1st Quarter 2017 Conference Call

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PRESENTATION

Mike Majors - *Torchmark Corporation* - *VP of 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 2016 10-K on file with the SEC. Some of our comments may also contain non-GAAP measures. Please see our earnings release and website for 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-CEO*

Thank you Mike, and good morning everyone. In the first quarter, net income was $134 million or $1.11 per share, a 10% increase on a per share basis. Net operating income from continuing operations for the quarter was $139 million or $1.15 per share, a per share increase of 6% from a year ago. On a GAAP reported basis, return on equity as of March 31 was 11.5%, and book value per share was $39.61. Excluding unrealized gains and losses on fixed maturities, return on equity was 14.2% and book value per share was $32.77, a 7% increase from a year ago.

In our life insurance operations, premium revenue grew 6% to $576 million, while life underwriting margin was $144 million, approximately the same as a year ago. Underwriting margin was flat due to the decline in the Direct Response margins. For the year, we expect life underwriting income to grow around 1% to 3%. Net life sales were $106 million, up 2% from the year-ago quarter.

On the health side, premium revenue grew 4% to $245 million and health underwriting margin was up 4% to $53 million. For the year, we expect health underwriting income to remain relatively flat. Health sales were $34 million, up 6% from the year-ago quarter. Individual health sales were $30 million, up 10%.

Administrative expenses were $52 million for the quarter, up 7% from a year ago, and in line with our expectations. As a percentage of premiums from continuing operations, administrative expenses were 6.3% compared to 6.2% a year ago. For the year, we expect administrative expenses to remain around 6.3% of premium. I will now turn the call over to Larry for his comments on the marketing operations.

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

Thank you Gary. I will now go over the results for each company. At American Income, life premiums were up 9% to $241 million and life underwriting margin was up 10% to $76 million. Net life sales were $53 million, up 6%, due primarily to increased agent count. The average agent count for the first quarter was 6,713, up 8% from a year ago, but down 2% from the fourth quarter. The producing agent count at the end of the first quarter was 6,768. We expect 7% to 11% life sales growth for the full year 2017.

At Liberty National, life premiums were $69 million, and life underwriting margin was $19 million, both up 1%. Net life sales increased 16% to $11 million, while net health sales were $4 million, down 8% from the year-ago quarter. The life sales increase was driven primarily by improvements in agent count. The average producing agent count for the first quarter was 1,820, up 18% from a year ago and up 2% compared to the fourth quarter. The producing agent count at Liberty National ended the quarter at 1,953.

Life net sales growth is expected to be within a range of 14% to 18% for the full year 2017. Health net sales are expected to be flat to down 4% for the full year 2017. We continue to be encouraged with the progress at Liberty National. Due to increased sales, we are seeing growth in life premium. While only 1% over the prior year, it marks a significant turning point given the size of the inforce block and Liberty's history of flat or declining premiums. We expect continued life premium growth going forward.

In our Direct Response operation at Globe Life, life premiums were up 5% to $210 million. Life underwriting margin declined 21% to $29 million. Net life sales were down 6% to $39 million. This sales decline is by design. We have decreased circulation in order to improve profitability in certain segments. Our primary marketing focus is to grow overall new business profits by maximizing margin dollars rather than emphasizing sales levels or margins as a percentage of premium. We anticipate that life sales will be down 4% to 9% for the full year 2017.

At Family Heritage, health premiums increased 7% to $62 million and health underwriting margin increased 7% to $13 million. Health net sales grew 26% to $13 million. The average producing agent count for the first quarter was 894, up 8% from a year ago, but down 6% from the fourth quarter. The producing agent count at the end of the quarter was 980. We expect health sales growth to be in a range from 7% to 10% for the full year 2017. We are pleased with Family Heritage's performance and believe we are on a good track going forward.

At United American General Agency, health premiums increased 5% to $92 million. Net health sales were $11 million, down 5% compared to the year-ago quarter. Individual Medicare Supplement sales were flat, while group sales declined 19% to $3 million. For the full year 2017, we expect growth in individual Medicare Supplement sales to be approximately 4%.

I will now turn the call back to Gary.

Gary L. Coleman - *Torchmark Corporation - Co-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 $59 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 was up 11%. For the full year, we expect similar results. We expect excess investment income to grow around 7% to 8% and excess investment income per share to grow around 10% to 11%.

Now regarding the investment portfolio

Invested assets are $15.3 billion, including $14.6 billion of fixed maturities at amortized cost. Of the fixed maturities, $13.9 billion are investment grade with an average rating of A-, and below investment grade bonds are $711 million, compared to $771 million a year ago. The percentage of below investment grade bonds to fixed maturities is 4.9%, compared to 5.7% a year ago. With a portfolio leverage of 3.7X the percentage of below investment grade bonds to equity, excluding net unrealized gains on fixed maturities, is 18%.

Overall, the total portfolio is rated BBB+, just slightly under the A- a year ago.

In addition, we have net unrealized gains in the fixed maturity portfolio of $1.3 billion, approximately $302 million higher than a year ago.

As to the investment yield

In the first quarter, we invested $522 million in investment grade fixed maturities, primarily in the industrial sectors. We invested at an average yield of 4.92%, an average rating of BBB+ and an average life of 23 years. For the entire portfolio, the first quarter yield was 5.70%, down from the 5.83% yield in the first quarter of 2016. At March 31, the portfolio yield was approximately 5.70%.

For 2017, the midpoint of our guidance assumes an average new money yield of around 5% for the full year. We are still hoping to see higher interest rates going forward. Higher new money rates will have a positive impact on operating income by driving up excess investment income. We are not concerned about potential unrealized losses that are interest rate driven, since we would not expect to realize them. We have the intent and more importantly, the ability to hold our investments to maturity. However, if rates don't rise, a continued low interest rate environment will impact the income statement, but not the balance sheet. Since we primarily sell non-interest sensitive protection products accounted for under FAS 60, 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. Certainly, while we would benefit from higher interest rates, Torchmark would continue to earn substantial excess investment income in an extended low rate environment.

Now I will turn the call over to Frank.

Frank M. Svoboda - *Torchmark Corporation - CFO*

Thanks, Gary. First, I want to spend a few minutes discussing our share repurchases and capital position. In the first quarter, we spent $82 million to buy $1.1 million Torchmark shares at an average price of $76.18. So far in April, we have used $20 million to purchase 263,000 shares. Thus for the full year through today, we have spent $102 million of Parent Company cash to acquire more than 1.3 million shares at an average price of $76.15. These purchases are being made from the Parent Company’s excess cash flow. The Parent Company's excess cash flow, as we define it, results primarily from the dividends received by the Parent from the subsidiaries less the interest paid on debt and the dividends paid to Torchmark’s shareholders. We expect the

Parent Company's excess cash flow in 2017 to be in a range of $325 million to $335 million. After including the $45 million available from assets on hand at the beginning of the year, we currently expect to have around $370 million to $380 million of cash and other assets available to the Parent during the year. As previously mentioned, to date, we have used $102 million of this cash to buy 1.3 million Torchmark shares, leaving approximately $270 million to $280 million of cash and other assets available 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, we expect that share repurchases will continue to be a primary use of those funds. We also expect to retain approximately $50 million of Parent assets at the end of 2017, absent the need to utilize any of these funds to support our insurance company operations.

Now regarding RBC at our insurance subsidiaries

We currently plan to maintain our capital at the level necessary to retain our current ratings. For the past several 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 and the relatively lower risk of our policy liabilities and our ratings.

At December 31, 2016, our consolidated RBC ratio was 324%. We are targeting a 2017 consolidated RBC ratio of 325%. At this time, and as was discussed on prior calls, it is likely that the capital freed up from the sale of our Part D operations will be retained within the insurance companies.

Next, a few comments to provide an update on our Direct Response operations

During the first quarter of 2017, the growth in total life underwriting income lagged behind the growth in premium income due to higher policy obligations in our Direct Response operations. As discussed on prior calls, this is mostly attributable to higher than originally expected claims related to policies issued in calendar years 2011 through 2015.

On our last call, we noted that we anticipated the margin, as a percentage of premium, for the full year of 2017 to range between 14% to 16%. For the first quarter, the margin was 14%, at the low end of this range, but fully in line with our expectations for the quarter due to normal seasonality. We still anticipate the margin percentage for the full year to range between 14% to 16%.

Now with respect to our guidance for 2017

We are projecting the net operating income from continuing operations per share will be in the range of $4.63 to $4.77 for the year ended December 31, 2017. The $4.70 midpoint of this guidance reflects a $0.03 increase over our previous guidance. The increase is primarily attributed to an improved outlook for underwriting and investment income and a slightly lower projected stock option expense. As noted on the last call, we have not reflected any possible changes in the tax law in our 2017 earnings guidance and our calculations assume that existing tax law stays in effect through 2017. Those are my comments. I will now turn the call back to Larry.

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

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

QUESTIONS AND ANSWERS

Jimmy Bhullar - *JP Morgan Chase - Senior Analyst*

Hi, I had a couple of questions, first on the Direct Response business. I understand why you're guiding to lower sales, just given reduced circulation. But I -- at what point do you think the circulation levels bottom out? Because I think we've had 6 straight quarters of down sales. So just trying to get an idea on, should this be a year where sales reach the bottom and begin to grow? Or are you expecting them to continue to decline for the next several quarters?

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

Jimmy, I can't give you an exact date, but the earliest we will see sales begin to increase would be late 2018, more likely sometime in 2019. We're currently focused on restoring those acceptable levels of profitability, and these positive sales will occur as we begin to use analytics and better segmentation to identify those better responding and most profitable consumers within each segment of our business. But that's the best guidance we can give at this time.

Jimmy Bhullar - *JP Morgan Chase - Senior Analyst*

And so -- that's because you're intending to continue to reduce circulation further as you go through this year?

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

We're going to keep circulation at the current levels. If you look at this year, we expect circulation to be down 7% to 10%. And from that, electronic inquiries will be up about 5% versus a reduction in insert media inquiries of 7% to 10%. So inquiries will be down slightly for the year, and we think our mail volume will be flat for 2017.

Jimmy Bhullar - *JP Morgan Chase - Senior Analyst*

Okay, and then you have a fairly large deferred tax liability. If tax rates are in fact lowered, any reason why a big portion of that wouldn't accrue to book value and like, not the actual cash savings in the future? Are there any offsets or anything else?

Frank M. Svoboda - *Torchmark Corporation - CFO*

No, Jimmy, I think if the tax rates were to decrease, you're right that the decrease in the liability would essentially increase our overall equity. Of course, then with the lowering of the GAAP -- GAAP tax rate, you'd expect some lower tax, GAAP tax expense as well.

Jimmy Bhullar - *JP Morgan Chase - Senior Analyst*

Okay, and then just one more on stock option expense. It was very low this quarter. Any changes in your assumptions? I think you've previously said, it should be, I think, either $2 million to $4 million a year, something in that range. But does this quarter change your view on what it will be for 2017?

Frank M. Svoboda - *Torchmark Corporation - CFO*

Yes just a little bit. I think, Jimmy, for the full year, probably in that $1 million to $3 million, $0 to $4 million range, somewhere in there, so probably the midpoint of that is coming down just slightly from $3 million to like $2 million.

Jimmy Bhullar - *JP Morgan Chase - Senior Analyst*

Okay, thank you.

Erik Bass- *Autonomous Research - Analyst*

Hi, thank you, so a question on the health business. Health underwriting margins, I think we’re pretty strong across most businesses this quarter. You believe that this is just unusually strong performance? Or is there anything changing in the underlying claim experience that makes you think that could continue? And I guess, is there any change to your view that overall health underwriting margin would be roughly flat with 2016 and for the full year?

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

Yes, your latter comment was what we expect. We were 21.8% for the first quarter, and we're thinking it's going to be at or right around that for the full year, which is just -- I think, last year we were slightly above that, but there is not a material change there.

Erik Bass- *Autonomous Research - Analyst*

Got it. And then in terms of, sorry, the underwriting margin and dollars -- I think you've guided to it being roughly flat with 2016. Is that still your expectation?

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

Yes. It's because the -- we are -- we will have -- we're thinking that we'll have premium growth around 2%, but there is a slight decline in margin and that keeps -- the margin percentages, and that keeps the margin dollars flat.

Erik Bass- *Autonomous Research - Analyst*

Okay thank you. And then you touched on this during your opening comments, but I was hoping you could talk a little bit more about the outlook for premium growth at Liberty National and the life business, since you have consistent double-digit growth in sales. You're forecasting strong sales again this year and healthy growth in the agent count. So when should we see that start to translate to acceleration in premiums and earnings?

Frank M. Svoboda - *Torchmark Corporation - CFO*

Yes, I think the -- for the next couple of years, again, because of the large inforce block that you have, we do anticipate premium growth of probably in that 1% to 3%, getting up to maybe 3% growth here over the next few years. But it's going to take a couple of years before the increase in sales really starts to translate into a much faster growth rate.

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

For the last couple of years, we've been flat and prior to that, we were routinely a 2% reduction in premiums. So -- we're pleased that this year we're going to have, we think, around a 1% increase in premiums. We reversed the trend, but as Frank said, that inforce block is so large, it's going to take a while to build up to a healthy increase in premiums.

Erik Bass- *Autonomous Research - Analyst*

Got it, thank you.

Robert Glasspiegel - *Janney Montgomery Scott - Analyst*

Good morning Torchmark, this is a small point, but I'm intellectually interested. The annuity underwriting margin has been marching along at about $1 million higher clip the last 3 quarters. What in the business is sort of driving the improved earnings outlook from that line, which has been considerably smaller over a long period of time?

Frank M. Svoboda - *Torchmark Corporation - CFO*

Yes Bob, we talked about it just a little bit in the last call, but it was -- we slowed down the amortization expense, just due to the business staying on the books a little bit longer than what we'd originally projected. For the full year, we anticipate around $10 million underwriting margin on that business.

Robert Glasspiegel - *Janney Montgomery Scott - Analyst*

And it will stay there or grade down slowly from there as the book runs off?

Frank M. Svoboda - *Torchmark Corporation - CFO*

Likely to grade down slowly over time.

Robert Glasspiegel - *Janney Montgomery Scott- Analyst*

*O*kay. And the Liberty National agent story is really pretty amazing. Following the company a long time, we just have never seen -- it's been a long time since we thought of this business being able to grow. Are we comfortable that the quality of agents and the quality of book that they're writing is worth the investments you're making in growing the agency force still?

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

We are comfortable with that, Bob. We've used best practices from our other agencies to introduce better training systems, better recruiting systems. And I think the quality of agent at Liberty National is the highest it's been in the last several years.

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

Bob, one thing that's important about Liberty's growth is that we're finally building up a middle management group, and the middle management are the ones responsible for recruiting and training. We really didn't have that before, but the middle management grew almost 40% last year. We will not see that kind of growth this year, but we are still going to see growth, and as that middle management grows, then it helps us to recruit and train new agents. So we think we're on good footing there.

Robert Glasspiegel - *Janney Montgomery Scott - Analyst*

Am I correct that it's been decades since you've showed this sort of growth in your force?

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

That's a correct statement.

Robert Glasspiegel - *Janney Montgomery Scott - Analyst*

Appreciate it, thank you.

Yaron Joseph Kinar - *Deutsche Bank AG - Analyst*

Good morning everybody, so we talked a little bit about the very strong agent growth in Liberty National. Can we also touch on Family Heritage? What has led to strong growth there?

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

Part of the change is that we had a very slow start to 2016 and again, Family Heritage is using best practices to develop a better system to recruit and train agents. And we're seeing those initiatives take place at Family Heritage as well as Liberty National.

Yaron Joseph Kinar - *Deutsche Bank AG – Analyst*

Okay, and is that also something that you think you'll be able to sustain not necessarily at these levels, but strong growth, generally speaking?

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

I think we can sustain that at Family Heritage. Again, we have better in-house training systems, we have better recruiting systems and we're seeing the effect of that take place. We are also seeing the growth in middle management. This year, they introduced a new management track at Family Heritage, and so as we hire agents, they know what needs to be achieved to move up to management and eventually become the agency owners. So what we're seeing at Family Heritage is really a continuation of what's happened at Liberty National starting in 2011, and American Income has been the leader in terms of these better training systems and better recruiting systems that the other 2 companies have followed.

Yaron Joseph Kinar - *Deutsche Bank AG - Analyst*

Okay, and then if we touch on the investment portfolio, I couldn't help but notice that the average maturity was a little on the low side this quarter. Is there anything in particular that led to that? Or is that just the normal fluctuation?

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

We didn't change any policies. I think that's just a normal fluctuation.

Yaron Joseph Kinar - *Deutsche Bank AG - Analyst*

Okay, thank you very much.

Operator

And there are no further questions in the queue at this time.

Michael C. Majors - *Torchmark Corporation - VP of IR*

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