Q2 2022 Globe Life Inc. Earnings Call

JULY 28, 2022 - 11:00 AM CT

Corporate Participants

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

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

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

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

Brian Mitchell- Globe Life Inc. - EVP, General Council

Conference Call Participants

Ryan Joel Krueger - Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research

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

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

Thomas George Gallagher - Evercore ISI Institutional Equities, Research Division - Senior MD

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

John Bakewell Barnidge - Piper Sandler & Co., Research Division - MD & Senior Research Analyst

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 earnings release, 2021 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 second quarter, net income was $177 million or $1.79 per share, compared to $200 million or $1.92 per share a year ago. Net operating income for the quarter was $205 million or $2.07 per share, an increase of 12% from a year ago.

On a GAAP reported basis, return on equity was 9.8% and book value per share is $54.18. Excluding unrealized losses on fixed maturities, return on equity was 12.6% and book value per share is $60.71, up 9% from a year ago.

In life insurance operations, premium revenue increased 4% from the year-ago quarter

to $760 million. Life underwriting margin was $198 million, up 11% from a year ago. The increase in margin is due primarily to increased premium and improved claims experience. For the year, we expect life premium revenue to grow around 5%, and at the midpoint of our guidance we expect underwriting margin to grow around 23%, due primarily to an expected decline in COVID claims for the full year.

In health insurance, premium grew 8% to $319 million and health underwriting margin was up 7% to $80 million. For the year, we expect health premium revenue to grow 6% to 7%, and at the midpoint of our guidance, we expect underwriting margin to grow around 5%.

Administrative expenses were $74 million for the quarter, up 9% from a year ago. As a percentage of premium, administrative expenses were 6.8% compared to 6.6% a year ago. For the full year, we expect administrative expenses to grow around 11% and be around 7% of premium due primarily to higher IT and information security costs, employee costs, an increase in travel and facilities costs and the addition of the Globe Life Benefits Division.

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

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

Thank you Gary. At American Income, life premiums were up 8% for the year-ago quarter to $376 million, and life underwriting margin was up 19% to $128 million. A higher underwriting margin was primarily due to higher premium and improved claims experience.

In the second quarter of 2022, net life sales were $85 million, up 16%. The increase in net life sales was caused by improvement in productivity and new business processing. The average producing agent count for the second quarter was 9,670, down 8% from the year-ago quarter, but up 3% from the first quarter. The producing agent count at the end of the second quarter was 9,637. The decline in average agent count resulted from a challenging recruiting environment. While conditions have been tough, the components necessary for agency growth remain in place. Also in a slowing economy, it becomes easier to recruit and retain new agents. As we have said before, agency growth is a stair-step process. It is best to compare agent counts over several years to evaluate agency growth.

At Liberty National, life premiums were up 5% over the year-ago quarter to $81 million and life underwriting margin was up 12% to $18 million. The increase in underwriting margin is primarily due to higher premium and improved claims experience. Net life sales increased 7% to $19 million. Net health sales were $7 million, up 10% from the year-ago quarter due mainly to increased agent productivity. The worksite business has picked up significantly, as sales were up 11% over the year-ago quarter and 24% over the first quarter of this year. The average producing agent count for the second quarter was 2,713, flat compared to the year-ago quarter, but up 2% compared to the first quarter. The producing agent count at Liberty National ended the quarter at 2,782. We continue to see positive momentum at Liberty National.

At Family Heritage, health premiums increased 7% over the year-ago quarter to $91 million, and health underwriting margin increased 9% to $24 million. The increase in underwriting margin is due to increased premium and improved claims experience. Net health sales were up 1% to $19 million due to agent productivity. The average producing agent count for the second quarter was 1,173, down 4% from the year-ago quarter.

However, the agent count grew 7% from the first quarter to the second quarter. I indicated in our first quarter call that Family Heritage would concentrate on recruiting, and we are seeing results from those efforts. Producing agent count at the end of the quarter was 1,201. The recent sales and recruiting trends at Family Heritage are encouraging.

In our Direct to Consumer Division at Globe Life, life premiums were flat over the year-ago quarter at $249 million, while life underwriting margin declined 16% to $29 million. The decrease in underwriting margin is due to increased policy obligations. Net life sales were $33 million, down 23% from the year-ago quarter, due to lower response rates and lower paid initial premium. As a reminder, Direct to Consumer provides reduced premium introductory offers, and we do not record a sale until the first full premium is received.

While changes in the macro environment have not impacted our marketing activities much in the past, the current environment with record inflation is challenging. Our typical Direct to Consumer customer is in a lower-income bracket than our agency customers and generally has less discretionary income to purchase or retain insurance. We have also had to reduce our circulation in mailings as increases in postage and paper costs impede our ability to achieve a satisfactory return on investment for certain marketing campaigns.

At United American General Agency, health premiums increased 16% over the year-ago quarter to $135 million, and health underwriting margin increased 8% to $19 million. Net health sales were $12 million, up 2% compared to the year-ago quarter.

I will now provide projections based on trends we are seeing and knowledge of our business. We expect the producing agent count for each agency at the end of 2022 to be in the following ranges: American Income, a decrease of 2% to an increase of 4%; Liberty National, an increase of 3% to 11%; Family Heritage, an increase of 12% to 21%.

Net life sales for the full year 2022 are expected to be as follows: American Income, an increase of 12% to 18%; Liberty National, an increase of 8% to 12%; Direct to Consumer, a decrease of 19% to a decrease of 11%.

Net health sales for the full year 2022 are expected to be as follows: Liberty National, an increase of 5% to 9%; Family Heritage, an increase of 7% to 11%; United American General Agency, a decrease of 7% to an increase of 3%.

I will now turn the call back to Gary.

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

Thanks Larry.

We will now turn to our investment operations.

Excess investment income, which we define as net investment income less required interest on net policy liabilities and debt, was $57 million, down 4% from the year-ago quarter. On a per share basis, reflecting the impact of our share repurchase program, excess investment income was flat. For the full year, we expect excess investment income to decline between 1% and 2% due to higher interest on debt, but to be up around 3% on a per share basis.

After 3 years of declining excess investment income, we expect to see growth in 2023 due primarily to the impact of higher interest rates on the investment portfolio. As to investment yield, in the second quarter, we invested $400 million in investment-grade fixed maturities, primarily in the municipal and financial sectors. We invested at an average yield of 5.29%, an average rating of A+ and an average

life of 26 years. We also invested $25 million in limited partnerships that have debt-like characteristics. These investments are expected to produce additional yield and are in line with our conservative investment philosophy.

For the entire fixed maturity portfolio, the second quarter yield was 5.16%, down 8 basis points from the second quarter 2021. As of June 30, the portfolio yield was 5.16%. While the yield declined 8 basis points from a year ago, it is worth noting that it is up 1 basis point from the end of the first quarter. This is the first time we have seen an increase in the portfolio yield since 2016.

Regarding the investment portfolio

Invested assets are $19.6 billion, including $18 billion of fixed maturities at amortized costs. Of the fixed maturities, $17.4 billion are investment grade with an average rating of A-. And overall, the total portfolio is rated A-, same as a year ago.

During the quarter, we went from a net unrealized gain position to a net unrealized loss position of approximately $814 million due to higher treasury rates and spreads. The unrealized loss position is mitigated by our ability and intent to hold fixed maturities to maturity. Overall, we are comfortable with the quality of our portfolio.

Bonds rated BBB are 53% of the fixed maturity portfolio compared to 55% a year ago. While this ratio is in line with the overall bond market, it is high relative to our peers. However, we have little or no exposure to higher risk assets such as derivatives, equities, residential mortgages, CLOs and other asset-backed securities. Because we primarily invest long, a key criterion utilized in our investment process is that an issuer must have the ability to survive multiple cycles. We believe that the BBB securities we acquire provide the best risk-adjusted, capital-adjusted returns due in large part to our ability to hold securities to maturity regardless of fluctuations in interest rates or equity markets.

Below investment grade bonds were $585 million compared to $764 million a year ago. The percentage of below investment grade bonds to fixed maturities is 3.2%. This is as low as this ratio has been for more than 20 years. Excluding net unrealized losses in the fixed maturity portfolio, below investment grade bonds as a percentage of equity are 10%. Below investment grade bonds plus bonds rated BBB as a percentage of equity are 169%, and that is the lowest this ratio has been in 10 years.

I would also mention that we have no direct investments in Ukraine or Russia and do not expect any material impact to our investments in multinational companies that have exposure to these countries.

For the full year, at the midpoint of our guidance, we expect to invest approximately $1.3 billion in fixed maturities at an average yield of 4.9% and approximately $200 million in limited partnership investments with debt-like characteristics at an average yield of around 7.6%. We are encouraged by the increase in interest rates and the prospect of higher interest rates in the future. Higher new money rates will have a positive impact on operating income by driving up net investment income.

As I mentioned earlier, 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. In addition, our life products have fixed benefits that are not interest sensitive.

Now I will turn the call over to Frank for his comments on capital and liquidity.

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

Thanks Gary.

First, I want to spend a few minutes discussing our share repurchase program, available liquidity and capital position.

The Parent began the year with liquid assets of $119 million and ended the second quarter with liquid assets of approximately $318 million. This amount is higher primarily due to the net proceeds of the issuance in May of a 10-year $400 million senior note with a coupon rate of 4.8%, less amounts used to temporarily reduce our commercial paper balances. The net proceeds will ultimately be used to redeem our $300 million 3.8% senior note maturing on September 15, with the excess proceeds being available for other corporate purposes.

In addition to these liquid assets, the Parent Company annually generates excess cash flow. 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 Parent Company debt.

During 2022, we anticipate the Parent will generate between $355 million and $365 million of excess cash flows. This amount of excess cash flows, which, again is before the payment of dividends to shareholders, is lower than the $450 million received in 2021 primarily due to higher COVID life losses and the nearly 15% growth in our exclusive agency sales in 2021, both of which resulted in lower statutory income in 2021 and thus lower cash flows to the Parent in 2022 than were received in 2021.

Obviously, while the increase in sales creates a drag to the Parent's cash flows in the short term, the higher sales will result in higher operating cash flows in the future. We anticipate that approximately $145 million of excess cash flows will be generated during the second half of the year, out of which we anticipate distributing approximately $40 million to our shareholders in the form of dividend payments.

In the second quarter, the Company repurchased 1,388,000 shares of Globe Life Inc. common stock at a total cost of $134.2 million and at an average share price of $96.64. Total repurchases during the quarter were higher than normal as we accelerated approximately $50 million of repurchases from the second half of the year given favorable market conditions. These additional repurchases were at an average price of $94.39. Year-to-date, including $11.6 million in purchases made so far in July, we have repurchased 2.4 million shares for approximately $234 million at an average price of $98.22.

Taking into account the liquid assets of $318 million at the end of the second quarter plus the estimated $145 million of excess cash flows expected to be generated in the second half of the year, we anticipate having around $463 million of assets available to the Parent for the remainder of the year. As previously noted, we have used $12 million for buybacks so far this quarter and anticipate using approximately $40 million to pay shareholder dividends and approximately $180 million in net debt reduction, leaving approximately $230 million for other uses.

As noted on previous calls, we will use our cash as efficiently as possible. We still believe that share repurchases provide the best return or yield to our shareholders over other available alternatives. Thus, we anticipate share repurchases will continue to be a primary use of the Parent's excess cash flows along with the payment of shareholder dividends.

It should be noted that the cash received by the Parent Company from our insurance operations is after our subsidiaries have made substantial investments during the year to issue

new insurance policies, expand and modernize our information technology and other operational capabilities, and acquire new long-duration assets to fund their future cash needs.

As discussed on prior calls, we have historically targeted $50 million to $60 million of liquid assets to be held at the Parent. We will continue to evaluate the potential capital needs, and should there be excess liquidity, we anticipate the Company will return such excess to the shareholders in 2022. In our earnings guidance, we anticipate between $410 million and $420 million will be returned to shareholders in 2022, including approximately $330 million to $340 million through share repurchases.

With regard to the capital levels at our insurance subsidiaries

Our goal is to maintain our capital at levels necessary to support our current ratings. Globe Life targets a consolidated Company Action Level RBC ratio in the range of 300% to 320%. For 2021, our consolidated RBC ratio was 315%. At this RBC ratio, our subsidiaries have approximately $85 million of capital over the amount required at the low end of our consolidated RBC target of 300%.

During 2022, the NAIC will be adopting new RBC factors related to longevity and mortality risk, also known as C2 factors. While the longevity risk factors that primarily relate to life contingent annuities will have little impact on our subsidiaries, the new mortality factors do apply to our products and will increase our Company Action Level required capital by approximately 4% to 5%. We believe the conservative statutory reserve levels held for our life insurance products already provide for a very strong total asset requirement.

Given the consistent generation of strong statutory gains from operations from our product portfolio, these new factors will simply result in even stronger capital adequacy at our target RBC ratios. At this time, while we do not anticipate that any additional capital will be required to maintain the low end of our targeted RBC ratio, the Parent Company does have sufficient liquid assets available should additional capital be required.

At this time, I would like to provide a few comments related to the impact of COVID-19 and our excess non-COVID policy obligations on second quarter results.

In the second quarter, the Company incurred approximately $8.4 million of COVID life claims relating to approximately 30,000 U.S. COVID deaths occurring in the quarter as reported by the CDC. However, these incurred claims were fully offset by a favorable true-up of COVID life claims incurred in prior quarters.

Based on the additional claims data we now have available relating to first quarter COVID deaths, we now estimate that our average cost per 10,000 U.S. deaths in the quarter was approximately $2.4 million, down from the $3 million average cost previously estimated on our last call. As a result, the net COVID life claims reported in the second quarter were not significant overall or at any of the individual distributions.

For the full year and at the midpoint of our guidance, we now estimate we will incur approximately $62 million of COVID life claims, a decrease of $9 million from our prior estimate. This estimate assumes an estimated 60,000 U.S. COVID deaths and an average cost per 10,000 deaths of approximately $2.8 million in the second half of the year.

While we had favorable experience with respect to COVID losses incurred in prior quarters, we did experience higher life policy obligations from non-COVID causes. The increase from non-COVID causes of death are primarily medical related, including deaths due

to lung disorders, heart and circulatory issues and neurological disorders. The losses that we are seeing continue to be elevated over 2019 levels. As stated on prior calls, we believe these higher deaths are due in large part to the pandemic. Given the lessening number of COVID deaths, we do anticipate these claims will moderate over the remainder of the year.

In the second quarter, we estimate that our excess non-COVID life policy obligations were approximately $28 million, $10 million higher than expected, primarily due to adverse development of first quarter incurred losses in our Direct to Consumer channel. For the full year, we anticipate that our excess life policy obligations will be around $64 million or around 2% of our total life premium. Essentially all of these higher obligations relate to higher non-COVID causes of deaths.

With respect to our earnings guidance for 2022.

We are projecting net operating income per share will be in the range of $7.90 to $8.30 for the year ended December 31, 2022. The $8.10 midpoint is higher than the midpoint of our previous guidance of $8.05, primarily due to a greater impact of our share repurchase program. We continue to evaluate data available from multiple sources, including the IHME and CDC to estimate total U.S. deaths due to COVID and to estimate the impact of those deaths on our in-force book. We estimate the total U.S. deaths from COVID will be in the range of 215,000 to 275,000 and that our cost per 10,000 U.S deaths for the year will be approximately $2.5 million.

Before I close, a few comments with respect to the potential impact of the upcoming changes of long-duration accounting that will be effective in 2023.

As I discussed on our February call, we expect the new accounting guidance to have a significant impact on our reported GAAP income and our reported equity, including accumulated other comprehensive income, or AOCI. The impact on GAAP income will primarily result from changes that affect the future capitalization and amortization of deferred acquisition costs and, to some degree, changes in the manner of computing policyholder benefits. The impact on AOCI will primarily be related to the new requirement to revalue policy reserves using current discount rates.

The new accounting guidance is especially relevant to our GAAP financial statements since nearly all of our business is subject to the new rules. Our products are highly profitable and persistent, and we have many policies still on the books that were sold decades ago. While the GAAP accounting changes will be significant, it is very important to keep in mind that none of the changes will impact our premium rates, the amount of premiums we collect, nor the amount of claims we ultimately pay. Furthermore, it has no impact on the statutory earnings or the statutory capital we are required to maintain for regulatory purposes, nor will it cause us to make any changes in the products we offer. In other words, the accounting change will in no way modify the way we think or manage our business.

Under the new standard, our GAAP earnings will be higher. The annual amortization of deferred acquisition costs, or DAC, will be lower than under current guidance in the near and intermediate term due to changes in the treatment of renewal commissions, the treatment of interest on DAC balances and the methods of amortizing DAC. We currently estimate that these changes will increase net income after tax in the range of $120 million to $145 million on an annual basis. Due to the treatment of deferred renewal commissions in our captive agency channels, we do expect the impact of this change to diminish over a period of time.

It is important to note that our policyholder benefits reported for 2021 and 2022 will be required to be restated to reflect the new guidance. While we are not able to provide a range of expected impact at this time, the restated policy obligations as a percent of premium are expected to be lower in both 2021 and 2022 than under the current guidance due to the treatment of COVID life claims and other fluctuations in claims experience in both of these years as the new guide requires us, in concept, to recognize these fluctuations over the life of the policies. This will result in higher net income in both 2021 and 2022 than reported under current guidance.

Going forward, we anticipate that our policy obligations, as a percent of premium, will be similar in the near term to those restated percentages in the absence of assumption changes.

With respect to changes to the balance sheet and AOCI, the new guidance adopts a new requirement to remeasure the Company's future policy benefits each quarter utilizing a discount rate that reflects upper-medium-grade fixed income yields, with the effects of the change to be recognized in AOCI, a component of shareholders' equity. The upper-medium grade fixed income yields generally consist of single A rated fixed income securities that are reflective of the currency and tenor of the insurance liability cash flows.

On the transition date, which will be January 1, 2021, the Company expects an after-tax $7.5 billion to $8.5 billion decrease in the AOCI balance as of this date due to this new requirement since the discount rate to be used will be lower than what was used in valuing the future policy benefits under existing guidance.

Given the long average duration of our liabilities, changes in the current discount rate could have a meaningful effect on the reported AOCI. For instance, if we were to hold all else equal as of the transition date, but use current discount rates as of June 30, 2022, the after-tax decrease in AOCI due solely to the increase in future policy benefits would have been only in the range of $2.4 billion to $3.2 billion. Keep in mind that AOCI would also be adjusted in such a situation to reflect changes in the valuation of the fixed maturity bond portfolio.

As discussed on the February call, while the new guidance requires the Company to recognize the inherent unrealized interest rate loss for purposes of determining AOCI, it ignores the unrealized gains from underwriting margins that are available to fund future policy benefits and changes in interest rates.

Given our strong underwriting margins, this omission has the effect of reporting a policy liability that understates the value of these margins. This fact, along with the non-economic impact of this new requirement for determining our future policy obligations for AOCI purposes, we continue to believe that equity, excluding AOCI, will be a more meaningful measure of Globe's financial condition going forward.

The new guidance also requires a more granular assessment of the ratio between present value of benefits and the present value of gross premium, also known as a net premium ratio. Any blocks of business that require increases in future policy benefits to minimum levels or that have a net premium ratio greater than 100%, will require a decrease to the opening balance of retained earnings.

At the transition date, we expect this adjustment to retained earnings to be less than $50 million. We will provide more discussion of the impact of the accounting change in our second quarter Form 10-Q to be filed next month, and we may be in a position to provide more guidance on our anticipated restated 2021

and 2022 operating income and initial views on 2023 earnings on our next call.

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.

Question And Answers

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

Hi, I had a question first just on the persistency. And it seems like during the pandemic, you benefited from people unwilling to cancel policies, and now you are seeing an uptick in lapse rates. Do you think that is because of the weaker economy? Or is it because of a catch-up from what happened during the pandemic as the pandemic impact is fading? Or are there other reasons that sort of make you concerned about persistency getting worse if we, in fact, do enter a recession?

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

Jimmy, there are several reasons that could be causing the slight uptick in lapses, the economy, inflation. We have said in the past that during periods of inflation, we have not seen that much impact on persistency. But of course, this is the highest inflation we have had in 40 years. So it is reasonable to think that, that inflation could be affecting persistency, especially in the Direct to Consumer area. But also, the end of the government COVID relief payments is less income in the hands of our policyholders. That could have an impact.

And also, we think we are seeing a little bit of impact of some insurers feeling like they no longer need the coverage. Maybe they bought it at the beginning of the COVID outbreak, and now they are seeing -- are feeling like they do not need the coverage. It is hard to pinpoint what the causes are. But I do want to emphasize that we are not concerned about having adverse persistency have it -- getting worse. So what we are seeing is it looks like it is getting back towards the pre-pandemic levels. And -- but at this point, we do not see anything to indicate that that's going to be an ongoing increase in lapses.

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

Okay, and can you talk about the labor market and how -- and just your ability to recruit and retain agents with the fairly tight labor market that we have still.

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

While it has been a tough recruiting market, sequentially we did see the producing agent count increase at American Income, Liberty National, and Family Heritage. What is more important than the labor market are the components necessary for agent growth and those remain in place. All 3 agencies are opening new offices in 2022, middle management is projected to grow by 5% to 10% this year, and we are providing additional sales technology to the agency forces. Also in a slowing economy, Jimmy, it is always easy to recruit and retain new agents.

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

Okay. And then just lastly on -- can you quantify the impact -- or what the actual COVID claims were this quarter and what the offsetting reserve release was? Because I think on a net basis, you had a negative $1 million impact from COVID. But what were the actual claims and what were the associated reserve releases that led to a negative net result?

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

Yes, Jimmy, as I noted, we estimate that our, if you will, is about $8.5 million of COVID losses just relating to the -- truly relating to Q2 incurred deaths, and that was about $9 million, $9.5 million favorable development of a true-up, if you will, to those prior period claims.

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

Okay thank you.

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

And I will say that on DTC, it was about -- the excess was -- we had originally projected around $5.6 million, but it was -- ended up probably being about $2.5 million of a negative, if you will, net benefit in the quarter.

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

Hi thank you. I was hoping you could provide a little bit more color on the non-COVID mortality experience this quarter, particularly in the Direct to Consumer block and maybe talk a little bit as well about the out-of-period adjustment there. And I guess where you see margins being for DTC in the near term and where you think they can get to if mortality normalizes?

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

Yes, Erik. In general, in the second quarter, we had originally estimated about $18 million of total excess obligations. We ended up with, as I noted, about $28 million. So it was about $10 million higher than what we had anticipated and really, all of that was on the non-COVID side. Lapses were actually a little bit favorable. They were high -- the lapses were higher than what we had anticipated for the quarter. So some of the releases of some of those excess reserves there helped out. All of that difference was related to DTC, and that is -- was about $10 million of additional claims that we are seeing, higher policy obligations incurred in the second quarter relating to those non-COVID claims.

So really what we are kind of seeing in both of DTC as well as just an organization as a whole, while we have those favorable developments, if you will, on COVID, there is maybe a little bit of a misclassification, if you will, with respect to some of the non-COVID because then we clearly saw the non-COVID being a little bit higher. So -- and whether that stems from just some changes in how death certificates are ultimately getting recorded and how precise some of those are being or if it is just some of the other factors and just our estimation techniques, it is a little bit hard to tell. But a little bit of an offset with the higher non-COVID that we saw with the favorable developments on the COVID side.

And with respect to overall for the year for DTC, we do anticipate that the non-COVID -- the excess non-COVID claims kind of for the full year probably be about 2% of premium, and -- excuse me, about 5% of premium for the entire year. So in total, about $45 million -- around $50 million of total excess obligations for Direct to Consumer related to the non-COVID causes of death and probably about 3% related to COVID.

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

Got it. And then from a margin standpoint, I guess, looking forward, in a normal environment, would you still expect to be in sort of, I guess, the 17% to 18% margin range for DTC and kind of 28% for life overall?

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

Yes. For the full year, we estimate that we are probably somewhere in that 11% to 13% range for our projected margin for the entire year. And with COVID, if you will, the higher obligations for COVID and non-COVID being around 8%, that kind of points to around 20%. But with some of the favorable persistency that we have had in the past couple of years, our amortization of our DAC is a little bit favorable. If you kind of normalize all that, it kind of does bring you back down in that 17% to 19% range, right around 18% to 19%.

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

Got it. And 28% sort of for the overall life business. Is that still reasonable?

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

That is reasonable, yes.

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

Got it. And if I could just squeeze in one last quick one. For the LDTI impacts, I think you gave the earnings impact on a net income basis. Would you expect much difference for operating income?

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

No, would be essentially the same. Some of the components of net operating income, how we think about excess investment income versus some of the underwriting income and how we treat required interest on that, those components will be a little bit different, but the overall net operating income would be the net same impact overall.

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

Got it, thank you.

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

Hey, good morning. So just to kind of follow on with the excess non-COVID claims of about $28 million this quarter, did I recall correctly that you were expecting about $64 million of excess non-COVID for the year? Is that correct?

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

That is correct.

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

And that is what you were previously, Frank, guiding to. So even though you had $10 million more than -- I think that is what you said, $10 million more than anticipated...

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

Yes.

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

This quarter, you are still standing by that previous guidance of $64 million. And if that is the case, you just -- I guess, you are just kind of anticipating that this excess non-COVID mortality is going to gradually dissipate. It will still be there, but you will continue to kind of see that subside. Is that right?

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

That's… I mean that is correct. Over the course of the year, that we do anticipate that the additional impact of that will be less than what we have seen in Q1 and Q2. But we have kept the overall view of about $64 million. But what we have done there, Andrew, is we have increased our expectations of what portion of that is related to -- so the increases that we have seen on the non-COVID causes of death, what has really happened is that that's been offset by decreases in our -- the excess obligations related to lapses. And so as our persistency -- as the lapses have ticked up, then some of those excess reserves that we were carrying have been released and the effect of that is offsetting the higher non-COVID claims, kind of keeping our total year approximately the same.

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

Got it, and nothing would lead you to believe that in '23 or 2024, assuming and hoping that COVID dissipates, that this excess non-COVID will be a problem?

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

Yes. What really -- something we have done here recently is we have gone back -- our actuarial team has gone back and really tried to look back at relationships that are higher non-COVID losses and to see what relationships these higher non-COVID losses have to the actual timing of the COVID deaths. And we have actually seen a really strong relationship between the COVID deaths, especially with the heart, circulatory and the neurological disorders and more recently, the lung disorders.

And so given the strong relationships that we have been seeing -- or that we have seen over the course of this pandemic and with the decline in COVID deaths, I think that gives us a level of comfort that has -- that those -- that the excess non-COVID causes of death will start to dissipate as well. And so at least at this point, we are not seeing any reason why we -- any evidence that would point that they should be higher in the long term and that they eventually should gravitate back to more normal levels.

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

Got it. As I said, that makes a lot of sense. And then just lastly, on lapsation, you gave some really good reasons, inflation, less supplements from government, et cetera. Given the environment we are in, I guess, is the expectation that we could kind of see these elevated lapses, particularly in Direct to Consumer, over the foreseeable future?

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

Yes, I think from what we are seeing -- what we are anticipating at the midpoint of our guidance is that we are expecting the level of lapses to be more toward more normal levels. It is always possible in DTC that they might continue to be a little bit elevated. We are really pretty comfortable on the exclusive agencies given the nature of the touch points with the -- with our agents that persistency will just kind of more - be at the normal levels. But that's -- in our guidance of what we have got for the remainder of the year we do just anticipate that they will be consistent with pre-COVID levels.

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

Yes. Andrew, I would add that we have seen more of the increases in the lapses we have seen in the policies in the last 2, 3 years. And if you go out policies that have been on the books longer, we have not seen as much of an increase in the lapse rate. So -- and that gets back to what we talked about earlier, maybe that some of the policies that we sold in the last 2 to 3 years, people are thinking they do not need that coverage anymore. So at this point, especially looking out at the policies that have been on the books longer, we do not see anything to indicate that we are having a major shift and it is going to continue. But obviously, we will continue to monitor it. But so far, it's more of the lapse rates moving back to where they were in the 2019 time period.

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

That is great to hear. Actually, let me just sneak one in. American Income looked good. Your guidance has bumped up 1% in terms of agent count on that growth over year. Are you getting a little more encouraged by what you are seeing? Is it easier to recruit than you thought 3 months ago?

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

Yes, we are encouraged. We are seeing more, I guess, candidates looking for the opportunity. And what we see is a change in economy as recruiting has actually increased during the second quarter and through the current date. What we need to do is convert more of those agents -- or more of those recruits into producing agents, and we see that happening. There is always a lag between recruiting and producing agents. And so I think in the third quarter, the increase in recruiting we saw in the second quarter should carry through in the next quarter, particularly at American Income. The American Income position is also more attractive. 85% of our sales are still virtual. And with the cost of gasoline, with inflation, there is a need to, I guess, work or produce business. At the same time, you can work from home and you have lower expenses. So I think

the opportunity at American Income is much better than it was pre-COVID.

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

Thanks so much.

John Bakewell Barnidge - Piper Sandler & Co., Research Division - MD & Senior Research Analyst

Thank you. My first question, you previously talked about a 20% increase in average premium. How did that trend in 2Q '22? Just trying to dimension if the consumers may be pulling back on a size of policy possibly.

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

Well, I will address it from an agency standpoint. We are talking about the average premium per sale, what we see is that increasing across the 3 agencies. So at American Income, Family Heritage, and in our Liberty National unit, the average premium has increased and that is -- what is driven sales is the increase in productivity and average premium and also the percentage of agents submitting business. As you have seen the agent counts, the average agent counts were fairly flat quarter-over-quarter. As we added agents in the second quarter, that did help sales at Family Heritage more than the other 2 agencies.

I think the other thing you are seeing is, particularly at Liberty National, I mentioned in the script that the worksite sales increased both year-over-year with a substantial increase in the fourth quarter. I think what you are seeing is a return to normal in terms of that worksite market that is helping the average premium increase and the productivity increase in that market also.

John Bakewell Barnidge - Piper Sandler & Co., Research Division - MD & Senior Research Analyst

Okay. And then my follow-up question. You provided some great color on the portfolio. Clearly, some concern generally in the world about economic growth and the changing business cycle. And appreciate BBB portfolio is targeted for multiple sectors. But can you talk about maybe plans to re-underwrite for potential credit rating changes and whether you would opportunistically maybe trim some of the BBBs?

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

Well, we have done some of that. In the second quarter, we did a slight repositioning of the portfolio. We sold $185 million worth of bonds. That's about 1% of the portfolio. These are bonds that we did not have credit concerns regarding, but market conditions were such that we could sell these bonds and reinvest in higher-grade bonds. And what we did is we reinvested the proceeds and we sold BBB bonds, reinvested in AA bonds, muni bonds. We also increased our earnings because we reinvested at a higher yield. And with the higher quality, it also reduces our required capital. And at the same time, we were able to offset some prior year tax gains. So it was a win-win all the way around.

But this is an example of how we, from time to time, will take advantage of the situations and where we can improve the quality. But with that, we feel good about the quality of the portfolio. Through the last 3 years,

we have added more municipal bonds that are in the AA category.

As I mentioned earlier, our ratio of BBB and below investment grade bonds as a percentage of equities is as low as it's been in 10 years. And also, we feel good about the issuers that we have had on the books for a while. During the pandemic, companies bolstered their balance sheets. So going forward, we feel like our portfolio -- the quality will hold up well.

John Bakewell Barnidge - Piper Sandler & Co., Research Division - MD & Senior Research Analyst

Thank you

Thomas George Gallagher - Evercore ISI Institutional Equities, Research Division - Senior MD

Hi, first question is the $28 million of elevated non-COVID excess that you referenced, was any of that related to prior period catch-up from 1Q? And if so, how much of that $28 million would have been 2Q versus 1Q?

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

Yes, it was -- about $10 million of that really did relate to a catch-up from Q1, and that was pretty much primarily at Direct to Consumer.

Thomas George Gallagher - Evercore ISI Institutional Equities, Research Division - Senior MD

Got you, so if we were to look at kind of a normal margin in Direct to Consumer, we should probably be adding the $10 million back from a run rate perspective.

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

Yes, I think that would be right.

Thomas George Gallagher - Evercore ISI Institutional Equities, Research Division - Senior MD

Okay. You also referenced on Direct to Consumer, some of the expenses like shipping costs, et cetera, have gone up, making it less attractive. If that was the case, how did you respond to that? Did you just scale back in mailings? Did you change pricing at all? What was the response to that?

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

I think I would not agree with the statement that it is less attractive. If you remember in direct response that the acquisition expenses incur prior to the sale as contrasted to the agencies were at the time of the sale, you incur the acquisition expense. As we think about Direct to Consumer, we determine our mailings, we determine our insert media based on our analytics, which is based on tests that we do. As we see lower response rates, where we then -- and when we are issuing premium in response to those offers, we lower the volume of those mailings, we lower the volume of the insert media.

And so it is really maintaining the return on investment that is adequate for that particular campaign. And realize too during the year, we have 30, 40, 50 campaigns going on. So each one is measured independently. And so we adjust that continually to see what are response

rates, what are the first full premium paid in response to the applications received, and that is how we determine what the volumes are going to be.

Based on what we see in the analytics to date, we expect in Direct to Consumer, we are going to have a reduction in our mailings this year of about 9% and our insert circulation decrease in a range of 9% to 11% for 2022. As the campaigns continue, if the economy improves, if we see a higher demand for life insurance again and it is not really increasing the investment, it's increased the investment in response to the results we are seeing in those campaigns.

Thomas George Gallagher - Evercore ISI Institutional Equities, Research Division - Senior MD

Got you, that is helpful color. And then just a final one for me on LDTI. So it is kind of interesting. You had a meaningful positive from a GAAP operating earnings perspective. But at least upon the initial balance sheet implementation date, looking back to when rates were lower, I think it would have resulted in Globe having a negative book value given the size of the adjustment to AOCI. And I realize that is a lot less now with where rates are. I think you said the transition impact was all the way down only $2.4 billion to $3.2 billion as of June 30.

So that is clearly a lot less of an impact. But any initial sense just given those 2 kind of large impacts positive on income statement, but meaningful negative on GAAP book value? Any initial response from the rating agencies that you think this is going to be consequential? Because I think I heard you say earlier, and I think every other Company has said, this won't impact capital adequacy at all. But is the fact that could have resulted in a negative book value raising any eyebrows at the rating agencies or not necessarily?

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

So Tom, let me correct it. As of 12/31/20, which would be the balance sheet that we would be restating at the transition date, our total equity as reported was about $8.8 billion at that point in time. So the adjustment that we are anticipating right now won't take us into a negative. It will still be kind of at the midpoint of that range, would point to something around $1 billion of positive GAAP equity as of that transition date.

That being said, that is still a significant decline, admittedly, a significant decline in the reported equity, which, we say again is related to these market adjustments relating to the market rates at that point in time being significantly below the average portfolio yield. So our average portfolio yield is around 5.8%, it was around that. And so -- and the average probably closer to about 3%, it's kind of -- it moves around with the curve and that type of thing. But -- so it is a significant drop from that period of time. But -- so as that curve has improved since 12/31/20 up to the current time, as we kind of said, that helps to -- it won't be as significant.

I think that is one of the reasons and just that we look at AOCI as not being -- really a difficult measure to evaluate the Company on is because there is so much of that interest rate driven, and it will change over time. With respect to the rating agencies, we do not anticipate any issues at this point in time given the nature of -- it does not change our real ability to generate cash flows, our ability to repay our debt and our obligations or just the overall strength of our operations, especially from just an overall cash flow and statutory earnings generation perspective. So -- but as we continue to have further discussions with all of them, we will be able to provide more input on that. And as time goes on and they are able to absorb not only

what they are seeing from our Company, but as well as others in the industry.

Thomas George Gallagher - Evercore ISI Institutional Equities, Research Division - Senior MD

Okay thank you for the color.

Ryan Joel Krueger - Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research

Hi thanks, I just had -- I just have one more follow-up on LDTI. The increase in GAAP earnings of $120 million to $145 million annually, is that something that you would expect to be relatively stable for -- over the intermediate term? Because I think you had mentioned over time, it will decline some. If you could just give a little more color there.

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

Yes, we do anticipate in the near and intermediate term that it would be relatively stable. It kind of will increase over time as the new rules will require us to -- as we continue to pay deferrable renewal commissions, those will increase some of our amortization with respect to new business as we put that new business on the books and just in future periods on existing business as well. So -- but that will be -- take a while for some of that to make a real meaningful impact as well.

Ryan Joel Krueger - Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research

Got it, and then on the increased C2 mortality factors, would that have much of an impact on your future free cash flow generation or would you view that as more of a one-time increase to required capital?

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

Yes, it would be more of a one-time increase to required capital for the most part that we will have to take into account. So I do not see -- I mean there will be some incremental impact obviously from year-to-year just to some of the growth in that business, but it should not have a meaningful impact on a going forward basis.

Ryan Joel Krueger - Keefe, Bruyette, & Woods, Inc., Research Division - MD of Equity Research

Okay got it, thank you.

Operator - -

There are no further questions at this time. Mr. Majors, we will turn the conference back over to you for any additional or closing remarks.

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.