Insurance Company, Teachers Insurance Company, Horace Mann Property & Casualty Insurance Company and Horace Mann Lloyds.

It is suggested that these financial statements be read in conjunction with the financial statements and the related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

The results of operations for the three and six months ended June 30, 2005 are not necessarily indicative of the results to be expected for the full year.

The Company has reclassified the presentation of certain prior period information to conform with the June 30, 2005 presentation.

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Note 2 - Stock Based Compensation

The Company grants stock options to executive officers, other employees and directors. The exercise price of the option is equal to the fair market value of the Company s common stock on the date of grant. Additional information regarding the Company s stock-based compensation plans is contained in Notes to Consolidated Financial Statements Note 6 Shareholders Equity and Stock Options of the Company s Annual Report on Form 10-K for the year ended December 31, 2004. The Company accounts for stock option grants using the intrinsic value based method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and accordingly, recognizes no compensation expense for the stock option grants which have an exercise price equal to market price on the date of grant resulting in an intrinsic value of $0.

Alternatively, Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation , allows companies to recognize compensation cost for stock-based compensation plans, determined based on the fair value at the grant dates. If the Company had applied this alternative accounting method, net income and net income per share would have been reduced to the pro forma amounts indicated below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Net income				
As reported	$ 33,507	$ 18,937	$ 60,155	$ 40,628
Add: Stock-based compensation expense, after tax, included in reported net income				
Deduct: Stock-based compensation expense, after tax, determined under the fair value based method for all awards (1)	12	9,647	23	10,956
Pro forma	$ 33,495	$ 9,290	$ 60,132	$ 29,672
Net income per share basic				
As reported	$ 0.78	$ 0.44	$ 1.40	$ 0.95
Pro forma	$ 0.78	$ 0.22	$ 1.40	$ 0.69
Net income per share diluted				
As reported	$ 0.72	$ 0.41	$ 1.29	$ 0.89
Pro forma	$ 0.72	$ 0.21	$ 1.29	$ 0.66

(1) The fair value of each option grant was estimated on the date of grant using the Modified Roll-Geske option-pricing model with the following weighted average assumptions for 2005 and 2004, respectively: risk-free interest rates of 4.3% and 4.0%; dividend yield of 2.3% and 2.6%; expected lives of 7 and 10 years; and volatility of 19.4% and 25.1%. The six-month expense amounts represent one-half of the full year expense, reflecting options granted through June 30, 2005 and 2004, respectively, and vesting during the respective calendar years. The expense amounts for the three and six months ended June 30, 2004 also include the impact of accelerated vesting of stock options, as described in Notes to Consolidated Financial Statements Note 1 Summary of Significant Accounting Policies Stock Based Compensation of the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

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Note 3 - Debt

Indebtedness outstanding was as follows:

	June 30, 2005	December 31, 2004
Short-term debt:		
Bank Credit Facility	$	$ 25,000
Long-term debt:		
1.425% Senior Convertible Notes, due May 14, 2032. Aggregate principal amount of $244,500 less unaccrued discount of $128,362 (3.0% imputed rate)	116,138	116,138
6.05% Senior Notes, due June 15, 2015. Aggregate principal amount of $75,000 less unaccrued discount of $266 (6.1% imputed rate)	74,734	
6 5/8% Senior Notes, due January 15, 2006. Aggregate principal amount of $28,600 less unaccrued discount of $18 (6.7% imputed rate)		28,582
Total	$ 190,872	$ 169,720

The 1.425% Senior Convertible Notes due 2032 and 6 5/8% Senior Notes due 2006 are described in Notes to Consolidated Financial Statements Note 5 Debt of the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

Credit Agreement with Financial Institutions (Bank Credit Facility)

On May 31, 2005, the Company entered into a new Bank Credit Agreement which provides for unsecured borrowings of up to $100,000 (the Current Bank Credit Facility). The Current Bank Credit Facility expires on May 30, 2009. Interest accrues at varying spreads relative to corporate or eurodollar base rates and is payable monthly or quarterly depending on the applicable base rate. The unused portion of the Current Bank Credit Facility is subject to a variable commitment fee, which was 0.175% on an annual basis at June 30, 2005. On May 31, 2005, the Company borrowed $25,000 and subsequently repaid this balance in full on June 13, 2005, utilizing a portion of the proceeds from the issuance of the Senior Notes due 2015, described below.

On May 29, 2002, Horace Mann Educators Corporation entered into a Bank Credit Agreement that was amended effective June 1, 2004, increasing the commitment amount to $35,000, and May 3, 2005, extending the commitment termination date to June 30, 2005 from the previous termination date of May 31, 2005 (the Previous Bank Credit Agreement). The Previous Bank Credit Agreement was terminated on May 31, 2005, when the Company entered into the Current Bank Credit Facility. The $25,000 balance outstanding under the Previous Bank Credit Agreement was repaid in full on May 31, 2005, utilizing the borrowing under the Current Bank Credit Facility, described above.

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Note 3 Debt-(Continued)

6.05% Senior Notes due 2015 (Senior Notes due 2015)

On June 9, 2005, the Company issued $75,000 face amount of senior notes at an effective yield of 6.1%, which will mature on June 15, 2015. Interest on the Senior Notes due 2015 is payable semi-annually at a rate of 6.05%. The Senior Notes due 2015 are redeemable in whole or in part, at any time, at the Company s option, at a redemption price equal to the greater of (1) 100% of their principal amount or (2) the sum of the present values of the remaining scheduled payments of principal and interest thereon discounted, on a semi-annual basis, at the Treasury yield (as defined in the indenture) plus 30 basis points, plus, in either of the above cases, accrued interest to the date of redemption.

As of June 30, 2005, the net proceeds from the sale of the Senior Notes due 2015 have been used to (1) repay the Current Bank Credit Facility and (2) redeem the Senior Notes due 2006, described below. As of the date of this Report on Form 10-Q, management anticipates utilizing the remaining proceeds to recapture the Company s life reinsurance agreement with the United States branch of Sun Life Assurance Company of Canada. See also Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Financial Resources Capital Resources .

6 5/8% Senior Notes due 2006 (Senior Notes due 2006)

On June 30, 2005, the Company redeemed all of its outstanding Senior Notes due 2006, $28,600 aggregate principal amount, utilizing a portion of the proceeds from the issuance of the Senior Notes due 2015, described above. The aggregate cost of the repurchase was $29,107.

Universal Shelf Registration

To provide additional capital management flexibility, the Company filed a universal shelf registration on Form S-3 with the SEC in December 2003. The registration statement, which registers the offer and sale by the Company from time to time of up to $300,000 of various securities, which may include debt securities, preferred stock, common stock and/or depositary shares, was declared effective on December 30, 2003. The $75,000 face amount of Senior Notes due 2015 was issued utilizing this registration statement. No other securities associated with the registration statement have been issued as of the date of this Report on Form 10-Q.

Debt Retirement Charges

The repurchase of the Senior Notes due 2006 resulted in a pretax charge to income for the three and six months ended June 30, 2005 of $507, which was reported as a component of interest expense for these periods.

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Note 4 - Investments

Fixed Maturity Securities

The following table presents the composition and value of the Company s fixed maturity securities portfolio by rating category. The Company has classified the entire fixed maturity securities portfolio as available for sale, which is carried at fair value.

Rating of Fixed Maturity Securities (1)	Percent of Fair Value June 30, 2005	Percent of Fair Value December 31, 2004	June 30, 2005 Fair Value (2)	June 30, 2005 Amortized Cost
AAA	41.9%	42.0%	$ 1,544,196	$ 1,519,373
AA	7.8	7.5	286,929	277,360
A	24.3	24.3	895,928	829,940
BBB	20.0	20.3	738,933	691,546
BB	2.4	1.8	87,431	87,044
B	3.4	3.7	125,390	123,553
CCC or lower	0.1	0.3	3,767	1,350
Not rated (3)	0.1	0.1	3,035	3,042
Total	100.0%	100.0%	$ 3,685,609	$ 3,533,208

(1) Ratings are as assigned primarily by Standard & Poor s Corporation (S&P) when available, with remaining ratings as assigned on an equivalent basis by Moody s Investors Service, Inc. (Moody s). Ratings for publicly traded securities are determined when the securities are acquired and are updated monthly to reflect any changes in ratings.

(2) Fair values are based on quoted market prices, when available. Fair values for private placements and certain other securities that are infrequently traded are estimated by the Company with the assistance of its investment advisors utilizing recognized valuation methodology, including cash flow modeling.

(3) This category includes $3,035 of private placement securities not rated by either S&P or Moody s. The National Association of Insurance Commissioners (NAIC) has rated 100% of these private placement securities as investment grade.

The following table presents the distribution of the Company s fixed maturity securities portfolio by estimated expected maturity. Estimated expected maturities differ from contractual maturities by reflecting assumptions regarding borrowers utilization of the right to call or prepay obligations with or without call or prepayment penalties. Estimated expected maturities consider broker dealer survey values and are verified for consistency with the interest rate and economic environments.

	Percent of Total June 30, 2005	Percent of Total December 31, 2004	Fair Value June 30, 2005
Due in 1 year or less	8.6%	7.9%	$ 317,807

Due after 1 year through 5 years	27.1	26.1	997,890
Due after 5 years through 10 years	38.5	40.7	1,417,994
Due after 10 years through 20 years	8.1	7.5	300,196
Due after 20 years	17.7	17.8	651,722
Total	100.0%	100.0%	$ 3,685,609

The average option adjusted duration for the Company s fixed maturity securities was 5.6 years at June 30, 2005.

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Note 4 - Investments-(Continued)

The Company s investment portfolio includes no derivative financial instruments (futures, forwards, swaps, option contracts or other financial instruments with similar characteristics).

Securities Lending

The Company loans fixed income securities to third parties, primarily major brokerage firms. As of June 30, 2005 and December 31, 2004, fixed maturities with a fair value of $290,427 and $0, respectively, were on loan. Loans of securities are required at all times to be secured by collateral from borrowers at least equal to 100% of the market value of the securities loaned. The Company maintains effective control over the loaned securities and therefore reports them as Fixed Maturity Securities in the Consolidated Balance Sheets. Securities lending collateral is classified as investments with a corresponding liability in the Company s Consolidated Balance Sheets.

Note 5 - Pension Plans and Other Postretirement Benefits

The Company has the following retirement plans: a defined contribution plan; a 401(k) plan; a defined benefit plan for employees hired on or before December 31, 1998; and certain employees participate in a supplemental defined benefit plan or a supplemental defined contribution plan or both. Additional information regarding the Company s retirement plans is contained in Notes to Consolidated Financial Statements Note 10 Pension Plans and Postretirement Benefits of the Company s Annual Report on Form 10-K for the year ended December 31, 2004.

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Note 5 - Pension Plans and Other Postretirement Benefits-(Continued)

The following table summarizes the components of net periodic pension cost recognized for the defined benefit plan and the supplemental defined benefit plans for the three and six months ended June 30, 2005 and 2004.

	Defined Benefit Plan		Supplemental Defined Benefit Plans	
	Three Months Ended June 30,		Three Months Ended June 30,	
	2005	2004	2005	2004
Components of net periodic pension expense:				
Service cost	$	$	$ (7)	$ (7)
Interest cost	625	776	229	243
Expected return on plan assets	(594)	(678)		
Recognized net actuarial loss	380	382	156	132
Settlement loss	412	523		
Net periodic pension expense	$ 823	$ 1,003		