Torchmark Corporation

First Quarter 2019 Conference Call

April 18, 2019 10:00 a.m. CDT

CORPORATEPARTICIPANTS

Gary L. Coleman Torchmark Corporation - Co-Chairman & CEO

Larry M. Hutchison Torchmark Corporation - Co-Chairman & CEO

Frank M. Svoboda Torchmark Corporation - Executive VP & CFO

Michael C. Majors Torchmark Corporation - EVP of Administration & IR

Brian Mitchell Torchmark Corporation – Executive VP, General Counsel and Chief Risk Officer

CONFERENCECALLPARTICIPANTS

Erik James Bass Autonomous Research LLP - Partner of US Life Insurance

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

John Matthew Nadel UBS Investment Bank, Research Division - Analyst

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

PRESENTATION

Michael C. Majors - Torchmark Corporation - 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 on file with the SEC. Some of our comments may also contain non-GAAP measures. Please see our earnings release and website for a discussion of these terms and reconciliations to GAAP measures.

I will now turn the call over to Gary Coleman.

Gary L. Coleman - Torchmark Corporation - Co-Chairman & CEO

Thank you Mike and good morning everyone. In the first quarter, net income was $185 million or $1.65 per share compared to $174 million or $1.49 per share a year ago. Net operating income for the quarter was $185 million or $1.64 per share, a per share increase of 12% from a year ago.

On a GAAP reported basis, return on equity as of March 31 was 12.9% and book value per share was $54.13. Excluding unrealized gains and losses on fixed maturities, return on equity was 14.7% and book value per share grew 11% to $45.45.

In our life insurance operations, premium revenue increased 4% to $624 million, and life underwriting margin was $170 million, up 10% from a year ago. Growth in underwriting margin exceeded premium growth due to higher margins in all distribution channels. For the year, we expect life underwriting income to grow around 4% to 6%.

On the health side, premium revenue increased 6% to $267 million, and health underwriting margin also grew 6% to $62 million. For the year, we expect health underwriting income to grow around 3% to 5%.

Administrative expenses were $59 million for the quarter, up 7% from a year ago and in line with our expectations. As a percentage of premium, administrative expenses were 6.6% compared to 6.5% a year ago. For the year, we expect administrative expenses to grow approximately 5% to 6% and be around 6.6% of premium.

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

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

Thank you Gary. At American Income, life premiums were up 7% to $282 million and life underwriting margin was up 10% to $93 million. Net life sales were $58 million, up 4%. The average producing agent count for the first quarter was 6,865, up 1% from the year-ago quarter, but down 1% from the fourth quarter. However, the producing agent count at the end of the first quarter was 7,233.

At Liberty National, life premiums were up 2% to $71 million, while life underwriting margin was up 10% to $18 million. Net life sales increased 8% to $12 million, and net health sales were $6 million, up 12% from the year-ago quarter.

The sales growth was driven by increases in both agent count and productivity. The average producing agent count for the first quarter was 2,179, up 4% from the year-ago quarter, but approximately the same as the fourth quarter. The producing agent count at Liberty National ended the quarter at 2,297.

In our direct response operation at Globe Life, life premiums were up 3% to $218 million and life underwriting margin increased 11% to $37 million. Net life sales were $32 million, up 1% from the year-ago quarter. In recent years, we have focused primarily on maximizing profit dollars while adjusting our marketing efforts to stabilize margins. As we go forward, we expect to grow both sales and profits.

At Family Heritage, health premiums increased 8% to $71 million and health underwriting margin increased 14% to $18 million. Net health sales were down 3% to $13 million. The average producing agent count for the first quarter was 1,002, up 1% from the year-ago quarter, but down 11% from the fourth quarter. The producing agent count at the end of the quarter was 1,020.

At United American General Agency, health premiums increased 9% to $103 million. Net health sales were $15 million, up 5% compared to the year-ago quarter.

To complete my discussion on the marketing operations I will now provide some projections. Approximate net life sales for the full year 2019 are expected to be as follows: American Income, 5% to 9% growth; Liberty National, 7% to 11% growth; direct response, flat to 2% growth. Approximate net health sales for the full year 2019 are expected to be as follows: Liberty National, 6% to 10% growth; Family Heritage, 2% to 6% growth; United American Individual Medicare Supplement, 4% to 8% growth.

I will now turn the call back to Gary.

Gary L. Coleman - Torchmark Corporation - 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 liabilities and debt, was $66 million, a 6% increase over the year-ago quarter. On a per share basis, reflecting the impact of our share repurchase program, excess investment income increased 9%. For the full year, we expect excess investment income to grow by about 5%, which would result in a per-share increase of around 9%.

Regarding the investment portfolio

Invested assets were $16.9 billion, including $16 billion of fixed maturities at amortized cost. Of the fixed maturities, $15.3 billion are investment grade with an average rating of A-, and below investment grade bonds were $671 million compared to $688 million a year ago. The percentage of below investment grade bonds to fixed maturities is 4.2% compared to 4.5% a year ago. Overall, the total portfolio is rated BBB+, same as a year ago.

Bonds rated BBB are 57% of the fixed maturity portfolio, which is high relative to our peers. However, we have no exposure to higher risk assets such as derivatives or equities and little exposure to commercial mortgages and asset backed securities.

Finally, we have net unrealized gains in the fixed maturity portfolio of $1.2 billion, $691 million higher than the previous quarter due primarily to changes in market interest rates.

As to investment yield

In the first quarter, we invested $451 million in investment grade fixed maturities, primarily in the municipal and financial sectors. We invested at an average yield of 4.88%, an average rating of A+, and an average life of 28 years.

For the entire portfolio, the first quarter yield was 5.53%, down 5 basis points from the 5.58% yield in the first quarter of 2018. As of March 31, the portfolio yield was approximately 5.51%. For 2019, the average new money yield assumed at the midpoint of our guidance is 4.90% for the full year.

While we would like to see higher interest rates going forward, Torchmark can thrive in a lower for longer interest rate environment. A continued low interest rate environment will impact our income statement, but not the GAAP or statutory balance sheets, since we primarily sell non-interest sensitive protection products accounted for under FAS 60. While we would benefit from higher interest rates, Torchmark will continue to earn substantial excess investment income in an extended low interest rate environment.

Now I will turn the call over to Frank.

Frank M. Svoboda - Torchmark Corporation - Executive VP & CFO

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

The Parent ended the year with liquid assets of $41 million. In addition to these liquid assets, the Parent will generate excess cash flow in 2019. 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 Torchmark’s shareholders. We anticipate our excess cash flow in 2019 will be in the range of $365 million to $375 million. Thus, including the assets on hand at the beginning of the year, we currently expect to have around $405 million to $415 million available to the Parent during the year.

As discussed on the prior call, we accelerated $25 million of 2019 repurchases of Torchmark stock into December 2018 with commercial paper and Parent cash. We plan to utilize $15 million of the 2019 excess cash flow to reduce the commercial paper for those repurchases. As such, we expect to have approximately $390 million to $400 million to be available to the Parent for other uses, including the $50 million of liquid assets we normally retain at the Parent.

In the first quarter, we spent $89 million to buy 1.1 million Torchmark shares at an average price of $81.32. So far in April, we have spent $11 million to purchase 131,000 shares at an average price of $84.61. Thus, for the full year through today, we have spent $100 million of Parent Company cash to acquire more than a million shares at an average price of $81.68.

Excluding the $100 million spent on repurchases so far this year and the $50 million we plan on retaining at the Parent, we will have approximately $240 million to $250 million of excess cash flows available to the Parent for the remainder of the year.

As noted on previous calls, we will use our cash as efficiently as possible. If market conditions are favorable and absent alternatives with higher value to our shareholders, we expect that share repurchases will continue to be a primary use of those funds.

Now regarding capital levels at our insurance subsidiaries

Our goal is to maintain capital at levels necessary to support our current ratings. As discussed on our previous call, Torchmark intends to target a consolidated company action level RBC ratio in the range of 300% to 320%. At December 31, 2018, our consolidated RBC ratio was 326%, slightly greater than the high point of our range. The increased RBC ratio was primarily attributable to slightly lower required capital and higher statutory earnings than anticipated.

At this RBC ratio, we have approximately $129 million of capital at the insurance subsidiary over the amount required at the low end of our consolidated RBC target of 300%. This excess capital, along with the $50 million of assets held at the Parent, provide approximately $179 million that are available to fund possible needs in the insurance companies should they arise.

In addition, due to the fact that deferred tax assets were replaced in 2018 with marketable securities purchased with capital contributions, the quality of our capital has substantially improved.

Finally, with respect to our earnings guidance for 2019

We are projecting that net operating income per share will be in the range of \$6.61 to \$6.75 for the year ended December 31, 2019. The \$6.68 midpoint of this guidance reflects an \$0.08 increase over the prior quarter midpoint of \$6.60, primarily attributable to an improved outlook on our underwriting results due to lower policy obligations than anticipated in the first quarter, largely attributable to our life insurance operations.

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

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

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

Q U E S T I O N S A N D A N S W E R S

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

Hi good morning, so I had a few questions. First, on your EPS guidance, the midpoint going up by \$0.08. How much of that is just the fact that you had good results in 1Q versus maybe a more optimistic view of the rest of the year as well?

Frank M. Svoboda - Torchmark Corporation - Executive VP & CFO

Jimmy, I think most of the increase is due to the better than expected first quarter. If you look at the second quarters through fourth quarters, I think what we anticipate is largely going to be in line with what we have seen there last year. So I think there may be some -- a little slight improvement in a couple of those lines, but I think the vast majority of it is really the lower claims and the better than expected results we had in the first quarter.

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

Okay. And then in direct response, you have had 2 quarters now where sales have been positive, pretty modest but positive. And I think you are expecting a flat to 2% increase. I would have thought that with the expected increases in circulation volumes, you would actually see a little bit of -- more of a pickup. But maybe you could just give some color on why you are expecting some -- such a modest increase, or are you being conservative in your outlook?

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

Well, I do not think we are being conservative in our outlook. When we look at our inquiries, for 2019, we think insert media inquiries will be down about 2% to 3%, our electronic inquiries will be up about 5%, circulation itself will be up about 2%, and mail volumes will be down about 5%. Given constant response rates, I think the flat to 2% increase is a good prediction for what we think sales will be for the full year 2019.

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

And then just lastly, have you seen any impact on your business from either the Supreme Court ruling on Unions and its effect on American Income or just the strong labor market and it affecting your ability to recruit or retain agents?

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

We have not seen an impact at American Income on lead production, recruiting, or sales as a result of the Supreme Court decision.

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

Okay, thank you.

Erik James Bass - Autonomous Research LLP - Partner of US Life Insurance

Hi thank you. First, to follow up on the agent side, can you talk about any changes in agent retention rates at American Income following the recent changes you made to compensation?

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

The first quarter agent retention has stayed relatively unchanged. We measure 3rd month, 6th month and 13th month retention. However, that retention is historical. When we look at the first quarter, we did see a decrease in terminations, particularly in the second half of the quarter, and so we will have retention, particularly for 3 month retention, at the time of our next earnings call. The reduction in terminations is a good indicator that we think retention will be better as we go through 2019.

Erik James Bass - Autonomous Research LLP - Partner of US Life Insurance

Okay, thank you and then I was hoping, maybe switching gears to the investment portfolio, that you could provide more details on your BBB exposures. And specifically, can you talk about how much is rated BBB- and maybe comment on the sector allocations?

Gary L. Coleman - Torchmark Corporation - Co-Chairman & CEO

Well, as far as the sector allocations, I think they are pretty well spread among all of the sectors that we have. As far as how many are BBB-, out of the total BBBs, less than 20% are BBB-. The other 80-something percent is BBB or BBB+.

Erik James Bass - Autonomous Research LLP - Partner of US Life Insurance

Okay, thank you and that is of the -- 20% of the BBBs, not of the overall portfolio, right?

Gary L. Coleman - Torchmark Corporation - Co-Chairman & CEO

No, not the portfolio, 20% of the BBBs.

Erik James Bass - Autonomous Research LLP - Partner of US Life Insurance

Got it, okay thank you.

John Matthew Nadel - UBS Investment Bank, Research Division - Analyst

Alright, good morning and congrats on the good quarter. I guess 2 questions from me. One is agent count at Family Heritage -- last couple of quarters have declined. I was just wondering if you could just characterize what is happening there. Is that more of a culling of low end performers? Or is that recruiting driven? Just -- and what is your outlook there?

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

John, when we look at Family Heritage, we saw that recruitment activity was particularly slow during the holiday season and the month of January. We did not see recruiting activity really recover at Family Heritage until early February. I think that part of the cause of that, I think we were really focused on production in the third and fourth quarter of last year, and so we saw the recruiting start to drop off in November. We are back to normal recruiting levels now, and I think we will see an increase in the agent count in the second quarter of this year.

John Matthew Nadel - UBS Investment Bank, Research Division - Analyst

And then the second question, this is very hypothetical and I do not know how to think about the probability of some significant change here. But clearly, there has been an awful lot of political posturing recently as it relates to Medicare for all. It has had some impact on, I think, the health care providers. I am just wondering if you laid out a scenario where a Bernie Sanders kind of Medicare for all were to go through, how might you expect that to impact the Medicare Supplement business?

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

John, this is Larry. I think it is really too early to tell. We really have to wait and see how that program will be structured. On one hand, it could be an opportunity if we have Medicare for all and we have a Medicare system where co-pays and deductibles are covered by a medigap-type insurance, that could be an opportunity. On the other hand, if the proposal-- if they eliminate all private insurance, certainly, that will have a negative effect. Let's remember that Medicare is a fairly small part of our operation now. It occurs – it is a fairly small part of our overall earnings.

John Matthew Nadel - UBS Investment Bank, Research Division - Analyst

What proportion of the health segment premiums comes from the Medicare Supplement business?

Gary L. Coleman - Torchmark Corporation - Co-Chairman & CEO

John, lets see -- Frank you have a...

Frank M. Svoboda - Torchmark Corporation - Executive VP & CFO

It is about 50% of our total health -- of our total health premium is Med Supp.

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

It is about $500 million.

Frank M. Svoboda - Torchmark Corporation - Executive VP & CFO

About $500 million.

John Matthew Nadel - UBS Investment Bank, Research Division - Analyst

Okay that is helpful. Thank you so much.

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

Hi good morning, just a question on the admin expenses. They were a little elevated this quarter. It did not look like you guided to significantly higher growth. Was there anything that was sort of one time in nature there, or anything to note on sort of investments in systems, accounting, that sort of thing?

Gary L. Coleman - Torchmark Corporation - Co-Chairman & CEO

No, there was a one time type item that was in our employee benefits area that made the expenses a little bit higher this quarter. As I mentioned, the expenses were up 6.7%, but for the year we are expecting that expenses will be up 5% to 6%. So that was more of an unusual item that occurred in the first quarter, but will not carry forward.

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

Got it, and then just kind of high level, could you talk about sort of the comp structure changes you have made and sort of the impact that you are seeing on recruiting and how much of that is sort of in your go forward guide on sales and sort of the growth in agent counts? Anything you could provide there would be helpful.

Larry M. Hutchison - Torchmark Corporation - Co-Chairman & CEO

I will address that. At American income, the compensation change, we did not increase the total compensation. We restructured the compensation, and so that more of the agent commission is towards the front end to encourage new agents to stay in the business. The other is bonuses that -- for middle managers, that encourage retention of new agents so they are better -- they will spend more time in training and trying to retain those agents. So at a high level, that is the compensation change. At Family Heritage, to address the recruiting, we also have a new bonus for agents, that is based on them meeting recruiting objectives. At Liberty National, the compensation is largely unchanged.

Gary L. Coleman - Torchmark Corporation - Co-Chairman & CEO

But Alex, we have seen some positive results at American Income. I think Larry mentioned it. We have added new agents, but our terminations are down. It is too early to make a definitive conclusion, but the results so far look promising.

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

Okay. And maybe if I could sneak one last one in. Just on the favorable mortality that you experienced during the quarter. Is there anywhere you saw that more concentrated? Was it older age policies, specifically some of the older blocks or anything else that you have kind of gleaned as you looked through those results?

Gary L. Coleman - Torchmark Corporation - Co-Chairman & CEO

No, we did not. It was really throughout the blocks. And we -- not only did we not see a difference, really, among the ages, but also as far as medical reasons and those kinds of things, it was just -- it was really just low across the board for really American Income, Direct Response and Liberty National.

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

Okay, thank you.

Operator

There are no additional questioners at this time.

Michael C. Majors - Torchmark Corporation - EVP of Administration & IR

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