Torchmark Corporation

2nd QUARTER 2014 CONFERENCE CALL

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Randy Binner *FBR & Co. - Analyst*
Sarah DeWitt *Barclays Capital - Analyst*
Yaron Kinar *Deutsche Bank - Analyst*
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Mike Majors

Thank you. Good morning everyone. Joining me 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 2013 10-K and any subsequent forms 10-Q on file with the SEC.

I will now turn the call over to Gary Coleman.

Gary Coleman

Thank you Mike, and good morning everyone.

Please note that the share and per share information in our comments this morning have been adjusted to reflect the three-for-two stock split that was effective on July 1.

Net operating income for the second quarter was $136 million or $1.02 per share – a per share increase of 7% from a year ago. Net income for the quarter was $131 million or $0.98 per share – a 2% increase on a per share basis.

With fixed maturities at amortized cost, our return on equity as of June 30 was 15.4% and our book value per share was $27.02 - a 10% increase from a year ago. On a GAAP reported basis, with fixed maturities at market value, book value per share increased 24% to $33.93.

Life Insurance

In our life insurance operations, premium revenue grew 4% to $492 million and life underwriting margins increased 4% to $141 million.

Life sales increased 11% to $102 million.

For the full year, we expect the dollar amount of our life underwriting margins to increase around 3-4%.

On the health side, premium revenue, excluding Part D, declined 1% to $215 million and health underwriting margin also declined 1% to $50 million.

Health sales increased 21% to $29 million.

For the full year, we expect the dollar amount of our health margins to be about the same as last year.

Administrative expenses were $45 million for the quarter, 3% more than a year ago. For the full year, we anticipate that administrative expenses will be up around 1% and be approximately 5.7% of premiums.

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

Larry Hutchison

Thank you Gary.

First, let's discuss American Income

At American Income, life premiums were up 7% to $190 million and life underwriting margin was up 6% to $60 million. Net life sales were $45 million, up 9% due primarily to increased agent counts and a higher percentage of agents submitting business. The producing agent count at the end of the second quarter was 5,890, up 6% from a year ago. The average agent count for the second quarter was 5,744, up 8% from the first quarter.

We expect 8 to 11% life sales growth for the full year 2014.

Now, Direct Response

In our direct response operation at Globe Life, life premiums were up 5% to $177 million and life underwriting margin increased 2% to $44 million. Net life sales were up 12% to $44 million.

We expect 8 to 10% life sales growth for the full year 2014.

Liberty National

At Liberty National, life premiums declined 2% to $68 million, while life underwriting margin increased 6% to $18 million. Net life sales grew 7% to $9 million, while net health sales increased 22% to $4 million.

The producing agent count at LNL ended the quarter at 1,500 – up 17% from a year ago. The average agent count for the second quarter was 1,492, up 7% from the first quarter.

For the full year 2014, sales growth is expected to be 4 – 6% for life and 12 – 14% for health.

Now, Family Heritage

Health premiums increased 7% to $51 million while health underwriting margin increased 13% to $10 million. Health net sales were up 15% to $13 million.

The producing agent count at the end of the quarter was 771, up 4% over a year ago. The average agent count for the quarter was 758, up 15% from the first quarter.

We expect sales growth for the full year 2014 to be in a range from 3 to 8%.

Now, the United American General Agency

Health premiums declined 1% to $76 million. Net health sales grew 34% to $9 million.

While the group Medicare Supplement business is somewhat hard to predict, we expect general agency net sales growth for the full year 2014 to be in a range of approximately 25 to 35%.

Medicare Part D

Premium revenue from Medicare Part D grew 16% to $85 million, while the underwriting margin increased 6% to $9 million. The growth in underwriting margin lagged behind premium growth due to the higher claims related to newly approved Hepatitis C drugs. As a result, we now expect Part D margin for the year to be in a range of 8 to 11%, rather than the 10% to 13% that was expected earlier in the year.

Part D sales for the quarter were $20 million, up from $8 million a year ago.

I will now turn the call back to Gary.

<u>Gary Coleman</u>

Thanks Larry.

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 policy liabilities and debt) was $57 million, an increase of $2.4 million or 4% over the second quarter of 2013. On a per share basis, reflecting the impact of our share repurchase program, excess investment income increased 10%.

For the full year, we expect excess investment income to increase by about 3 to 5%. On a per share basis, the increase should be about 8% to 10% compared to 2013.

Now, regarding the investment portfolio:

Invested assets were $13.2 billion, including $12.7 billion of fixed maturities at amortized cost.

Of the fixed maturities, $12.1 billion are investment grade with an average rating of A- and below investment grade bonds are $563 million, compared to $585 million a year ago.

The percentage of below investment grade bonds to fixed maturities is 4.4%, down from 4.8% a year-ago. With a portfolio leverage of 3½ X, the percentage of Below Investment Grade (BIG) bonds to equity, excluding net unrealized gains on fixed maturities, is 16%.

Overall, the total portfolio is rated A-, same as a year ago.

In addition, we have net unrealized gains in the fixed maturity portfolio of $1.4 billion compared to $1 billion at the end of the first quarter. The increase in unrealized gains is due primarily to the recent decline in market interest rates.

As to the investment yield:

In the second quarter, we invested $167 million in investment grade fixed maturities, primarily in the industrial and financial sectors.

We invested at an average yield of 4.7%, an average rating of BBB and an average life of 21 years. While the BBB average rating is lower than the A- to BBB+ average of recent years, the weighted average was just below BBB+. We haven’t changed our philosophy regarding credit quality - the investment grade bonds we purchased in the quarter met our long-standing credit criteria.

The new money rates for the first and second quarters were 5.4% and 4.7%, respectively. The midpoint of our guidance assumes a new money rate of 5% for the remainder of 2014.

For the entire portfolio, the second quarter yield was 5.92%, same as the first quarter of 2014 but down 3 basis points from the 5.95% yield in the second quarter of 2013. For the full year, we expect the portfolio to yield approximately 5.90%.

And I would add that while we would benefit from higher new money rates, we are confident that we can have sustained growth in investment income in the current rate environment.

Now, I will turn the call over to Frank to discuss share repurchases and capital.

Frank Svoboda

Thanks, Gary.

I want to spend a few minutes discussing our share repurchases and capital position.

First, regarding share repurchases and parent company assets:

In the second quarter, we spent $82.2 million to buy 1.5 million Torchmark shares at an average price of $52.86. For the full year through today, we have spent $210.1 million of parent company cash to acquire 4 million shares, at an average price of $51.95.

The Parent started the year with liquid assets of $60 million. In addition to these liquid assets, the parent will generate additional free cash flow in 2014. 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 2014 to be around 380 million dollars. Thus, including the $60 million available from assets on hand as of the beginning of the year, we currently expect to have around $440 million of cash and liquid assets available to the parent during the year. As previously noted, to date in 2014, we have used $210 million to purchase Torchmark shares, leaving around $230 million of cash available for the remainder of the year.

As noted before, we will use our cash as efficiently as possible. Absent better alternatives AND 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 $50-60 million of liquid assets at the parent company.

Now Regarding RBC at our Insurance Subsidiaries:

As stated on previous calls, we have maintained our insurance company capital levels at or above an NAIC RBC ratio of 325% on a consolidated basis, which has historically been sufficient to maintain our ratings. This RBC ratio is lower than some peer companies, but has been sufficient for our companies in light of our consistent statutory earnings, and the relatively lower risk of our assets and policy liabilities.

At December 31, 2013, our consolidated RBC was 341%. We do not currently anticipate any significant changes to our targeted RBC levels in 2014.

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

Larry Hutchison

Thank you Frank

Guidance

For 2014, we expect our net operating income will be within a range of $4.05 per share to $4.15 per share. The midpoint of $4.10 is $ .03 lower than projected earlier in the year due primarily to the impact of higher Part D claims on underwriting and investment income.

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

Question and Answer

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

Hi. Thank you. Just had a couple of questions on part D. I guess first, is it correct to assume that you're reflecting the higher drug costs related to the hepatitis C treatment in your pricing submissions for 2015? So therefore, should we think of this issue being only a meaningful drag on margins in 2014 and that your target margins would revert to the level you had guided to earlier in the year for 2015?

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

Yes. Erik, the hepatitis C drug was included in our 2015 pricing for part D.

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

Okay. So would you -- you had guided to 10% to 13% margins for part D earlier in the year. So is that a reasonable range to think about for 2015 at this point?

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

Erik, I would say you look back historically, we've been around the 10% to 11% range. I think for sure, the 10% to 11%. It could be the 10% to 13%, but we still don't know, because we don't know -- although, we submitted our bids, we still don't know how they relate to other bids and how many lower income assignments we would get. So I think you're safe around the 10% to 11%

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

Erik, we'll receive those results in August, and we're going to give better guidance on our third-quarter call.

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

Okay, thank you, and then one last thing to clarify. You mentioned the cash-flow timing issues being -- suppressing investment income a little bit, because you have to pay the claims before you get reimbursed by the government. Does that have any impact on your expected cash flow to the holding Company?

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

Hey Erik. This is Frank Svoboda. You know that will have a little bit of impact on the timing of the cash flow to the holding Company in the fact that again, it's going to reduce some of our investment income. When you look at -- we anticipate for the full year of 2014 that we'll probably incur somewhere in the range of $45 million to $60 million worth of additional claims.

Now the majority of that, or maybe around 85% of that, will be reimbursed from CMS.

And as you noted, we don't get reimbursed from that until sometime late in 2015. So we'll have that drag -- we'll see that drag on investment income here in 2014. And of course, that lost investment income on 2014 not only affects GAAP, but also the statutory earnings.

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

Got it, but in terms of the cash flow to the holding Company, your guidance for the year of the $380 million or so, that's unaffected.

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

Correct.

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

Okay. Thank you very much.

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

Again Erik, I would add that it's not the $50 million to $60 million that's going to impact the cash flow to the holding Company; it's investment income on that $50 million to $60 million, and that $1 million, $2 million or whatever of investment income will impact what we can dividend next year. So it won't have an impact on 2014 free cash flow; it will be on 2015 free cash flow.

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

Right. Okay.

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

Hey. Thank you. I have a question about sales seasonality for life insurance. And first of all I think that we've seen a pattern for at least the last few years where the second quarter has better sales across the board for life, but American Income might be a little bit better in the second quarter. So the first part of my question is to confirm that that is something we should rely upon in the future. And what is the cause of the better sales in the second versus the third quarter, generally speaking?

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

Randy, I think it's true that generally, as you look at the year, you have a better agent activity, which is a higher percentage of submitting agents in the second and the third quarter. If you looked at American Income, we believe the increase in sales was a result of better recruiting and improved agent retention and the increase in agent activity.

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

And Randy, I would add too, Direct Response traditionally, the second quarter has been a little bit higher than the first quarter.

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

Can you remind us as of why -- what is it about the second quarter that is better?

Larry Hutchison *- Torchmark - Co-CEO*

I think one thing in the second quarter-your circulation is higher in the first quarter. Your circulation typically is a little bit lower in the fourth quarter. There is some seasonality to that. So that would result in -- with the lag in sales of circulation, you would see a midyear increase in sales versus the fourth or the beginning of the first quarter in Direct Response.

Randy Binner *- FBR & Co. - Analyst*

So it's mail issues in Direct, and then for AIA, it's just people are more receptive to buying in the second versus the latter part of the year of the first quarter?

Larry Hutchison *- Torchmark - Co-CEO*

I don't know that people are more receptive. I think it's on expanding the agencies, that management is more active in recruiting. And with those new recruits, you have a higher activity level. You have more submitting agents into the middle of the first quarter through the second and the third quarter. Usually, the agent recruiting isn't as strong in the fourth quarter.

Gary Coleman *- Torchmark - Co-CEO*

I think probably both sides-agency and for sure in Direct Response, there's less activity around the Christmas and New Year's holiday period. And the activity starts picking up in the first quarter, and it gets higher as we go into the latter part of the year.

Randy Binner *- FBR & Co. - Analyst*

Okay. And that's helpful. And then just focusing on AIA, I think that explains why productivity peaks in the second quarter. So as far as AIA goes, this is a good sales result. It's on a lower comp, but it seems like it's turned the corner a little bit.

So would be interested in your commentary. You mentioned you have a lot of recruiting efforts. I think you have technology efforts through CRM and laptop presentations and that kind of stuff. I guess I would be interested in what's working and what the follow-through you think is on the momentum you've been able to build here at AIA.

Larry Hutchison *- Torchmark - Co-CEO*

I think the agency force of American Income has responded well to the changes we made in both our compensation and recruiting systems. We don't expect to see that momentum drop significantly. I don't think the agent count will increase as quickly as it did in the second quarter, but I think we're going to continue to see increases in the agent count to the third and fourth quarters of this year.

Gary Coleman *- Torchmark - Co-CEO*

Randy, we've seen improvement in the -- as Larry mentioned, improved recruiting, but also we've seen an increase in activity level, in other words, percentage of agents that we have that are submitting business. One thing we've talked about in the past is we're working on retention, and we've seen some impact on -- positive impact on retention, although, we need to do more there. But I think for the second quarter is the -- not only the increase in the agent count, but is also the improved activity level of the agents.

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

That's right. I think the other two factors in American Income is that we really haven't seen a change in agent productivity, and that's a positive sign. Need to keep in mind how many new agents who've entered American Income. The other good result that we're seeing at American Income is the increase in that middle management count. The middle management count has grown about 10% since January 1st, and middle management is really what trains your new agents in the field. So it's a very positive development at American Income.

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

I'm sorry the sales managers you said were up 10% in the first half or in the quarter?

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

It's in the first half of 2014, our middle-management count in the American Income was increased.

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

Okay. Got you. Thanks for the answers.

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

Sure.

Sarah DeWitt ***- Barclays Capital - Analyst***

Hi. Good morning. The 8% to 11% outlook for Life net sales growth this year is a very strong result. If we look out a bit longer term, do you think high single-digit; low double-digit sales growth is sustainable? And what would be the biggest driver of that? Is that mostly just growing the agent count?

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

I think the biggest driver is driving the agent count, and it's also having the correct training systems to keep your activity levels at the levels that they are in the second quarter and that we expect to be in the third quarter. For 2015, that's guidance we'll give on the next call. It's a little early to give 2015 guidance. I'd say generally with Direct Response and each of the agencies, we think the results we saw in the second quarter are certainly sustainable through the end of the year.

Sarah DeWitt ***- Barclays Capital - Analyst***

Okay. Great. And then secondly, the guidance you gave for the life underwriting margin to grow 3% to 4% this year, that's slightly down from the 3% to 5% you said before, and I think you were at about 5% year to date. So what's driving that slight decline?

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

Sarah, we had a little bit higher claims than we anticipated at the beginning of the year. But we are still talking about, I think our margin, underwriting margin for life this year is around 28.7%. We are expecting it to be at 28% to 29% for the year. So it's not a big change.

Sarah DeWitt ***- Barclays Capital - Analyst***

Okay. Thank you.

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

Good morning, everybody. I look at the extra investment income guidance, and I think that's dropped slightly from the last guidance. And want to make sure, is that just by virtue of the new money rate having dropped a little bit? Or is there also a lower expectation of assets -- asset growth?

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

Well, it's more -- the effect of the new money rate has more of a minor impact than at the -- at the midpoint of our guidance, our excess investment income is about $2.5 million less than it was previously. Less than $1 million of that is from having a lower new money rate. But over $1.2 million of that is the impact of the cash flow from part D that we talked about earlier. And then the remainder is other cash flow, timing of other cash flow. But more so than the new money rate is the impact of the part D that's caused us to change the guidance.

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

That makes sense. And then I'm sorry if I missed that, but did you -- when you talked about the new guidance for excess investment income, did you say what the new money rate target or guidance was for the full year?

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

Well, for the remainder of the year, the guidance is -- at the midpoint of the guidance, we used a 5.0% yield.

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

Okay. And that seems to have dropped a bit more radically than at least what I seem to be seeing in the 30-year treasury rates, at least over the last quarter. Has anything else happened there?

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

No. I'm not sure what you're looking at, but what we've seen out in the market, the yields are lower. The treasury rates have dropped and the credit spreads have not offset the rates. So I think we dropped to 4.7% yield in the second quarter, and we do think it's going to get better the remainder of the year, we are just not sure how much. We think we can do at least 5% that we have at the midpoint.

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

Okay. Thank you very much.

Chris Giovanni ***- Goldman Sachs - Analyst***

Thanks so much. Good morning. A few follow-up questions on part D. My understanding is 47 state Medicaid agencies are covering the hepatitis C drug, and wondering how much of your business comes from those 3 states that aren't covering it? And how should we think about future or potential risks to the margin, either up or downside?

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

Yes. Chris, this is Frank. I don't have in front of me the actual number of states that we have where the state Medicaid is covering that. I know that we've lost -- we've had some dis-enrollees with respect to both California and Illinois. So to the extent that there are some of the members that are subject to hepatitis C there, that may help us to some degree. But I don't really have that information with me.

Chris Giovanni ***- Goldman Sachs - Analyst***

Okay. And then, the repricing or pricing that you're doing for the 2015 enrollment, you note that reflects the high cost of that hepatitis C drug. Just wondering if in that pricing you're fully reflecting the current Gilead product, or are you assuming that the cost could go even higher if they're successful in getting the approval of the companion HEP C drug?

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

Yes. What we are -- we're reflecting the best information we have today on what that pricing would be and our best estimates on utilization using our experience, and then consultations, of course, with our actuarial consultants on what that pricing would be. And that pricing would include, to the extent that there is a new drug that would come out that would replace Sovaldi or Olysio it would -- the pricing would take into account that replacement type of a drug.

Chris Giovanni ***- Goldman Sachs - Analyst***

Okay. And within your pricing for 2014, any sense of if or what was embedded within that, if anything?

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

Yes, for our 2014 pricing, we really did not include anything specifically for either one of these two new drugs. We always include some type of an allowance and a claims trend margin, if you will, for -- from new drugs that will be -- they are in the pipeline or that will come out, but the allowance that was built in here for 2014 was nothing that would have accommodated the high price that's associated here with these two new drugs.

Chris Giovanni ***- Goldman Sachs - Analyst***

Okay. Thanks so much.

Steven Schwartz ***- Raymond James & Associates - Analyst***

Yes. Hey. Good morning, everybody. To follow-up on the hep C drugs and make sure I got the right numbers here, were you -- I think it was Gary. Gary, were you suggesting that the amount of total spend on these drugs would be $60 million for the year? And of course on a GAAP basis, you would recognize the reinsurance from the government, so it would be 85--so $45 million coming back, so the net effect would be $15 million, but the cash outflow would actually be $65 million, $60 million, $65 million?

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

Frank, why don't you comment on that?

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

Yes. The total outlay that we are estimating at this point in time is around $45 million to $60 million, and then we are anticipating getting back from CMS or their share of those total claims to be somewhere in that $43 million to $50 million range. So we're anticipating that our impact on underwriting income for the full year will be somewhere in the range of $7 million to $10 million.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. Frank, how much has already been spent in the total outlay for this?

Frank Svoboda - *Torchmark - EVP & CFO*

Through first six months?

Steven Schwartz - *Raymond James & Associates - Analyst*

Yes, through June 30.

Frank Svoboda - *Torchmark - EVP & CFO*

Through June 30, total outlay is about $24.5 million, of which our share was about $4 million.

Steven Schwartz - *Raymond James & Associates - Analyst*

Right, but it's the $24.5 million that affects next year's cash flow. You get the money back at the end of next year.

Frank Svoboda - *Torchmark - EVP & CFO*

Yes, in next November.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay.

Frank Svoboda - *Torchmark - EVP & CFO*

We'll get $20.5 million back; we won't get the $4 million back, but we will get the $20.5 million.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. Alright. And then if I may, on recruiting in general, and then on Liberty National Life, recruiting in general, obviously first year up. Any sense that maybe the economy is helping with that?

Larry Hutchison - *Torchmark - Co-CEO*

I think the real change is our internal recruiting incentives and the implementation of our improved training systems at both Liberty and American Income.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. And then, Larry, can you touch on -- it's interesting the agent count has been growing. The new recruits have been growing at Liberty National, but the renewals have not, and actually have continued to come down. What's the reason for that, and how do you fix that? Do you want to fix it?

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

I do not think it’s a fix so much. I think it's intentional that as we change our compensation systems, we realize we're going to lose some veteran agents, since we have moved away from a service salary. So we think it will stabilize, and there's just a greater emphasis on new recruits.

So over time, all the changes we've implemented at Liberty National the last few years, things are settling down, the culture has been accepted. And I think we'll see the same percentage of veteran agents that we keep at Liberty that we see at American Income.

Steven Schwartz ***- Raymond James & Associates - Analyst***

Okay. So this decline is still left over from the compensation changes?

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

That's correct.

Steven Schwartz ***- Raymond James & Associates - Analyst***

Okay. Alright. That's what I had. Thanks, guys.

Joanne Smith ***- Scotiabank - Analyst***

Good morning. Most of my questions have been asked and answered, but just on Family Heritage, did you give any guidance for agent recruiting -- or agent counts for the full year? I don't think I heard them, and if you did say them, I missed them**.**

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

No one's asked that question for any of the agencies. At the end of 2014, we expect the agent count at Family Heritage to be between 775 agents to 800 agents. At American Income, at the end of 2014, we expect the agent count to be between 6,000 and 6,100 agents.

Joanne Smith ***- Scotiabank - Analyst***

Okay. Great.

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

And at Liberty National we have an increase - at the end of the year we would be between 1,550 and 1,600 agents.

Joanne Smith ***- Scotiabank - Analyst***

Okay. Great. Thanks very much.

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

Thanks very much. To a certain extent my question has been asked, but I'm hoping you can build on the answer to Steven Schwartz's question regarding Liberty. Where are you in the process of sort of restructuring that Company to make it more like American Income? And do feel that you're getting the intended result? Are you are pleased with this effort to remake that Company?

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

I think the restructuring is completed at American Income and Liberty National. Over time, we've always changed compensation and recruiting systems. We expect the same, make the necessary changes. So as agent counts grow, we are seeing some new offices that are productive at Liberty National. We opened two new offices in the second quarter. We plan to open two new office through the end of the year.

We look at the offices we opened last year. We are pleased they are producing at the expected level that we had hoped to see. So I think at Liberty you'll see continued slow, steady growth, but it takes time to develop that middle-management you can promote into the agency ownership position at Liberty National, Eric.

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

Eric, also to answer question, you asked if we were satisfied. We knew going into this that this process would take time. And we are starting to see positive -- even more positive impacts than before, and we are pleased with the progress there.

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

Alright. Thank you.

Bob Glasspiegel ***- Janney Capital Markets - Analyst***

Good morning, everyone. Eric was on the same wavelength as I am. It seems like you've bumped up your sales outlook from low- to mid-singles across the board to approaching double-digit in all three segments. And I think this is after a few years of sales coming in disappointing. And clearly there's been a positive surprise to the sales momentum across the board and the pivots around agent count at both Liberty and American Income.

So I'm a little surprised you don't have a little more bounce to your steps, Gary and Larry, in your pitch. You read it with the same level of intensity as you normally do. Am I right that you're pumped up about what's going on? And a little color on why direct is doing a little bit better than you thought going into the year?

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

Well on the agency side, to use your term, we are pumped up and we are very pleased. We are seeing better recruiting. We are seeing better agent retention. Probably a third factor is we're just seeing more agent activity. That means that we have better training systems in place. And to sustain your sales, you have to have that higher level of agent activity.

I think the sales growth at direct response could be explained by the real increase in inquiries from electronic -- or Internet inquiries. Our Internet inquiries are expected to be up about 20% for the full year. We're seeing strong sales increases in our electronic media. Both the Internet and our inbound phone calls are up quarter over quarter, and we are pleased with results at direct response.

Bob Glasspiegel ***- Janney Capital Markets - Analyst***

Thank you.

Jimmy Bhullar ***- JPMorgan Chase & Co. - Analyst***

Hi. On investment income, you mentioned you are expecting excess investment income to increase 3% to 5% I think it is in 2014. What's your expectation or your view on how much you can grow investment income next year if we actually stay at this type of environment, in terms of rates, and your new money yield does not move up as you are expecting it to?

And then how much do you think the portfolio yield will drop next year if we are in this type of rate environment? So not necessarily looking for guidance, but just can you grow investment income at mid- to single-digit rate, if you actually see these types of rates? Or would investment income growth slow down dramatically next year?

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

Well Jimmy, in the current rate environment, we feel like we can grow investment income next year in the 3% to 4% range. And as far as the portfolio yield, as you know, with the calls we had the last couple of years and the hybrid securities we saw some dramatic declines in the portfolio yield.

Now what we're looking at is over the next five years that the portfolio yield -- assuming current new money rates -- or assuming new money rates of 5% that we talked about earlier - that the portfolio yield will stabilize; it may drop 2 or 3 basis points a year. And because the portfolio yields will be fairly stable, and we will be seeing growth in investment income that's in line with the growth in required interest, we think that we can grow investment income after next year in the 4% to 5% range, and that excess investment income, because our interest expense is going to be flat in those years, that we think we'll see -- we're talking about maybe 3.5% at the midpoint for next year. We're thinking that will be above 4% going forward.

Jimmy Bhullar ***- JPMorgan Chase & Co. - Analyst***

And then on the share buybacks, obviously over the past year and a half, the stock has done really well and the buybacks have become less accretive over time. Have you thought about the balance between buybacks and dividends? Have you looked at deploying capital at all, like shifting that balance in one direction or another?

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

Yes, we have. And we -- that's something that we discuss every quarter with our Board. And in the last three years, we have increased our dividend rate. But to increase them further, we still think buying back stock is -- we still think it's a good buy at this point. If things remain as they are right now, I think you'll see us continue to increase our dividend rate, but still the bulk of the money will be going to the share repurchase program.

Jimmy Bhullar ***- JPMorgan Chase & Co. - Analyst***

Okay. Thank you.

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

Good morning, gentlemen. I'm just wondering, I have a couple of follow-up questions, if we could focus on the Life side. First, with respect to direct and sales, just to follow-up on your other comments, do you think the pace we've seen for the first half here is going to be sustainable over the second?

Second question, if we take a look at the inforce rollforwards, were there some reserve adjustments made at either American Income or direct response? I'm looking at the levels for the death and others seem to move around a little bit, more than I would have expected.

And then finally, could you provide a bit of color on how you've been able to achieve what's been really quite a steady reduction in your first-year lapse rates, improving those at both American Income and Liberty. When I look back to where they were a couple years ago, obviously it's been dramatic. Has that gone about as far as it's going to go, and how much is that impacting your profitability?

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

We think we are going to have mid-to high-level single-digit sales growth in direct response in the third and fourth quarters. As you'll recall, our standard adult insurance products were rolled out fully in the third quarter of 2013, Colin. Those accounted for a good portion of our sales growth in the first and second quarter. We don't think we'll see the same increases generated from those products on a quarter-over-quarter basis going forward, but we will have steady sales growth.

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

Colin, the improvement in the lapse rates at American Income and direct response are due to our conservation efforts, which we began -- I think we began in 2010, but we really geared up in 2011. To give you an example of the impact, this year, we expect to conserve about $40 million of lapsed premium. In other words, about 16 -- a little over 16% of the lapses we will save.

The impact of that is that the impact of those, being able to save those policies plus what we've done in the past years will increase our premium income by a little over $40 million, and it will add $6 million to our underwriting income. It's a positive program. Like I say, we will save about 16% of the premium. We think that percentage can go higher if we continue to find new ways to conserve the policies, but you really have to attribute the improvements to the conservation program.

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

Now, in terms of, if I think of American Income or Liberty National, looking at the current levels, they both continued to improve this year. Are we getting towards where 8% is going to be the run rate for American Income, and maybe a little over 7% for Liberty National? Or have you still got room to go?

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

Well Colin, we -- that's a good question. We're getting to the point we may not see much additional improvement for -- what you were talking about, the 8% of American Income in 2011 was like 9.25%. And it's even better improvement at Liberty National, but you get to the point where that lapse rate is not going to improve that much more.

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

Okay. Thank you very much.

Rob Myers, Sun Trust - ***Analyst***

This is Rob Myers on for Mark Hughes. I had a question, if you had any perception about the demand difference between whole life and term currently? If there's any industry-wide dynamic that you are gathering from the market?

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

I don't think in the market internally. We don't see a shift from term to whole life. Ours are basic protection products in both cases, and so we do a needs-based analysis in all of our agency sales. And really drives on a needs basis, not whole versus a term product.

Rob Myers, Sun Trust - ***Analyst***

Okay. Thank you.

John Nadel ***- Sterne, Agee & Leach, Inc. - Analyst***

I get that a lot. Good morning, everybody. So you've got this high-quality problem that continues - that your stock's valuation is roughly 2 times book. And I'm curious, it looks to me if I look at stock price daily during the quarter, it looks to me like you're -- and compare that to your average repurchase price, it looks like you were pretty strong on your buybacks in the first half the quarter, but tailed it off pretty significantly when the stock was in the $54 to $55 range, or roughly 2 times your 2Q book, ex-AOCI. Should we take anything away from that, or was it just a matter of the timing of your cash flow, the timing of putting the capital to work?

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

Frank, do you want to handle that?

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

I would say**,** the one thing I would probably note, John, is that we did have a significant portion of our purchases in the very first quarter of when we had 100 -- or $210 million and an overall price there of about $50.72. We did end up, as we -- just looking at overall the timing, it's a little bit of a combination of both in that we did have, as we normally would, a little bit more purchases in the first part of the second quarter. As the price moved up, it probably slowed down a little bit, but we also, quite honestly, as we normally do, we are looking at spreading our purchases out over the course of the year and we were literally looking for about $190-million target for the first half of the year, and so that's what we are really trying to push towards.

John Nadel ***- Sterne, Agee & Leach, Inc. - Analyst***

Okay. Perfect. Thank you very much guys.

Operator

It appears we have no further questions at this time, so I will turn the program back over to our presenters for any closing remarks.

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

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