Second Quarter 2019 Conference Call

July 25, 2019 10:00 a.m. CDT

## CORPORATE PARTICIPANTS

Frank M. Svoboda Torchmark Corporation - Executive VP & CFO

Gary L. Coleman Torchmark Corporation - Co-Chairman & CEO

Larry M. Hutchison Torchmark Corporation - Co-Chairman & CEO

Michael C. Majors Torchmark Corporation - EVP of Administration & IR

## CONFERENCE CALL PARTICIPANTS

Erik James Bass Autonomous Research LLP - Partner of US Life Insurance

Jamminder Singh Bhullar JP Morgan Chase & Co, Research Division - Senior Analyst

Taylor Alexander Scott Goldman Sachs Group Inc., Research Division - Equity Analyst

## PRESENTATION

**Michael C. Majors** - Torchmark Corporation - EVP of Administration & IR

Thank you. Good morning everyone. Joining the call today are Gary Coleman and Larry Hutchison, our Co-Chief Executive officers, Frank Svoboda, our Chief Financial Officer, and Brian Mitchell, our General Counsel.

Some of our comments or answers to your questions may contain forward-looking statements that are provided for general guidance purposes only. Accordingly, please refer to our 2018 10-K and any subsequent forms 10-Q on file with the SEC.

Some of our comments may also contain non-GAAP measures. Please see our earnings release and website for a discussion of these terms and reconciliations to GAAP measures.

I will now turn the call over to Gary Coleman.

**Gary L. Coleman** - Torchmark Corporation - Co-Chairman & CEO

Thank you Mike, and good morning everyone. In the second quarter, net income was $187 million or $1.67 per share, compared to $184 million or $1.59 per share a year ago. Net operating income for the quarter was $187 million or $1.67 per share, a per share increase of 11% from a year ago.

On a GAAP reported basis, return on equity as of June 30 was 12.3% and book value per share was $60.22. Excluding unrealized gains and losses on fixed maturities, return on equity was 14.6% and book value per share grew 10% to $46.43.

In our life insurance operations, premium revenue increased 5% to $631 million and life underwriting margin was $175 million, up 9% from a year ago. Growth in underwriting margin exceeded premium growth due to a higher percentage of premium margins in all distribution channels. For the year, we expect life underwriting income to grow around 6% to 7%.

On the health side, premium revenue grew 6% to $266 million and health underwriting margin was up 1% to $60 million. Growth in premium exceeded underwriting margin growth primarily due to lower margins at United American. For the year, we expect health underwriting income to grow around 3% to 4%.

Administrative expenses were $59 million for the quarter, up 7% from a year ago and in line with our expectations. As a percentage of premium, administrative expenses were 6.6%, compared to 6.5% a year ago. For the full year, we expect administrative expenses to grow approximately 6% and to remain around 6.6% of premium, compared to 6.5% in 2018.

I will now turn the call over to Larry for his comments on the marketing operations.

**Larry M. Hutchison** - Torchmark Corporation - Co-Chairman & CEO

Thank you Gary. At American Income, life premiums were up 7% to $288 million and life underwriting margin was up 9% to $97 million. Net life sales were $61 million, up 2%. The average producing agent count for the

second quarter was 7,364, up 4% from the year-ago quarter and up 7% from the first quarter. The producing agent count at the end of the second quarter was 7,477.

At Liberty National, life premiums were up 3% to $71 million and life underwriting margin was up 6% to $18 million. Health premiums were down 1% to $47 million and the health underwriting margin was down 4% to $12 million. Net life sales increased 4% to $13 million and net health sales were $6 million, up 11% from the year ago quarter. The sales growth was driven primarily by agent count growth.

The average producing agent count for the second quarter was 2,290, up 5% from the year-ago quarter and up 5% from the first quarter. The producing agent count at Liberty National ended the quarter 2,390.

In our direct response operation at Globe Life, life premiums were up 4% to $217 million and life underwriting margin increased 9% to $39 million. Net life sales were $34 million, down 2% from the year-ago quarter. Year-to-date, sales are flat. As we go forward, we expect to grow both sales and profits.

At Family Heritage, health premiums increased 8% to $73 million and health underwriting margin increased 14% to $18 million. Net health sales were up 9% to $17 million due primarily to increased agent productivity. The average producing agent count for the second quarter was 1,081, up 3% from the year-ago quarter and up 8% from the first quarter. The producing agent count at the end of the quarter was 1,089.

At United American General Agency, health premiums increased 9% to $102 million, while margins declined 8% to $14 million. Net health sales were $17 million, up 24% compared to the year-ago quarter.

To complete my discussion of the marketing operations, I will now provide some projections. We expect the producing agent count for each agency at the end of 2019 to be in the following ranges: American Income, 7,200 to 7,500; Liberty National, 2,300 to 2,500; Family Heritage, 1,175 to 1,225.

Approximate net life sales for the full year 2019 are expected to be as follows: American Income, 5% to 9% growth; Liberty National, 9% to 13% growth; direct response, flat to 2% growth.

Approximate net health sales for the full year 2019 are expected to be as follows: Liberty National, 7% to 11% growth; Family Heritage, 3% to 7% growth; United American individual Medicare Supplement, 7% to 13% growth.

I will now turn the call back to Gary.

**Gary L. Coleman** - Torchmark Corporation - Co-Chairman & CEO

I want to spend a few minutes discussing our investment operations.

**First, excess investment income**

Excess investment income, which we define as net investment income less required interest on net policy liabilities and debt, was $65 million, an 8% increase over the year-ago quarter.

On a per share basis, reflecting the impact of our share repurchase program, excess investment income increased 12%. Year-to-date, excess investment income is up 7% in dollars and 10% per share. For the full year 2019, we expect excess investment income to grow about 5%, which would result in a per share increase of around 8% to 9%.

**Investment Portfolio**

Invested assets are $16.9 billion, including $16 billion of fixed maturities at amortized cost. Of the fixed maturities, $15.3 billion are investment grade with an average rating of A-, and below investment grade bonds are $646 million, compared to $688 million a year ago. The percentage of below investment grade bonds to fixed maturities is 4.0%, compared to 4.5% a year ago. This is the lowest this ratio has been in the last 20 years.

Overall, the total portfolio is rated BBB+, same as the year-ago quarter. Bonds rated BBB are 56% of the fixed maturity portfolio as compared to 58% at the end of 2018. While this ratio is high relative to our peers, we have no exposure to higher risk assets such as derivatives or equities and little exposure to commercial mortgages and asset backed securities.

We believe BBB securities provide us the best risk adjusted, capital adjusted returns due in large part to our unique ability to hold the securities to maturity regardless of the fluctuations in interest rates or equity markets.

Finally, we have net unrealized gains in the fixed maturity portfolio of $2 billion, $715 million higher than the previous quarter due primarily to changes in market interest rates.

**Regarding investment yield**

In the second quarter, we invested $253 million in investment grade fixed maturities primarily in the financial and industrial sectors. We invested at an average yield of 4.95%, an average rating of A- and an average life of 29 years.

For the entire portfolio, the second quarter yield was 5.50%, down 7 basis points from the 5.57% yield in the second quarter of 2018. As of June 30, the portfolio yield was approximately 5.50%. At the midpoint of our guidance, we are assuming an average new money rate of around 4.5% for the remainder of 2019.

While we would like to see higher interest rates going forward, we can thrive at a lower for longer interest rate environment. Extended low interest rates will not impact the GAAP or statutory balance sheets under current accounting rules since we sell non-interest sensitive protection products. While our net investment income will be impacted in a continuing low interest rate environment, our excess investment income will still grow, it just won't grow at the same rate as the invested assets.

Now I will turn the call over to Frank.

**Frank M. Svoboda** - Torchmark Corporation - Executive VP & CFO

Thanks Gary. First I want to spend a few minutes discussing our share repurchases and capital position. The Parent began the year with liquid assets of $41 million. In addition to these liquid assets, the Parent is generating excess cash flow in 2019. The Parent Company's excess cash flow, as we define it, results primarily from the dividends received by the Parent from its subsidiaries less the interest paid on debt and the dividends paid to Torchmark shareholders.

We anticipate our excess cash flow in 2019 to be in the range of $365 million to $375 million. Thus, including the assets on hand at the beginning of the year, we currently expect to have around $405 million to $415 million available to the parent during the year. As discussed on prior calls, we accelerated the repurchases of $25 million of Torchmark's stock into December 2018 with commercial paper and Parent cash. We have utilized $15 million of the 2019 excess cash flow to reduce the commercial paper for those repurchases. As such, we expect to have approximately $390 million to $400 million to be available to the Parent for other uses, including the $50 million of liquid assets we normally retain at the Parent.

In the second quarter, we spent $85.4 million to buy 979,000 Torchmark shares at an average price of $87.18. Including the $88.6 million spent for repurchases in the first quarter and the $16 million spent so far in July, we have spent $190 million of Parent Company cash thus far in 2019 to acquire more than 2.2 million shares at an average price of $84.67.

Taking into account the $190 million spent on year-to-date repurchases and the $50 million we plan on retaining at the Parent, we will have approximately $150 million to $160 million of excess cash flow available to the Parent for the remainder of the year.

As noted on previous calls, we will use our cash as efficiently as possible. If market conditions are favorable and absent alternatives with higher value to our shareholders, we expect that share repurchases will continue to be a primary use of those funds.

**Now regarding capital levels at our insurance subsidiaries**

Our goal is to maintain capital at levels necessary to support our current ratings. As discussed on our previous call, Torchmark intends to target a consolidated company action level RBC ratio in the range of 300% to 320% for 2019.

**Finally, with respect to our earnings guidance**

We are projecting the net operating income per share will be in the range of $6.67 to $6.77 for the year ended December 31, 2019. The $6.72 midpoint of this guidance reflects a $0.04 increase over the prior quarter midpoint of $6.68, primarily attributable to the favorable underwriting results in the second quarter and an improved outlook on life underwriting income for the second half of the year. These positive adjustments are offset somewhat by slightly lower expectations of excess investment income and health underwriting income for the remaining part of the year.

Those are my comments. I will now turn the call back to Larry.

**Larry M. Hutchison** - Torchmark Corporation - Co-Chairman & CEO

Thank you Frank. We have two more topics to discuss before taking questions. We announced yesterday that Torchmark will be renamed Globe Life Inc. on August 8. We will be listed on the New York Stock Exchange as GL. The name change reflects the company's commitment to an enterprise-wide brand alignment to enhance sales and recruiting to improve name recognition.

We chose the Globe Life name to capitalize on the branding investments we have made in recent years at Globe Life and Accident Insurance Company. These investments have increased Globe's name recognition and improved sales in Texas and the surrounding states. While the individual insurance subsidiaries will continue to exist as legal entities and retain their unique cultures and market niches, they will all eventually use and take advantage of the Globe Life brand.

Our operating companies have been successful using their own brands despite a lack of name recognition among agent recruits and prospective customers. We expect unified branding and the resulting name recognition to expand that success. Over time branding will significantly

enhance our ability to recruit agents and reach new customers.

We expect this initiative to evolve over a number of years and create a strong unified brand. As we go forward, we will maintain our usual disciplined approach to expense management to ensure branding has a positive effect on recruiting, sales and underwriting income.

Lastly, we announced earlier today that Globe Life is now the Official Life Insurance of the Dallas Cowboys. We are excited about this new relationship. It provides a great opportunity to strengthen Globe Life's brand recognition in a cost effective manner.

Those are our comments. We will now open the call up for questions.

## QUESTIONS AND ANSWERS

**Jamminder Singh Bhullar** - JP Morgan Chase & Co, Research Division - Senior Analyst

Hi good morning. I had a couple of questions. First on the direct response business, I think you are guiding to flat to up 2% sales growth in -- for the year. First half, you are down almost 1%, and I think this quarter obviously was down after 2 positive quarters in the last couple of quarters. So what gives you confidence that things or the insight -- or that things are going to get better in the second half? And then secondly on American Income, there were a lot of concerns last year on how the strong economy was going to affect your ability to recruit and also just how your sales were going to be affected by the Supreme Court decision related to unions. And wondering if you can comment if you have seen any impact on your close rates or any – on the sales side or on recruiting just from the tight labor market.

**Larry M. Hutchison** - Torchmark Corporation - Co-Chairman & CEO

Let me comment on Globe first. The first quarter, as you stated, was up slightly at 1%. As expected, the second quarter was down 2%. That decline was due primarily to a decrease in mailing volumes. We are expecting to have 2% to 3% sales growth for the second half of the year. Thus, our guidance is flat to up 2%. With respect to American Income, the Supreme Court decision has had no effect on our sales, our recruiting or our persistency.

Jimmy, I think the third question had to do with agent retention. And what we have seen on agent retention is that in the first and second quarter, the increase in agent count seems to reflect an increase in our year over year recruiting. The short term is positive since terminations have slowed down compared to the new agent appointments. For the year, our guidance for the ending agent count is between 7,200 and 7,500, and we expect that, that will be the case. But the sales growth did not equal the agent growth in the second quarter, and that is because new agents are generally less productive in their first several months as compared to veteran agents.

**Jamminder Singh Bhullar** - JP Morgan Chase & Co, Research Division - Senior Analyst

Okay. And maybe if I could just ask one more on the name change. Any financial impact you expect from it, like either in the form of increased spending initially, maybe to build the brand further, or maybe expense efficiencies or something like positive or negative financial impacts from the name change over the next year?

**Larry M. Hutchison** - Torchmark Corporation - Co-Chairman & CEO

Well, Jimmy, additional advertising spending is going to be coordinated with the brand alignment timeline for our various distribution channels. We plan on increasing advertising spend in a measured way to coincide with increases in our sales and recruiting. We do not believe there will be significant impact on our underwriting income.

**Jamminder Singh Bhullar** - JP Morgan Chase & Co, Research Division - Senior Analyst

Okay thank you.

**Erik James Bass** - Autonomous Research LLP - Partner of US Life Insurance

Hi, good morning thank you. Based on your strong life underwriting margins in the first half of the year, are you making any changes to your full year expectations and/or the longer-term targets for margins by business?

**Frank M. Svoboda** - Torchmark Corporation - Executive VP & CFO

Yes. I would say, Erik, that we are increasing our expectations with respect to our overall life for the second half of the year. If you look at last year we probably -- on a total life basis, we were just a little bit under 28% margin for the second half of the year. This year, we probably, given the favorable experience that we have seen so far in the first half of the year, we are thinking that is probably going to be closer to 28% for the remainder of the year, just a little bit of an uptick greater than what we saw last year and a little bit better than what we had anticipated as of our last call. I think most of this probably really relates to American Income, but we are also just seeing a slightly better expectation with respect to direct response as well.

**Gary L. Coleman** - Torchmark Corporation - Co-Chairman & CEO

Erik, I would add that it is mostly margin improvement. The growth in premium in the second half of the year will be very close to what the growth of the first half of the year is. The growth there is coming from the increased margins that Frank mentioned.

**Erik James Bass** - Autonomous Research LLP - Partner of US Life Insurance

Got it thank you, and would that margin be something that you would expect to continue into 2020? I mean a little bit above 28%?

**Frank M. Svoboda** - Torchmark Corporation - Executive VP & CFO

Well, we will obviously be taking a look at those projections again here in the next quarter, we will really be able to give some better guidance on that next quarter where we kind of see 2020 coming off.

**Gary L. Coleman** - Torchmark Corporation - Co-Chairman & CEO

But I would add, I do not think we expect to see much variability. For example, we are 27.7% this year, we were 27.1% last year. It is not going to vary too much from either of those numbers.

**Erik James Bass** - Autonomous Research LLP - Partner of US Life Insurance

Got it thanks, and then on just life sales, I think you are trending year-to-date a little bit lower than your full year targets. So can you talk about some of the dynamics behind that and your expectations for the second half of the year, where it seems from your guidance that you expect activity to pick up a bit?

**Larry M. Hutchison** - Torchmark Corporation - Co-Chairman & CEO

Erik, your question again was life sales in the second half of the year?

**Erik James Bass** - Autonomous Research LLP - Partner of US Life Insurance

Yes.

**Larry M. Hutchison** - Torchmark Corporation - Co-Chairman & CEO

The life sales, I think the guidance I gave for the second half of the year is, we are going to see positive life sales out of each distribution. American Income, for the full year 5% to 9%. We had I believe 4% and 2% in the first and second quarters. So we will see a little stronger life sales in the second -- third and fourth quarter. When you think about it, those are fairly easy comparables. We had weaker third and fourth quarter sales last year. Liberty National net life sales for the remainder of the year should be strong. Again, the guidance for the full year is 9% to 13%. And direct response, to answer Jimmy's question, our guidance is still flat to 2%.

**Erik James Bass** - Autonomous Research LLP - Partner of US Life Insurance

Got it thank you.

**Taylor Alexander Scott** - Goldman Sachs Group Inc., Research Division - Equity Analyst

Good morning, first question I have is just a bit of a housekeeping question. As we think about the decline in rates, actuarial reviews and so forth, would you expect to have any impact -- I mean, I think a lot of your business is FAS60, and so I would think there is probably plenty of margin and no risk from cash flow testing. Like is that the case? What do you use for long-term rate assumptions when you do that work?

**Gary L. Coleman** - Torchmark Corporation - Co-Chairman & CEO

Well, you are right that almost all our businesses is FAS60 basis. And as far as the rates that we use, we -- for each year of issue, we select an interest rate based on what current rates are. But in doing the cash flow testing that we do each year, we have never had an issue where we-- a change in rates could cause us to write off DAC or affect our liabilities. It is just -- for one thing, we do not sell interest sensitive business. The other thing we have such strong margins in the business that we would -- I cannot ever see us getting to the point where we had to make any kind of adjustment.

**Taylor Alexander Scott** - Goldman Sachs Group Inc., Research Division - Equity Analyst

Got it. And then second question I had is just on expenses. And I guess there is some headwinds that I think are facing the industry in general, which is system upgrades, improving tech and dealing with the new accounting standards and all of the time and effort that is

probably going into converting, even though I know it got pushed back a year. With all these things going on and just like the scale of Torchmark, I would think that maybe some of those expenses might impact you guys a bit more than some of the bigger life insurers. Are you feeling any of that? Is that already in numbers and the run rate that you are kind of showing us today? Any anticipation of any of those expenses increasing over the next year or two?

**Gary L. Coleman** - Torchmark Corporation - Co-Chairman & CEO

The answer is yes and yes. We are feeling it and it is in our numbers and in our guidance. The 7% increase this year in administrative expenses, most of that is related to IT and information security expenses. And you are right, I think all companies and industries are being hit by that. And this is a trend over the last few years that we ramp up these expenses. We expect to continue to increase these expenses, maybe not at the rate we have in the last year or so. But in our guidance what we say is we expect administrative expenses to be 6.6% for the year, that includes all the IT and information security costs that I have just mentioned.

**Taylor Alexander Scott** – Goldman Sachs Group Inc., Research Division – Equity Analyst

Thanks very much.

**Operator**

At this time, there are no further questions in the queue.

**Michael C. Majors** – Torchmark Corporation – EVP of Administration & IR

All right. Thank you for joining us this morning. Those are our comments, and we will talk to you again next quarter.