Torchmark Corporation

1st QUARTER 2015 CONFERENCE CALL

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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 2014 10K and any subsequent forms 10-Q on file with the SEC. I will now turn the call over to Gary Coleman.

Gary Coleman - *Torchmark Corporation - Co-CEO*

Thank you, Mike. Good morning, everyone. Net operating income for the first quarter was $134 million, or $1.04 per share, a per-share increase of 3% from a year ago. Net income for the quarter was $122 million, or $0.95 per share, a 3% decrease on a per-share basis. With fixed maturities and amortized cost, our return on equity as of March 31 was 14.7% and our book value per share was $28.44, a 7% increase over a year ago. On a GAAP reported basis, with fixed maturities at market value, book value per share increased 22% to $38.17.

In our life insurance operations, premium revenue grew 5% to $513 million while life underwriting margin was $141 million, up 1% from a year ago. Growth in underwriting margin lagged premium growth due to higher claims, primarily in direct response. For the full year, we expect life underwriting margins to increase 3% to 5% over 2014. Also in the quarter, net life sales increased 17% to $104 million.

On the health side, premium revenue grew 4% to $229 million and health underwriting margin grew 4% to $52 million. For the full year, we expect health underwriting margin to increase 2% to 4%. Health sales increased 2% to $32 million. Excluding group business, individual health sales increased 22%.

Administrative expenses were $47 million for the quarter, up 7% from a year ago and in line with our expectations. The primary reasons for the increase to administrative expenses are higher pension and IT costs. As the percentage of premium, administrative expenses were 5.7% compared to 5.6% a year ago. For the full year, we anticipate that administrative expenses will be up around 6% to 7% and around 5.8% of premium. I will now turn the call over to Larry Hutchison for his comments on the marketing operations.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Thank you, Gary. We are pleased about the sales activity at Torchmark. We have had year-over-year increases in net life sales in each of our major life distribution channels for five quarters in a row. Now I will go over the results for each company.

At American Income, life premiums were up 9% to $202 million and life underwriting margin was up 4% to $62 million. Net life sales were $47 million, up 24% due primarily to increased agent counts. The average agent count for the first quarter was 6,317, up 19% over a year ago, but approximately the same as the fourth quarter. The producing agent count at the end of the first quarter was 6,541. We expect life sales growth for the full year 2015 to be within a range of 9% to 13%.

At our Direct Response operation at Globe Life, life premiums were up 5% to $187 million, but life underwriting margin declined 5% to $43 million. Net life sales were up 11% to $45 million. We expect 4% to 7% life sales growth for the full year 2015.

At Liberty National, life premiums were $68 million, down 1% from a year ago. While life underwriting margin was $17 million, the same as the year ago quarter. Net life sales grew 16% to $9 million while net health sales increased 8% to $4 million.

The average producing agent count for the first quarter was 1,464, up 5% from a year ago, but down 7% from the fourth quarter. The producing agent count at Liberty National entered the quarter at 1,544. Life net sales growth is expected to be within a range of 6% to 9% for the full year 2015. Health net sales growth is expected to be within a range of 4% to 7% for the full year 2015.

At Family Heritage, health premiums increased 8% to $54 million; while health underwriting margin increased 6% to $11 million. Health net sales were up 18% to $12 million.

The average producing agent count for the first quarter was 784; up 19% from a year ago, but approximately the same as the fourth quarter. The producing agent count at the end of the quarter was 881. We expect health sales growth to be in a range from 7% to 10% for the full year 2015.

At United American General Agency, health premiums increased 6% to $83 million. Net health sales declined from $14 to $12 million. Excluding our group business, net health sales grew 30%. For the full year 2015, we expect growth in individual sales to be around 15% to 20%. As we discussed last quarter, we expect lower group sales in 2015 due to the unusual number of large group cases we acquired in 2014.

Premium revenue from Medicare Part D declined 4% to $79 million. While the underwriting margin declined from $10 million from to $5 million. The decline in underwriting margin was in line with our expectations and was due to the increase in Part D drug cost discussed on our previous call. We expect Part D premiums of $310 million to $320 million for the full year 2015, expect margin as a percentage of premium to be approximately 6% to 8%. I will now turn the call back to Gary.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

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

First, the excess investment income

Excess investment income, which we define as net investment income less required interest on policy liabilities and debt, was $55 million, a decline of 3% from the first quarter of 2014.

On a per-share basis reflecting the impact of our share repurchase program, excess investment income increased 2%. We have discussed on previous calls the effect of Part D on excess investment income. Excess investment income was negatively impacted by Part D to the extent of $2 million in the first quarter of 2015. Excluding the negative impact of the Part D, excess investment income would've been flat with the year ago quarter, but up about 5% on a per-share basis. For the full year 2015, we expect excess investment income to decrease by about 1% to 3%. However, on a per-share basis, we should see an increase of about 2% to 3%. At the midpoint of our 2015 guidance, we are expecting a drag on excess investment income from Part D of approximately $7 million.

Now, regarding the investment portfolio

Invested assets were $13.5 billion, including $13 billion of fixed maturities at amortized cost. Of the fixed maturities, $12.4 billion are investment grade with an average rating of A- and Below Investment Grade bonds are $604 million compared to $552 million a year ago. The percentage of Below Investment Grade bonds to fixed maturities is 4.7% compared to 4.4% a year ago. For the portfolio leverage of 3.6 times, the percentage of Below Investment Grade bonds to equity, excluding net unrealized gains from fixed maturities, is 17%. Overall, the total portfolio is rated A-, the same as a year ago. In addition, we have net unrealized gains in the fixed maturity portfolio of $1.9 billion, approximately $256 million higher than at the end of the fourth quarter.

To complete the investment portfolio discussion, I'd like to address our investments in the energy sector. We believe that the risk of realizing any losses in the foreseeable future is minimal for the following reasons. Over 96% of our energy holdings are investment grade. At the end of the first quarter, our energy portfolio had a net unrealized gain of $173 million. Plus, 8% of our energy holdings are in the oilfield service and drilling sector. And we've reviewed our energy holdings and have concluded that while we may see some downgrades, we believe that the companies we've invested in can withstand low oil prices for an extended duration.

Regarding investment yield

In the first quarter, we invested $292 million in investment grade fixed maturities, primarily in industrial sectors. We invested at an average yield of 4.5% at an average rating of triple B+ at an average life of 29 years. For the entire portfolio, the first quarter yield was 5.87%, down 5 basis points from the 5.92% yield in the first quarter of 2014. At March 31, 2015, the portfolio yield was approximately 5.86%. The midpoint of our guidance for 2015 assumes new money yields of 4.5% for the second quarter and 4.75% for the last two quarters of the year.

One last thing; on past analyst calls, we have discussed in detail the impact of a lower for longer interest rate environment. As a reminder, an extended low-interest rate environment impacts our income statement, but not the balance sheet.

Since we primarily sell noninterest sensitive protective products accounted for under

FAS60, we don't see a reasonable scenario that would require us to write off DAC or put up additional GAAP reserves due to interest rate fluctuations. In addition, we do not foresee a negative impact on our statutory balance sheet. While we would definitely benefit from higher interest rates, Torchmark will continue to earn substantial excess investment income in an extended low interest rate environment.

Now I'll turn the call over to Frank to discuss share repurchases at capital.

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Thanks, Gary. First, I'd like to briefly discuss a few items impacting our 2015 earnings guidance. As Gary mentioned, growth in the life underwriting income lagged behind the growth in premium in the first quarter, primarily due to higher policy obligations in our Direct Response operations. In the first quarter this year, policy obligations at Direct Response were 49.1% of premiums versus 46.9% in the first quarter of 2014. Looking back, the first quarter of last year was low as the policy obligations for the full-year 2014 ended up at 48.1%.

As we discussed in our last call, this percentage was trending higher than prior years, primarily due to actual claims coming in higher than our expectations on policies issued in the early 2000s. We also noted that we expected the policy obligations percentage for 2015 to be around 48%. Based on the additional claims experience we saw in the first quarter, and further review of the emerging claims trends, we now believe the Direct Response policy obligations for the full-year 2015 will be in the range of 48.5% to 49% of premiums. This increase in the expected policy obligations at Direct Response is the primary driver of the $0.02 reduction in the midpoint of our guidance.

In addition, we revised our expectations for the Canadian foreign exchange rate which will cause the earnings from American Income life to be somewhat lower than previously anticipated. On a positive note, we do anticipate our premium income will be higher than previously estimated, primarily at American Income due to the strong first quarter sales. The net effect of these three items results in the reduction in the midpoint of our guidance from $4.30 to $4.28.

Now regarding our share repurchases and capital position

In the first quarter, we spent $90 million to buy $1.7 million Torchmark shares at an average price of $53.20. So far in April, we have used $18 million to purchase 328,000 shares. For the full year through today, we have spent $108 million of parent Company cash to acquire 2 million shares at an average price of $53.57. The parent started the year with liquid assets of $57 million. In addition to these liquid assets, the parent will generate additional free cash flow during the remainder of 2015.

Free cash flow results primarily from the dividends received by the parent from the subsidiaries less the interest paid on debt and the dividends paid to Torchmark shareholders. We expect free cash flow in 2015 to be around $360 million. Thus, including the $57 million available from assets on hand, we currently expect to have around $417 million of cash and liquid assets available to the parent during the year.

As previously noted, to date we have used $108 million of this cash to buy 2 million Torchmark shares ,leaving around $309 million of cash and other liquid assets available for the remainder of the year. As noted before, we will use our cash as efficiently as possible. If market conditions are favorable, we expect that share repurchases will continue to be a primary use of those funds. We also expect to retain approximately $50 billion to $60 million of liquid assets at the parent Company.

Now regarding RBC at our insurance subsidiaries

We plan to maintain our capital at the level necessary to retain our current ratings. In the last two years, that level has been around an NAIC RBC ratio of 325% on a consolidated basis. This ratio is lower than some peer companies, but is sufficient for our Companies in light of our consistent statutory earnings, the relatively lower risk of our policy liabilities and our ratings.

As of December 31, 2014, our consolidated RBC was 327%. We do not anticipate any significant changes to our targeted RBC levels in 2015. Those are my comments. I will now turn the call back to Larry.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Thank you, Frank. For 2015, we expect our net operating income to be within a range of $4.20 per share to $4.36 per share, a 6% increase over 2014 at the midpoint. Those are our comments. We will now open the call up for questions.

Question and Answer

Jimmy Bhullar ***- JPMorgan - Analyst***

-- the margins in the life business that you addressed to your Direct Response margins, but as I look at American Income, the margins there were a lot weaker than they been in a while as well. So maybe talk about what caused that and what your expectations are, and then secondly on growth in the agent count. The average agents were down, but the ending number was actually higher across all channels. So just wondering if you could describe a little bit what you're doing each of the business in each of the channels and what your expectations for growth in the agent count are.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Okay Jimmy, I'll go first on the American Income margins. The underwriting margins at American Income were a little lower than anticipated, but it's because we had, as we mentioned, higher claims. But if you look at, it's more of a timing thing. If you go back and look at the fourth quarter of last year, the claims were low. And there were 31% of premium, this quarter they're 33%. We are expecting 32% for the year, so we think that's it’s just a timing. We think that the margin -- we had 31.7% underwriting margin in 2014, and we're expecting about that same margin for 2015.

Jimmy Bhullar ***- JPMorgan - Analyst***

Okay.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

With respect to the agency counts, we saw an increase in agent recruiting and better agent retention in each of the distribution units as we moved through the first quarter. The trend after the first quarter has been positive, we continue to see strong agent recruiting and better retention in each of the distribution units.

Jimmy Bhullar ***- JPMorgan - Analyst***

And then just one more on capital, your RBC obviously is lower than other companies, but business mix is different as well. A while ago S & P had raised issues about just preferred stock and how they're going to – how they potentially might change their treatment of those. Have you had any discussions with them, and what are your views on the potential for that and how that would affect your capital management strategy?

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Sure. Jimmy, we have not had any recent discussions with them with regard to that. At the time that we had – you know last fall when we had our initial discussions, it was -- there was a contemplation that there would be some time to address the situation and really looking at within a couple of years. And so we've, as we've said, really talked about on some of the prior calls, we're really taking a look at our various options. We really don't have any update as far as what we're going to do or how we are going to address that going forward. I think the bottom line is we don't think at this point in time that we need to -- or that any resolution to the issue would impact our stock buybacks. We think we can address the issue through other forms of financing and other options that we would have available, and so we probably would look maybe toward the latter part of this year or the first part of next year to really get some resolution to that.

Jimmy Bhullar ***- JPMorgan - Analyst***

Okay. Thank you.

Erik Bass ***- Citigroup - Analyst***

All right thank you. I just wanted to touch first on Direct Response margins. I think when you've talked about it in the past, you've said that I think the pressure point on margins was isolated to an older block. If you could just maybe size, what percent-- or what the size of that older block is and if there's anything that you're seeing there that you think might also be relevant to other pieces or other vintages of the Direct Response business.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Yes, Erik. The we --on the last call we discussed -- it's a block of business that was written over 10 years ago, and the claims are coming in a little bit higher than expected. Now as far as the size of that block, it is currently about -- if you look at total Direct Response premiums, that block was about 18% of premium. But it's declining about 6% to 7% year, so as it continues to decline, and as we add new business, the combination of those two things will make the impact of that block on the policy obligations going forward, it will be less impact as we go forward.

Erik Bass ***- Citigroup - Analyst***

Got it, and is there anything unique about that block you've identified that could cause the margin profile to be different?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Not anything in particular. We -- it is in our adult products that we sell, and so we've taken a look at that. We haven't seen anything that is troublesome there, but we I will say this. Our current pricing, our pricing for the last two years is we feel is adequate to the point we won't have this problem going forward.

Erik Bass ***- Citigroup - Analyst***

Great thank you. Just one last question on your sales guidance changes. Are those mainly just to reflect where you've seen stronger recruiting at American Income than you'd expected? I think that was probably the biggest change, where you raised the sales guidance there.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Yes, at American Income we had stronger agent recruiting, agent retention than we'd anticipated it, and that's reflected in our guidance.

Erik Bass - ***Citigroup - Analyst***

Got it, thank you

Seth Weiss ***- BofA Merrill Lynch - Analyst***

Hi, good morning, thank you. Just a question on margins again. Did you see any weakness due to more severe flu season? If you have any comments on that, that be helpful.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

No. We really haven't seen any impact of that.

Seth Weiss ***- BofA Merrill Lynch - Analyst***

Okay. Great, thanks, and to follow up on Erik's question in terms of American Income increased sales guidance. The agent recruiting obviously has a go forward benefit. First-quarter sales seemed particularly strong. Was that significantly higher than what your expectations were? And how much did that lead to the increased sales guidance?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

If you recall, we had strong recruiting and an increasing agent count in the third and fourth quarter. We think sales were improved in part because the agents recruited in the last half of 2014 have gained experience and have become more productive.

Seth Weiss ***- BofA Merrill Lynch - Analyst***

Okay. Thank you.

Randy Binner ***- FBR & Co. - Analyst***

Hey good morning, thanks. I guess just a couple on the agent count, so one would be, you'd mentioned agent retention improving a couple of times. I was wondering if it's possible for you to quantify how that got better than wherever it was before. And then on the data that's being provided now on you know the average producing agent count, I'm just curious, was that -- it was flat on a link quarter basis, meaning first quarter 2015 relative to fourth quarter 2014. Is that a normal first-quarter versus fourth-quarter dynamic, if you look back at that data set?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Let's talk about the agent increase. First of all, I think the strength at American Income is we've increased our agent activity through better training and new technology. And as you have higher agent activity, you have a better retention rate because the agents are making more money and they stay with the agency longer.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Randy, on the -- as far as the average agent count, we really only started putting that information together first quarter of last year. But I think what -- based on past trends, I think what we would have seen is actually the average agent count for first quarter might be lower than the fourth quarter in prior years. Because we generally- the latter part of the fourth quarter in past years has been pretty light in terms of recruiting. As Larry mentioned, we had a strong third and fourth quarter in recruiting and so we - - to stay at about the same level I think is an improvement. I don't have the exact numbers, but that's where the trends will..

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

I agree with Gary, it depends on holidays in each of the distribution units.

Randy Binner ***- FBR & Co. - Analyst***

Yes, that was my question, because we don't have the data either, so that helps explain it, just normal seasonality of recruiting. And then -- but back to retention again, any quantification there on how much better it is now? Versus before, however you guys measure that internally?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

We measure it internally and we check in on a monthly basis. As we check retention it's for 3rd month through 13th month retention. It's one of the factors, we've had higher agent activity, which means we have more submitting agents. So it's not just agent retention, it's greater activity leads to a greater percentage of agents that submit every week and that results in higher retention. So I don't want to mislead, it's just retention is driving the increased sales, it's a combination of better training, better recruiting, a focus on retention. It's changing our compensation models to drive those behaviors.

Randy Binner ***- FBR & Co. - Analyst***

Okay. And then just -- sorry, go ahead Gary.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

No, go ahead Randy

Randy Binner ***- FBR & Co. – Analyst***

Sorry, so just one more, just on the yield assumption for the second half, the 475 basis points. How long can you stick with that before having to revisit it?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Well, we'll keep looking at it as we go forward. That's not something we're just sticking to because we want to. We're looking at all the projections as to what the treasure rates are going to be, we're looking at the consensus of the treasury rates and where we think spreads will fall in. Right now we're comfortable with the 4 3/4, but that's something we revisit constantly.

Randy Binner ***- FBR & Co. - Analyst***

Alright, fair enough. Thanks.

Yaron Kinar ***- Deutsche Bank - Analyst***

Good morning everybody, have a couple of questions. One on the revised sales guidance, it seems like in Direct Response life and also in Liberty National you're actually lowering the top end of guidance despite very strong first quarter sales. So I was wondering if you could maybe give a little more color and say what was behind that.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

We did have a strong first-quarter in Direct Response, but we're starting to come up against stronger quarters in the second, third and fourth quarter of 2014. So I think that reflects the sales guidance for the whole year; leaving a range of 4% to 7%.

Yaron Kinar ***- Deutsche Bank - Analyst***

So would that mean that initially you'd expect an even stronger quarter in the first quarter?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

I think the first quarter's coming in a little bit stronger than we thought with the growth in the first quarter. But for each of these agencies and for Direct Response, if you go back to 2014, you saw that there is a significant increase in our net sales in the second, third, and fourth quarter. We'll be measuring against those quarters as we go forward.

Yaron Kinar ***- Deutsche Bank - Analyst***

Okay and then with regards to agent growth. Family Heritage clearly showed a very significant improvement in first-year agents, was there any in particular that drove that?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

We didn't have a recruiting push, we just stayed focused on recruiting, we’re seeing the benefit of using our Internet recruiting that's now about 25% of the recruits, where before 100% was just personal recruits, so that's been a plus at Family Heritage. And then we added some new agencies at Family Heritage and we're seeing the positive impact of an increased number of agencies in the Family Heritage system.

Yaron Kinar ***- Deutsche Bank - Analyst***

Okay. And a quick numbers question, I noticed on the balance sheet, the cash number was actually quite low. About $3 million, was there anything in particular going on there and should we expect that to increase?

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Yes. I think that is just -- I think just a quarterly fluctuation and just a timing issue with respect to the end of a particular quarter. I do think that on a normal basis it would be a little bit higher than that. Just happen to hit both right at the end of the quarter.

Yaron Kinar ***- Deutsche Bank - Analyst***

Got it, thank you very much

John Nadel ***- Piper Jaffray - Analyst***

Hey, good morning, so just a question about the level of life insurance sales production in particular. Maybe health sales too, but you know I guess it's sort of an issue that we haven't really had to grapple with for some time in that it's a high quality issue, of course. How strong do life skills have to be before it actually does negatively impact your expectation for free cash flow generation, i.e., you need more capital to support the fact that you're growing faster than you might've otherwise expected to grow.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

This is Larry, your question is a little hard for us to hear, but I think your question was as we see higher life sales, what impact does that have on our capital requirements and in turn, on our free cash flow? Is that your question?

John Nadel ***- Piper Jaffray - Analyst***

Yes. I'm sorry if I was difficult to hear. Yes, it's essentially right along those lines, Larry.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Okay

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Frank.

Frank Svoboda ***- Torchmark Corp – EVP & CFO***

Yes, the -- you are seeing you know a drag on the - - one of the reasons why the statutory income is actually down from 2014 and 2013 and you're seeing a little bit of a decrease in the cash -- in our free cash flows in expectations for 2015 versus 2014 really is you know a result of some of those strong sales that we had in 2014. You know those do create a statutory drag at the current level. We're very happy to have those strong sales and that current drag, but I think that with the level of sales that we're seeing, you will see kind of a flattening of that free cash flow for the next – you know for as long as we continue to have the sales and you'll see that really filtering in just having on a flat free cash flows.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

John, I would add to that, then our products do have a first-year drag but as soon as they get into the second year, we start turning into not only a statutory positive, but a cash positive. So it's --I agree with Frank, it could be a temporary drag, but we want to put as much business on the books as we can. That generates – you know we want to grow the - in force and of course, because of the high underwriting margins that we have, that also grows the free cash in the future.

John Nadel ***- Piper Jaffray - Analyst***

Oh yes. Don't get me wrong. Like I said, high quality problem, right? Can you remind us how fast on a statutory basis your life insurance sales, you know let's say sales in year one, at what point do you get back to sort of a cumulative breakeven on a statutory basis?

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Yes I think John, I think it's in about somewhere in that six to eight year timeframe.

John Nadel ***- Piper Jaffray - Analyst***

Okay. And then you know maybe another high quality issue that we've talked about in the past. Given the stock price, price to book multiple, price-to-earnings multiple, you know I guess there's been one or two occasions you know over Torchmark's publicly traded life where it felt like the share price was approaching your own internal view of embedded value or whatever it is exactly that you guys calculate, but you know how do you - - are there any sort of updated thoughts along those lines? I know you've talked about shareholders really liking the buyback over you know a significant increase in your dividend yield as an example.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Well John, what we've said is that if the stock becomes fully valued that we will more than likely stop the share repurchase, but our objective is to give cash back to the shareholders, so we would probably move that into something of a dividend, special dividend or whatever. But yes, we're trading toward the high side of price to book for Torchmark, but still, as we've talked about before, we have -- we calculate what we think the intrinsic value is and we look at that in relation to the market value and we look at it over- trends over a period of time. We still don't think we're at a point where you know we're buying shares at too high a price. So we anticipate continuing to buy the shares, but that's something that we're committed to returning the cash to the shareholders, but we're not going to dilute the shares. So we don't think we're there yet, we'll continue to follow. If we get to that point then we would consider doing probably a special cash dividend.

John Nadel ***- Piper Jaffray - Analyst***

Okay. Thank you. I appreciate the comments.

S**teven Schwartz** ***- Raymond James & Associates, Inc. - Analyst***

Hey, good morning, everybody. Frank, can you kind of give us, I guess, do you know the effect of the Canadian dollar both on the change in premium in force for the life business between year-end and quarter end, and maybe talk about how that might be playing into the new sales guidance?

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Yes. I'm not sure if I have quite the break down exactly the quarter versus the year-end, but if you recall, we -- it's the average rate that works in over time that impacts the actual amount of reported premium as well as the reported underwriting from those premiums. In 2014, we had an average exchange rate of about 90.7%. And we're anticipating now that the average rate for all of 2015 would be around 80%. And so that's based upon -- you know we have Canadian premium of around, in Canadian dollars, of a little over $90 million. You've got roughly for the full-year 2015, you know roughly a $10 million impact on American Incomes reported premiums.

Steven Schwartz ***- Raymond James & Associates, Inc. - Analyst***

Okay

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Now for the first quarter of the year the average exchange rate was around 88%. So that's one of the things that – kind of a continuing impact, we didn't really see that much of a drag on first-quarter earnings, as a result of the lower foreign-exchange rate, but you'll kind of see a continuing drag over the course of the year as the -- assuming that the existing and the current rates stay there -- the exchange rates stay in place for the remainder of the year.

Steven Schwartz ***- Raymond James & Associates, Inc. - Analyst***

Okay thank you that will be useful, and then a little bit of a one off maybe. The doc fix for Medicare. This is a few years away, but the doc fix includes a proposal to do away with first dollar Med Supp, I'm wondering if that's important product for you all.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Brian you want to address that.

Brian Mitchell ***- Torchmark Corp - General Counsel***

Larry you want me to take that?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Yes

Brian Mitchell ***- Torchmark Corp - General Counsel***

This is Brian, you know that's really going to kick in with regard to the Med Supp policies in 2020. And you know what they're looking at right now is the reduction in spending on first dollar coverage, but primarily with the possible elimination of the Part B deductible. We still maintain that it's not affecting our current policyholders. And you know it's hard to estimate, it's hard to know exactly what other changes there might be going down the road in future budget talks or further Medicare reform. But that is something that we are watching very closely.

Steven Schwartz ***- Raymond James & Associates, Inc. - Analyst***

Is it a large part of your business currently or sales currently?

Brian Mitchell ***- Torchmark Corp - General Counsel***

Medicare supplement - - Larry you want to comment on that?

Steven Schwartz *- Raymond James & Associates,* ***Inc. - Analyst***

No, first dollar Med Supp

Brian Mitchell ***- Torchmark Corp - General Counsel***

Well that's going to be what all our Med Supp products are.

Steven Schwartz ***- Raymond James & Associates, Inc. - Analyst***

All your first products are first dollar?

Brian Mitchell ***- Torchmark Corp - General Counsel***

Larry, do you want to comment on that?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Well, you have high deductible, when you define first dollar Med Supp, we want to be careful how we define that because there's different levels of coverage Med Supp. But we tend to sell the higher deductible Med Supp products. It's so far out, Brian, that it is really difficult to give guidance in 2015 for something that might be enacted in 2015 -- between now and 2015 - -

Brian Mitchell ***- Torchmark Corp - General Counsel***

Between now and 2020

Steven Schwartz ***- Raymond James & Associates, Inc. - Analyst***

Right, yes. All right, that's all I had.

Brian Mitchell ***- Torchmark Corp - General Counsel***

When we were considering first dollar coverage plans, I mean generally that means plans that cover almost all deductibles and co-pays. If that's what you're referring to?

Steven Schwartz ***- Raymond James & Associates, Inc. - Analyst***

Yes. I can't remember which plans they were talking about, but it was two special plans that they were referencing, but I don't remember what the letters were. I'll leave it there.

Brian Mitchell ***- Torchmark Corp - General Counsel***

I'm sorry on that. I'd have to look into the specifics more closely. But reading that act, it references the first dollar coverage and specifically the Part B deductible. But again, that's not going to take place for five years, and so we're not anticipating any effect now, but that is something that we're monitoring and looking at very closely.

Steven Schwartz ***- Raymond James & Associates, Inc. - Analyst***

Okay, all right, fair enough. Thanks, guys.

Colin Devine ***- Jefferies & Co. - Analyst***

Good morning I had a couple questions. First with respect to the average policy size you're selling now. Clearly, you've been very successful with recruiting, frankly much stronger than I think most of your peers. Are you starting to move up the average policy size? Thinking I guess on average it's what, about $30,000 and in the business around $17? Has that started to trend up, is the first question.

Second question is, if you can come back on the capital issue. Unless I'm mistaken, I do believe S&P, with the changes to the capital model has Torchmark on criteria watch. And if you can perhaps elaborate on what the issue is that they are looking at and how that may impact potentially on buybacks. And then the next one would be, as you're well aware, the NAIC is changing risk-based factors on fixed income securities this year. I had heard that on average RBCs were going down about 50 points from the NAIC. I would think that's probably about a fair estimate for Torchmark, and I would assume, based on what you said that you don't want your RBC sort of really dropping much below 325. So again, what will you be doing to sort of address that?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

This is Larry, I'll address the agency question first. In terms of the size of the policy we've seen some impact at American Income, we talked last your about introducing our new senior life sales. And the average premium for a senior life product is $740 versus the average premium for a non-senior life product is about $470.

So there's a significant difference. As a percentage of our sales, senior life has increased from about 15% to 20% of American's business, and we've seen a positive impact for the size. But I think the real change in agency, it's not the size of the premium level or the face amount, I think really what is impacting it is the strong leadership we have in our agencies. From a home office perspective, we have very strong leadership at American Income, Liberty National and Family Heritage. We also have strong leadership in the field. And the owners of those agencies, the SGAs, the sales directors, provide us with the ideas for better training, the better technology, and they work with our home office staff. And I think that's been the impact is that they work together in 2014, we're seeing the benefit of those actions in 2015.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

But Colin, if you're asking about average face amounts, it varies by Company, but American Income is a little over $40,000 average face amount. Where we're seeing an increase really at a face amount is in Direct Response, the Direct Response has been lower than the $40,000 in the past. But we're starting to sell some higher face amounts, up to $100,000, and that's -- so we see -- . It hasn't been a dramatic increase yet, but we are seeing an increase there. But still, when you compare us to other companies, our face amounts are pretty low. But again, American Income a little over $40,000 and Globe is under that.

Colin Devine ***- Jefferies & Co. - Analyst***

Yes I was talking about $17 per the K, but I was just trying to get at, you know if the success you've had at recruiting, and I think we got the answer to that, is also sort of flowing through to success in you know higher face amounts, higher premium amounts. So it's not just you are adding more agents, but you really are adding more productive and I assume more profitable agents, is that is a fair way to --

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

That’s true, to give you example in 2014 we started with growth in middle management. We saw growth in middle management in each of our sales systems for each of our agencies. As you grow your middle management, you have better training; those middle managers are better recruiters. So that's another positive impact from 2014 that's flowed through to 2015.

Colin Devine ***- Jefferies & Co. - Analyst***

Thank you.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Frank, do you want to handle the RBC questions?

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Yes. I'll touch on the S&P issue first. And you're right, the S&P placed us on negative outlook last fall. And it's really based upon their view of certain intercompany preferred stock that is part of our insurance companies' capital structure.

The preferred stock has been in place since 1998 and then has not really changed any substantial level since that period of time. But the S&P in their adoption of - - you know they don't look at RBC, they have their own capital models. And basically there was just a change in view on their part on how they -- on how much credit they want to give us with respect to that preferred stock. And so with respect to -- and again, they want to give us a little bit -- some less credit than what we're getting under our RBC models. So we're taking a look at different options that we have with respect to address the additional capital that they would like to see you know within the insurance companies.

And whether it's -- and we're taking a look at whether we want to -- while we're interested in keeping our S&P rating, we also do recognize that the S&P is not that critical, or isn't critical at all from our marketing efforts. And that would probably tend to be one notch above many of our peers with respect. So at least a one notch downgrade should we have one, really wouldn't be that costly from our perspective. And so we are looking at different methods to cure that, and it might take different forms of financing. And so maybe we'd end up having little more external financing and replace some of that preferred stock, intercompany preferred stock that's currently down in the insurance companies. Really don't see that having any impact on the RBC within the companies and may in fact improve it to some degree.

With respect to the bonds and the initiatives going on at the NAIC, it is something that we have been watching. The information that I have it's that it's really not going to, for the most part, be fully implemented until 2017 or 2018. Once it's fully implemented, it definitely could have,-- you know, some meaningful impact on how we think about the capital and some of our RBC levels. We don't see it having any impact on us in 2015. I don't have any numbers in front of me here that would indicate exactly what that would be, other than it's definitely something that we'll have to watch a year or two down the road.

Colin Devine ***- Jefferies & Co. - Analyst***

Okay. Just to come back on S&P for second. What I had seen is you did go on criteria watch, not just in a negative outlook, but criteria watch when they announced the capital model changes towards the end of March. And my understanding of that process, it's somewhat mechanical, but it's got to get resolved in the next six months in -- or else they could take some rating action.

You mentioned on the preferred, I guess what might be helpful for all of us is how much are they actually talking about in terms of dollars. Because I do appreciate the criteria watch thing, it is something that's got a dollar cost to it, right? They're looking for X amount that if you add that to the capital structure, I assume the rating stays where it is? If you could just maybe put a number on it, because it does seem to me, this is something that's got to get resolved by the end of the third quarter.

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Well I don't think - - I don't think that it's something that we have to have as far as the additional amount of capital resolved by the end of the third quarter. We will have discussions with them that are our normally scheduled discussion sometime in the latter part of the second or likely the third quarter. That we will be talking about that.

The total amount of preferred stock that is in the insurance companies is around $300 million. But that is not an amount that we believe in the - - that has to be replaced in its entirety. And so the numbers that we would think we would have to do to address the situation is much less than that. But again, as we're looking through the options, you know I'm not really at a point to say exactly what we think we would have to replace that with.

Colin Devine ***- Jefferies & Co. - Analyst***

Okay. And the just the final clarification, just to be certain, does Torchmark use any sort of captive reinsurance to fund redundant reserves and/or bank LC's ?

Frank Svoboda ***- Torchmark Corporation - EVP & CFO***

Not the latter, we do have an offshore captive insurance company that does seed some redundant reserves. They're not triple X or A triple X reserves. They are just non- economic reserves that we are required to hold at a couple of our companies, and we do reinsure a couple hundred million dollars of that.

Colin Devine ***- Jefferies & Co. - Analyst***

Okay. Thank you. I suspect that's the criteria watch issue, but thanks very much.

Eric Berg ***- RBC Capital Markets - Analyst***

Sure thanks, sorry, I was on mute. I wanted to start with Globe. Are you in effect saying that the business was effectively modestly more underpriced than you had thought it was when you first broached this topic last year?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

I'm sorry Eric, could you repeat the question?

Eric Berg ***- RBC Capital Markets - Analyst***

Sure. You've discussed the fact that underwriting profitability, I believe you're saying at Globe, please correct me if I don't have that right, is not as great as you thought. In particular, are you saying that it's just modestly worse than you thought it would be when you first broached the topic of this older block of business several quarters ago?

Gary Coleman ***- Torchmark Corporation - Co-CEO***

Yes. As Frank mentioned, looking at trends, instead of being our -- the total policy obligations or the entire Direct Response, instead of being 48%, we're expecting it to be more 48.5%

to 49%. And again, it's due primarily to this older block of business in the way the claims are coming in on that block.

Eric Berg ***- RBC Capital Markets - Analyst***

My second question relates to Family Heritage. You know it's clear that you've had a sharp increase in recruiting. As we think about all the measures that look quite good; strong growth in premiums, strong growth in sales, strong growth in in-force. Is it just about the fact that you have a lot more people selling your product these days? Or is there more going on at Family Heritage that would explain the very healthy increase in all the major measures of corporate performance at this Company?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

I think Family Heritage driven primarily by an increase in the number of agents. And I want to caution that those additional agents-- I would expect that they will write a slightly lower weekly premium than experienced agents, but the additional agents will result in an overall premium growth for Family Heritage. Certainly.

Eric Berg ***- RBC Capital Markets - Analyst***

Could I, I'm sorry please continue.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Certainly not productivity as much as I just see a greater number of agents writing business at Family Heritage.

Eric Berg ***- RBC Capital Markets - Analyst***

If I could just sneak in one more quick one. As we continue to monitor the -- to study the data that you report out in one of your supplementary pages on agent count. I'd be curious to know how you look at those data. Are you interested in the relationship between, say renewal agents and the total? The idea being that first year agents tend to be not nearly as productive as renewal agents? Are you looking at the total number? What numbers would you encourage readers of your financial statements to really hone in on or ratios on that page showing the agent count?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

The two things that we focus on is the average agent count is indicative of what production was for the quarter. As we provide an ending agent count I think it's an indicator of what's going to happen in the subsequent quarter in terms of new sales. With a mix of first year agents versus renewal agents, there's a concern you know at Liberty where you've seen some improvement in that ratio, but the two primary focus points are average agent count and ending agent count in terms of an indicator of where we're going with our recruiting.

Eric Berg ***- RBC Capital Markets - Analyst***

All right. Thank you very much.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Thank you very much. I'm sorry if you've touched on this earlier, but could you talk about trends in policy retention? With the good strong growth in life sales lately, has there been any impact on retention, any new initiatives or sustained initiatives internally that will influence that going forward?

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Mark, this is Larry. I think the one concern we had as we look at Liberty National we saw a little decrease in agent retention. As we look further into that item, it really was some specific agencies that we're addressing for Liberty National. We have a conservation person in the agency, and she's addressing the agencies, we don't think they'll be a decline. We think we'll see normal persistency or cancellation rates within that agency.

Gary Coleman ***- Torchmark Corporation - Co-CEO***

As far as -- if you're talking about policy lapse rates, we're continuing to see improvement in our lapse rates. We've talked about our conservation program and it's continuing to -- we're improving there. We're expecting to conserve a little over 18% of policies that lapse this year versus just three years ago, or five years ago it was like 5%. We're continuing to find new ways to conserve policies that had lapsed or are about to lapse, so we feel very good about where we are with our conservation program, our unit there is doing a really good job. And we think that we will continue to see improvement in the conservation. So that's a good sign. As you mention, our production grows, as we improve the conservation, I think we'll see further improvements in our lapse rates.

Larry Hutchison ***- Torchmark Corporation - Co-CEO***

Mark, this is Larry again. If I misspoke, I may have said agent retention, I was talking about policy retention at Liberty National. We talked about agent retention so much this morning, I may have used that term, but the concern we have at Liberty is actually with policy retention, and that's been addressed.

Mark Hughes ***- SunTrust Robinson Humphrey - Analyst***

Okay. Yes, thank you

Operator

And there are no other questions, so at this time, I'd like to turn the call back to Mike Majors for any additional closing remarks.

Mike Majors ***- Torchmark Corporation - VP of IR***

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