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Globe Life Inc. (GL) CEO Gary Coleman on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-23-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $1.73 beats by $0.04 | Revenue of $1.14B (5.28% Y/Y) beats by $8.25M

Earning Call Audio

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Globe Life Inc. (NYSE:GL) Q3 2019 Results Conference Call October 24, 2019 11:00 AM ET

Company Participants

Mike Majors - EVP, IR

Gary Coleman - Co-CEO

Larry Hutchison - Co-CEO

Frank Svoboda - CFO

Brian Mitchell - General Counsel

Conference Call Participants

Jimmy Bhullar - JP Morgan

Andrew Kligerman - Credit Suisse

Erik Bass - Anonymous Research

Ryan Krueger - KBW

Ian Ryave - Bank of America

Alex Scott - Goldman Sachs

Operator

Good day and welcome to the Globe Life Inc. Third Quarter 2019 Earnings Release Conference Call. Today's conference is being recorded. For opening remarks and introductions, I would like to turn the conference over to Mike Majors, Executive Vice President, Investor Relations. Please go ahead, sir.

Mike Majors

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

Some of our comments or answers to your questions may contain forward-looking statements that are provided for general guidance purposes only. Accordingly, please refer to our 2018 10-K and any subsequent forms 10-Q on file with the SEC. Some of our comments may also contain non-GAAP measures. Please see our earnings release and website for a discussion of these terms and reconciliations to GAAP measures.

I will now turn the call over to Gary Coleman.

Gary Coleman

Thank you, Mike, and good morning, everyone.

In the third quarter, net income was $202 million or $1.82 per share, compared to $179 million or $1.55 per share a year ago. Net operating income for the quarter was $192 million or $1.73 per share, a per share increase of 9% from year ago.

On a GAAP reported basis, return on equity as of September 30th was 12% and book value per share was $65.96. Excluding unrealized gains and losses on fixed maturities, return on equity was 14.7% and book value per share grew 10% to $47.58.

In our life insurance operations, premium revenue increased 4% to $631 million and life underwriting margin was $181 million, up 8% from a year ago. Growth in underwriting margin exceeded premium growth due to higher margin percentages in our all distribution channels. For the year, we expect life underwriting income to grow around 7% to 8%.

On the health side, premium revenue grew 5% to $269 million, and health underwriting margin was up 1% to $61 million. Growth in premium exceeded underwriting margin growth, primarily due to lower margin percentage at United American. For the year, we expect health underwriting income to grow around 3% to 4%.

Administrative expenses were $61 million for the quarter, up 8.5% from a year ago. As a percentage of premium, administrative expenses were 6.7%, compared to 6.5% a year ago. For the full year, we expect administrative expenses to grow approximately 6% and to be around 6.6% to 6.7% of premium, compared to 6.5% in 2018.

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

Larry Hutchison

Thank you, Gary.

I'm going to go through the results of each of our distribution channels. I'll start by saying we were especially pleased with the year-to-date agent count growth, we've seen across all three of our exclusive agencies.

At American Income, life premiums were up 7% to $293 million and life underwriting margin was up 9% to $100 million. Net life sales were $60 million, up 9%. The sales growth was driven primarily by agent count growth. The average producing agent count for the third quarter was 7,578, up 7% from the year ago quarter and up 3% from the second quarter. The producing agent count at the end of the third quarter was 7,770.

At Liberty National, life premiums were up 2% to $72 million and the underwriting margin was up 12% to $19 million. Net life sales increased 12% to $13 million and the net health sales were $6 million, up 8% from the year ago quarter. The sales growth was driven primarily by agent count growth. The average producing agent count for the third quarter was 2,398, up 10% from the year ago quarter and up 5% from the second quarter. The producing agent count at Liberty National ended the quarter at 2,421.

At our Direct Response operation at Globe Life, life premiums were up 2% to $212 million and life underwriting margin increased 5% to $41 million. Net life sales were $30 million, down 1% from year ago quarter. Year-to-date, sales were down 1% due primarily to a decrease in juvenile life insurance mailing volume.

At Family Heritage, health premiums increased 7% to $74 million and health underwriting margin increased 12% to $19 million. Net health sales were up 9% to $18 million due to an increase in both agent count and agent productivity. The average producing agent count for the third quarter was 1,135, up 5% from both the year-ago quarter and the second quarter. The producing agent count at the end of the quarter was 1,236.

At United American General Agency, health premiums increased 8% to $103 million, while margins declined 10% to $14 million. Net health sales were $16 million, up 25% compared to the year ago quarter.

To complete my discussion on marketing operations, I will now provide some projections. We expect the producing agent count for each agency to be in the following ranges for the full year 2019: American Income, 7,350 to 7,450; Liberty National, 2,300 to 2,400; Family Heritage, 1,210 to 1,230.

Approximate net life sales are expected to be as follows: American Income for the full year 2019, 6% to 7% growth, for 2020, 5% to 9% growth; Liberty National for the full year 2019, 8% to 10% growth, for 2020, 6% to 10% growth; Direct Response for the full year 2019 down 2% to flat, for 2020, down 3% to 1% growth.

Approximate net health sales are expected to be as follows: Liberty National for the full year 2019, 7% to 9% growth, for 2020, 6% to 10% growth; Family Heritage for the full year 2019, 5% to 7% growth, for 2020, 5% to 9% growth; United American individual Medicare

Supplement for the full year 2019, 8% to 12% growth, for 2020, relatively flat.

I will now turn the call back to Gary.

Gary Coleman

I want to spend a few minutes discussing our investment operations. First, excess investment income. Excess investment income, which we define as net investment income less required interest on net policy liabilities and debt, was $65 million, a 5% increase over the year ago quarter. On a per share basis, reflecting the impact of our share repurchase program, excess investment income increased 7%. For the full year, we expect excess investment income to grow by about 5%, which would result in a per share increase of around 8.5%.

Regarding the investment portfolio. Investment assets are $17.2 billion, including $16.2 billion of fixed maturities and amortized cost. Of the fixed maturities, $15.6 billion are investment grade with an average rating of A minus. And below investment-grade bonds are $623 million compared to $682 million a year ago. The percentage of below investment-grade bonds to fixed maturities is 3.8% compared to 4.4% a year ago. This is the lowest this ratio has been in the last 20 years.

Overall, the total portfolio is rated A minus compared to BBB plus a year ago. This is the first time the overall portfolio rating has been A minus since 2016. Bonds rated BBB are 56% of the fixed maturity portfolio as compared to 58% at the end of 2018. While this ratio is higher relative to our peers, we have no exposure to higher risk assets such as derivatives or equities and little exposure to commercial mortgages in asset-backed securities. We believe BBB securities provide us the best risk-adjusted, capital-adjusted returns due in large part to our unique ability to hold securities to maturity regardless of fluctuations in interest rates or equity markets. Finally, we have net unrealized gains in the fixed maturity portfolio of $2.6 billion, $638 million higher than the previous quarter, due primarily to changes in market interest rates.

Regarding investment yield. In the third quarter, we invested $409 million in investment-grade fixed maturities, primarily in the financial, industrial and municipal sectors. We invested at an average yield of 4.12%, an average rating of A, and an average life of 29 years. For the entire portfolio, the third quarter yield was 5.47%, down 9 basis points from the 5.56% yield in the third quarter of 2018. As of September 30, the portfolio yield was approximately 5.45%.

At the midpoint of our guidance, we are assuming a new money rate of around 4% in the fourth quarter and a weighted average rate of 4.25% in 2020. At these new money rates, we expect the annual yield on the portfolio to be around 5.49% in 2019 and 5.38% in 2020. While we would like to see higher interest rates going forward, Globe Life can thrive in a lower for longer interest rate environment. Extended low interest rates will not impact the GAAP or statutory balance sheets under the current accounting rules since we sell noninterest sensitive protection products.

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

Now, I'll turn the call over to Frank.

Frank Svoboda

Thanks, Gary.

First, I want to spend a few minutes discussing our share repurchases and capital position. The parent began the year with liquid assets of $41 million. In addition, as is the norm for Globe Life, the parent will generate excess cash flow in 2019. The parent company's excess cash flow, as we define it, results primarily from the dividends received by the parent from its subsidiaries less the interest paid on debt and the dividends paid to Globe Life's shareholders.

We anticipate our excess cash flow in 2019 to be approximately $375 million. Thus, including the assets on hand at the beginning of the year, we currently expect to have around $415 million available to the parent during the year. As discussed on our prior calls, we accelerated the repurchases of $25 million of Globe Life stock into December

2018 with commercial paper and parent cash. We have utilized $15 million of the 2019 excess cash flow to reduce the commercial paper for those repurchases, leaving approximately $400 million available to the parent, including the $50 million of liquid assets we normally retain at the parent.

In the third quarter, we spent $83 million to buy 933,000 Globe Life shares at an average price of $89.26. So far in October, we have spent $25 million to purchase 265,000 shares at an average price of $93.50. Thus, for the full year through today, we have spent $282 million of parent company cash to acquire more than 3.3 million shares at an average price of $86.33. Taking into account the $282 million spent year-to-date, we now have around $118 million of available cash, of which $50 million will be retained at the parent, leaving approximately $68 million for use in the remainder of the fourth quarter.

Looking forward to 2020, we preliminarily estimate that the excess cash flow available to the parent will be in the range of $365 million to $385 million. As noted on previous calls, we will use our cash as efficiently as possible. If market conditions are favorable and absent alternatives with higher value to our shareholders, we expect that share repurchases will continue to be a primary use of those funds.

Now, regarding capital levels at our insurance subsidiaries. Our goal is to maintain capital at levels necessary to support our current ratings. As discussed on our previous calls, Globe Life intends to target a consolidated company action level RBC ratio in the range of 300% to 320% for 2019.

Finally, with respect to our earnings guidance for 2019 and 2020. Our third quarter earnings were slightly higher than we anticipated, primarily due to favorable life claim fluctuations during the quarter, plus a onetime $1.2 million consent fee received on the forced exchange of one of our bond holdings. As a result, we are now projecting net operating income per share will be in the range of $6.71 to $6.77 for the year ended December 31, 2019, a $0.02 increase at the $6.74 midpoint of this range over the prior quarter midpoint of $6.72. For 2020, we are projecting the net operating income per share will be in the range of $7 to $7.30, a 6% increase at the midpoint from 2019. Growth will be impeded in 2020 due to the lower interest rate environment, which we currently expect to continue through 2020.

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

Larry Hutchison

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

Question-and-Answer Session

Operator

Thank you very much. [Operator instructions] Our first question will come from Jimmy Bhullar, JP Morgan.

Jimmy Bhullar

I had a couple of questions. First, on Direct Response. Your margins seem like they are starting to recover now. To what extent -- given some of the changes in pricing, the marketing, to what extent do you think this is the continuation of a trend? And, are the margins that you reported in the third quarter sustainable in Direct Response? And then, also, just on sales in Direct Response, I think you had been expecting an improvement in late 2019. Do you still expect sales to turn positive in the fourth quarter and what your outlook is into 2020?

Gary Coleman

Jimmy, first of all, the Direct Response margin is at 19.5% in the third quarter. That was a little bit higher than expected. And we think for the year that there’ll -- be between 18% and 18.5%, that's for 2019. And as far as 2020, our preliminary guidance there is that we will still be at around the 18% level. We talked about a couple of years ago that that's where we thought we would get today, 18% where we'd get to. We're there now, and we think it's going to be stable.

Frank Svoboda

Yes. One thing I'd just add to that, Gary, is that we're pleased we're seeing a real stabilization in the policy obligation percentage there at around 54%. And so, I agree with Gary that we'd expect that 18% to looking forward around that level, anyway. Probably the one thing in the Q3 that we benefited from and there was a little bit of a fluctuation on our amortization of our acquisition costs due to just updating some models and we have some favorable persistency, we don't really see that continuing into -- into Q4 -- for operating our Q4 a little bit from where we saw Q3.

Larry Hutchison

Jimmy, I think you also have a question about fourth quarter sales in Direct Response. And we are expecting to have lower sales in the fourth quarter. This is due to the lower juvenile mailing volumes in the third quarter. The decline has been due to the weaker than expected juvenile response rates.

Jimmy Bhullar

Okay. And then, for Gary or Frank, how much insight do you have on the changes in accounting for long duration contracts? Obviously, that's been delayed by a year. But, how do you think your book value and/or future earnings would be affected by it?

Frank Svoboda

Yes. Jimmy, we do continue to work through the implementation of that new guidance. We are pleased to see that it won't be standard for another year just to give us more time, and I think the industry as well to really make sure we understand what the implications are. We do have some ideas on directionally, yet at this point in time, still working through a lot of the details. So there's not a lot of detail to share. I think at current -- one thing we would say is that at the current interest levels, we do anticipate that the reserves would have to -- reserve levels would end up going up. So, it would have some negative impact on that overall equity. And so, there will be some adjustments there. Now, there's a certain portion of that that's going to be included in other comprehensive income that as far as what the amounts are and what that's actually going look like, we really don't have anything to share at this point in time.

Operator

Our next question will come from Andrew Kligerman, Credit Suisse.

Andrew Kligerman

A first question, the health margins were 100 basis points lower year-over-year on lower Medicare Supplement margins at United American. And I guess the question is -- will these margins, they need to face pressure from higher medical inflation for MedSup products? Do you think we're at kind of a level where it's going to stay?

Gary Coleman

Well, Andrew, we have seen an uptick in the clients this year. And as you mentioned, I think it's industry-wide. Our expectation now is that going forward that the policy obligations, say in 2020 will be in the 65% to 66%, somewhere in between that range. It’s early. And I think when we give our guidance in the fourth quarter call, I think, we'll have a better feel for that.

Andrew Kligerman

Okay. And then, what was driving the strong health sales growth at United American and Family Heritage in the quarter? It was pretty robust.

Larry Hutchison

United American, the growth was driven primarily by the individual business. In the individual business, market conditions are favorable from a pricing standpoint at this time. Also, we had some strong growth from some of our larger agencies. At the Family Heritage, the sales growth is driven by a rise in agent counts and greater productivity.

Andrew Kligerman

Okay. And then, lastly, just on the new money yields. It was interesting that you came in with a new money yield of 4.1% in the quarter. Just given that last quarter you had a 5% new money yield -- and I get that interest rates came down pretty sharply, but maybe a little color on why it was such a steep drop off quarter-over-quarter?

Gary Coleman

Well, Andrew, the biggest part there was the drop in the treasury rates during the quarter. And we -- to a lesser extent, the quality of the bonds purchased in the third quarter is a little higher than we had in the second quarter. But, the big part of it was out -- of that 4.12% that we had in the third quarter, the treasury rates from the -- the spreads were pretty much the same but the treasury rates had dropped by 60 basis points. And so, that's what's impacted our new money rate that we're projecting for the fourth quarter and for 2020 because for all we can see, those rates are going to be that low, going forward.

Andrew Kligerman

Yes. I think, you said a little earlier that it's going to be 4.25% is your projection next year for the new money rates. Is that right? Do you expect a little rise in treasury?

Gary Coleman

Yes.

Andrew Kligerman

Yes. You do?

Gary Coleman

Yes. In this slide -- a little bit higher treasury rates. And that's more toward the end of the year. That 4.25% was a weighted average rate, start out lower in the first part of the year. We do think it will increase slightly as we move through the year.

Operator

Our next question will come from Erik Bass, Anonymous Research.

Erik Bass

I just wanted to touch on life underwriting margins more broadly. It looks like they came in better than your expectations across almost all of the segments this quarter. And I know you touched on Direct Response, but was this just a particularly favorable quarter for mortality experience at American Income than Liberty, or is there something else that led to the improvement? And what are you assuming for life margins across the other businesses in 2020?

Gary Coleman

Erik, you're right. Across the board, we did have better mortality than expected. I think, the bigger surprise was Liberty. And in that one, we're thinking maybe a fluctuation because of the policy obligation there, the ratio there, 33.7 is lower than we've seen in quite some time. At American Income, we saw improvement there, but we think that -- we see improvement in mortality over the last several quarters at American Income. And the impact on the margin has been -- the underwriting margin going from 33% to 33.6%. That doesn't sound like a big change over $1 billion for the premiums, it does make quite a bit of change for our growth in earnings. The margins for this quarter were over 28% for the overall life business. We think that's going to revert back. And we're looking for underwriting margin for the full year to be around 27.9%, right at 28%. And our early thoughts on 2020 are that we’ll still be in that same range. What we have seen is increased or improved mortality, especially at American Income and also Direct Response over the last couple of years, we don't think we'll see improvement going forward, but we think we'll maintain the profit margins and where we are for this year. So, again, we think we'll be right around 28% for the year, and we think that that will hold in 2020 as well.

Erik Bass

And then, just moving to the health side. I guess, you gave some expectation around the United American margin. It looks like it would stabilize a bit. Is the reason that you're assuming flat sales that you're having to raise price a bit to reflect some of the experience?

Larry Hutchison

I think, it's given us strong growth in Medicare Supplement for 2019. It's really a tough comparable. So, our Medicare Supplement sales in market that's hard to predict. We use general agency distribution and those market conditions have changed rapidly. Although we're giving that guidance to be flat, it's really truly to give any certainty to the guidance.

Operator

Thank you. Our next question will come from Ryan Krueger, KBW.

Ryan Krueger

I have a couple of questions about the 2020 EPS guidance. Can you give us a sense of what your expectation is for admin expense growth in 2020?

Gary Coleman

Yes. Ryan, we're expecting around a 5% to 6% growth in administrative expenses.

Frank Svoboda

Yes. I was just going to say that we really anticipate that percentage of premium to be -- should probably stick to be about the 6.7% that we're anticipating here for 2019.

Ryan Krueger

I may have missed this, but could you also give the rough expectations for underwriting income growth for both life and health in 2020?

Gary Coleman

Well, for life, we're looking at 3% to 5% growth; and for the health insurance, we're looking at 4% to 6%.

Operator

[Operator Instructions] Our next question will come from Ian Ryave, Bank of America.

Ian Ryave

On the Direct Response margins, you're now at about 18% to 19% for life underwriting margin. And if we look back to 2011 through 2015, that margin percentage is in the 23% range. So, is there anything that's preventing you from getting back to that level?

Frank Svoboda

Yes. I think, the -- at this point in time, as we are having to kind of recalibrate our thought process, taking into account the additional information that we're getting on our underwriting and the results that we had from that during that 2011 to 2014 time frame, in the near term, we really think that it's going to continue to be in the 18% to 19% range. It's difficult to say over time as we work through testing and work through continuing changes, if we can get back to those levels. But, at least in the near term, we think we'll be closer to this 18% and 19%.

Ian Ryave

And does it have anything to do with the IRRs on new products? Is that a consideration as well?

Frank Svoboda

I don't think it's really the IRRs on the new products. The products are essentially the same. It's just getting the right mix of pricing and underwriting and working through all those to -- so we can really maximize the underwriting dollars, and trying to get the right mix to give us the right response rates, growth in sales, but at a price and a margin that we can ultimately grow underwriting dollars more so than -- we're not as focused on the underwriting percentage as much as we are trying to grow the underwriting dollars.

Ian Ryave

Got it. And then, just real quick on American Income sales. So, you talked about some near-term pressure from just opening up new offices. I assume this kept middle management busy, just onboarding and training new agents. Given the results last couple of quarters, they were particularly good this quarter, are we starting to see a turnaround in sales? Is this headwind starting to abate?

Larry Hutchison

I think we've had several factors in American Income that led to the industry growth. First, we had strong recruiting, a fewer terminations that was caused in part by the restructuring compensation. Year-to-date, our recruiting is up 9%. I think, another important factor is that for this year, we got middle management growth of 9% year-to-date. As you stated, we have 13 new offices that opened since January 2018. Middle management and officers have been replaced now. We're starting to see recruiting activity in those 13 new offices. All those factors are at work and increasing the agent count at American Income.

Operator

Our next question will come from Alex Scott, Goldman Sachs.

Alex Scott

First question I had was on agent count and recruiting. I guess just looking at the landscape and it sounds like some of these online distributors are looking for higher growth rates and there's a bit more conversation around sort of a gig economy type approach to agents and so forth. I'd just be interested to hear your take on that business model versus yours. And what you're doing to -- this result and you're now feeling pressure from agents leaving for that kind of a gig, or any color that you could provide on what's allowing you to strengthen your agent recruiting here?

Gary Coleman

To discuss the marketing generally, we operate in an underserved market. So, typically, we're the only agent in that home. And so, there's not a competition from other agents nor is there digital competition in a sense that this is a need that's filled. People aren't looking to buy life insurance. You're really explaining the need and people buy insurance if they understand the need. So, I think there will be a place for life insurance agents as we go forward. The thing is we're selling smaller face policies, and there's not real competition in that part of the market because other agencies or other companies can't control expenses. And expense control is so important in who you're writing lower face policies. So, for both, expense control and for the market that we serve, I think, the agents fill an important issue of market.

Alex Scott

Got it. So, in the last couple of years, thinking now longer term, I mean, you're not seeing any signs that would lead you to believe in any way that there is shifting consumer preference for online purchasing versus in-home with an agent in person. Do you still feel like all the trends are still there for this to be the business model long term?

Frank Svoboda

Yes. I think, all the trends are there. And we continue to grow the agency force. We continue to grow middle management and open offices. We haven't seen a change in persistency that we're losing policies, as we said our persistency and retention of agents remained unchanged. So, the short-term factors we discussed in earlier calls, was low unemployment rate, and we've dealt with that and much research and compensation and really focused on the training and retention of our new agents. So, I'd say the long-term business model that works.

Alex Scott

Got it. Okay. Maybe one last one for you guys. One of your peers has talked about efficiencies, and I think they were similarly organized with multiple subs under a holding company with maybe some different brands. So, I guess I'd just be interested to know if you guys are looking at anything structurally or if there's anything going on. I know you changed the name of the Company recently at the parent level. So, any thoughts on if there's sort of more to come in terms of thinking through like structure and efficiency, particularly as I know some of the tax -- the systems and progress towards the new accounting requirements, some companies are thinking more holistically, any insight there?

Gary Coleman

There is no major plans to change structure. First, from a legal structure, there is really no plans. We'll continue to have several companies, will operate under the Globe brand. But, as far as -- there is a lot of, for example, our systems and back-office operations, we consolidated those quite some time ago. What we're doing now is we're upgrading those systems, and that will benefit -- we'll have systems that are enterprise-wide. We've had them but what we're doing now is upgrade to some more efficient systems that will provide better service.

Frank Svoboda

Yes. And one thing I would just add to that, I think, from a pure structural perspective, we don't have that many operating companies to begin with, as we have taken a look at and considered it along with the branding strategy, the cost ultimately of moving that, working through changes to all policyholders and the transferring of policyholders through some type of a merger, getting -- or putting the entities together really wasn't worth the additional benefits that we might be able to achieve from that. As Gary said, we felt comfortable operating within the current operating -- current legal structures that we have and still being able to get efficiencies from the overall consolidation of systems and then working under the unified brand.

Operator

Thank you very much. [Operator instructions] Speakers, at this time, we have no further questions in the queue.

Mike Majors

All right. Thank you for joining us this morning. Those are our comments. And we'll talk to you again next quarter.

Operator

Operator

Thank you very much. Ladies and gentlemen, at this time, this concludes today's conference. You may disconnect your phone lines and have a great rest of week. Thank you.