4th Quarter 2016 Conference Call

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PRESENTATION

Mike Majors - Torchmark - VP of IR

Thank you. Good morning everyone. Joining the call today are Gary Coleman and Larry Hutchison, our co-Chief Executive Officer's, 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 2015 10-K and any subsequent forms 10-Q on file with the SEC. Some of our comments may also contain non-GAAP measures. Please see our earnings release and website for discussion of these terms and reconciliations to GAAP measures. I will now turn the call over to Gary Coleman.

Gary Coleman - Torchmark - Co-CEO

Thank you Mike and good morning everyone.

In the fourth quarter, net income was $135 million or $1.12 per share, a 5% 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 10% from a year ago. On a GAAP reported basis, return on equity as of December 31 was 12%, and book value per share was $37.76. Excluding unrealized gains and losses on fixed maturities, return on equity was 14.6% and book value per share was $32.13, a 7% increase from a year ago.

In our life insurance operations premium revenue grew 6% to $550 million, while life underwriting margin was $143 million, down 1% from a year ago. The decline in underwriting margin is due primarily to the decline in the Direct Response margins. In 2017 we expect life underwriting income to grow around 1% to 3%.

Net life sales were $99 million, approximately the same as the year-ago quarter. On the health side, premium revenue grew 1% to $238 million and health underwriting margin was up 4% to $53 million. In 2017 we expect health underwriting income to remain relatively flat. Health sales in total were $47 million, down 21% from a year ago. Individual health sales were $37 million, down 4%.

Administrative expenses were $50 million for the quarter, up 6% from a year ago and in line with our expectations. As a percentage of premium from continuing operations, administrative expenses were 6.4%, compared to 6.3% a year ago. For the full year, administrative expenses were $197 million or 6.3% of premium. In 2017 we expect administrative expenses to grow approximately 5% and to remain around 6.3% of premium.

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

Larry Hutchison - Torchmark - Co-CEO

Thank you Gary.

At American Income, life premiums were up 11% to $236 million and life underwriting margin was up 10% to $75 million. Net life sales were $52 million, up 3%, due primarily to increased agent count. The average agent count for the fourth quarter was 6,874, up 4% from a year ago and down 2% from the third quarter.

The producing agent count at the end of the fourth quarter was 6,870. We expect the producing agent count to be in a range of 7,100 to 7,400 at the end of 2017. Life sales for the full year 2016 grew 6%. We expect 6% to 10% life sales growth in 2017.

At Liberty National, life premiums were $67 million, approximately the same as the year-ago quarter, while life underwriting margin was $19 million, down 4%. Net life sales increased 15% to $10 million, while net health sales were $5 million, approximately the same as the year- ago quarter.

The life sales increase was driven primarily by improvements in agent count. The average producing agent count for the fourth quarter was 1,781, up 16% from a year ago and down 1% compared to the third quarter. The producing agent count at Liberty National ended the quarter at 1,758. We expect the producing agent count to be in a range of 1,800 to 2,000 at the end of 2017.

Life net sales for the full year 2016 grew 12%. Life net sales growth is expected to be within a range of 8% to 12% for the full year 2017. Health net sales for the full year 2016 grew 8%. Health net sales growth in 2017 is expected to be within a range of 5% to 9%.

We are enthusiastic about Liberty National's prospects. Life premiums grew on a year-over-year basis in both the first quarter and the fourth quarter of 2016. The last time we had year-over-year growth for a quarter was in 2004. While the fourth quarter growth was slight, it is an indicator of the positive effect of the changes that have been made at this agency. We expect to see consistent life premium growth at Liberty National going forward.

I would like to make one more comment regarding American Income and Liberty National. Roger Smith, who oversees both of these agencies, announced he will retire at the end of the year. Roger has contributed greatly to the growth at American Income and the turnaround at Liberty National. Over the past several years, Roger has developed talented leaders at both American Income and Liberty National.

Steve Greer, the President of American Income Agency Division, will succeed Roger at American Income. Steve has served in his current capacity for over a year, and was an SGA for American Income for 12 years prior to that. Steve DiCharo, President of the Liberty National Agency Division, will succeed Roger at Liberty National. Steve has served in his current capacity for over five years, and was an SGA at American Income before that. Roger will serve in an advisory capacity to both agencies after his retirement.

Now Direct Response. In our Direct Response operation at Globe Life, life premiums were up 4% to $192 million. Life underwriting margin declined 21% to $29 million. Net life sales were down 7% to $34 million.

For the full year 2016, life sales declined 9% due primarily to decreases in circulation designed to improve profitability in certain segments. We expect life sales to be down 4.5% to 9.5% in 2017 as we continue those efforts.

At Family Heritage, health premiums increased 7% to $61 million, while health underwriting margin increased 26% to $14 million. Health net sales grew 8% to $13 million. The average producing agent count for the fourth quarter was 947, up 8% from a year ago and down 4% from the third quarter.

The producing agent count at the end of the quarter was 909. We expect the producing agent count to be in a range of 950 to 1,050 at the end of 2017. Health sales for the full year of 2016 grew 2%. We expect health sales growth to be in a range from 3% to 7% in 2017.

At United American General Agency, health premiums declined 2% to $89 million. Net health sales were $24 million, down 38% compared to the year-ago quarter. Individual Medicare Supplement sales for the full year 2016 declined 3%. In 2017, we expect growth in Individual Medicare Supplement sales to be approximately 5%.

I will now turn the call back to Gary.

Gary Coleman - Torchmark - Co-CEO

I will spend a few minutes discussing our investment operations.

First let's talk about excess investment income.

Excess investment income, which we define as net investment income less required interest on policy liabilities and debt, was $58 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 12%. In 2017, we expect excess investment income to grow by about 6% to 8%; however, on a per share basis, we should see an increase of about 9% to 11%.

Now regarding the investment portfolio

Invested assets were $14.8 billion, including $14.2 billion of fixed maturities at amortized cost. Of the fixed maturities, $13.4 billion are investment grade with an average rating of A-, and below investment grade bonds are $751 million, compared to $640 million a year ago. The percentage of below investment grade bonds to fixed maturities is 5.3%, compared to 4.8% a year ago.

The increase in below investment grade bonds is due primarily to downgrades of securities in the energy and metals and mining sectors that occurred early in 2016. However, due to the increases in the underlying commodity prices, the current market value of these securities are significantly higher than at the time of the downgrades.

With a portfolio leverage of 3.7 times, the percentage of below investment grade bonds to equity, excluding net unrealized gains on fixed maturities, is 19%. Overall, the total portfolio is rated high BBB+, just slightly under

the A- of a year ago. In addition, we have net unrealized gains in the fixed maturity portfolio of $1.1 billion, approximately $550 million higher than a year ago.

Regarding investment yield

In the fourth quarter we invested $607 million in investment grade fixed maturities, primarily in the industrial sectors. We invested at an average yield of 4.58%, an average rating of BBB+ and an average life of 26 years. For the entire portfolio, the fourth quarter yield was 5.75%, down 6 basis points from the 5.81% yield in the fourth quarter of 2015. At December 31, the portfolio yield was approximately 5.74%.

For 2017, the midpoint of our current guidance assumes an increasing new money yield throughout the year, averaging 4.80% for the full year. We are encouraged by the prospect of higher interest rates. 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. While we would benefit from higher interest rates, Torchmark would continue to earn substantial excess investment income in an extended low interest rate environment. Now I will turn the call over to Frank.

Frank Svoboda - Torchmark - CFO

Thanks Gary. First I want to spend a few minutes discussing our share repurchases and capital position. In the fourth quarter, we spent $71 million to buy 1.0 million Torchmark shares at an average price of $68.60. For the full year, we spent $311 million of Parent Company cash to acquire 5.2 million shares at an average price of $59.78. So far in 2017, we have spent $19 million to purchase 257,000 shares.

The Parent ended the year with liquid assets of about $45 million. In addition to these liquid assets, the Parent will generate additional

free cash flow in 2017. The Parent Company's free 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.

While our 2016 statutory earnings have not yet been finalized, we expect free cash flow in 2017 to be in the range of $325 million to $335 million. Thus, including the assets on hand at the beginning of the year, we currently expect to have around $370 million to $380 million of cash and liquid assets available to the Parent during the year. This level of free cash flow in 2017 is slightly higher than 2016, primarily due to the net proceeds received in 2016 from the sale of our Medicare Part D business.

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 rates. 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.

Although we have not finalized our 2016 statutory financial statements, we expect that our consolidated RBC ratio -- our RBC percentage at December 31, 2016 will be around 325%. We do not anticipate any changes to our targeted RBC levels in 2017.

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

During 2016, the growth in total life underwriting income lagged behind the growth in premium due to higher than expected policy obligations in our Direct Response operations. As discussed on previous calls, this is attributable to higher than originally expected claims related to policies issued in calendar years 2000 through 2007, and 2011 through 2015.

During the fourth quarter, claims emerged as anticipated and policy obligations were in the range we expected for the fourth

quarter and consistent with those reported for the third quarter. In addition, at 16.5% of premiums, the underwriting margin for the full year 2016 fell within the 16% to 17% range we expected. Looking forward, and as indicated on the last call, we anticipate that the underwriting margin for 2017 will decline slightly and be in the range of 14% to 16% of premium for the full year.

Now with regard to the recognition of excess tax benefits on equity compensation

As we previously discussed, in the first quarter of 2016 the Company adopted the new accounting standard relating to the treatment of excess tax benefits on a prospective basis. This new accounting standard primarily causes excess tax benefits to be recognized through earnings and affects Torchmark's computations of net income, diluted shares outstanding and earnings per share.

In the fourth quarter, the reduction in expense relating to the adoption of the standard caused earnings per share from continuing operations to increase $0.04. During the full year 2016, earnings per share increased $0.13. While several factors influenced the amount of excess tax benefits, we anticipate that the excess tax benefits recognized in 2017 will be slightly less than 2016 and that stock option expense as reflected in net operating income will be in the range of $2 million to $4 million for the year, compared to a benefit of $1.5 million in 2016, a negative swing of $3.5 million to $5.5 million.

Finally, with respect to our earnings guidance for 2017, we are projecting net operating income from continuing operations per share to be in the range of $4.57 to $4.77. The $4.67 midpoint of this range reflects a $0.03 decrease from the midpoint of our previous guidance. This decrease is due to a $0.05 reduction resulting from the higher current share price, which is causing the number of shares expected to be repurchased in 2017 to be lower than anticipated at the time of our last call. The negative effect of the higher share price is offset somewhat by a slightly improved outlook for underwriting and investment income.

Much speculation exists that Congress will enact some type of tax reform in 2017. At this time, few details are known as to the direction that Congress will ultimately take, including what statutory rate might be agreed to, and what, if any, changes to the tax base might occur. As such, we have not reflected any possible changes in the tax law in our 2017 earnings guidance and our calculations assume that existing tax law will stay in effect through 2017.

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

Larry Hutchison - Torchmark - Co-CEO

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

QUESTION AND ANSWER

Jimmy Bhullar - JPMorgan - Analyst

Hi, first I had a question on the annuity business. You've had pretty strong underwriting income in each of the last two quarters. What really drove that – I am assuming it is lower amortization and stuff, but what really drove it and what is your expectation of sort of a more normalized ongoing earnings number for that business?

Frank Svoboda - Torchmark - CFO

Yes, hi Jimmy, you are right that the increased income from the annuity business relates to lower amortization. Really, we slowed down the amortization on that business due to it staying on the books longer due to the lower interest rate environment. Going forward, really at the midpoint of our guidance we see annuity income probably being in that $10 million range. Pretty similar to what we saw on a per quarter basis to what we had in the fourth quarter.

Jimmy Bhullar - JPMorgan - Analyst

Okay, and then I think you mentioned retaining $50 million of liquidity at the holding company. In the past I thought it was $50 million to $60 million, so not sure -- has there been a change or is it still consistent with what you were planning before.

Frank Svoboda - Torchmark - CFO

Generally consistent, but I think looking realistically that we would probably be at the lower end of that range given our starting point where we ended up in 2016, a little below $50 million, just really due to some timing of some items.

Jimmy Bhullar - JPMorgan - Analyst

Okay, and then have the final numbers in terms of sales proceeds from the Part D block -- do you have the final numbers on what you are expecting to get from the Part D sale?

Frank Svoboda - Torchmark - CFO

The numbers aren't totally finalized until after the end of the first quarter.

Jimmy Bhullar - JPMorgan - Analyst

Okay

Frank Svoboda - Torchmark - CFO

We did receive, you know -- right now we estimate that the proceeds will be around $18 million. But it's subject to a little bit of adjustment still through the first quarter.

Jimmy Bhullar - JPMorgan - Analyst

And then just lastly, how do you think about the impact of the exit on your investment income? I'm assuming at some point down the road it should help your investment income. How do you think about how it affects it this year, next year and the year after?

Frank Svoboda - Torchmark - CFO

Yes, as the exit of the business occurs we will receive the various receivables that we have on the Part D business. We did see a pickup here in 2016, as we collected a significant portion of our CMS receivables here in 2016. As of the end of 2016 we still have around $100 million of net receivables from that business.

We expect to probably get around $80 million of that in 2017 and that will be fairly pro rata over the course of the year. And then it looks like there will be a little bit of a tail on the final $20 million or so that we don't anticipate to receive from CMS until probably the end of 2018. Just -- there’s some review processes that take a couple of years since we've exited the business.

Jimmy Bhullar - JPMorgan - Analyst

So more normal number -- it will take till 2019 to get to sort of a more normal number on investment income and no lag effect from this?

Frank Svoboda - Torchmark - CFO

Ultimately, yes. There is a little bit of that drag that we're going to see here in 2017. Probably around the $2 million to $3 million range of a net drag, but then ultimately it will be cleaned up, for the most part, by the end of next year, into 2019.

Gary Coleman - Torchmark - Co-CEO

But Jimmy, that is a comparison of -- the drag in 2016 was $9 million, so we are going from $9 million to $2 million to $3 million of drag.

Jimmy Bhullar - JPMorgan - Analyst

Got you, thank you.

Bob Glasspiegel - Janney Montgomery Scott - Analyst

Good morning Torchmark, Direct Response margins were sort of flat sequentially, but you're guiding sort of to a further decline from the Q4 run rate into 2017. Have we turned the corner there or is there still a little bit of marginal deterioration?

Frank Svoboda - Torchmark - CFO

Yes Bob, I think we do anticipate having a little bit of marginal deterioration in 2017, just as the 2000 through 2014 years related to the RX business, that were primarily due to the RX business that we have talked about in the past, as that really kind of goes through its maturity, if you will, in its higher years and then starts to decline as an overall percentage of our premium.

Looking past 2017, we really see it stabilizing for the most part in that -- maybe that 14% to 15% range, so there might be just a slight deterioration past 2017. But at this point in time, it is really difficult to determine exactly -- until we see what impact the changes that we have made at the end of 2016 and on our 2017 sales will ultimately have.

Bob Glasspiegel - Janney Montgomery Scott - Analyst

Okay, thank you. And one quick follow-up on the guidance on new money rates for 2017 of 4.8%. How does that compare to what you're getting today? Do we need a further increase in rates to get there?

Gary Coleman - Torchmark - Co-CEO

No. As I mentioned, we invested at 4.58% in the fourth quarter. So far this quarter we are a little bit above where we thought we would be. We're in the high 4.80% range. What we contemplated is that first quarter would be around 4.70% and then it would ratchet up toward the end of the year, it would be just a little under 5%. When you average all that out, you get to the 4.80%. We are a little ahead of the game through the first part of the first quarter and, of course, we hope that continues.

Bob Glasspiegel - Janney Montgomery Scott - Analyst

Okay. You said you are getting above 4.8% now? I missed --

Gary Coleman - Torchmark - Co-CEO

Yes, a little above 4.80% right now.

Bob Glasspiegel - Janney Montgomery Scott - Analyst

Okay appreciate it. Thank you.

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

Hi, thanks for taking the question. If I look at amortized costs of your invested assets -- I'm thinking about the excess investment income calculation, and we ended 2016 with about $14.2 billion. I know there's a bunch of different cash flows. How much do you think that should grow? Should we be thinking about that growing in that 2% to 3% range annually or do we get a bump up with some of the proceeds?

Gary Coleman - Torchmark - Co-CEO

Okay, John, you are talking about the growth in the fixed maturity assets?

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

The $14.2 billion of invested assets in your excess investment income calc.

Gary Coleman - Torchmark - Co-CEO

Yes. I think you can -- we are looking at growth of 4% to 5% in the next two to three years.

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

Okay, each year?

Gary Coleman - Torchmark - Co-CEO

Yes, each year, right.

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

Okay, that is helpful. And then I have a -- I guess it is a more of a hypothetical question.

And I understand your guidance does not contemplate any changes in statutory tax rates. You know that seems sensible. Even if something happens it does not feel like it's going to happen that soon.

But hypothetically, if domestic tax rates, corporate tax rates fell from 35% to, I don't know, pick a number, 20% or 25% or even lower, do you expect to be able to capture all of that to the bottom line or would you expect to sort of price new product sales differently, perhaps generate a faster pace of sales growth, and still target a similar after-tax ROE just recognizing that your profit margin -- a greater proportion of your profit margin might come from a lower tax rate? Do you understand -- I don't know if I'm phrasing that very well.

Frank Svoboda - Torchmark - CFO

Yes I think, John, I understand, I believe what your question is. It's really hard to say with respect to the impact that the sales might have. And to be honest, we really haven't spent any time really thinking about how we might adjust the pricing at all with respect to changing the tax rates.

We would clearly see -- let's just say if tax rates were to decrease to 25%, we would expect there to be a decrease in the cash taxes we pay, but at this point in time, we really don't know what changes they might make to the tax base to eat into that to some degree.

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

Understood.

Frank Svoboda - Torchmark - CFO

While we would -- we should end up having a benefit on the GAAP side, clearly, on the statutory side it is a little bit more difficult to see exactly how that might materialize and how that might impact future cash flows, if you will.

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

Okay. It's more of a, I guess a bit of a philosophical question, right? Because you know I suppose at the end of the day, lower corporate tax rates is intended to help the consumer and grow the economy faster, and so in that respect, I guess I'm wondering if you would target a higher ROE recognizing a lower tax rate or if you would just look to pass along savings in the form of a lower premium rate to customers?

Gary Coleman - Torchmark - Co-CEO

Well John in our businesses -- Direct Response would be an area we would consider that more than others because their more price competitive there. In our agency operations it's not that price competitive, so I think we would be careful about what we did to those premiums.

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

Okay, understood. Alright I will take it offline with you. Thank you.

Operator

Gentlemen, we have no further questions at this time. I will turn it back to you for any additional or closing remarks.

Mike Majors - Torchmark - VP of IR

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