

Aflac Incorporated NYSE:AFL

FQ1 2008 Earnings Call Transcripts

Thursday, April 24, 2008 1:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2008-			-FQ2 2008-	-FY 2008-	-FY 2009-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.48	0.50	▲4.17	0.50	2.00	2.29
Revenue	-	-	▲1.28	-	-	-
Revenue (mm)	4213.18	4267.00	-	4323.58	17447.68	18261.80

Currency: USD

Consensus as of Apr-24-2008 1:29 PM GMT

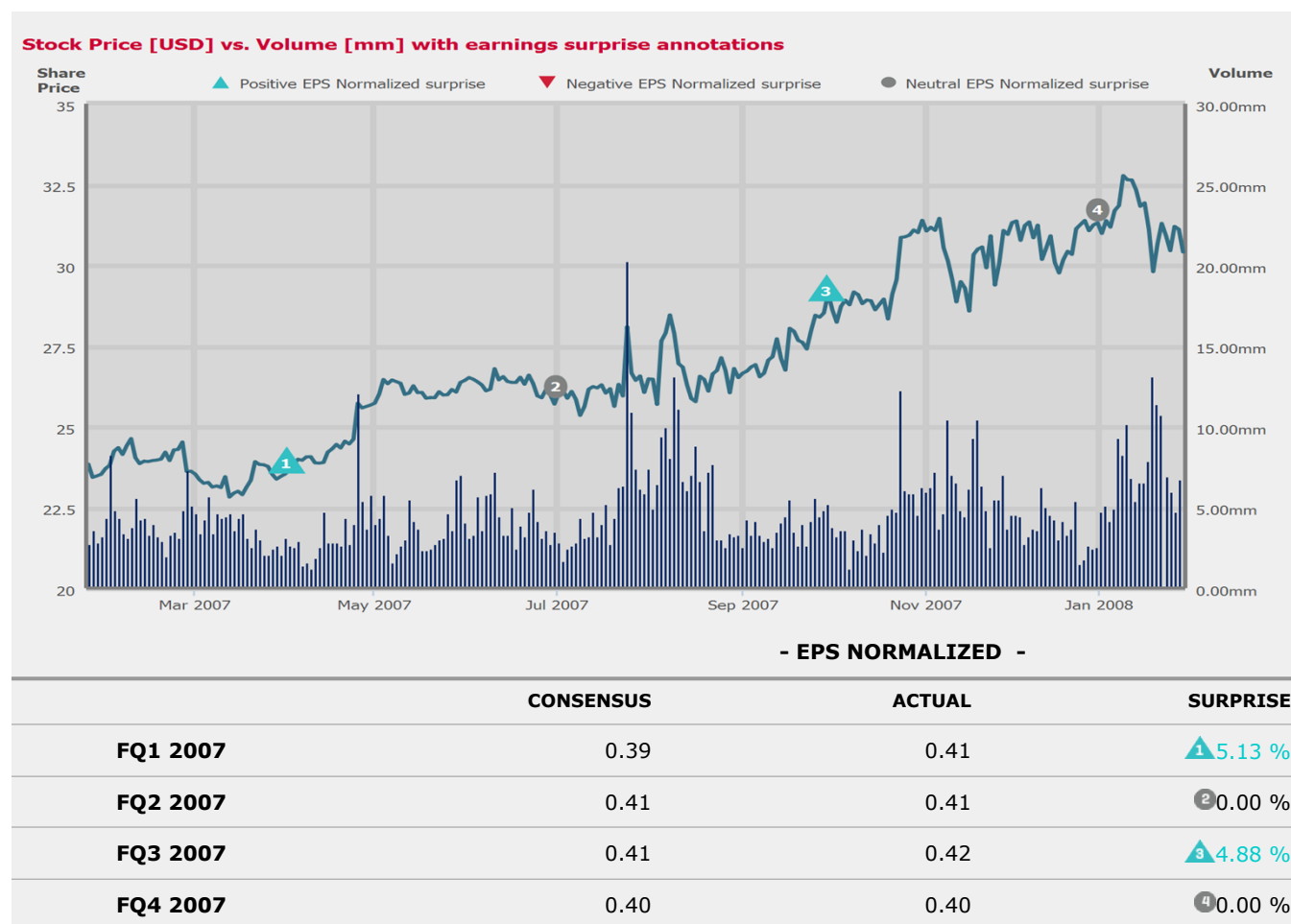


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Presentation

Operator

Welcome, and thank you for standing by. At this time, all participants are in a listen-only mode. [Operator Instructions]. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

Now I'll turn the meeting over to Ken Janke.

Kenneth S. Janke

Good morning and thank you everybody for joining us on our first quarter call. With me this morning is Dan Amos, Chairman and CEO of Aflac Incorporated; Kriss Cloninger, President and CFO of AFLAC Incorporated; Paul Amos, President of Aflac and Chief Operating Officer of our U.S. Operations, Jerry Jeffery, Senior Vice President and Chief Investment Officer and Tohru Tonoike is President and COO of Aflac, Japan and he joins us this morning from Tokyo.

Before we begin, let me mention the Safe Harbor. I would like to point out that some of the statements in this conference call are forward-looking within the meaning of Federal Security laws. Although we believe in statements are reasonable, we can give you no assurance they will be prove to be accurate because they are prospective in nature. The actual results in the future could differ materially from those that we discuss today. So, I'd encourage you to please look at our press release from last night for some of the various risk factors that could materially impact our future results.

Now, I would like to turn the program over to Dan, who will talk about the quarter and some comments on our businesses in the U.S. and Japan. Dan.

Daniel P. Amos

Good morning and thank you for joining us today. Overall, I am pleased with the way we started 2008. Although we just have one quarter under our belt, I believe we are well positioned to achieve our objective of operating earnings per share growth this year. Let me give you more detail about the quarter beginning with Aflac Japan

As a leading contributor to our consolidated financial statements, we were very satisfied with Aflac Japan's operating and financial results in the first quarter of 2008. In addition, our top line was consistent with our budget for the year and the benefit ratio continued to improve as we expected. As a result, we again produced solid pre-tax earnings growth.

I was especially pleased with Aflac Japan's continued sales improvement. I hope you remember that when we released the fourth quarter earnings, we said that Aflac Japan's sales would start slow in 2008. Personally, I thought the first quarter sales could be flat. That was largely because we knew it would take time to build momentum in the bank channels.

In fact only 1% of sales came from the banks in the quarter. Yet despite our caution, we began the year with very good quarter. Total new annualized sales rose 5% to 27.6 billion yen. That result, is much better than we had anticipated and in line with our annual sales objective. With bank sales still in the infancy, we believe our solid first quarter sales benefited instead from recent product introductions.

Medical sales improved sharply in the quarter, rising 17.6% over a year ago. Medical sales were helped by Gentle EVER, our non-standard medical product, which targets consumers aged 40 and older, who typically would not qualify for our standard EVER product.

During the quarter, we sold 12,400 Gentle EVER policies. Gentle EVER sales of 1.4 billion yen accounted for approximately 15% of the medical sales in the quarter. Since we began marketing Gentle EVER last August, it became the number one selling non-standard product in Japan. We were also pleased with cancer insurance sales, up 2.8%. We expected to see solid cancer sales this year in par because of the

favorable reception of our new Cancer Forte product. This product is the first major revision to our cancer policy in more than six years. Cancer Forte increases daily out-patient benefits, adds an annuity for newly diagnosed patients and offers the canceling and doctor referral benefit.

On March 24th, Dai-ichi Mutual Life joined Aflac Japan in selling Cancer Forte. Earlier in the year we introduced the special cancer policy that allows existing policy holders to upgrade their coverage to that of the Cancer Forte. In the first quarter, we sold approximately 54,500 of these upgrade policies. We believe this will be an effective means for enhancing customers' coverage, while also leveraging our policy holder base to increase sales.

We also believe sales of cancer medical insurance will benefit from the addition of our new sales channels. As we discussed, we expect to leverage our long standing and extensive relationships in the banking sector to secure a significant number of selling agreement once the banks could finally offer their products to the... over the counter. That is exactly what has happened.

At the end of March, we had agreements with 55 banks to sell our products. That number rose to 90 on April, the 1st, and by mid-year, we expect that number of agreements to be about 150 bank distributors. One reason we expect the numbers to increase is endorsement of Aflac's products by the National Association of Shinkin Banks. This association of about 280 Shinkin banks chose Aflac as one of only four companies to provide third sector products.

Not only was Aflac the only foreign company chosen but Aflac was the only company selected to sell both cancer and medical insurance. Even though we don't know with certainty how much business the bank channels would generate, we believe this new channel will gain momentum as the year progresses. We look for significantly better bank channel sales in the second quarter and this new channel should give us greater confidence in achieving our sales adjective for the year.

We are also very excited about the opportunity to sell Cancer Forte through an agreement with Japan Post network. As I am sure you are aware, Japan Post chose Aflac as the cancer insurance provider through their network company. Initially we expect to sell through about 300 postal outlets, beginning on October, the 1st of this year. Needless to say, we believe this is a great opportunity for both Japan Post and Aflac.

We also believe we are benefiting from the training initiatives. New agents who have gone through the new associate basic training program have generated better production than those who started before the training program was implemented. Although recruiting has been more challenging due to the tighter labor market in Japan, we are still focused on expanding our traditional distribution channel.

In that regard, we recruited 771 new associates or agencies in the first quarter, which was 14.9% higher than a year ago. Remember that we are also adding significant number of licensed agents this year through the bank channel.

I firmly believe there is a strong need for our products in Japan and I think we are well positioned to achieve our sales objective of a 3% to 7% increase for the year. We believe that's a reasonable target and we expect to produce strong financial results that are consistent with our budget for 2008.

Now let me turn to the business in the United States. We are pleased with Aflac U.S. for financial performance in the first quarter. Our top line was consistent, with our expectations and our pre-tax earnings were better than our target. Total new annualized premium sales were 0.4% to 353 million. We were not surprised that sales were sluggish. However, we did think that sales would be up about 3%.

You will recall that in the fourth quarter press release, we expected first quarter sales to be weak. There were a couple of reasons behind I think. First, we pointed out that we have transferred \$8 million of sales for the first quarter of this year to the fourth quarter of last year due to administrative changes that we had in processing conversions. Second, we also needed our agents, particularly our veteran agents pushed very hard at the end of 2007, and as result, sales were sharply down in January.

In addition, we had one less production day in the first quarter compared with the year ago. I'd like to point out that sales improved after the weak start of the year. From the beginning of February to the end of last week, our sales were up 6.5%. The number of average weekly producer rose 0.2% in the

first quarter. However, the number of new average weekly producers, are those who in their first year increased 2.7% in the quarter.

Production of new associates rose 4.2% over last year, and in addition we were pleased with the growth of our new payroll deduction accounts, which was up 8.5% over last year. That leads us to believe that the fundamental approach to building an effective distribution is still working and we continue to focus on that.

As we've said previously, we've been in weak economies. We have found it easier to recruit because of rising unemployment means salary jobs are more difficult to come by. We think the weaker U.S. economy resulted in good recruiting increase for the quarter. Recruiting was up 8.6% in the first quarter, so almost 6500 new associates.

I know many of you have asked whether the U.S. economy is affecting other aspects of our business. As we've said before, we really have not experienced any material impact on claims or sales in fast economic downturns. The last recession occurred in 2001, when our sales were up 29%. That incredible sales growth was attributable to the success of the new Aflac duck advertising campaign, which could have simply mitigated any impact of the recession.

Of course, we recognize that the current economy is impacting consumers and we are seeing lower penetration rates in accounts compared to last year. However, we are sure of one thing, the need for our products we sell have not changed. The incidence of cancer, accident and other serious health events does not fluctuate during economic cycles. In fact, I believe the need for our products is actually more compelling when the economy weakens because of the financial risk to the household, becomes more pronounced.

With the price of food and gas climbing so rapidly, coping with those rising costs is even more burdensome to the health event occurs. That's precisely why our products provide distinct value to the average American households. We are taking steps to amplify that message to our sales force.

This past Monday, we held a national training day that was offered to the entire sales force. One of the main objectives of this training day was to convey to the sales force, how a weak economy enhances a need for our products, and to train them how to better sell in this economy environment. Rest assured, we continue to take every opportunity we can to provide our sales force with the tools and skills that they need to be more successful.

At the same time, there are other initiatives that we are working on, that we believe will help us tap into this fast U.S. market. At our analyst meeting next month, we'll talk about our new business-to-business marketing. This is the first time, we have directly approached business owners and we are excited about its potential. We have created business-to-business television commercials, which expect to begin running in May. These initial testings of these commercials was very high and we believe they will help us communicate our brand message to employers.

We are also going to continue to segment the market to more effectively meet the needs of the specific consumers such as the Hispanic market. We will continue to enhance our distribution by looking more cautiously at the non-traditional channels such as national insurance brokers.

I am pleased with the direction of our operation and enthusiastic about the opportunities we see in the marketplace. Our objective is still an 8% to 12% increase in sales for the full year and I expect our sales growth to improve, as I still believe our sales target is achievable, although it's obviously tougher than it was... than we had originally thought.

I am counting on the marketing and sales officers as well as the field force to do what they can to help drive sales. I believe employers and workers alike are gaining a better understanding of our products and our services, and I am certain we have an effective combination of product, distribution, customer service and brand to meet customer needs.

On a consolidated basis, I am pleased with the financial position. Our balance sheet is still marked by a conservative investment posture and very favorable risk profile. The credit ratings of our holdings remain high as you know and we do not have any direct investment exposure to sub-prime lending markets.

We have limited investment exposure to CMOs asset-backed securities or CDOs, and all the investments in those areas are highly rated. We also have a very strong risk-based capital.

Our RBC ratio for 2007 was 574. Although it declined some what from 2006, keep in mind that we transferred \$1.4 billion to the parent company in 2007. That capital transfer allowed us to repurchase 12.5 million shares in February 2008. In other words, they impacted the funding of our 2008 share repurchase was reflected in 2007 RBC ratio.

As I mentioned in our press release, we have narrowed our outlook for this year from a 13% to 15% increase in operating earnings on a diluted basis before the impact of currency to 14% to 15% increase. I have a high degree of confidence that we will achieve that target, and we hope to grow at the high end of that range this year. We are very pleased with our U.S. financial results, which were in line or better than expectations.

At the same time, I am extremely pleased with Aflac Japan's continued recovery of new sales. Aflac Japan sales results exceeded our expectations for the quarter and as a contributor to more than 70% of the consolidated earnings, Aflac Japan's financial results were solid and consistent with our target. I am still focused on increasing operating earnings per share by at least 15% annually, excluding the impact of the Yen from my first 20 years as CEO. If attend our analyst meeting next month, you will hear about our 2009 earnings target. Beyond my first 20 years as CEO, I still think we can produce another ten years of double-digit earnings growth.

As we look ahead, we believe our strong earnings growth will reflect our underlying earnings power of our insurance operations in Japan and the United States. It will also reflect our prudent approach to deploying excess capital in a way that benefits shareholders. Ken?

Kenneth S. Janke

Thanks Dan. Let me briefly run through some of the first quarter numbers, beginning with Aflac Japan. Starting at the top line in Yen terms, revenues were up 2.7% for the quarter. Investment income growth of 0.2% was held back by the impact of the stronger Yen on Aflac Japan's dollar denominated investment income. And excluding the effect of the stronger Yen, investment income was up 5.1%.

The annualized persistency rate for the quarter, excluding annuities was 94.4% compared with 94.8% in the first quarter of 2007. We believe the persistency was impacted by a higher proportion of the population as well as our customer base reaching retirement age, though we expect that this will not only influence persistency this year, but in 2009 as well.

And looking at the operating ratios for the quarter, as we expected, the benefit ratio continue to improve over last year. It declined from 63.9% to 62.4% in the first quarter of '08. The expense ratio was 19.6%, up from 18.5% a year ago. The increase in the expense ratio was budgeted and in part attributable to greater spending on bank channel preparations.

The pre-tax profit margins showed further improvement, rising from 17.6% to 18.0%. Pre-tax earnings rose 4.8% for the quarter in Yen, and again excluding the impact from the stronger Yen and net investment income, pre-tax earnings were up 10.6%. Investment yields declined slightly in the quarter in looking at government bonds. For instance, the average yield on an index of 20 year JGB's was 2.08% in the first quarter compared with 2.13 in the fourth quarter. That composite yield right now is a little less than 2%. However for the quarter, we invested our cash flow in Yen securities of 3.41% and including dollars, the blended rate was 3.85%.

Portfolio yield at the end of March was 399. That was three basis points lower than year end and 13 basis points lower than a year ago. Overall as Dan mentioned, the credit quality of the portfolio remains very high. On a consolidated basis, securities rated double B or lower, represented only 1.9% of investments at the end of March that was unchanged from year end.

And looking at Aflac U.S., revenues were up 8.4% in the quarter. Earned premium increased 9.3%. Investment income was up 1.3%. As expected investment income growth was muted by higher dividends that we had paid to the parent company in 2007. The annualized persistency rate of our U.S. business was

71.9% in the quarter compared with 73% a year ago. I would note however that on a rolling 12 months basis, there was only a 40 basis point change from the prior year.

So looking at the operating ratios for the quarter, the benefit ratio was 52.4% compared with 52.7% in the first quarter of '07. The improvement in the benefit ratio largely reflected a change in accounting for internal replacements, which we adopted at the end of last year. The expense ratio was 31.4% compared with 31.7%, and as a result, the margin was 16.2%, up from 15.6% a year ago.

Pre-tax earnings were up 12.6% for the quarter. In terms of U.S. investments, the new money yield for the quarter was 7.03 versus 6.27 a year ago, although again we did not have significant cash flows going to investments this year. The yield on our portfolio was 7.01% at the end of March, up one basis point from year end but six basis points lower than a year ago. Turning to some other items for the quarter, we did purchase 12.5 million shares, this purchase was executed through an accelerated share repurchase program that we had announced in January, excluding [indiscernible] 115 in the ratio, of debts total capital was 16.9% at the end of March compare with 16.80, a year ago. Non return interest expense was 7 million for the quarter compare with 5 million a year ago, and parent company and other expenses were 10 million, up from six million in the first quarter of 2007, that largely reflected the timing issue between corporate expenses in the first and second quarter. Total company operating margin rose reflecting the improved profitability of Aflac, Japan and Aflac, US. Pre-tax margin improve from 16.7% to 17% and in the after-tax margin rose from 10.9 to 11.1%. On an operating basis, the tax-rate was little change it was 34.7 versus 34.6.

And as reported operating earning per diluted share rose 19.5% to \$0.98, the stronger increased operating earnings by \$0.05 per share for the quarter and excluding the Yen's impact, operating earnings rose 13.4%. Up finally, and looking at the outlook for the balance of the year, as you heard from Dan, our objective for 2008 is a 14 to 15% increase in operating EPS excluding the impact of the Yen. That would suggest \$3.73 to \$3.76, assuming an identical exchange rate that we had in 2007.

However, as you know the Yen is significantly stronger that it was a year ago, so we achieve our objectives in the Yen average as 101 to 105 for the full year, we would expect that will translate to reported earnings per of \$3.95 to \$4.09 for the year and under that same currency scenario second quarter operating earnings per share will likely be a \$1 to a \$2. Other the current first quarter... estimate is the \$1.00 for the second quarter and 397 for the full year. I would now be happy to take your questions and we would like make sure that everyone has an opportunity to ask the questions. So please limit your question to one and then hopefully if you have more we can come back to you, Judie now I will turn the call over to you for polling.

Question And Answer

Question and Answer

Operator

[Operator Instructions]. Your first question comes from Nigel Dally with Morgan Stanley.

Nigel Dally

Morgan Stanley

Hey, thank you, good morning. My question is on Japan post, you mention that you'll go through 300 channels are they focused in one particular region and would it be correct to assume that they are the larger channel. More generally how should we be thinking about the impact on sale given the rollout in October should be a drive for sales for 2008 or assume it what we see in the banks will it take time for this channel, how to we gain momentum? Thanks.

Daniel P. Amos

Okay, thank you Nigel I am going to let Tohru talk about the details but I will tell you that I wouldn't expect Japan post to play any significant roll in sales this year. If we are going to roll it out and tested in... I mean in October it can be very significant. Now... my opinion that's actually good news for us because it allow us to concentrate on bank and then next year we can concentrate on post. I have been worried all along that we would be have both of them at the same time and create some time and create some problem for us. It also allows us to talk to the banks about pushing hard now because the postal will be in the business latter on. So it think that's encouraging for us... Tohru would you touch on these, if you know details of how these 300 banks, where they might come from or any of the details or any of the comments you might have about postal.

Tohru Tonoike

Oh yes, first of all those 300 offices pretty much spread out all over Japan, not concerned to the research in a certain area, so its supposed to be the representative of the whole Japan, and as Dan mentioned seems they are going to start operation in October and start rolling out. We do not expect any meaningful affairs within the... by the end of the year, so we expect that Japan post is mostly, the next year event. And as to the question to the rolling out of the banks, the banks, as we expected, started rather slow and because of their concern over the compliance and the concern over the level of the preparations they are making. And now most of the banks are... that of the financial year for the most of banks start in April, so now that we are in April, number of the banks have set the sales target for the insurance product, so we are hoping that more banks beginning to sell the insurance on the larger scale, but so far we don't see the big numbers yet. They are rising but are still on the way.

Daniel P. Amos

Let me make one other comment about what Tohru has said, which is important, when you hear that Japans sales from the banks are rising, your immediate conclusion might be then sales are totally rising. And they should be, in terms of the bank, but I want to point out, what happened in the fourth quarter

In the U.S, also happened in the first quarter in Japan, there was a real surge in production in December and if you really want me to quote what I thought the first quarter would be, I think we probably picked up another 2% in March that may have been... with people pushing that may take away a little bit in April, so I would say that if I kind of look at our sales numbers, I would say that Japan, for the first quarter was probably up closer to 3% even though we showed 5 which is still better than the flat number we thought because of the new product introduction and what they've done with it, but I think you're going to see the fourth quarter... I mean the second quarter a little softer than what we originally thought still positive, but still all-in-all we'll still make all of our numbers, but I just want to make sure that everyone note that March was very-very strong and frankly I was pushing them, I wanted a strong first quarter so that's part of the reason for that. Nigel I answered your question?

Nigel Dally

Morgan Stanley

Yeah, that was very helpful, thank you.

Unidentified Company Representative

Sure.

Operator

Sunit Kamath with Sanford Bernstein.

Sunit Kamath

Sanford Bernstein

Thanks, I just wanted to go back to some of the comments in the prepared remarks about the U.S, I think you said that the penetration rate in the U.S were low and as you were talking about the impact of the economy, and I just want to understand what that means, are you talking about the new business that you're riding, or you're just selling less then each payroll account and as you think about it being low is that compared to what is first quarter this year or first quarter last year or is this something that has been going on for some time.

Daniel P. Amos

Okay, I've got Ron, Paul and I do in the field with this national trading guy, so he's not here, but Paul's going to try to take this question.

Paul S. Amos, II

It is not a long term trend. It is something that we have seen, only beginning in this first quarter, what I can tell you is that yes, we are seeing less people purchasing, in any given account, be it a new account or existing account, however those people that are purchasing are purchasing at the same level, with rates they were purchasing before. You know, is the economy of affecting us we have traditionally said that it is not higher I have to say that from what I'm seeing out there, there is the huge demand for our products and there is still an equal demand for the amount of product they were purchasing or more than they were purchasing in the past.

I firmly believe that our products are positioned well and its national training day was focused all around on how our agents need to be... what they need to be doing to sell our products in a difficult economic environment. It is not about the economy effecting us it's about they are being question and people and ideals around what's going wrong with the economy and making sure that our agents are well prepared to deal with those objections.

I think its probably been a single biggest thing we've done in the last three years on a single event basis to get our field force inline with what they are doing and as Dan said with the Veteran agent moving slow at the beginning of the year, this National Training day was directly going out there to inject our veteran into to doing a better job and I believe it has, so to answer your question I believe in the Yen, that yes we are seeing some lower account penetration but my hope is that this National Training day combine with getting things, had things have already showing a much better trend, February and beyond that we are moving right back in the direction that it needs to be

Daniel P. Amos

And also remember again the number of new accounts was up 8.5% in the first quarters, so the number of accounts and the need for the products according to the employers about put in on payroll has grown significantly.

Sunit Kamath

Sanford Bernstein

Okay, thank you

Operator

Tom Gallagher with Credit Suisse.

Thomas Gallagher

Credit Suisse

Hi, just a question on persistency in the US declined about 200 basis point this quarter. Just wondering what was driving that?

Kriss Cloninger

This is Kriss. Well we did experience some... I'll say it's probably more seasonal thing in large part because we have big production in the fourth quarter. We do tend to have somewhat higher lapses in this sequential first quarter that is of lapses get process from the prior year big fourth quarter production. That's a trend... that's annualized in our computation and I'm not always satisfied about the first quarter number, I think it's somewhat overstayed but, quite frankly I didn't put a great deal of importance on it.

Thomas Gallagher

Credit Suisse

Okay. So, Kriss...

Unidentified Company Representative

Remember too that we've also been making an effort to sale some micro accounts we started initiative a while ago and half like it has to be your small business in... although we don't have any imperical [ph] data to really support the notion it wouldn't be surprising that if business are folding in this environment, it's the small business that we would could go first and that could be impacting some of the accounts that we had.

Unidentified Company Representative

Tom just add to my comment, I look back on my seasonality thing, in the first quarter persistency the last three or four years has been allowing 1% worse than it turned out for the year, and that to my seasonality seasonally comment.

Thomas Gallagher

Credit Suisse

But with that... Kriss, would it be fair to say that the 200 basis points declined may be half of that seasonality, the rest is the point that can't made?

Kriss Cloninger

I would think that correct.

Unidentified Company Representative

Yeah. My comment on the call that if you look at it on kind of on a rolling 12 month basis as opposed to annualizing the quarter, you still get a decline but it's a 40 basis point decline.

Thomas Gallagher

Credit Suisse

Okay, and then as we think about rolling that up and to earn premium growth, how should we expect that level to come through in 2008 rate? It was a little bit above 9%. Is that a reasonable run rate for this year?

Unidentified Company Representative

Yes. Our plan is pretty consistent with what we experienced in the first quarter, about 9, 3 or so.

Thomas Gallagher

Credit Suisse

Okay, thanks.

Unidentified Company Representative

In the range. I mean I have to quote ranges say, 9.5 and 3 is in the middle. Thank you.

Operator

Jeff Schuman with KBW.

Jeffrey Schuman

Keefe, Bruyette & Woods

Good morning. I was hoping to ask Paul little bit more about the U.S. recruiting. It was up a lot this quarter. It sounds like based on the economy that may continue, I guess that we've seen in the past that certain levels of recruiting is good, but at times when the system wasn't necessarily ready to absorb it, it was a bit of a challenge. How do you feel you positioned at this point Paul with the district sales coordinators to handle higher level of recruiting? You have the right number, is the system ready to absorb this and I am embrace this and can you move these people to productivity pretty quickly?

Paul S. Amos, II

Absolutely. I appreciate you asking that. The fact of the matter is I believe because of our training systems, because of the level of our state training coordinators and how our district sales coordinators involved into that training, that we are more prepared than any time in our history to take a high volume of recruits and make them successful. I believe that international training day just reemphasize exactly what we are doing, and while we don't necessarily see our recruiting uptick affect sales in the following 13 weeks. We do expect during the 2008 year for these recruits to have an effect on our sales, as well as on our new accounts, which you have already seen an uptick in because we know new associates generate a good portion of our new accounts. So, I feel very confident that there is 8.6% increase in recruiting will have a very good effect on what we are trying to do for the remainder of 2008 and beyond.

Jeffrey Schuman

Keefe, Bruyette & Woods

Great. Thanks a lot.

Unidentified Company Representative

Judy?

Operator

One moment. Mark Finkelstein with FPK.

Mark Finkelstein

Fox-Pitt Kelton

Good morning. I wanted you to just talk about medical sales in Japan, specifically Gentle EVER. It accounted for about 5% of total sales and I just wanted to kind of get your current thinking on those. Are they mainly previously declined applicants or are they new, are you seeing more new applicants and is the current level of sales sustainable or do you continue to think that it's going to kind of peak and then start to subside materially as you kind of get passed that, previous denied applicant base?

Paul S. Amos, II

Tohru? I can say some but why don't you... do you have any comments you want to make on it? Well, I will comment on it. Let me just say this that I believe that the Gentle EVER has been a nice addition. It has allowed us to go back. We believe that there were certain amount of people that were out there that

we had not had an opportunity to add a product to that we went back to, but it has also brought on a lot of new customers in the process. In regard to our abilities to sustain, I am sure there is some what of a spike in it. And we're not... I think we actually started in August, so we will... so I would expect it to stay strong through August and then for it to level out, at some point, normally 80% of what we did the year before is normally a number that's reasonable the next year but it being new, I am not sure.

I do think its worth noting that every new product we have ever introduced, even if we basically found somebody else to really start selling it first, how we've captured the market and taken it away from them. I mean medical insurance, we got in too late, and with the number one seller within a short time. This Gentle EVER taken away the substandard and now we are number one.

The message gets out that we offer the best product at the best price. And from my standpoint, our sustainability with these new products works much better and allows us to stay at a much higher level of consistently producing that amount than say one of our competitors, then only goes in and offers it to their existing customers. It gets out throughout all of the consumers in Japan that we truly are the best, and so I think we can hold the higher number because of that

Unidentified Company Representative

Let me add one thing to that comment. As far as the mix between previously declined applicants and current applicants, it may not meet the standard underwriting forever and therefore take Gentle EVER. It's a mix of those people and people that had not been previously declined and some that have. But, because of privacy laws, we're not able to directly approach people that have previously been declined. We have to approach them only in a say a mailing process that's designed to expose the product to a broader class of people. We're not allowed to go in and specifically target people that have been previously declined. So, the sales methodology in that targeted. I didn't know if we had covered that before or not.

Mark Finkelstein

Fox-Pitt Kelton

Okay, great. Thank you.

Operator

Darin Arita with Deutsche Bank.

Darin Arita

Deutsche Bank Securities

Thank you. Just a question on the Japan bank channel sales; they realized that's early days in the first quarter. But, can you give us a sense of the mix of business that have been sold through the channels, cancer versus medical and also to what degree consumers chosen the single premium payment option.

Unidentified Company Representative

I am not sure I got that.

Unidentified Company Representative

I don't think... we've seen... we hadn't seen hardly any of the single premium so far. I think, Tohru are you there you or did we lose you?

Tohru Tonoike

Yes. Let me have that. Yes. Almost all of the bank sales are not the single payment. That very small portion is a pay duct. But, mostly they are the level payments, and the incomes of the... type of the product, they have sold... there have to be a similar amount of cancer and medical. Cancer a little bit more than medical.

Darin Arita

Deutsche Bank Securities

All right. Thank you.

Operator

Steven Schwartz with Raymond James and Associates.

Steven Schwartz

Raymond James and Associates

Hey, good morning everybody. I am going to be bit of bigger. I wanted a follow-up first on the question of penetration Paul. I don't quite understand what you're getting. Why is... given a continuing channel, why would penetration be less? Do you have... are there continued employees that are dropping your policies? I am not quite getting the math here, the numerator and the denominator.

Paul S. Amos, II

I am sorry, maybe I misspoke. It's not the penetration of an existing account, is going down. It's the average increase in a existing account that we would normally have penetration-wise, is less. So if our account penetration was 25% and the second year we would expect... and these are not real numbers. We expected to go to 40%, its going to 35%.

Unidentified Analyst

Okay. Okay, that's great. I did not understand that. I didn't get that part at all.

Unidentified Company Representative

It is rising. It's just not rising at the same incremental amount that we would have expected in previous years of our existing account.

Unidentified Analyst

Okay, got it. And then if I can ask you a question on my own. Just revisiting the banks, I think you have 40 banks at the end of the year, 3300 banks... 3300 branches excuse me, do you know how many branches you have with the 90 that you sighted on the news release and what the 150 would the Shinkin banks might give you, what kind of branch numbers you might have?

Unidentified Company Representative

Tohru, are you on.

Tohru Tonoike

Yes I am. But, I am sorry I don't have that number at hand.

Unidentified Analyst

Okay. Can you get back to me?

Tohru Tonoike

Well, sure.

Unidentified Company Representative

Sure we will.

Tohru Tonoike

I will be happy to.

Unidentified Analyst

Okay, thanks.

Unidentified Company Representative

Let me just point out, and I know this is a gut call that I made last year, the end of the year. But I said, I thought we did more than ten times in the fourth quarter, while we did in the first quarter from banks. So we expect it to continue to grow.

Operator

Your next question is from Randy Binner with FBR.

Randy Binner

Friedman, Billings, Ramsey Group

Hi, thanks; quick question on the balance sheet. I saw that CDO allocation increased fairly significantly in the first quarter to around \$661 million from \$495 million. We're not seeing that allocation in investments grow, a lot of places. Are you seeing opportunities there, can we get some color on that? Thanks.

Jerry Jeffery

Hi it's Jerry Jeffery. Yeah, we're seeing tremendous opportunities and I guess on a percentage basis that appears large but on an actual basis, \$165 million is relatively strong. But, just to give you an idea what we've been able to achieve here. We are getting much higher yields than we had previously been able to get and not to get too technical but, our purchases are all AAA rated. Currently the ones we've been making in the first quarter. But, not only are they AAA rated but, previously we've been getting 30 or 40 basis point of what we call ratings cushion in the purchase we made. The ratings cushion that we didn't receive, we received in the first quarter range between 2 and 400 basis points. So, you mount a credit protection, if we are getting on new purchases and the yields we are achieving are much better than we've been able to in the past. So, we consider... we continue to think that this is very attractive space and it's not a core strategy but at the margin we think it as a season beneficial cost.

Randy Binner

Friedman, Billings, Ramsey Group

That's interesting, thanks. And what's the underlying collateral on the new stuff?

Jerry Jeffery

Well, the underlying refer [ph] insurances are all corporate credits and they are all investment grades.

Randy Binner

Friedman, Billings, Ramsey Group

Thank you.

Operator

Eric Berg with Lehman Brothers.

Eric Berg

Lehman Brothers

Thanks very much and good morning to everyone. I just wanted to follow-up on Steve Schwartz question regarding the general picture in the U.S. On the one hand you are saying that the increase in the penetration is, has slowed somewhat. I think Ken was saying that on an adjusted sort of normalized basis, there has been a modest deterioration. I think I heard Ken saying in persistency. But at the same token you're saying you have your national training day and things have gotten better in February and March. So, with all said and done, where does that leave us? Is business in the U.S. slowing?

Jerry Jeffery

Go ahead.

Daniel P. Amos

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I was just going to say that the one thing I think you left out Eric is the number of new accounts is accelerating, at 8.5%. So within the accounts it's smaller increase in terms of penetration but the number of new accounts that are coming on realizing they need additional coverage, right now is going up. So, those two things together is somewhat of an offset and that's why I think we are running 6.5% right now instead of flat is that. The new recruits are up because of the economy. The new accounts are up and it's a little softer than we'd like right now but the national training program is going to help hopefully offset that to a degree and we're hoping we'll get right back on track.

Daniel P. Amos

The other thing is Eric. I am thrilled with the recruiting. I mean remember in the past, we never have had such a turnaround in recruiting with four quarters of decreases going to such a strong increase in the first quarter. So traditionally in the past, you had strong recruiting lead to strong recruiting so those producers would continue to come off. We've finished changing and we are seeing the strong recruiting that began the first quarter. I believe that will take a little time to really see the effect of that. I don't however see it going anywhere but in a positive direction for us.

I am very excited about what's going to happen going forward. Can I qualify that directly? I don't believe I can. What I can tell you is that I do not believe there is anything broken with the U.S. business. I believe the demand for our products is greater than ever. I believe that at a time when people are discussing the economy it shows the need for our products to help them from a disposable income standpoint more than ever, and if nothing else, getting these additional accounts by those access to those in the future. So what do we have is higher penetration or higher penetration than we have had in the past. In the future, we will be able to go back and write even more business in those businesses. The economy, it makes it tougher but we are doing everything we can do to grow our business and I'm excited about where we are heading.

Eric Berg

Lehman Brothers

Thank you. Very helpful from, both point, thank you.

Operator

Tom Gallagher with Credit Suisse.

Tom Gallagher

Credit Suisse

Hi, just a quick follow-up. Can you just comment on the environment as it relates to the whole regulatory issue in Japan, do you think that's pretty much behind us now or, just an update there? Thanks?

Daniel P. Amos

I do think its better. I was over there in January unfortunately. I was supposed to be there a few weeks ago and dad had to have open-heart surgery and I didn't get a chance to go, but I'll be going after the shareholders meeting again. So I have not followed up since my January trip. But, I believe that its one of those things, no news is good news and we've heard nothing in any way that makes us think there, have any problems other than they've been totally happy with Aflac and what's going on and there have been no rumblings in the newspapers about the companies. So we think we are in good shape.

Tom Gallagher

Credit Suisse

Okay. Thanks.

Daniel P. Amos

By the way someone said, my dad is doing well. I've had a lot of people asking, he's home now. So, we are hoping we'll get him in the shareholders meeting.

Tom Gallagher

Credit Suisse

Glad to hear it, thanks.

Andrew Kligerman
UBS

Good morning. A couple of questions, maybe you can give a little color around the economy in Japan and how that might be affecting your sales outlook? And also, with respect to where you are in the bank channel right now, what's the process, how far long is the technical? I see in the release you mentioned 90 banks are signed up. How far along is the technical bank in terms of the training and when might they be in a position to have some material impact on sales?

Daniel P. Amos

I am going to let Tohru talk a little bit more than I will. But I can tell you that from the banks perspective, each one is totally different. Some of the banks jumped right on it, one in particular, and is doing great. Others are very bureaucratic and slow and their profits are rolling it out, which I think is a bad decision, but that's theirs. So it varies up and down the scale in terms of what's happening. But all in all, I would say to get them to full speed, if you look the average one, it's a quarter before they start picking it up. Training, everything along those lines, we had some that came out of the chute doing it. Others will be six months or longer. But I think on average, it takes at least a good quarter for them to get started. Tohru you want to comment?

Tohru Tonoike

Yes. And I think that was absolutely right. Of course the banks vary in terms of the size. Then the mega banks have several hundred branches and tens of thousands of employees. So it... it takes them to be fully prepared of some times close to a year. Some of the mega banks have been working preparation almost a year, and then are starting to work. But smaller banks... smaller banks can get up speed much quicker. So, on an average, I don't know but the quarter to six months is a... I think is a good estimate. And also the... I think you asked if economy in Japan is affecting our sales, and I understand that Japanese economy is slowing a little bit. But, we have no symptom of slowing down on our business yet, so we hope it doesn't affect us.

Andrew Kligerman
UBS

And then just may be talk a little bit about what kind of involvements your agents will have in this bank distribution and how they feel about it in general?

Tohru Tonoike

In most cases or some of the banks have their affiliates, which have been agents. For those banks, some of the banks use them to support them in say, administration or otherwise. But some banks are operating pretty much independently from their affiliates. It varies. But overall, the involvement of our existing agents are very limited in the bank channel business.

Andrew Kligerman
UBS

And how do they feel about it. Are they nervous, are they okay with it?

Tohru Tonoike

They have been very concerned and I think that some of them were nervous. But, the general feeling I am listening now is that they are say, kind of accepting that is another factor and they are... they seem to be prepared to the new environment.

Andrew Kligerman
UBS

Thank you.

Operator

Steven Schwartz with Raymond James and Associates.

Steven Schwartz

Raymond James and Associates

Hi, can you hear me? Hi, can you hear me?

Daniel P. Amos

Yes.

Steven Schwartz

Raymond James and Associates

Just a quick follow-up. Looking at the below investment grade holdings, maybe it has do with currency or maybe... maybe it's just a stupid question. But, looking at the par values of a number of the holdings that are listed there hold, Ford Motor credit, CSAV, whatever that is, and Bawa Capital. Just noticing that the par values have risen in the quarter, I am just wondering is that... do money go into those names because they are attractive, is it currency related or something else?

Daniel P. Amos

That's currency related.

Steven Schwartz

Raymond James and Associates

Okay.

Daniel P. Amos

There is no additions to any of those holdings.

Steven Schwartz

Raymond James and Associates

Okay. All right, thank you.

Daniel P. Amos

In fact, it's not, we are not prohibited to investing in below investment grade but as a policy we just have never done it.

Steven Schwartz

Raymond James and Associates

Okay. Thank u.

Operator

Tamara Kravec with Banc of America.

Tamara Kravec

Banc of America Securities

Thank you. Good morning. Just wanted to ask a quick question on the margin, the pre-tax margin in Japan and just based on how your sales are flowing, how you are feeling about continued margin expansion and what you have expected and how that's playing out?

Unidentified Company Representative

Well, I'll say its right in line with plan, Tamara. We had expected an improvement in benefit ratio on magnitude, 150 basis points. This year, we got 140 in the first quarter or 150 compared to the prior year, 140 compared to the... I mean, 140 compared to the year, 150 compared to the quarter. But, margin overall is up about 1.2%, and that's in line with our plan and expectation. So we would expect 1.2 or so percent improvement for year to play out.

Tamara Kravec*Banc of America Securities*

Okay. And can you comment at all about whether you think this is something that can continue in over a longer period of time.

Daniel P. Amos

Yes, we will give you some color on that at the flat meeting, the analyst moving and May, give you more details at that time. But, we continued to see some improvement in benefit ratio due to mix of business, some improvement relative to continued decline in healthcare cost per unit of service in Japan, lower days in the hospital and that sort of things. So, we will give you some more color on that in May. But I'd say, yes, its continuing to improve.

Tamara Kravec*Banc of America Securities*

Okay. And if I could ask just ask one quick one. The business to business initiatives that you have are those built into your 8% to 12% target for sales or none of those initiatives are in there?

Unidentified Company Representative

They are built into the 8% to 12% target for sales and they are a good reason why I feel very strong about what is going to happen. But, it is built into the existing 8% to 12%.

Tamara Kravec*Banc of America Securities*

Okay. Thank you.

Operator

Jeff Schuman with KBW.

Jeffrey Schuman*Keefe, Bruyette & Woods*

I guess I want to follow up a little bit on Andrew's question about kind of the mechanics of how you work with the banks. In terms of training and sales support I mean, take the mega banks for example, do you... just do kind of initial training with the banks staff, then the bank staff goes untrained, people in these hundreds of branches or is that something where you are involved in an ongoing basis training all these people, and then... likewise, on sales support, is that something that's handled internally or are you kind of in daily contacts supporting all these people in the banks?

Daniel P. Amos

It's a little... I'll let Tohru. Tohru comes from the banking side so he can give you a real good answer on this one. Tohru.

Tohru Tonoike

Yes. Most of the mega banks are doing the training, mostly in-house. We help them to be prepared for that, giving training to their employees. So we teach them, we teach their trainer. And also, some of the times we can visit the branches and train... give the training by ourselves. But mostly, training in... within the mega banks are handled internally. They have a large number of employees, a couple of hundreds who are specialized, who have the experience in the banking kind of the insurance industry and they

are dedicated to that insurance business. They have plenty resources, we have. For the smaller regional banks, very often and Shinkin banks, we very often ask to visit their branches and offices and provide the training to their employees working there.

Jeffrey Schuman

Keefe, Bruyette & Woods

So, going forward on kind of a daily basis, it sounds like you will be a little closer to certain development in the smaller banks, is that the case? Then at the mega banks, may be a little bit removed from kind of day-to-day operation, is that correct?

Tohru Tonoike

Yes. We have about 200 people who are specialized in this kind of business. So, they rotate amongst the banks which they are responsible for. So, we are sure that we can be in the position... we can be helping them in a sufficient fashion.

Daniel P. Amos

The answer to your question is yes, that's right.

Jeffrey Schuman

Keefe, Bruyette & Woods

Okay, great. Thank you

Unidentified Company Representative

Do the answer on just a couple of minutes to the top of the hour. We have got time for one more short question with an easy answer.

Operator

Thank you. Mark Finkelstein with FPK.

Mark Finkelstein

Fox-Pitt Kelton

And I think I can do that. Can you just give an update on which I guess the mega banks, which ones you are selling? I think there was a couple that we are going to start selling in April. I wanted to just kind of confirm whether that's the case or if not, when you expect them to start selling?

Daniel P. Amos

Tohru.

Tohru Tonoike

Yes. All of the mega banks including [indiscernible] banks, selling the insurance products, now. It varies... how... the sale is different but the... all of who are now selling that insurance products beginning April 24.

Mark Finkelstein

Fox-Pitt Kelton

Okay, great. Thank you.

Kenneth S. Janke

Okay. That will conclude our first quarter call and we greatly appreciate you joining us this morning. If you require any follow-up, please feel free to give Robin or myself a call on our toll-free number. If we don't talk with you today, surely we sure hope we'll see you at our analyst meeting on May 14th and 15th in New York. Thank you.

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