Torchmark Corporation

1st QUARTER 2014 CONFERENCE CALL

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CORPORATE PARTICIPANTS

Mike Majors *Torchmark Corporation - VP of IR*

Gary Coleman *Torchmark Corporation - Co-CEO*

Larry Hutchison *Torchmark Corporation - Co-CEO*

Frank Svoboda *Torchmark Corporation - EVP, CFO*

Brian Mitchell *Torchmark Corporation - General Counsel*

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Jimmy Bhullar *JPMorgan Chase & Co. - Analyst*

Eric Bass *Citigroup - Analyst*

Yaron Kinar *Deutsche Bank - Analyst*

Ryan Krueger *KBW - Analyst*

Chris Giovanni *Goldman Sachs - Analyst*

Mark Finkelstein *Evercore Partners - Analyst*

Steven Schwartz *Raymond James & Associates - Analyst*

Mark Hughes *SunTrust Robinson Humphrey - Analyst*

Eric Berg *RBC Capital Markets - Analyst*

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

Robert Glasspiegel *Langen McAlenney - Analyst*

Joanne Smith *Scotiabank - Analyst*

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.

Net operating income for the first quarter was $137 million or $1.52 per share – a per share increase of 9% from a year ago. Net income for the quarter was $133 million or $1.48 per share – a 17% increase on a per share basis.

With fixed maturities at amortized cost, our return on equity as of March 31 was 15.5% and our book value per share was $39.68 - a 10% increase from a year ago. On a GAAP reported basis, with fixed maturities at market value, book value per share was $46.85, a 2% increase.

Life Insurance

In our life insurance operations, premium revenue grew 4% to $489 million and life underwriting margins increased 6% to $141 million. The growth in underwriting margin exceeded the premium growth due to lower amortization on our deferred acquisition costs and the deferral of certain direct response internet acquisition costs that had not been deferred prior to the second quarter of 2013.

The lower amortization rate is a result of improvements in persistency attributable to our ongoing conservation program, and is incorporated in our guidance.

For the full year, we expect life underwriting margin to increase approximately 3 to 5% over 2013. The growth rate for the year will be less than the first quarter growth rate primarily because the direct response internet costs will be on a comparable basis for the remainder of the year.

Net life sales were $89 million, up 5% compared to the 1st quarter of last year, and up 7% over the fourth quarter of 2013.

Health Insurance

On the health side, premium revenue, excluding Part D, declined 1% to $219 million and health underwriting margin declined 1% to $49 million. For the full year, we expect health underwriting margin to decline from 2 to 4%.

Health sales increased 34% to $32 million, due primarily to an increase in group Medicare Supplement sales.

Administrative Expenses

Administrative expenses were $44 million for the quarter, 1% 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.

Before I get into the marketing operations, I'd like to point out that the agent count information on our website now includes an average agent count for the first quarter of 2014 in addition to the quarter-end counts we have historically provided. Due to significant fluctuations that can occur from week to week, we believe that adding an average agent count for the quarter will provide more meaningful information regarding agent trends.

Now let's look at the results of our marketing operations for the first quarter.

First, let's discuss Direct Response, which generates approximately 35% of our life premiums.

We are pleased with the Direct Response results. Life premiums were up 6% to $178 million and life underwriting margin increased 15% to $45 million. Net life sales were up 9% to $40 million.

We are continuing to see significant production growth generated by our lower–rate adult insurance offerings and electronic media.

We expect life sales growth for the full year 2014 to be in a range of 6 to 9%.

Now, American Income, which generates approximately 38% of our life premiums.

American Income's life premiums were up 7% to $186 million and life underwriting margin was up 7% to $60 million. Net life sales increased 1% for the quarter to $38 million. The producing agent count at the end of the first quarter was 5,500, down 2% from a year ago, but up 4% during the quarter. The average agent count for the first quarter was 5,298.

On our last call we indicated that we expected sales to be flat for the first half of the year and then ramp up in the second half as changes in the compensation system kicked in. Despite significant weather-related difficulties around the country, life sales increased slightly.

We believe the changes implemented early in 2014 began to have a positive impact during the first quarter. We have seen improvements in the percentage of agents submitting business and the average premium per application.

While the average agent count for the quarter was lower than the count at the end of the fourth quarter, we saw strong, steady growth during March. While it's still early, we believe that agent retention will be positively impacted by the compensation changes.

We opened a new office in the first quarter and we plan to open five more during the remainder of the year.

We expect life sales growth for the full year 2014 to be within a range of 3 to 6%, with most of the growth coming in the third and fourth quarters.

Now, Liberty National

At Liberty National, life premiums declined 2% to $69 million while life underwriting margin declined 10% to $17 million. Net life sales grew 4% to $7 million, while net health sales increased 25% to $4 million.

The producing agent count at Liberty National ended the quarter at 1,451 – up 6% from a year ago and up 1% during the quarter. The average agent count for the full quarter was 1,400. While this is lower than the count at the end of 2013, we saw a steady increase through the last half of the quarter.

The first quarter sales increases were higher than we had anticipated due largely to improvements in agent productivity and activity levels.

We opened another new office at Liberty in the first quarter and we expect to open 4 more new offices at Liberty during the remainder of 2014. We will continue to expand into more heavily-populated, less-penetrated areas to generate long-term agency growth at Liberty.

We expect to see total life and health sales growth for the full year 2014 in a range of 3 to 6%.

Now, Family Heritage

Health premiums increased 7% to $49 million while health underwriting margin increased 16% to $11 million. Health net sales declined 8%, to $10 million. The agent count also declined during the first quarter. We believe these disappointing results were due in large part to weather-related issues that affected Family Heritage to a greater extent than our other distribution channels.

On a positive note, we saw improvements in agent count throughout March and have seen positive sales momentum during March and April.

We still expect growth in health sales at Family Heritage for the full year 2014 to be in a range of 2 to 6%.

Now, United American General Agency

Health premiums grew 1% to $78 million in our general agency. Net health sales grew 116%

to $14 million. The increase was due primarily to a large group Medicare Supplement case. We also continued to see strong growth with our individual Medicare supplement sales.

While it is difficult to project group Medicare supplement sales activity, our guidance for the full year assumes general agency net health sales growth of approximately 25 to 35%.

Medicare Part D

Premium revenue from Medicare Part D grew 8% to $83 million, while the underwriting margin grew 19% to $10 million. Part D sales for the quarter were $31 million compared to $9 million in the year-ago quarter due to the increase in low-income subsidized enrollees for 2014 and a large employer group case.

The midpoint of our 2014 guidance assumes an increase of 16-17% in Part D premiums for the full year.

I will now turn the call back to Gary.

<u>Gary Coleman</u>

Thanks Larry.

Now, 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 $1 million, or 2% over the first quarter of 2013. On a per share basis, reflecting the impact of our share repurchase program, excess investment income was up 7%. For the full year, we expect excess investment income to increase by about 4-6%; on a per share basis, the increase should be about 9-11% compared to 2013.

The growth rate expected for the full year 2014 is higher than that of the first quarter since the excess investment income in the first quarter of 2013 was the highest of any quarter in 2013 due to the impact of calls of higher-yielding securities during the first and second quarters.

Now, regarding the investment portfolio:

Invested assets were $13.2 billion, including $12.6 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 $552 million, compared to $573 million a year ago.

The percentage of below investment grade bonds to fixed maturities is 4.4% compared to 4.7% a year ago. With a portfolio leverage of 3.6X, 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 billion compared to $390 million at the end of the fourth quarter. The increase is due primarily to recent declines in market interest rates.

Regarding investment yield:

In the first quarter, we invested $158 million in investment grade fixed maturities, primarily in the industrial and financial sectors.

We invested at an average yield of 5.4%, an average rating of BBB+ and an average life of 25 years.

For the entire portfolio, the first quarter yield was 5.92%, down 8 basis points from the 6.00% yield in the first quarter of 2013. For the full year 2014, we expect the portfolio to yield approximately 5.90%.

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 first quarter, we spent $108 million to buy 1.4 million Torchmark shares at an average price of $76.09. So far in April, we have used $33 million to purchase another 427,000 shares. So, for the full year through today, we have spent $141 million of parent company cash to acquire 1.8 million shares.

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. 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 $141 million to purchase Torchmark shares, leaving approximately $300 million available to the parent 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 $50-60 million of liquid assets at the parent company.

Regarding RBC at our Insurance Subsidiaries:

We plan to maintain our capital at the level necessary to retain our current ratings. For 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.

At December 31, 2013, our consolidated RBC ratio was 341%, and adjusted capital was approximately $70 million in excess of that required for the targeted RBC ratio. We do not anticipate any 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 that our net operating income will be within a range of $6.08 per share to $6.32 per share.

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

Question and Answer

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

Hi, good morning. Just had a couple of questions. First, Larry you mentioned weather a couple of times. Maybe talk about if you did see an impact on your sales in either life or health or Direct Response from weather, and whether that affected recruiting as well?

And then secondly, on the agent count you saw a nice increase at American Income but if I look over the past couple of years your agent count in the first quarter increased a decent amount, I think up 17% in the first quarter of 2012, 8% in the first quarter 2013, and last year it actually declined in the other quarters. Is there seasonality and what your expectations are for the agent count at American Income for the rest of the year?

Larry Hutchison *- Torchmark Corp - Co-CEO*

For Liberty National and American Income, the severe weather did have a slight negative impact on both sales and recruiting. At Family Heritage, the agencies work primarily in rural areas for the majority of the sales. It involves travel of long distances to market the products. It was challenging to overcome the setbacks and in addition at Family Heritage the inclement weather coincided with the company’s major sales incentive weeks.

With respect to the agent retention, we're not expecting a drop in agent retention at American Income later this year. We believe we will continue to see the positive impact from the changes in compensation that we introduced in January. We will have better information regarding agent retention trends later this summer. But primarily we're seeing three positive trends in agent productivity at American Income.

Our total bonus earners increased in the first quarter. The percentage of agents submitting new business on a weekly basis increased and the average premiums submitted also increased. Those three indicators will tell us that we believe our retention is going to better over the next quarter through the remainder of the year.

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

And with Direct Response were there any disruptions or any effect on their sales with disruptions in mail delivery and stuff over? And actually in the Liberty and at American Income have you seen better trends in April as the weather has gotten a little bit better or not?

Larry Hutchison *- Torchmark Corp - Co-CEO*

We are seeing the same trends in April at American Income and Liberty. Direct Response is also affected by the bad weather, particularly in the insert media. Some of the delivery of the insert media was delayed and that's a loss because when you have bad weather when the next mailing goes out it is on top of the first mailing.

Growth had.., Direct Response had a strong first quarter and so it had a fairly minor impact upon the Direct Response operation.

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

Okay, thank you.

Eric Bass - *Citigroup - Analyst*

Hi, thank you. I was hoping you could discuss the current trends in the Med Supp business a little bit more? And are you seeing any pickup in demand for individual policies or any increase in dis-enrollments from Med Advantage at this point?

Larry Hutchison - *Torchmark Corp - Co-CEO*

The Medicare Advantage dis-enrollments did not have a major impact upon the Company. It was our estimate that in the first quarter, our production increased by approximately 10% to 15% because of Medicare dis-enrollments.

The growth we're seeing in 2014 in the general agency really comes from the individual sales which is a result of strong recruiting and its implementation of a new E-application. In the group Medicare Supplement we benefited from a large case written in the first quarter. And that business tends to be a little bit lumpy. We're hopeful we'll see more large cases during the year, but our guidance does not reflect that.

Eric Bass - *Citigroup - Analyst*

Okay and what are some of the dynamics in the group market in terms of competition or margin trends in that business? You have had some relatively good sales in recent periods.

Larry Hutchison - *Torchmark Corp - Co-CEO*

Again the business is lumpy. It is a competitive market and they are continually quoting different large group cases and medium group cases. We price to a profit margin and we either receive the business or we do not receive the business.

Eric Bass - *Citigroup - Analyst*

Okay and then just one on Part D. You have pretty strong margins there. Can you just remind us what are you expecting or what is assumed in guidance for Part D margins for the year? And should we expect that they can hold up at first quarter levels?

Larry Hutchison - *Torchmark Corp - Co-CEO*

It's pretty early in 2014 to really measure our claims experience. But we expect margins in Part D for the year 2014 to be in the range of 10% to 13%.

Eric Bass - *Citigroup - Analyst*

Okay, thank you.

Yaron Kinar - *Deutsche Bank - Analyst*

Hi, good morning gentlemen. I have a couple of questions. First on Liberty National's margins. Which I noticed were off a little bit this quarter. And seemed to be a little -- going maybe the wrong direction certainly relative to the other segments. I was curious as to what was causing that and if you thought that would correct itself as the year progresses?

Gary Coleman - *Torchmark Corp - Co-CEO*

Well the impact in the first quarter was really the claims, we had higher claims in the first quarter, and also the claims for the first quarter last year were a little bit low. At Liberty, claims are high in the first half of the year, higher than they are in the second half.

And it just so happens that in the first quarter was high, this year and last year the second quarter was over 40% as a percentage of policy obligations. So it's a little bit of seasonality here. For the year though, we expect the policy obligations at Liberty to be around 38% to 39% and that is compared to a little over 38% the last year.

Yaron Kinar - *Deutsche Bank - Analyst*

Okay. And then on the excess investment income side, with yields pulling back a little bit, at the beginning of the year, are you still comfortable with the initial guidance you gave for the full-year? I think it was 5% to 7% growth?

Gary Coleman - *Torchmark Corp - Co-CEO*

Yes, I feel comfortable with the guidance we gave earlier. We did lower though our new money rate from 5.5% to 5.25%. 5.5% is what we used in our previous guidance. As we have seen that market rates declined somewhat but we feel confident that we can hit the 5.25%. At that again, I think we will see increasing growth as the year goes on.

Yaron Kinar - *Deutsche Bank - Analyst*

Okay. And if I could, just maybe a quick numbers question, something I missed. Larry, I think you talked about 25% or 35% sales growth guidance for the year? I missed for what segment that was.

Larry Hutchison - *Torchmark Corp - Co-CEO*

That's for the United American general agency. We expect health sales from the United American independent agents to be up approximately 25% to 35%. Group health Medicare Supplement sales projected to be up about 35%.

Yaron Kinar - *Deutsche Bank - Analyst*

Thank you very much.

Ryan Krueger - *KBW - Analyst*

Hey, good morning thanks. First, I wanted to follow-up on the Med Supp discussion. You have a pretty good outlook for the year. Sounds like there weren't a lot of dis-enrollees in Med Advantage, but I am just curious, is the competition increasing in Med Supp just based on this idea that, that Med Advantage funding pressures could go on over time?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I think Med Supp is a growing market. If you look at the demographics, certainly there are many people turning 65 so it'll be a growing market over time. Our sales really aren't dependent on the assumption of any dis-enrollments from Medicare Advantage.

What we're focusing on recruiting agents to sell the Medicare Supplement business and we've implemented a new E-application system that makes it easier for the agents to write the business at United American Insurance Company. So the growth is really driven here by our strong agent recruiting and our new E-application process.

Ryan Krueger - *KBW - Analyst*

Okay, have you seen any changes in the competitive environment over the last year or so?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I think it's really the same environment. As I said, we saw an increase in dis-enrollments in the first quarter. As we look at replacement forms it is our estimate that those first quarter Medicare Advantage dis-enrollments led to an increase in production of about 10% to 15%.

Ryan Krueger - *KBW - Analyst*

Okay. And then I had a couple quick weather-related ones. You noted a little bit higher claims at Liberty which I know is typical of the first quarter from a seasonal perspective but wondering if you thought the bad weather had caused any uptick in mortality rates in the first quarter?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I don't think the bad weather affected the mortality rate. When Gary's talking about a seasonal pattern, is when we look back at Liberty over the many years, the claims tend to be higher in the first half of the year than the second half of the year.

Ryan Krueger - *KBW - Analyst*

Understand.

Gary Coleman - *Torchmark Corp - Co-CEO*

It may be the first quarter's a little higher --or maybe the second quarter as it was last year but I don't think there's anything surprising here.

Ryan Krueger - *KBW - Analyst*

Okay then just last one, on Family Heritage the sales weakness from the weather. Do you think that uniquely impacted of that business because of its rural focus? Or do think more of an industry issue for kind of all supplemental health?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I think the weather uniquely affected Family Heritage. Again, most of our other agency forces for Liberty, and particularly for American Income are in urban areas. At Family Heritage those agencies were primarily in rural areas and so the sales force travels long distances to market products. Given the bad weather in the upper Midwest and the East and even the South, it really had a negative impact upon Family Heritage.

In addition, at Family Heritage they have major incentive weeks and it so happened that the bad weather coincided with several of those major sales incentive weeks. So the impact was greater at Family Heritage than our other two agencies.

Ryan Krueger - *KBW - Analyst*

Got it, thanks a lot.

Chris Giovanni - *Goldman Sachs - Analyst*

Thanks so much. Good morning. I guess first question is just over the past several years we have heard from several competitors that talk about moving down market, maybe not all the way down to your target customer. But Met certainly rolled out its partnership with Walmart in some states. Others are seemingly working with what looks like the big-box and department store retailers as customers seem to be more willing to purchase through retail channels. So wondering, if you're seeing any signs of increased competition or any comments you can make around those strategies and the impact it could have on your distribution?

Larry Hutchison - *Torchmark Corp - Co-CEO*

We've looked at our Direct Response operation and we also looked at each of the agency operations and we have not seen any evidence of increased competition in the field in our direct marketing.

Chris Giovanni - *Goldman Sachs - Analyst*

Okay and any comments just in terms of the direct-through, the retail distribution versus mail or Internet?

Larry Hutchison - *Torchmark Corp - Co-CEO*

Well, life insurance is a product that doesn't sell itself. The need is sold in the agency, so we believe in the agency system but we have had great success in Direct Response in all three channels. In Direct Response we have direct mail, the insert media and our fastest-growing segment is electronic media. Part of the reason I can say we’re not seeing an increase competition - if you look at the electronic media in the first quarter our inquiries were up 40% compared to the same period a year go.

We don't think that will continue for the full-year, but we are expecting electronic media inquiries to be up at least 20% for the full-year and so in electronic media we focus on different areas. We are comfortable that Globe will continue to grow and it supports the other two segments or the other two channels and its distribution.

Chris Giovanni - *Goldman Sachs - Analyst*

Okay and then last question, just wanted to get some perspective in terms of how much runway you think you have with the higher face amount policies that you guys are selling direct?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I am a little slow answering, just thinking about your question. The actual numbers of policies issued at higher face amounts has increased. By offering the higher face amounts we are also seeing an even bigger increase in policies issued across all policy face amounts.

So we will continue to explore the higher face amoun, but we are finding that it helps our sales in the other smaller face amounts as we make those offers. But we really rolled out, in the third and fourth quarter, the different rates, the different adult products. We're testing some other adult products now. So in terms of that runway, we're more comfortable addressing that in the third and fourth quarter as we seen the results of those additional tests.

Chris Giovanni - *Goldman Sachs - Analyst*

And when you talk about tests are you talking geographically, even exploring further increases in the face amounts, or both?

Larry Hutchison - *Torchmark Corp - Co-CEO*

It is geographic. It is different packaging. It's different riders, there's a lot of different testing we do with the adult products.

Gary Coleman - *Torchmark Corp - Co-CEO*

Chris, we've talked about in the past $50,000 being the maximum face amount. We've increased that up to around $100,000. If your question is, are we going to go further up from $100,000, I'm not sure that happens. It's a little bit hard in Direct Response because we can't do a great deal of underwriting and it'd be difficult to go into higher face amounts than that.

Chris Giovanni - *Goldman Sachs - Analyst*

Understood. Great, thanks, appreciate the comments.

Mark Finkelstein - *Evercore Partners - Analyst*

Hi, Good morning, broader question on Family Heritage. You did talk about weather impact in the quarter and expecting a better March and April. You have also talked about in the past improving some of the recruitment tools of that business.

I guess what I am really curious about is if you look at the level of sales and you look at the level of recruiting generally, I assume it's probably been a little disappointing. I'm just curious how you think about the performance of that business broadly relative to how you originally thought about it when you bought it?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I don't think it's been disappointing. I think we made some adjustments in the systems for recruiting last year. If we look at this year, year-to-date it was disappointing in the first quarter because they were hit by the bad weather. If you go to the second quarter we are seeing some positive indicators for both recruiting and sales. Our sales projection for full 2014 is the range of 2% to 6%. We think the agent count at the end of the year for 2014 will be in a range of 675 to 725 agents.

And the growth at Family Heritage is going to come from the increase in the sales force. And so that's our focus and we believe that as the sales force grows, we're going to see significant growth in production follow that sales growth.

Gary Coleman - *Torchmark Corp - CFO*

Mark, as to our expectations when we bought the Company, we knew we were going to - there were going to be significant changes made to the way recruiting was done. We expected that it would take a little time to get Family Heritage up and going so we're not disappointed with it. We expected, this time, as a matter fact we be a little ahead of pace.

Mark Finkelstein - *Evercore Partners - Analyst*

Okay that is helpful, and then just one follow-up on the American Income agent count. You had a very strong first year improvement but you did see a little bit of a falloff in renewal year. Is that just fluctuation or anything else going on there?

Larry Hutchison - *Torchmark Corp - Co-CEO*

The follow up is an indication of the retention issues we have had over the last 15 to 18 months. And as we see better retention with first-year agents, we'd expect to see in the third and fourth quarter that those veteran agents numbers will grow. When you think about it, in any quarter you're going to lose certain veteran agents. If you're not adding new agents that enter that 13th month, that number will be flat or slightly drop.

Mark Finkelstein - *Evercore Partners - Analyst*

Okay.

Gary Coleman - *Torchmark Corp - CFO*

Mark, we're encouraged by the fact that when you look at the total agent count, the management count is pretty much flat with last year, but the growth has come in the writing agents. That's a good indicator because as we grow the number of agents, the writing agents, then they'll be the ones that will go into management. So we think that's a leading indicator that we will see an increase in the management as well.

Mark Finkelstein - *Evercore Partners - Analyst*

Okay, all right, thank you.

Steven Schwartz - *Raymond James & Associates - Analyst*

Hey good morning everybody. A couple numbers first. Frank, I think you typically talk about how you expect yield, you said that the yield should be about 5.9% for the year on average. But how should that develop quarterly? Can you give us that?

Frank Svoboda - *Torchmark Corp - CFO*

Yes, I think it drops - we're at 5.92% for the first quarter. And we really see it dropping probably just 1% to 2% basis points sequentially over the course of the quarters.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay and then one of the things I noticed on Part D, there seemed to be a significant change in PBM fees. Anything up with that?

Gary Coleman - *Torchmark Corp - Co-CEO*

Yes Steven. Included in those PBM fees is a new fee that we have to pay under the Affordable Care Act. It's a little over 1% of premium. And in addition to that, we renegotiated our contract and there is additional cost for an option that we agreed to where we could renegotiate the drug rebates in 2014. So that adds a little bit to it as well.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay great, and then just a more general question. Exchanges, group, probably a bit overwrought all the discussion about exchanges with regards to active employees. But it definitely seems to be making headway in the retiree market. Given the big group case sale that you made, does United American play in that? Are you on these exchanges through the agencies? Does this affect you at all?

Larry Hutchison - *Torchmark Corp - Co-CEO*

No, we are not on any exchanges currently. We are exploring opportunities in the supplemental health market, and so if we look at the exchanges, Obamacare, we look at those opportunities because we know there are going to be gaps that can be filled. So that is our focus, but to be on the exchanges…

Steven Schwartz - *Raymond James & Associates - Analyst*

No Larry, I was talking about the private exchanges like run through AR, or Towers Watson or somebody like that?

Larry Hutchison - *Torchmark Corp - Co-CEO*

We are not on those exchanges. I'm sorry miss understood. I thought you were saying are we were on the public exchanges, okay.

Steven Schwartz - *Raymond James & Associates – Analyst*

Yes

Larry Hutchison – Torchmark Corp – Co-CEO

No, we are not on those exchanges.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay. Will those, if those develop, will those affect the markets that you are in at all?

Larry Hutchison - *Torchmark Corp - Co-CEO*

We don't think so. They're certainly not going to affect our individual market and in the group, those are quoted individually, and so with those groups it could be competition but we think we will still be competitive in those markets.

Steven Schwartz - *Raymond James & Associates - Analyst*

Okay great, thanks guys.

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

Thank you, good morning. Have you got more flexible, perhaps opened up the top end in terms of the size of the group that you are willing to quote in the Med Supp business? Should we look for more big lumps perhaps in the future?

Larry Hutchison - *Torchmark Corp - Co-CEO*

That is possible. We do quote big groups, so that is possible. It is almost impossible to predict that business -- always in a sense an opportunistic business and we are going to maintain our profit margins. We don't cut profit margins based on the size of the group. We maintain a consistent profit margin whether it is medium or very large group.

Mark Hughes - SunTrust Robinson Humphrey - Analyst

Are there more prospects? Are you quoting more for those very large groups?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I don't think it is more or less. They look across the market and that's what that marketing group does. They go out and try to contact as many groups, as many brokers as possible and they're willing to write any size group. Obviously there's a little less competition if we have a group that has 2,000 members versus 20,000 members.

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

Thank you very much.

Eric Berg - *RBC Capital Markets - Analyst*

Thanks very much and good morning to everyone. I have a general question about the health business and then a narrow one about the health business. My first question is as follows. It feels like it wasn't terribly long ago, say within the last one to two years -- say two years ago that the health business was well in decline and with premiums falling sharply. Now they are falling a lot less sharply. Indeed they were essentially flat. It seemed back then at least to me that Torchmark was heading towards becoming overwhelmingly a life company and much less of a health company than it had been in the past.

My question, as we look forward, given the strength you are enjoying now in Medicare Supplement and elsewhere in health insurance, do you anticipate -- is the health business turning around really? Is what I am asking. And do anticipate a more balanced mix between life and health prospectively than what you would have said a year ago?

Larry Hutchison - *Torchmark Corp - Co-CEO*

You have to remember if you looked at 2010, 2011 and 2012 those declines you saw on our health line were largely the result of a large block of business that we wrote that would've been subject to the Healthcare Reform Act. We decided to exit that line of business in 2010 and saw significant declines. I think what you're seeing is the stabilization of our healthcare business because a large part of our Medicare Supplement business is growing in the individual and also growing in the group.

Long-term, our focus will remain on life insurance. We certainly like the health insurance business. But we find the life insurance business to be more predictable in terms of its sales growth. And it's easier to maintain a captive agency force in the life insurance business than it is in the health insurance business.

Gary Coleman - *Torchmark Corp - Co-CEO*

Yes, I would agree with Larry. We do prefer the life business, not only because of the higher margins, but that's where the excess investment income comes from. I think there's a place for us though, in the niches we have on the health insurance side but for example, this year we're looking at premium income being flat. That's actually an improvement over the years you were talking about Eric, but we expect to see some growth there but it's not going to be as much growth as we are going to have on the life side and that's fine with us.

Eric Berg - *RBC Capital Markets - Analyst*

My second question is similar but more focused and it is focused on Medicare Part D business. Again, if my memory serves me correctly, when Medicare Part D first began several years ago you had a burst of business and then there was uncertainty as to whether the drug related business, drug insurance related business would continue at the pace that it had been. There was a suggestion that it might fall sharply and now it seems to have stabilized. My question, do you see Medicare Part D remaining a meaningful and growing part of the business?

Gary Coleman - *Torchmark Corp - Co-CEO*

I think from where we stand now I think it's a meaningful part of our business. But to say whether it's going to grow or how big it is going to be in the future is difficult because it is such a competitive market. And in addition to that, there is a difference between the auto-assign market and the non auto-assign market and there's different levels of risk there.

Different uncertainty there and also when you take a look at it, we like the business but the profit margin there is lower than it is on our health business, I mean on our life business. So it is much more competitive, it is lower margin. We are glad to have the business but it is hard to predict in the future how big it will be or even if it will be bigger.

Larry Hutchison - *Torchmark Corp - Co-CEO*

Eric I agree with everything Gary said. We've looked at Part D as an opportunistic market. Every year we bid to achieve our target profit margins. Every year we're going to gain regions and we are going to lose regions. Currently we are in about 20 to 25 regions out of the 35 possible regions.

We hope to maintain that level of regions, but if competitors decide to buy the business, we could lose regions in that competitive bid process. If the auto-assign market becomes extremely competitive, we could lose most of our auto-assigns but we still have our regular market, our group market to rely on.

Eric Berg - *RBC Capital Markets - Analyst*

Very good thanks to both of you.

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

Hey, good morning everybody. I just have two. I think everything has pretty much been covered. I'm just curious how big was the large group case that was written this quarter in United agency on the Medicare Supplement - just to give us a sense, how many lives?

Larry Hutchison - *Torchmark Corp - Co-CEO*

On the Part D case it was a large case, I think there were approximately 2,800 new lives.

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

Okay.

Larry Hutchison - *Torchmark Corp - Co-CEO*

The annual premium came out to about $7 million.

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

Okay, that's helpful thank you and then I just have a quick numbers question. Option compensation expense grew on a year-over-year basis. Is the level that you see in the Q1 probably about what we should expect to see going forward?

Frank Svoboda - *Torchmark Corp - CFO*

Yes actually John, it will be… Q1 is always a little bit higher. It will grade down just slightly over the remainder of the year. But I think on an annual basis the midpoint of our guidance you should probably expect it to be around 4% of our net operating income before the stock option expense.

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

Okay and if I can sneak one more in. When you think about the range for your guidance, the 10% to 13% range for the margin expectation for Medicare Part D, is that contemplated in the low and the high? Or is there something more midpoint built in there?

Larry Hutchison – *Torchmark Corp - Co-CEO*

Frank do you want to take that.

Frank Svoboda - *Torchmark Corp - CFO*

Yes, the midpoint, as you get closer to the midpoint, you would be looking at around really an expectation of 11.5% to 12%.

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

Okay that's perfect. Thank you.

Robert Glasspiegel - *Langen McAlenney - Analyst*

Good morning Torchmark. I love your annual report letter. Kudos to whoever is in charge of writing it. I noticed that towards the end when you talk about use of free cash flow, for the first time you talked about a special dividend should the stock get at above your proprietary definition of intrinsic value.

And with the stock bouncing to a new high -- let me step back. You were active in the first quarter as the stock was down. But I was wondering if the caveat whether that would drive the special dividend, if you had another rocket ship year for the stock? Or, is it with the stock hitting sort of all-time high, are we getting in the neighborhood where the special dividend becomes a more reasonable option? You guys have been so good on capital management and investment management that I respect your judgment a lot.

Gary Coleman - *Torchmark Corp - Co-CEO*

Well Bob, first of all as we said in the letter, our first priority is to return the excess cash to the shareholder. We -- over the years, we've - the share repurchases have outweighed our dividends. But this last year though is the first year we've really hit -- our share price has gotten close to what we think intrinsic value is. That's why we mentioned the possibility of a special dividend. That would be something we would have to visit with our Board about, but absent an acquisition or absent other cash, it would provide a strong return to shareholders. We would consider that if we felt we needed to suspend the share repurchase because of valuation.

But we are not there yet, we felt good about the share repurchases for the first quarter. But as you say, if we have another 30% increase in share price, which we are not expecting but if we did -- we don't want to -- we recognize the fact that if we buy back shares at prices that we can't justify then that is bad for the shareholder. That is why we had a conversation about the special dividend as being a possibility.

Robert Glasspiegel - *Langen McAlenney - Analyst*

No, I applaud your logic and it is very sound. So you are somewhere in between close and not near the point where you would consider it? I guess that was the rough --

Gary Coleman - *Torchmark Corp - Co-CEO*

From a historical standpoint we are closer to the intrinsic value or what we feel the value of the stock is than we have been in past years. But we are not close enough that we think we should suspend the repurchases.

Larry Hutchison - *Torchmark Corp - Co-CEO*

It is not a fixed point. It's an ongoing analysis we look at that every quarter, we discuss that with our Board of Directors and together we'll make the decision we think is in the best interests of the policy - shareholders, rather.

Robert Glasspiegel - *Langen McAlenney - Analyst*

Thoughtful answer Larry, Gary.

Gary Coleman - *Torchmark Corp - Co-CEO*

Thanks.

Joanne Smith - *Scotiabank - Analyst*

Most of my questions have been asked and answered, but I just wanted to go back to American Income for a minute. Because you quoted some metrics in the Q&A regarding the fact that bonuses were up, and the weekly submissions were up, as well as total submissions. I'm wondering if you could give us a little bit of a feel as to how that played out through the quarter? And, if you think that all of the changes that you have made are really starting to hit stride now, or if they're still on the cusp? Thanks.

Larry Hutchison - *Torchmark Corp - Co-CEO*

We had better sales in the first quarter than we expected at American Income Life Insurance Company. And that is really driven by the percentage of agents submitting new business on the on a weekly basis. We didn't really see the increase in the agents until about mid-February. But we are seeing positive trends. With the new compensation program, from mid-February on, not just on current agents, we're seeing the number of recruits in a positive trend.

It's a little early to say what the effect of that new compensation system is going to be. I think, probably mid-July, early August, that we'll have enough data from January, February, March that we can look at that third, fourth, and fifth month retention and see the real effect that that is having.

Joanne Smith - *Scotiabank - Analyst*

Okay great, then I will check back with you on that front. Thanks very much.

Larry Hutchison - *Torchmark Corp - Co-CEO*

Sure.

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

Thank you. How much of the Globe Life inquiry volume or new policy volume is coming by electronic media?

Larry Hutchison - *Torchmark Corp - Co-CEO*

I think you are -- I'm going to try and understand your question. If you're asking what percentage of the Direct Response sales come from electronic media?

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

Exactly.

Larry Hutchison - *Torchmark Corp - Co-CEO*

That would be about 40% of our sales come from electronic media. In electronic media I'm including incoming telephone calls, the Internet, social media, and mobile search ads. Mark, it's hard to give you an exact percentage because as we have more electronic Internet traffic, we see a greater presence on social media, that also supports our Direct Response and our insert media operations. The three work in tandem but we would give you a rough estimate that about 40% of our new sales come from electronic media.

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

Thank you.

Operator

I'm showing no further questions at this time I would like to turn the call back over to Mr. Majors for closing remarks.

Mike Majors - *Torchmark Corp - 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.