S&P Capital IQ

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Aflac Incorporated NYSE:AFL

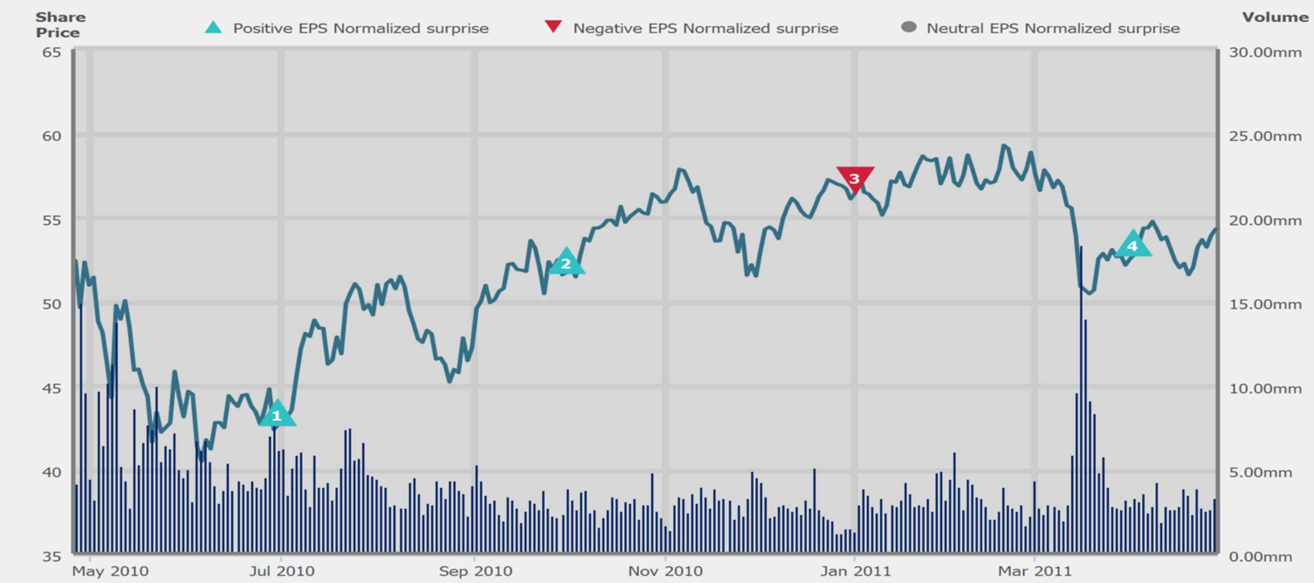
FQ2 2011 Earnings Call Transcripts

Thursday, July 28, 2011 1:00 PM GMT

S&P Capital IQ Estimates

	-FQ2 2011-			-FQ3 2011-	-FY 2011-	-FY 2012-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.54	1.56	▲1.30	1.55	6.24	6.46
Revenue (mm)	5712.08	5088.00	▼(10.93 %)	5751.14	22983.27	23309.00

Currency: USD
Consensus as of Jul-28-2011 1:19 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2010	1.33	1.35	▲1 1.50 %
FQ3 2010	1.39	1.45	▲2 4.32 %
FQ4 2010	1.35	1.33	▼3 (1.48 %)
FQ1 2011	1.51	1.63	▲4 7.95 %

Call Participants

EXECUTIVES

Daniel P. Amos
Chairman & CEO

Kriss Cloninger
President & Director

Paul Shelby Amos
Former Director

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

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Presentation

Operator

Welcome to the Aflac Second Quarter Earnings Conference Call. [Operator Instructions] Please be advised, today's conference is being recorded. I would now like to turn the call over to your host, Ms. Robin Wilkey, Senior Vice President of Aflac Investor Relations.

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

Thank you, and good morning, everyone, and welcome to our second quarter call. Joining me this morning is Dan Amos, Chairman and CEO; Kriss Cloninger, President and CFO; Paul Amos, President of Aflac and COO of U.S. Operations; Jerry Jeffery, Senior VP and Chief Investment Officer; and from Japan, we have Toru Tonoike, President and COO of Aflac Japan.

Before we start this morning, let me remind you that some statements in the teleconference are forward-looking within the meaning of federal securities laws. Although we believe these statements are reasonable, we can give no assurance that they will prove to be accurate because they're perspective in nature. Actual results could differ materially from those we discuss today. We encourage you to look at our quarterly report for some of the various risk factors that can materially impact our results.

Now I'll turn the program over to Dan, who will begin this morning with some comments about the quarter and our operations in Japan and the U.S. Afterwards, I'll follow-up with a few financial highlights for the quarter and the first half of the year, and then we'll be glad to take your questions. Dan?

Daniel P. Amos
Chairman & CEO

Thank you, Robin. Good morning, and thank you for joining us. I'm pleased with Aflac's overall financial and operational performance in the second quarter. I believe we've established a solid foundation toward achieving our annual operating earnings growth and capital strength objectives.

With half the year behind us, we believe we have substantially completed our proactive investment de-risking program from a realized investment loss perspective. I'll give you more details later, but first, I'll begin with a review of our operations in Japan and the United States.

Aflac Japan generated strong financial results for both the second quarter and the first 6 months of the year. Revenue growth rose 3.7% for both the quarter and the first 6 months. In addition, our pretax margin continued to expand, resulting in solid earnings growth for the quarter and for the 6 months. We are particularly pleased with the continued sales momentum in the quarter. New annualized premium sales in yen exceeded our expectations and rose 6.6% to JPY 36.1 billion for the quarter, which was a record for the second quarter production.

For the first half of the year, total new sales rose 9.4%. These results are even more remarkable when you consider that Aflac Japan overcame challenges resulting from the most destructive and devastating natural disaster in Japan's history. With the expanding bank channel in mind, Aflac Japan has developed innovative products that align well with the product needs of banks. Bank sales continued a strong growth trend with sales of JPY 7.6 billion, which represents an increase of 95.6% over the second quarter of 2010. Sales through banks accounted for more than 21% of the total sales for the second quarter. I'll mention how we believe more banks, mega banks, in particular would step up their efforts in selling Aflac products, and that's exactly what we've been seeing.

At the end of June, Aflac Japan was represented by 367 banks or more than 90% of the total number of banks in Japan. While many banks have agreed to sell our products, turning that agreement from ink on paper into sales does not happen overnight, especially with more than 20,000 branches representing 367 banks. It will take some time to facilitate training at all these locations. But we're continuing to see sales steadily improving at many of these bank branches as training continues and the banks expand their offering of Aflac's products. In many of these banks, sales representatives have gained experience at selling our products, and their confidence level in sales ability has also grown.

WAYS, which is especially popular with banks, was again a key driver to the growth in the second quarter. You will recall that WAYS in our unique hybrid whole life product that can be converted to a fixed annuity, medical coverage or nursing care benefits when the policy holder reaches a predetermined age. WAYS has been a phenomenal sales growth story, and in the second quarter generated an increase of 190.7% compared with the second quarter of 2010. Consumers find WAYS attractive because of its guaranteed principle and future flexibility of its benefit options. Banks like to sell this product because of the high premium and attractive commissions. And Aflac's profit margin on WAYS is more than double the profit margin for child endowment. On top of that, the profit margin is significantly enhanced even further when the policy holders elect to pay all their premiums upfront through the discounted advanced premium option. Importantly, 90% of the company's customers at the banks choose this type of payment. As our banking channel becomes a greater contributor to our top line growth, we expect sales of the innovative and flexible products to grow significantly in 2011.

With respect to child endowment product, as we expected, sales decline posting a decrease of 1.4% for the quarter. Furthermore, we have already seen sales of child endowment decline so far in July, and we expect sales of child endowment to continue to decline significantly for the remainder of the year. First and foremost, as we told you, we are shifting our focus from selling child endowment towards selling WAYS and our new cancer product, DAYS.

Second, having sold the child endowment product for 2 years now, we've already cycled through major first pass at selling our child endowment product to the eligible target of families in young people. At this range [ph], the remaining growth will primarily come from newborns, bearing in mind that Japan's birthrate is low. And finally, the government's towns and cities [ph] that initially helped fuel demand for this product is being re-evaluated for possible reduction or elimination. As such, we expect child endowment sales to diminish.

The foundation of the product portfolio has been and continues to be our cancer and medical products. Importantly, we maintained our position as the #1 seller of cancer and medical products in Japan, which confirms the continued popularity and demand for our innovative policies.

Following the March 2011 introduction of DAYS, cancer insurance sales increased 12.4% for the quarter. The enhancements to this new base policy speaks to the changing landscape in cancer treatments, as well as our commitment to remaining the #1 provider of cancer insurance in Japan. Sales of cancer insurance accounted for 24.4% of the total sales.

I don't think when the earthquake and the tsunami struck, followed by the nuclear issue, that anyone would have believed Aflac Japan sales would be up 6.6% for the second quarter and 9.4% for the first 6 months. This is a remarkable achievement and I am extremely proud of Aflac Japan.

As I've told you, following 2 years of strong sales results, the same comparisons get tougher as the year goes on, especially in the fourth quarter of 2011. However, with better-than-expected sales results in the first and second quarter, we are upwardly revising Aflac sales target to achieve flat to up 5% sales increase.

Now let me turn to our U.S. operation. We are very pleased with Aflac U.S. performance from both a sales and a financial perspective. Aflac U.S. generated a 5.9% increase in new annualized premium for the second quarter, and a 6.1% sales increase for the first 6 months. These results have benefited greatly from the addition of group products to the Aflac U.S. product portfolio. We are especially encouraged to see that the production from veteran agents continued to increase. Additionally, we continue to see crossover where Aflac's career agents embraced group products. To me, it boils down to giving our customers the choice between group and individual products. When it comes to selling group versus individual products, I've told our entire U.S. sales force many times that I'm product neutral. I don't care whether they sell group or individual products, but I do want both products to be offered at the work site to employers with more than 100 workers. That's because we don't offer the group product upfront, you can bet someone else will. I truly believe that if the employer wants group products and hears Aflac offers them, they'll choose Aflac over the competition. And that is proving to be true.

As you'll recall from both group and individual policies, we started driving sales earlier this year through specific product pushes called Smart Launches. Through these coordinated sales and marketing efforts, we look at the existing accounts, particularly those accounts most likely that need a particular product. We then align our field force resources strategically and efficiently target these accounts.

Our first Smart Launch was held in the first quarter and focused on promoting dental product. Building on the success of that effort, dental sales increased 44.1% over the second quarter of 2010. Our second Smart Launch promotes the critical care recovery product, which was previously called a specified health event product. Because this Smart Launch begins in the middle of the second quarter, it's too early to quantify its full impact, but we're excited about how our sales is embracing both the product itself and the Smart Launch.

On the distribution side, our strategy, we've said many times before that today's recruits are tomorrow's sales. Field force recruiting continues to benefit from a targeted national advertising campaign, generating a 10.2% increase of recruits for the second quarter and 11.9% for the first half of the year. We believe improved Aflac's U.S. sales, not only reflect our intense focus on supporting our field with enhanced products, including group products, but also reflects better resources and training that helps our sales force better approach selling in the current environment.

We will continue to help our entire distribution network, new and veteran agents, as well as brokers, with ways they can improve their performance, because they are essential part of our strategy and our success. We continue to believe the U.S. is a vast and accessible market for our products, and we are building our business with that potential in mind. We also believe the expectations at Aflac U.S. sales growth for 2011 will be flat to up 5% is reasonable. Our sales and recruiting trends are working in our favor, and I feel even better today than I did at the Analyst Meeting in May, and I'm optimistic that these trends will continue. It's clear that the addition of the group product platform and our growing broker initiative only served to enhance our ability to leverage Aflac's brand to reach more customers, large and small, across the United States.

Now let me update you on Aflac Inc. results. Overall, we're pleased with Aflac's financial performance. Operating earnings per diluted share rose 15.6% to $1.56 for the quarter, or 15.6% or $3.19 for the first 6 months. Excluding the benefit of the stronger yen, operating earnings per diluted share rose 7.4% for the quarter and 8% for the first 6 months. Consistent with the company's previous stated proactive investment de-risking objectives, net earnings in the second quarter included pretax realized investment losses of $668 million, or $453 million after-tax, which is $0.96 per diluted share.

During the second quarter of 2011, we sold investment securities with an amortized cost of $1.5 billion, resulting in a realized pretax loss of $182 million. The most notable sales in the quarter included several transactions that lowered our exposure to Peripheral Eurozone Holdings (sic) [Securities]. In addition, the company impaired certain securities resulting in a pretax loss of $528 million. These impairments included exposures to 2 Portuguese banks. As a result of our proactive investment de-risking program, Aflac has significantly reduced Peripheral Eurozone, Perpetual and Financial exposures on an amortized cost basis. As the world stands today, we believe we have substantially completed our proactive investment de-risking program from a realized investment loss perspective and we are comfortable with the current holdings in our below investment grade securities. Our unrealized loss position and below investment grades was $470 million at the end of the second quarter out of $93 billion in investment portfolio. The last time our unrealized loss position in this category was that low, was 2008 pre-financial crisis. Let me tell you that if we thought there was a question with the remaining below investment grade holdings, this would have been the quarter to have taken the action by either selling or impairing them.

The strength of our capital position has allowed us to pursue our proactive investment de-risking program to further strengthen our balance sheet and enhance shareholder value for the long term. As we have communicated over the past several years, maintaining a strong risk-based capital or RBC ratio remains a top priority for us. Although we've not yet completed our statutory financial statements for the second quarter, we estimate our RBC ratio will be within the range of 480% to 520% at the end of June.

Additionally, we estimate that the solvency margin ratio will be between 520% to 535%, based on the revised calculation methods for the quarter ending June 30, 2011. In Japan, even with significant proactive investment de-risking program in the second quarter, our preliminary solvency margin ratio calculation shows a slight improvement over the solvency margin of 512% for the quarter ending March 31, 2011. We are comfortable with this level, and absent a significant change in the market such as a sudden spike in interest rates, we anticipate it will improve. We also believe these ratios, our overall financial condition prove solid support to our single A credit rating.

As you'll recall, 2010 marked the 28th consecutive year of a dividend increase. Our objective remains to increase the cash dividend, generally in line with the earnings growth before the impact of the yen. The board will again evaluate the dividend increase later this year, but I am confident we will extend our consecutive annual dividend increases to 29 years.

Additionally, you'll recall that we resumed our share repurchase program in the fourth quarter of 2010. We purchased 1 million shares in the second quarter, bringing in the total number of shares purchased for the 6 months to 4.1 million shares. We anticipate ending up at the low end of the 6 million to 12 million shares repurchase target in 2011.

Despite the challenges of the low interest rate environment especially in Japan, we now have 2 good quarters under our belt. Additionally, we believe we've substantially completed our proactive investment de-risking program from a realized investment loss perspective. From an operational standpoint, I think we've done a very good job in managing our expenses. But keep in mind, as the year progresses, we anticipate increasing our spending, particularly on marketing and IT initiatives.

Taking all those factors into consideration, I want to reaffirm our 2011 objective of growing operating earnings per diluted share at 8%, excluding the impact of the yen. Looking ahead with this clarity and the year half completed, we expect 2012 earnings per diluted share to increase 2% to 5% on a currency neutral basis. This upward revision to our 2012 earning objective assumes no additional significant investment losses and no meaningful decline in interest rates.

Furthermore, once the effects of the proactive investment de-risking program and low investment rates have fully integrated into the financial results, we would expect the range of earnings growth in the future years to improve.

I'm pleased with Aflac's overall results for the quarter and for the 6 months. And I can tell you the global financial challenges we've all seen, especially in the changes in the investment environment, have only served to re-energize my enthusiasm as the CEO of this company. And I wouldn't trade places with any other CEO in the world.

And now, let me turn the program back to Robin. Robin?

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

Thank you, Dan. Let me get through some second quarter numbers starting with Japan. Beginning with the top line, in the interim's revenues were up 3.7% for the quarter, investment income was down 5% for the quarter. But excluding the impact of the stronger yen on Aflac Japan's dollar denominated investment income, net investment income declined 0.9% in the quarter.

The annualized persistency rate, excluding annuities, was strong for the first half of 2011 at 94.3% compared with 94.0% in 2010. In terms of quarterly operating ratios, the benefit ratio to total premiums that declined slightly to over last year, it was 69.9% in the quarter compared with 70.0% a year ago. The expense ratio for the quarter was 19.2%, down from 19.9% a year ago and a pretax margin remained stable at 21.1% in the quarter. Pretax earnings increased 3.4% for the quarter in yen terms.

For the quarter, we invested our cash flow in yen securities at a rate of 2.16%, including dollars. The blended rate was 2.67%.

As part of our strategy to address the low interest rate environment in Japan, we made dollar denominated purchases totaling $1 billion in the quarter, the total amount purchased through the end of June 2011 was $2.5 billion. The yield on these investments through June 30 was 4.72%. The portfolio yield was 3.51% at the end of June, down 5 basis points from the end of March and 20 basis points lower than a year ago.

Next, I'll turn to Aflac U.S. Total revenues rose 4.0% for the quarter. The annualized persistency rate for the first half of the year improved significantly and it increased to 75.2%, up from 71.1% a year ago. Persistency in U.S. was higher as a result of a return to a more normalized rate in 2011 after the decline of persistency in 2010 from the loss of a large account.

Looking at our operating ratios for the quarter, the benefit ratio to total premiums was 57.0% compared with 57.1% a year ago. The operating expense ratio declined from 31.3% to 31%, reflecting a delay in spending on several projects that will be started later in the year. The profit margin for the quarter was 18.4% compared with 17.7% a year ago. In terms of U.S. investments, the new money yield for the quarter was 5.72% versus 6.11% a year ago. The yield on the portfolio at the end of June was 6.7%, down 8 basis points from the first quarter and 28 basis points from a year ago.

Turning to some other items in the quarter. In June, we issued JPY 50 billion in the Samurai bond market, totaling JPY 50 billion or approximately $625 million. Noninsurance interest expense in the second quarter was $41 million compared with $31 million a year ago, primarily reflecting our debt issuance in the second half of 2010 of $750 million.

Parent Company and other expenses declined slightly from $16 million to $15 million in the second quarter of 2010. Total company operating margins rose, reflecting the improved profitability of Aflac Japan and Aflac U.S., both for the second quarter. Pretax margins rose slightly from 19.3% to 19.5%, and the after-tax margin increased slightly from 12.6% to 12.7%.

On an operating basis, the tax rate was 34.6% compared with 34.7% a year ago. Net earnings per diluted share for the quarter were $0.60 compared with $1.23 in 2010. And realized investment losses were $0.96 a share this year compared with $0.12 in 2010.

During the quarter, we realized investment losses of $453 million net of tax. $118 million were attributable to the sale of our holdings primarily in the various Peripheral Eurozone, Perpetual and Financial Securities. $343 million resulted from our impairments primarily in the Peripheral zone, Perpetual and securities of the financial sector.

We also had a $27 million net after-tax investment gain associated with foreign exchange impact and primarily passive derivative activities. As reported, operating earnings per diluted share rose 15.6% to $1.56. The stronger yen increased operating earnings by $0.11 per diluted share for the quarter. Excluding the yen's impact, operating earnings per share increased 7.4% for the quarter.

Lastly, let me comment on the earnings outlook for 2011. As we mentioned in our Analyst Meeting in May, given the continued low interest rate environment, especially in Japan, along with our concentrated efforts to de-risk the portfolio, we expect to increase operating earnings per diluted share, excluding the impact of the yen by 8%. Assuming an 8% increase in operating earnings per share, we would expect to earn $5.97 on a constant currency basis. If the yen averages $0.80 to $0.85 for the third quarter, we would expect operating earnings to be at $1.54 to $1.60 per diluted share. If we achieve our objective of 8% growth and the yen averages $0.80 to $0.85 for the full year, we would expect operating EPS to be somewhere in the area of $6.09 to $6.34 per diluted share.
Now, we will turn our attention to your questions. To be fair to everybody, please limit yourself to one question. And if you would first state your name and your company. We'll begin taking questions.

Question and Answer

Operator

Our first question comes from the Jeff Schuman of Keefe, Bruyette & Woods.

Jeffrey R. Schuman
Keefe, Bruyette, & Woods, Inc., Research Division

I wanted to talk a little bit about the issue of sort of cash positioning. You've bumped up the 2012 guidance range a bit and it sounds like that has a lot to do with greater clarity about capital position, the fact that you've done the heavy lifting on the portfolio. So that kind of clarifies the capital position. But there's also been this issue in terms of how you'd be positioned with cash. I'm wondering if you can talk about sort of stat earnings for this year, how you're set up in terms of regular dividend capacity for next year, and maybe what the holding company cash position is post the recent yen debt rate.

Kriss Cloninger
President & Director

This is Kriss, and I'll get into that for you, Jeff. The cash position right now at the holding company is good after the recent debt offering. We've got roughly $1.1 billion, $1.2 billion. We have to make the payment on the maturing Samurai notes of about $400 million in September. So let's anticipate that and say we've got about $700 million or so with the Life company -- I mean at the holding company. Having gone through the substantial bulk of the de-risking process from a realized loss perspective, we're now looking at our tax projections for the remainder of 2011 and doing cash flow planning for 2011 and '12. Let me just say that from a cash perspective, tax is a significant item that we have to look out for and watch because the realized losses are deductible for tax purposes in Japan, and we get a tax benefit from them. But in the U.S., in the consolidated return, we don't get to take a tax benefit for realized losses unless we have offsetting realized gains. So what happens from a cash perspective is that you reduce your income in the FSA statements in Japan, you get a tax benefit for it. It reduces the normal repatriation that occurs between Japan and the U.S. But in the U.S., we've got to pay the same amount of tax we would have paid if we didn't have the realized losses. So with a lower foreign tax credit, it means more cash is going out of the U.S. And so we've got a cash management exercise in front of us, and we're running through the numbers as we speak. We'll say that we're doing some -- developing some mitigation strategies that we can use to generate capital gains that we can use to offset some of these realized losses that are otherwise not deductible for tax purposes. And as you know, in the statutory accounting, a lot of the taxes were handled pretty much on a cash basis. There are some nominal deferred tax credits and the like that you can take advantage of but we pretty much reached the limit on our admissible deferred tax credits on the statutory. And so we're looking more at statutory taxes being incurred on a cash basis. That didn't totally answer your question in terms of numbers, but I don't have the numbers at the moment because we are finalizing the statutory results and running through the tax planning process. But we are very pleased that we think we've got the bulk of the losses behind us. I think it'll fare well for us not having to offset the strong operating earnings by realize losses for RBC purposes, for solvency margin purposes and the like. And ultimately, our cash position will improve even more.

Operator

Our next question comes from Ed Spehar with Bank of America.

Edward A. Spehar
BofA Merrill Lynch, Research Division

I would like to follow up on this line of questioning. I guess one of the disappointments at the fab meeting, I think, was the view that we got from management, that de-risking and share repurchase were mutually exclusive exercises, at least to some extent. And I guess, if we look at where we are today, you're saying that de-risking is substantially done, and also if we update the uncommitted cash flow analysis that you gave us at the fab meeting, the number you came up with then was, I think, $565 million for this year.

But that assumed no refinancing of debt. So now we've got $625 million that's coming in that was not assumed in that calculation. So the uncommitted cash at the holding company now is around $1.2 billion or twice what you guys had said at fab. So I understand the tax management and everything else, but I also know that there's extraordinary dividend capacity. If you needed to do that, I'm sure you could probably do that. $1.2 billion of uncommitted cash at the holding company at current share price, which happy to say is 5% higher than it was yesterday, is 26 million shares. So I was wondering if you can maybe, Kriss, go in a little bit more detail on this, because I think this was obviously a point that a lot of people were focused on.

Kriss Cloninger
President & Director

Ed, let me say that if we left the impression that share repurchase and financial de-risking were mutually exclusive, then we miscommunicated. They're very closely linked because they directly affect our ability to generate earnings on a statutory basis, and our dividend capacity is -- normal dividend capacity is controlled by statutory earnings, less realized losses. And we think...

Edward A. Spehar
BofA Merrill Lynch, Research Division

I'm sorry, Kriss, can I stop -- sorry, Kriss. I meant when I said mutually exclusive, I meant that you couldn't do both at the same time. That if you were de-risking, you weren't going to be buying back a lot of stock.

Kriss Cloninger
President & Director

Oh, well, you're correct, and that's the point I was trying to make. So to me, they're directly linked. And when we were at the fab meeting, we, quite frankly, weren't totally sure what the level of financial loss associated with de-risking would be, but we aggressively pursued it, not only after fab but before fab. We did a lot of de-risking in the first quarter and we followed it up with more in the second quarter. So now we've got more visibility. And so that outlook for share repurchase is significantly improved. And I'll be able to give you a better update, Ed, on anticipated share repurchase activity after we complete this cash management exercise we're going through now trying to project our tax position and our cash position and our statutory earnings for the remainder of 2011, taking into account the realized losses that we incurred this quarter. I can say that from an earnings perspective, we don't need to do a lot of share repurchase in the remainder of 2011 to make our earnings target. And we're somewhat -- we're always conservatively biased when we're looking at meeting our earnings estimates and certainly significant levels of share repurchase bolster earnings capability. Part of the reason we raised the guidance for 2012 from 0 to 5 to 2 to 5 was we kind of eliminated some of the murkiness associated with the cloud around how much realized loss we would end up taking as part of de-risking, and how much share repurchase we were going to be able to do. I put out there in assumption that we might do no share repurchase in 2012. But I think that's off the table now. We'll definitely be able to do some share repurchase if our operating assumptions are met. But whether we're in a position to apply $1 billion or $2 billion to share repurchase, we just hadn't determined yet. But those are still pretty high numbers, because we do still have a fairly uncertain outlook, I think, as far as other economic developments. I mean, we've got to get the stupid debt deal done in the U.S. for one thing, and who knows how that's going to affect world markets. But we've assumed that as of this day, and with no materially adverse economic developments, we're going to be in good shape.

Operator

Our next question comes from Andrew Kligerman with UBS.

Andrew Kligerman
UBS Investment Bank, Research Division

Can I get a better color on the trends in recruiting agents? You had a nice move in the first quarter, recruits up 13.5%, 10% plus in the second quarter. And the licensed agents year-over-year are flat right now, the licensed sales associates. So I'm wondering, if you maintain this double digit recruiting pace, where do you think the delta will be in licensed sales associates over the next 12 months? And if you maintain this recruiting pace, where do you think sales can go next year, single-digits, double-digits?

Paul Shelby Amos
Former Director

This is Paul. Let me begin by talking about recruiting. I must tell you that licensed sales associates is a number that we publish, but it's not a number that I manage our business from. As I've said in years past, really beginning about 2005, focused more on average weekly producers, the ability to produce the amount that's being produced is kind of the 2 factors that drive our business. I think Tom and our sales team, working with our marketing team, has done an awesome job of turning around our total recruiting. And I think it's 2 consecutive quarters of great recruiting. It really began back in the end of the third quarter of last year when we set the initiative, began communicating it. I told you at that time, it would take a period time to begin to get it turned. The combination of focus on that topic as well as our DRTV and some of the things that we've done that generated incredibly good results, and I'm very happy with where recruiting is. What I do want to see longer-term is that, that recruiting generates both new associate premium, as well as average weekly producer growth over the long term. I'm less concerned about the number of licensed agents. It's not how many people have a license, it's how many people are actually selling our products that makes a difference for us.

Andrew Kligerman
UBS Investment Bank, Research Division

So with the weekly average producers kind of flattish in the first half of the year, are you concerned about that? I mean, I know Dan was saying today's recruits are tomorrow's sales. I really like that. So the recruits are big. Do you think that...

Paul Shelby Amos
Former Director

It's a time lag, Andrew. It's a time lag. I mean, my expectation is although there is no guarantee that as we move forward, if things are moving in the right direction that average weekly producers should begin to grow. And so recruits happen first, we would train them, we'd get them into production and eventually they'll begin to make headway on moving toward being a part of our average weekly producer. So our recruit and train model should begin to generate that.

Andrew Kligerman
UBS Investment Bank, Research Division

[indiscernible]

[Technical Difficulty]

Operator

Our next question...

Paul Shelby Amos
Former Director

No. No, he got cut off. Let me finish. I don't know if you can bring him back but if not, I'll just finish the second part of his question. He asked about the sales. And I think it's a fair question. What I told you at the end of last quarter was we had one data point. We now have 2 data points, and I would much rather see 3 and 4 before I begin to make predictions. Am I happy with where we are? Yes, I'm very happy with where we are. If you take the first quarter and you take out the additional day, it drops it from 6 back to 5, and if you take the extra day and add it to the second quarter, it takes it from right at 6 and moves it to 7. So I'm very happy, I think the second quarter was better performance than the first quarter in terms of what I think, and I'm hoping to continue to see things move. Again, this is only our second big year in group business. We don't know how the fourth quarter is going to pan out. We continue to see positive signs as we move forward. But the fourth quarter number from last year is a large number. So I want to see where things go. I think some time in October, if not January, I'm going to feel comfortable really talking about things, but I think it would be a mistake not to say that momentum is extremely high. I've been traveling around the country meeting with our sales associates, they seem extremely optimistic. And I think that what we've done with our product portfolio has put us in a place that combined with our product marketing to be very successful going forward. But it's too early to say that the turn is completely in when you've got the economic factors where they are. We've dealt in the last few years with the economy being very difficult. I know this morning we got a good report on jobs supposedly, but in reality, we're not seeing jobs as optimistic out there in terms of small businesses as they were 180 days ago. So I want to see what's going to happen. I think our team is executing well with some performance places. We can continue to do better. But at the same time, there are economic factors that continue to hang over us, and that overhang will dictate how high we can go both the remainder of this year, as well as sales in 2012.

Operator

Darin Arita with Deutsche Bank.

Darin C. Arita
Deutsche Bank AG, Research Division

Had a question on the Aflac Japan's benefit ratio. It looks like the pace of the child endowment sales is slowing, and it sounds like it will continue to trend lower in the second half of this year. Just per the Japan benefit ratio guidance for 2012, if we think back from the financial analyst briefing in May, what level of child endowment sales did that contemplate, and how does that compare with the decline in child endowment sales that we're seeing?

Kriss Cloninger
President & Director

Darin, I think that the financial sales projection anticipated some decline in child endowment sales. I don't have those sales projections directly in front of me. But I believe that our actual experience is probably somewhat lower for child endowment sales than we had in the projection, partly because Dan and I have been directing Aflac Japan to reduce promotional efforts on child endowment and to increase promotional efforts on both the new cancer product and the WAYS product. And so we're trying to re-emphasize the desirability of selling the higher margin products. It's really the lower child endowment margin that's been driving the benefit ratio up some, and the overall margin preventing the expansion at the same level we've seen in the past. So we think the trends are moving in the right direction relative to selling higher margin products. Let me just leave it at that.

Daniel P. Amos
Chairman & CEO

Yes. The only other comment I would make is on top of all the disaster issues sales, trying to all of a sudden get your sales force to also change one of the products they're selling makes it difficult. But they've achieved it, and what you don't see is you see that sales were down 1.2% in endowment for the quarter. But what you don't see is that April was up, May was down and June was down even more, and our tracking for July shows it's even down even further. So they have definitely shifted. I give our management team at Aflac Japan credit for that. And as I've said, there are other reasons for that. It's an older product. It's been out there 2 years. And basically, they've made a pass at everybody, and now it's only the newborns. And in addition to that, there's a question of whether or not the government will even keep it or certainly reduce it. So all in all, I feel real good that that's in place in the second half. We're going to move on to WAYS which I've mentioned has more than 100% increase in the profit margin over the endowment.

Operator

Our next question comes from Tom Gallagher with Crédit Suisse.

Thomas George Gallagher
Crédit Suisse AG, Research Division

Just a question on the de-risking. Just so I'm clear on where things are likely to go going forward, Dan, it's the comment that your investment losses from a realized loss standpoint are pretty much done here. Is that because you don't have any intention to further de-risk peripheral Europe because you still have Italy, Spain and some Irish exposure? So should we take that comment to mean you don't intend to sell those down at all? Or is it because you do potentially expect to sell some of those positions down, but you just don't think you're going to have meaningful losses?

Daniel P. Amos
Chairman & CEO

I think we don't think we'll have meaningful losses. The one point that I wanted to make in that speech was that this is the time that we ought to hit everything we could. I mean we met and then we met again on -- look, if we've got it clean the house out, get it over with. And we have 4 others that we considered that were below investment grade. And we came to the conclusion that they were good. There was senior your debt on a couple of them. And so we made that decision that we thought they were all right. So to the best of our ability, unless there's some dramatic change, we think the majority of the losses are over. That isn't to say there may not be some small amount here and there or profit here and there. But I think it's basically over, and that's what we were trying to do, was end it by the second quarter. And we think we've achieved that provided there isn't any major issue that comes forward in the future.

Thomas George Gallagher
Crédit Suisse AG, Research Division

And so, Dan, should we take that to mean there won't be any more meaningful sales? Or is there still likely to be meaningful sales, but you just don't foresee substantial losses?

Daniel P. Amos
Chairman & CEO

I think we'll evaluate each position and look at it from an optimistic perspective of what we think might be out there. Certainly, we moved away and changed our focus to where -- as you know, we've moved away from financials. You've seen that cut dramatically. You've seen us move away in terms of the PIIGS and not made any investments there. So the numbers, as a percent of the portfolio, continue to drop and will continue to drop going forward. If we were offered opportunities to change investments in other areas, we'll evaluate it and see what it offers. We are truly going through a restructuring now, and viewing ourself from a pre-financial crisis to a post-financial crisis of our investments. And everything's on the table of looking at what will be our best strategy going forward to manage this company. And I really believe our operational issues are minor. I think we're running on, especially consider the economies, I think we're doing great operationally. So my biggest issue out there is investments. And we have a board that has an investment committee that is very laser-focused on this. And you're going to see us concentrating and giving more information to keep it as transparent as we can, everything we're doing and how we're doing it going forward.

Kriss Cloninger
President & Director

Let me just say that I think Dan said we're looking at things from an optimistic point of view. He really meant opportunistic.

Daniel P. Amos
Chairman & CEO

I'm sorry.

Kriss Cloninger
President & Director

That was one thing that I kind of tripped over there. But we're looking at things from an opportunistic point of view, being able to do the right thing at the right time. Otherwise, that was a strong statement.

Operator

Our next question comes from John Nadel with Sterne Agee.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

I wanted to take you back in time a bit, and maybe you could give us some perspective. Kriss, you alluded earlier to the folks in Washington and some risks we've got here. And you and Dan and others at Aflac were in your positions or at least in senior positions when Japan lost its AAA rating some time ago. So I was wondering if you could -- given that experience, if you could give us some of the lessons you learned from that event, how did it impact Aflac's results if at all. Any observations that might be helpful to us in thinking of what a U.S. downgrade from AAA to AA might mean.

Kriss Cloninger
President & Director

Well, I don't believe it had any significant effect on us directly, John. I know that we were rated AA at the time and the rating agencies told us that we couldn't be rated higher than the government of the country where we had our principal operations. And so that was one indirect effect. It really had no significant effect on JGB yields that I was aware of. I'd say the yields went up somewhat, but so did the [indiscernible] went up a lot when Japan got down rated. So I just alluded to the budget dilemma in Washington because my big concern is not so much the effect on our U.S. Treasuries but what overflowing effect it might have to Europe and even Japan, particularly if it impacted interest rates in Europe or economic conditions in Europe, which I doubt that it would. But anyway, we don't have any specific major concerns about the budget dilemma in Washington. I just used that as an example of economic uncertainty that seems to crop up every day.

John Matthew Nadel
Sterne Agee & Leach Inc., Research Division

Okay. I appreciate the color. And just one real quick one for Jerry, if I could, just thinking about the exposure that remains to Spain, both sovereign and financials, as well as Italy, can you just give us your current perspective? I mean, since the end of June, clearly CDS spreads have widened. Those remain, at least relative to your equity base, still pretty meaningful exposures. So any update there?

William Jeremy Jeffery
Former Senior Vice President of Fixed Income Investments

Look, I think they are meaningful exposures, but I think a lot of context needs to be applied when you look at these exposures. Take Spain, for example. Of our government exposures, 70% of those exposures have below investment grade put language. And that is a provision that's unique to the exposures we've negotiated. In our non-government, non-financial exposures in Spain, about 50% of our electric utilities, which is really the major component of our exposure to nongovernment spending exposure, have leveraged and/or interest coverage covenants of our nonutility industrial exposures, [indiscernible] about half of them have below investment grade puts on them. There's a lot of the context, it's not immediately evident when you look at our exposure to Spain. It's a similar situation in Italy. I would point out, in Italy, our financial exposure in Italy is extremely low. It's $183 million and that is senior indebtedness, and I don't think anybody is looking at burden sharing for senior debt, particularly in view of the recent releases as a result of the Basel III pronouncements of last week. We do have direct exposure to the government of Italy, which we're comfortable with in our utilities and industrials. Our utilities exposure in Italy of over 70% of those exposures have below investment grade put language. And our industrial exposure about 15% have a similar covenant protection to what I just described in Spain. So in the aggregate, it's not enough to just look at what the numbers are, but what the protections are that we have and individual credits that are nongovernment in both countries we're very comfortable with.

Operator

Our next question was from J. Gelb [ph] of Barclays Capital.

Unknown Analyst

I wanted to touch base on a few things. First on the outlook for new sales in Japan. It essentially implies that you're looking for a 4% to 5% year-over-year decline in the back half of 2011 to get to your guidance. And looking at past trends, it doesn't appear that link new sales in Japan always decline in the back half. So I'm just trying to understand why you feel you might be down year-over-year in the back half?

Tohru Tonoike
Vice Chairman of Aflac Japan

Yes. We made the projection earlier for the remainder of the year, we assumed that -- we think that factors into the consideration, and particularly that ones we are concerned. And now we didn't change those numbers in each country, but the more we see that the actual sales conditions, we are simply getting more comfortable with the projections. So that's why we increased that projection to some extent.

Daniel P. Amos
Chairman & CEO

I think the other comment I would make, it's the fourth quarter we're worried about. The third quarter, I think, will have a nice increase. But I think the fourth quarter, our numbers were so big. I think it was the biggest quarter in the company's history.

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

Two fourth quarters in a row, so we have 2 years.

Daniel P. Amos
Chairman & CEO

And that's our real issue. If we know that -- it's not the trending down us much as it is the comparison to the previous years. So we'll have to watch it and see. But there's no trend that we think is changing in terms of the projection of our sales going forward. It's simply the comparisons of the year before that's our worry.

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

And comparisons to the year before that. The fourth quarter in 2010 and 2009 were record-breaking quarters.

Unknown Analyst

I see. Okay. And then more broadly, is it fair to say that pretax operating earnings growth for the U.S. could be faster going forward than Japan in local currency?

Kriss Cloninger
President & Director

Right now, our projections for '11 and '12 have been growing at approximately the same rate. It is possible that U.S. could start growing faster than Japan because more of the U.S. premium income is first year premium, as opposed to -- it's about 33% first year in the U.S. compared to about 9% first year in Japan. So the U.S. is more reactive to changes in new sales and earnings directly follow or in premium. So it's possible that if U.S. gets good new sales, that'll convert to premiums over the course of the year and the growth rates could be faster in the U.S. than Japan.

Operator

Our next question comes from Steven Schwartz of Raymond James and Associates.

Steven David Schwartz
Raymond James & Associates, Inc., Research Division

Question for Paul. Paul, the group has gone great through the agents. I was hoping that maybe you could talk to or maybe give some indication of what kind of traction you're getting in brokerages.

Paul Shelby Amos
Former Director

Steve, that's be great to talk about it. You're right. The field force we did comment on in Dan's comments, it was doing extremely well in selling the group products. And I think that has been the greater surprise to us. I think all along, we assumed that group products would sell well through the broker market. As I've said, since we launched our broker initiative really going full time in 2009 and all the implementations we've made, things continue to go in the right direction. We're moving. We're growing and we're seeing positive growth in that. I feel confident that we continue to build these relationships. Relationships on the local level have long since been something Aflac has done. We wrote almost $200 million for several years, leading up to launching of our broker initiative. The relationships at the regional level are coming on faster. It's just a level of our ability to get in and out of the brokerage offices. And then relationships on a national level have done well in terms of our procurement on the corporate level, and now we're beginning to move them down toward the producer level. So do I feel good about what's going on? I think we're executing a plan, I think we're moving in the right direction, I think we could always continue to find ways to operationally improve. But I'm still confident that the group business will continue to be something that opens up the broker market for us. And our agents that are selling that business is really just icing on the cake in terms of our ability to grow. But it just -- we really point that out to you all to show you more that the group business isn't a single channel move. It's something that applies for both the broker channel, as well as the field force channel, and has really reinvigorated a lot of things in our business.

Robin Y. Wilkey
Former Senior Vice President of Investor & Rating Agency Relations

Okay, I think we've reached the top of the hour. So I'd like to thank everybody for your questions and participating this morning. If you'd like to follow up with any questions later on, we'll be in the office today, and give us a call. Thanks so much.

Operator
This concludes today's conference. Thank you for participating.