Globe Life

Fourth Quarter 2019 Conference call

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PRESENTATION

Michael C. Majors - Globe Life Inc. - EVP of Administration & IR

Thank you. Good morning everyone. Joining the call today are Gary Coleman and Larry Hutchison, our Co-Chief Executive Officers, Frank Svoboda, our Chief Financial Officer, and Brian Mitchell, our General Counsel.

Some of our comments or answers to your questions may contain forward-looking statements that are provided for general guidance purposes only. Accordingly, please refer to our 2018 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 L. Coleman - Globe Life Inc. - Co-Chairman & CEO

Thank you Mike, and good morning everyone. In the fourth quarter, net income was $187 million or $1.69 per share compared to $165 million or $1.45 per share a year ago. Net operating income for the quarter was $188 million or $1.70 per share, a per share increase of 9% from a year ago.

On a GAAP reported basis, return on equity for the year was 11.6% and book value per share was $66.02. Excluding unrealized gains and losses on fixed maturities, return on equity was 14.5% and book value per share grew 9% to $48.26.

In our life insurance operations, premium revenue increased 5% to $631 million and life underwriting margin was $177 million, up 6% from a year ago. In 2020, we expect life underwriting income to grow around 4% to 5%. On the health side, premium revenue grew 7% to $275 million and health underwriting margin was up 5% to $61 million. Growth in premium exceeded underwriting margin growth, primarily due to lower margins at Liberty National. In 2020, we expect health underwriting income to grow around 4% to 6%.

Administrative expenses were $61 million for the quarter, up 7% from a year ago. As a percentage of premium, administrative expenses were 6.7%, the same as a year ago. For the full year, administrative expenses were $240 million or 6.7% of premium compared to 6.5% in 2018. In 2020, we expect administrative expenses to grow approximately 6% and to be around 6.7% of premium.

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

Larry M. Hutchison - Globe Life Inc. - Co-Chairman & CEO

Thank you Gary. I am going to go through the fourth quarter results at each of our distribution channels. I'll start out by saying that I'm pleased with the sales growth in our agencies in 2019. I'm particularly pleased with the agent count growth and middle management increase we have seen across all of our exclusive agencies in 2019.

At American Income, life premiums were up 8% to $297 million and life underwriting margin was up 9% to $98 million. Net life sales were $59 million, up 9%. The average producing count for the fourth quarter was 7,631, up 10% from the year-ago quarter and up 1% from the third quarter. The producing agent count at the end of the fourth quarter was 7,551. Net life sales for the full year 2019 grew

6%. The sales increase was driven by increases in agent count.

At Liberty National, life premiums were up 3% to $72 million and underwriting margin was up 4% to $18 million. Net life sales increased 13% to $15 million and net health sales were $7 million, up 12% from the year-ago quarter. The average producing agent count for the fourth quarter was 2,534, up 17% from the year-ago quarter and up 6% from the third quarter.

The producing agent count at Liberty National ended the quarter at 2,660. Net life sales for the full year 2019 grew 9%. Net health sales for the full year 2019 grew 11%. The sales increase was driven by increases in agent count.

To better describe our non-agency business at Globe Life And Accident Insurance Company, we have begun replacing the term direct response with direct to consumer. In our direct to consumer division at Globe Life, life premiums were up 4% to $209 million and life underwriting margin was flat at $39 million.

Net life sales were $30 million, up 2% from the year-ago quarter. For the full year 2019, net life sales were flat, due primarily to a decrease in juvenile mailing volume resulting from a decline in the response rates from our juvenile mailing offers.

At Family Heritage, health premiums increased 8% to $76 million and health underwriting margin increased 7% to $19 million. Net health sales were up 19% to $18 million due to an increase in both agent productivity and agent count.

The average producing agent count for the fourth quarter was 1,228, up 9% from the year-ago quarter and up 8% from the third quarter. The producing agent count at the end of the quarter was 1,286. Net health sales for the full year 2019 grew 9%. The sales increase was primarily driven by an increase in agent count.

At United American General Agency, health premiums increased 11% to $108 million, while margins increased 12% to $15 million. Net health sales were $32 million, up 7% compared to the year-ago quarter.

To complete my discussion of marketing operations, I'll now provide some projections. We expect the producing agent count for each agency at the end of 2020 to be in the following ranges: American Income, 5% to 7% growth; Liberty National, 5% to 13% growth; Family Heritage, 2% to 7% growth. Net life sales for the full year 2020 are expected to be as follows: American Income, 5% to 9% growth; Liberty National, 8% to 12% growth; direct-to-consumer, down 2% to up 2%. Net health sales for the full year 2020 are expected to be as follows: Liberty National, 9% to 13%; Family Heritage, 8% to 12%; United American individual Medicare Supplement, relatively flat.

I will now turn the call back to Gary.

Gary L. Coleman - Globe Life Inc. - Co-Chairman & CEO

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

First, excess investment income

Excess investment income, which we define as net investment income less required interest on net policy obligations and debt, was $63 million, a 1% increase over the year-ago quarter.

On a per share basis, reflecting the impact of our share repurchase program, excess investment income increased 6%. For the year, excess investment income grew 5%, while on a per share basis, it grew 8%. In 2020, due to the impact of lower interest rates, we expect excess investment income to decline by 2% to 3%, but on a per share basis, be flat to up 1%.

Now regarding the investment portfolio

Invested assets are $17.3 billion, including $16.4 billion of fixed maturities at amortized cost. Of the fixed maturities, $15.7 billion are investment grade with an average rating of A-, and below investment grade bonds are $674 million compared to $666 million a year ago. The percentage of below investment grade bonds to fixed maturities is 4.1%, compared to 4.2% a year ago. Overall, the total portfolio is rated A- compared to BBB+ a year ago.

Bonds rated BBB are 55% of the fixed maturity portfolio, down from 58% at the end of 2018. While this ratio is in line with the overall bond market, it is high relative to our peers. However, we have less exposure than our peers to higher risk assets such as derivatives, equities, commercial mortgages and asset-backed securities. We believe that the BBB securities that we acquire provide the best risk-adjusted, capital-adjusted returns due in large part to our unique ability to hold securities to maturity regardless of fluctuations in interest rates or equity markets.

Finally, we had net unrealized gains in the fixed maturity portfolio of $2.5 billion, $97 million lower than the previous quarter.

Now as to investment yield.

In the fourth quarter, we invested $449 million in investment grade fixed maturities primarily in the municipal, industrial and financial sectors.

We invested at an average yield of 4.11%, an average rating of A+ and an average life of 31 years. For the entire portfolio, the fourth quarter yield was 5.41%, down 15 basis points from the yield of fourth quarter 2018. As of December 31, the portfolio yield was approximately 5.41%.

For 2020, at the midpoint of our guidance, we assumed an average new money yield of 4.10% for the full year. While we would like to see higher interest rates going forward, Globe Life can thrive in a lower for longer interest rate environment. Extended low interest rates will not impact the GAAP or statutory balance sheets under the current accounting rules since we sell non-interest sensitive protection products.

While our net investment income and to a lesser extent, our pension expense, will be impacted in a continuing low interest rate environment, our excess investment income will still grow. It just won't grow at the same rate as the invested assets. Fortunately, the impact of lower new money rates on our investment income is somewhat limited as we expect to have average turnover of less than 2% per year in our investment portfolio over the next 5 years.

Now I will turn the call over to Frank.

Frank M. Svoboda - Globe Life Inc. - Executive VP & CFO

Thanks, Gary. First, I want to spend a few minutes discussing our share repurchases and capital position. The Parent began the year with liquid assets of $41 million. In addition to these liquid assets, the Parent generated excess cash flow in 2019 of $374 million as compared to $349 million in 2018. The Parent Company's excess cash flow, as we define it, results primarily from the dividends received by the Parent from its subsidiaries less the interest paid on debt and the dividends paid to Globe Life shareholders. Thus, including the assets on hand at the beginning of the year, we had $415 million available to the Parent during the year.

As discussed on our prior calls, we accelerated the repurchase of $25 million of Globe Life shares into December of 2018 with commercial paper and Parent cash. We utilized $20 million of the 2019 excess cash flow to reduce the commercial paper for those repurchases. That left $395 million available for other uses, including the $50 million of liquid assets we normally retain at the Parent.

In the fourth quarter, we spent $93 million to buy 930,000 Globe Life shares at an average price of $99.82. For the full year 2019, we spent $350 million of Parent Company cash to acquire 3.9 million shares at an average price of $89.04. So far in 2020, we have spent $33.5 million to buy 322,000 shares at an average price of $104.20.

The Parent ended the year with liquid assets of approximately $45 million. In addition to these liquid assets, the Parent will generate excess cash flow in 2020. While our 2019 statutory earnings have not yet been finalized, we expect excess cash flow in 2020 to be in the range of $375 million to $395 million. Thus, including the assets on hand at January 1, we currently expect to have around $420 million to $440 million of cash and liquid assets available to the Parent in 2020.

As noted on previous calls, we will use our cash as efficiently as possible. It should be noted that the cash received by the Parent Company from our insurance operations is after they have made substantial investments during the year to issue new insurance policies, expand our information technology and other operational capabilities and acquire new long-duration assets to fund future cash needs.

With the Parent Company excess cash flows, if market conditions are favorable and absent alternatives with higher value to our shareholders, we expect that share repurchases will continue to be a primary use of those funds. We believe it yields a return that is better than other available alternatives and provides a return that exceeds our cost of equity.

Now regarding capital levels at our insurance subsidiaries

Our goal is to maintain capital at levels necessary to support our current rating. As noted on previous calls, Globe Life has targeted a consolidated Company Action Level RBC ratio in the range of 300% to 320% for 2019.

Although we have not finalized our 2019 statutory financial statements, we anticipate that our consolidated RBC ratio for 2019 will be toward the higher end of this range. For 2020, we will continue to target a consolidated

Company Action Level RBC ratio in the range of 300% to 320%.

Finally, with respect to our earnings guidance

As Gary previously noted, net operating income per share for the fourth quarter of 2019 was $1.70. In addition, net operating income per share for the full year 2019 was $6.75. This was $0.01 above the midpoint of our previous guidance primarily due to greater than anticipated life underwriting income at Liberty National and higher excess investment income.

For 2020, we are projecting that net operating income per share will be in the range of $7.03 to $7.23. The $7.13 midpoint of this guidance is slightly lower than previous guidance due to higher than expected employee pension and health care costs in 2020.

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

Larry M. Hutchison - Globe Life Inc. - Co-Chairman & CEO

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

QUESTIONS AND ANSWERS

Andrew Scott Kligerman - Credit Suisse AG, Research Division - MD & Senior Life Insurance Analyst

Hey good morning. Just sticking with that guidance -- EPS guidance question. So the new midpoint of your guidance is a mere $0.02 lower than previous. And I think you have just cited that it is the lower discount rate. I just want to make sure, could you give us a sense of how many cents per share that impacted your outlook? And if there were any other contributors to the revised guidance and how much?

Frank M. Svoboda - Globe Life Inc. - Executive VP & CFO

Sure. Yes. The -- as I noted in the comments, really, the kind of the primary reduction -- primary causes for the reduction in the midpoint was kind of higher employee costs in general, including our pension and health insurance costs. The combination of those is that -- right at that $0.02 per share. We also -- there are some offsetting items that are impacting the overall guidance.

As we look at the lower interest rates, we did have a little bit lower excess investment income expectations from what our previous guidance was, but a lot of that was also -- was due to some higher than previously anticipated acquisition of municipal investments. So while that is driving down our excess investment income, we are also seeing a little lower effective tax rate because of that. Those largely offset each other.

In addition, the higher share price had some impact. We are having -- getting less of an impact of our overall buyback program, but we are also seeing higher excess tax benefits, which impact the stock option expense -- stock compensation expense. And again, those are roughly offsetting each other. So kind of net-net. We really look to the kind of a higher pension expense and, to some degree, our higher health insurance cost for our employees as being the primary contributors.

Andrew Scott Kligerman - Credit Suisse AG, Research Division - MD & Senior Life Insurance Analyst

Got it. A lot of moving pieces there. Looking at the line items for both the life and health segments, we noticed that the non-deferred commissions and amortization line and the non-deferred acquisition expense line were both up materially in each segment. I guess if I would average it out for both, it was like 10% in life and maybe north of -- maybe closer to, yes, 10-plus percent in health as well.

So the question is, what is driving that number up so much that kind of dampened the EPS versus what we would have expected?

Frank M. Svoboda - Globe Life Inc. - Executive VP & CFO

Yes, we did see some higher growth in the non-deferred acquisition costs during quarter-over-quarter. Some of that is due to some timing of certain expenses and where they kind of hit in the year. But in general, they are up -- we are incurring higher cost in support of our various agencies. I mean there are higher marketing costs that we incur, some of our various meeting costs increased a little bit in 2019 over 2018. And then we also saw some of the branding changes.

So as we are going through and as you may have noticed in some of the materials, we are in the process of converting all of our agencies from the individual agencies to divisions of Globe Life. And so there is a fair amount of expenses that we have incurred in the fourth quarter just associated with changing the overall brands of those particular agencies and helping the individual agencies make that conversion as well. So we do anticipate the benefits of that really in the future.

But then really a key driver of the higher percentage increase are really some of the IT costs we have incurred year-over-year. We have implemented some new CRM systems at a couple of the agencies as well as new commission systems and just other agency support systems that we are starting to see the depreciation on those begin in 2019. And then overall, just trying to improve the overall agent experience and their -- and the service levels to the agencies.

We really think -- I was going to say, in 2020, we really see it leveling out. It should -- it will -- we do not expect it to increase at the midpoint of our guidance at near that level. It will be a lot closer to the overall 6% or 7% increase.

Andrew Scott Kligerman - Credit Suisse AG, Research Division - MD & Senior Life Insurance Analyst

Got it, that is helpful. And then just lastly, your agent count just increased so robustly. And as I look at your sales guidance, which is very compelling across both segments, I wonder, one, was it the rebranding that kind of got that growth? And two, maybe you could even exceed the guidance in sales that you just provided on the call for 2020.

Larry M. Hutchison - Globe Life Inc. - Co-Chairman & CEO

Let's just talk about the agency growth first. I think the two drivers for agency growth in 2019, recruiting activity and our middle management growth. If you look across the 3 agencies: American Income had an 11% increase -- recruiting in 2019; Liberty National had a 38% increase in recruiting. We had steady retention at both agencies.

Part of the steady retention is a result of the middle management growth, American Income had 9% middle management growth in 2020; Liberty National had 17% middle management growth. I think those are the primary factors.

Branding helps with the recruiting, but it was year-long recruiting activity that really increased the agent count. At Family Heritage, we had 2% year-over-year recruiting growth, where we doubled our retention at Family Heritage. That was driven by a 23% increase in middle management.
As you know, middle management really drives our recruiting and our training, so that also helps retention and agency growth.

I think -- the guidance we have given this year is good guidance. Just remember that agency growth is a stair step process, and you do not expect the same percentage growth every year. It is possible we could exceed that, but we are early in 2020. In our next call, we will have better guidance in terms of the final agent count for each of the 3 exclusive agencies.

Andrew Scott Kligerman - Credit Suisse AG, Research Division - MD & Senior Life Insurance Analyst

Thank you so much.

Jamminder Singh Bhullar - JP Morgan Chase & Co, Research Division - Senior Analyst

I had a question just on recruiting. I would have thought that with the strong labor market, the recruiting trends would not have been as good as they have been. So if you could just...

Larry M. Hutchison - Globe Life Inc. - Co-Chairman & CEO

Jimmy, I will take this comment, unemployment really affects retention not recruiting. Most of our recruits are not people that are unemployed, but people looking for greater opportunity. And so we really saw an increase in recruiting despite the record low unemployment this year.

I think the growth in middle management helped with retention because most of the training comes from middle managers. And as agents are better trained, they are more productive and they stay with the company longer. So I think that was a real driver for the steady retention we saw at American Income and Liberty National and, of course, the increase in retention we saw at Family Heritage.

Jamminder Singh Bhullar - JP Morgan Chase & Co, Research Division - Senior Analyst

And any comments you have or any sort of metrics that you could share on the quality of the new recruits? And so -- just so we can get an idea on how sales would follow -- sales would track given the strong growth in the agent count recently.

Larry M. Hutchison - Globe Life Inc. - Co-Chairman & CEO

Jimmy, I think with new recruits, you always see a little less productivity. They are just not quite as productive in terms of the percentage of business submitted. The average premium is more with a veteran agent. But the fact that we had sales growth in all 3 of the agencies tells me that we have a fairly high-quality recruit across the 3 agencies.

Jamminder Singh Bhullar - JP Morgan Chase & Co, Research Division - Senior Analyst

And just lastly, on direct response. Your sales over the last couple of quarters have been up slightly, they are down a lot from where they used to be. Do you think that the channel sort of turned the corner? And what is your expectation in terms of how much growth you have in this business in the next 2 to 3 years?

Larry M. Hutchison - Globe Life Inc. - Co-Chairman & CEO

In the fourth quarter, the better-than-expected sales were due to the strong electronic sales across both adult and juvenile product lines. If we look at the guidance for 2020, I guess we are fairly early -- there are 4 primary drivers in direct response. And if I look at 2020, with those 4 metrics versus 2019, we think insert media will be up about 2%; we expect electronic media to be up about 5%; our circulation to be up about 2%; and our mail volume will be stable. So I think the range of negative 2% to positive 2% of sales is really good guidance at this point. Let's remember, our focus is really not on increasing sales, it is increasing total profit dollars.

Jamminder Singh Bhullar - JP Morgan Chase & Co, Research Division - Senior Analyst

Thank you.

Ian James Ryave - BofA Merrill Lynch, Research Division - Research Analyst

Hi, thanks for taking my question. Just wanted to ask on the health margin. So while margin -- the underwriting income increased nicely year-over-year, the margin percentage was a little down. Just wanted to know if you are seeing any changes in utilization for Medicare Supp products? Or if there is anything you see on the horizon?

Gary L. Coleman - Globe Life Inc. - Co-Chairman & CEO

Well, I think, maybe the -- one of the most -- bigger contributing factors is that in the Med Supp business, we saw an increase in claims during the year, and that is something that was industry-wide. The policy obligations percentage for the GA business, which is where we have the Medicare Supplement, was a little over 65%. That is high compared to the previous years. But that -- we will be implementing rate increases in 2020 and going forward. And we will not only slow the increase in the policy obligations but, hopefully, bring it back closer to the 65%.

Ian James Ryave - BofA Merrill Lynch, Research Division - Research Analyst

Great. And then just to clarify on the excess investment income. I think you guys said it was going to grow 2% to 3%. Just wanted to clarify what your expectations are for excess investment income growth next year?

Gary L. Coleman - Globe Life Inc. - Co-Chairman & CEO

Well, for next -- for 2020, we are thinking in dollars, excess investment income will be down 1% to 3%. On a per share basis, it will be flat to 1%. What the issue is, there is -- the investment income will be a decline of 1% to 2%.

Ian James Ryave - BofA Merrill Lynch, Research Division - Research Analyst

And that is just based on the roll-off of higher yielding? Or is it just a lower new money yield that you are expecting to get?

Gary L. Coleman - Globe Life Inc. - Co-Chairman & CEO

Excuse me, I said a decline of 1% to 2%. Investment income is going to grow 1% to 2%, whereas invested assets are going to grow 4%. And the reason we are having that lower growth investment income is because the impact of lower rates. It is the new money rate that we -- this year – in 2020, we are saying 4.10%. That is down almost 50 basis points from what we did in 2019. So that is -- as far as the other components of excess investment income, they are about what we expected and what we had in 2019.

Ian James Ryave - BofA Merrill Lynch, Research Division - Research Analyst

Okay great

Frank M. Svoboda - Globe Life Inc. - Executive VP & CFO

And the only thing I would just add to that is, clearly, the volume of the calls that we did have in 2019 and that we do anticipate some additional calls in the first part of 2020. So as those roll off the books and get reinvested at a lower rate, that is also having a dampening effect, given the low new money rate.

Gary L. Coleman - Globe Life Inc. - Co-Chairman & CEO

Yes. I am glad Frank mentioned that. I mentioned in the opening comments that, going forward, we would expect that only about 2% of the portfolio coming off. That was 6% in 2019, it is going to be around 3% in 2020, and it will be 1% per year going forward for a while.

And Frank mentioned the calls, we had -- 10 years ago, we bought Build America Bonds. Those are now callable. And so we had $550 million of calls in 2019. We are expecting another $300 million of those will be called in 2020. And then after that, there will be very little calls.

So I agree with Frank, the call activity in 2019 to 2020 has had a big impact on investment income growth.

Ian James Ryave - BofA Merrill Lynch, Research Division - Research Analyst

Great appreciate the details.

Taylor Alexander Scott - Goldman Sachs Group Inc., Research Division - Equity Analyst

Hi, I just had a question around, I guess, reinsurance costs, where you do have reinsurance? A lot of your peers have talked about increased costs there, I think, probably a little more geared towards interest-sensitive blocks. I was just wondering if you have seen any of that. And if there is anything we should consider around principal-based reserving kind of going fully into effect at the beginning of 2020?

Gary L. Coleman - Globe Life Inc. - Co-Chairman & CEO

Well, first, I will mention, I think Frank will cover the principal-based reserves. As far as reinsurance costs, we do very, very little reinsurance. And so that will -- it really has no impact on us. Remember, the face amount – on the policies we sell are in the -- from the $20,000 to $30,000, $40,000 range, so we just do not do reinsurance. Frank?

Frank M. Svoboda - Globe Life Inc. - Executive VP & CFO

Yes. With respect to the principal-based reserves, we are pretty much -- have pretty much implemented that for all of our companies. We have got a couple of our smaller companies that we are implementing that for the new business here in 2020, we really do not anticipate a real meaningful impact one way or the other. We are finding, net-net, probably slightly favorable for us versus reserving methodologies pre PBR for those lines. But PBR primarily focuses on aggressive term and a bunch of the UL policies as secondary guarantees, and we just do not write those businesses – write those lines. So it does not have a significant impact, overall, on us.

Taylor Alexander Scott - Goldman Sachs Group Inc., Research Division - Equity Analyst

Got it. Okay. And then just in terms of the $375 million to $395 million excess cash flow you mentioned. Could you talk about just priorities there? I know you said share buybacks would probably continue to be the primary method. I know you guys have looked at acquisitions in the past. I mean is that something you guys are still entertaining?

Frank M. Svoboda - Globe Life Inc. - Executive VP & CFO

Yes. Yes, absolutely. So we do take -- we spread that -- those buybacks out -- intend to spread about ratably over the course of the year. So it gives us the flexibility to redirect those later in the year or throughout the year.

If we find other alternatives that provide a greater return to the shareholders, one of those is clearly M&A. We are interested in M&A. We are very focused on wanting to target an organization that would be strategically accretive to us, that is -- helps us to write protection-oriented products to the middle market and that has a controlled distribution. And so we continue to look for opportunities, and we will continue to do so.
And if we come across a good opportunity during the year then, clearly, that would be -- we would clearly look at redirecting some of that free cash flow into that type of an opportunity.

Taylor Alexander Scott - Goldman Sachs Group Inc., Research Division - Equity Analyst

Got it, thank you.

Operator

And at this time, we have no further questions in queue.

Michael C. Majors - Globe Life Inc. - EVP of Administration & IR

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