FBL Financial Group, Inc.
1Q20 Conference Call

Dan Pitcher
Chief Executive Officer

Thanks, Kathleen. And welcome to everyone on the call. I'm pleased that you are with us today.

I hope you and your families are doing well during this unprecedented time of the COVID-19 pandemic. The current situation has been difficult for everyone, and much more difficult for workers on the front lines of essential services. Our thoughts are with you and everyone impacted by this crisis.

This wasn't what I had envisioned for my first months as CEO, but I have never been prouder of the people of this organization.

I'll first discuss changes to our leadership team, then briefly summarize our first quarter results and finally share my comments on the impact COVID-19 has had to our business and constituents.

Since our last earnings conference call, we have had several changes to our executive management team. Jay Seiboldt has assumed my previous role as Chief Operating Officer - Property Casualty Companies. Dan Koster was named Vice President - Marketing & Agency Services and Ron Mead was named Vice President - Sales & Distribution. These three individuals are all proven leaders within our organization and have extensive experience in sales, operations, and marketing.

Chief Investment Officer Charlie Happel has served this company with great dedication for the past 36 years and plans to retire around midyear 2020. We therefore expect this will be Charlie's last earnings call with us. On behalf of everyone at FBL Financial Group, I thank Charlie for his wisdom and wish him well when he departs our companies later this year. We are currently conducting a search for Charlie's replacement.

Nick Gerhart, Chief Administrative Officer, also plans to leave our companies in the coming weeks. Thank you, Nick, for your contributions to our companies for the past three years and for your leadership in our community and state.

Turning now to earnings, for the first quarter of 2020 FBL Financial Group reported a net loss of $0.10 per share and adjusted operating income of $0.79 per share. Results were negatively impacted by financial market performance related to COVID-19. Don will discuss these results in more detail.

From a sales perspective, total life insurance premiums collected increased 6%, while annuity premiums collected decreased 16% compared to the same period last year. This continues the trend of the last few years where we experienced growing universal life and term life sales. At the same time, annuity premiums collected, specifically fixed rate annuity sales, have declined. We continue to maintain our financial discipline as we determine appropriate crediting rates in this continued low interest rate environment.

Next, the pandemic and its impact. As the severity of the pandemic became apparent, we activated our business continuity plans and formed an incident management work group. This work group, acting in conjunction with our executive management team, monitors business developments, identifies issues, recommends solutions and develops communications with employees, agents, advisors and client/members.

To provide for the health and safety of our employees, we transitioned to a mostly work-from-home environment in a matter of days. I am so impressed with all of our team members! This transition was carried out with minimal interruption to supporting our agents, advisors and client/members. This has allowed us to continue to deliver the first-class service that our client/ members count on from Farm Bureau Financial Services.

Our agents are adapting to new work styles and tools to interact with their clients and potential clients. In place of face-to-face meetings, they rely on phone calls, emails and video conferencing. They continue to work to secure life insurance coverage and annuity contracts for their clients, which is more important now than ever. In the short-term, the issuance of some life insurance business has been delayed due to impediments to completing necessary medical tests.

Our ability to onboard new agents and wealth management advisors has also been temporarily slowed due to the closure of governmental offices that issue required licenses. As of March 31, 2020, we had 1,831 exclusive agents and 27 Farm Bureau wealth management advisors.

Over the long term we expect to see an increase in life insurance applications as a result of the devastating impact of COVID-19 in our communities. The need for life insurance grows ever more apparent. This provides an opportunity for us to engage our client/members to ensure their needs are fully protected and covered.

Our organization and the territories in which we operate have been impacted by social distancing and shelter-at-home orders. But as a company that operates predominantly in rural areas and small towns in the Midwest and West, our customer base is often in less densely populated areas. As a result, we have not had as many cases of the virus as other geographic territories. Our top two states for life insurance sales are Iowa and Kansas and they rank 19^{th} and 34^{th} for total cases of the virus. Our hearts go out to the people of New York, New Jersey and other hard-hit areas.

While we expect to have additional claims due to the virus, to date, the impact to our mortality experience has been minimal. In March we had two life claims related to COVID-19 that totaled $400,000. And in April, we had one COVID-19 related claim, which was a $25,000 face amount term policy. We certainly expect more pandemic-related claims, but I do not expect this to be a significant mortality event for us. We also have reinsurance coverage in place by individual life. Our current retention limit is $1.0 million per life and has varied historically in the range from $250,000 to a million. At the same time, providing coverage allows us to truly fulfill our purpose of protecting livelihoods and futures.

We entered this challenging time from a position of financial strength. I am confident that FBL will navigate these difficult financial markets given our high-quality, diversified investment portfolio and strong capital position. Farm Bureau Life Insurance Company is strong and has successfully charted rough waters in its 75-year history. Today we are committed as ever to meeting the needs of our employees, agents and advisors and protecting the livelihoods and futures of our client/members.

Now I'll turn the call over to CFO Don Seibel to cover our financial results. Don.

Don Seibel
Chief Financial Officer

Thanks Dan. I also want to welcome everyone on the call.

I'll discuss our financial results for the first quarter, our investment portfolio, capital and liquidity.

Financial results for the first quarter of 2020 were below our expectations and were negatively impacted by financial market performance related to the COVID-19 pandemic. FBL reported a net loss of $0.10 per share. This includes $0.89 per share in net realized losses on investments and the change in the fair value of derivatives. This was primarily due to a net loss from equity securities held at quarter end of $13.2 million. In addition, we increased allowances for credit losses by $12.3 million. This includes a $12.2 million allowance for fixed maturity securities – an energy bond and a retail REIT – as well as a $100,000 allowance for commercial mortgage loans. These allowances were created under the under new accounting guidance for estimating credit losses associated with certain financial instruments. While the accounting guidance is new, the bonds would have been considered impaired under the previous accounting guidance.

Excluding these items, adjusted operating income for the quarter was $0.79 per share. There are three key drivers why earnings differed from our expectations.

- First, we had higher amortization of acquisition costs in the Corporate and Other segment due to the negative impact of equity markets on separate account performance. This impact totaled approximately $0.11 per share.

- Second, we increased reserves associated with index annuity Guaranteed Living Withdrawal Benefits also due to the unfavorable impact of market performance. This impact totaled approximately $0.07 per share.
- Third, these items were partially offset by better than expected mortality experience during the quarter. This impact totaled approximately $0.11 per share.

These items, coupled with lower-than-expected prepayment fee and equity income, resulted in a $0.12 per share decrease to operating earnings for the quarter.

Next, I discuss our results by segment.

Annuity segment results for the first quarter of 2020 reflect the impact of unfavorable market performance. Reserves associated with guaranteed living withdrawal benefits increased $2.3 million in the first quarter of 2020 due to the unfavorable impact of market performance. This compares to a decrease in the reserve of $800,000 in the first quarter of 2019 due to favorable market performance.

Results for our annuity business continue to be pressured by low market interest rates. Due to this pressure, we took several crediting rate actions in the first quarter. As a result, point-in-time spreads on our individual annuities increased two basis points during the first quarter.

Life insurance segment results for the first quarter of 2020 reflect a steadily growing book of business, lower amortization, and lower death benefits.

Spreads for our UL business continued to trend down due to the impact of low market interest rates on our portfolio yield and the impact of a shift in the mix of business to index universal life insurance. Our current index universal life insurance product is structured to have a lower spread than our traditional universal life business as more of the profitability comes from cost of insurance and other charges.

Corporate and Other Segment results were impacted by several items in the quarter.

- First, as previously stated, this segment experienced increased amortization of deferred acquisition costs due to impact of the negative equity market performance in the first quarter. This increased amortization by $3.7 million.
- Second, this segment experienced lower death benefits due primarily to fewer claims and a lower average face amount in our closed block of variable universal life insurance business. This is a normal quarterly fluctuation in mortality results in this relatively small block of business.

- We also continue to invest in our developing Wealth Management business. This segment includes an after-tax net loss totaling $1.3 million, or $0.05 per share, related to this investment. This level of investment in the Wealth Management business is expected to continue throughout 2020.

Next, I'll discuss FBL's investment portfolio. As of March 31, FBL had total investments of $9.0 billion, plus $78 million of alternative investments included in the securities and indebtedness of related parties line on the balance sheet. Our investment portfolio is of high quality and is well-diversified by individual issue, industry and asset class. The majority of our investments - $7.6 billion - are fixed maturity securities, with below investment grade bonds accounting for only 2.6% of the fixed maturity total.

Over the past five years we have upgraded the quality of our fixed-income portfolio. Consequently, we entered the current situation with above-industry average portfolio quality. We took action because we felt uncomfortable with the risk-reward across the fixed-income market. We have generally taken on credit risk at the short end of the yield curve, including in NAIC-1 rated structured securities, and duration in government-backed and other high-quality sectors.

I'll review a few asset classes where investors have had more questions.

Our CLO portfolio has a carrying value of $173 million, which is 1.9% of our total investments. We are comfortable with these holdings as the CLOs are of high quality with 100% being NAIC-1s. They consist of both floating- and fixed-rate securities backed by broadly syndicated and middle market loans. Our recent purchases have been rated AAA or AA.

FBL's commercial mortgage loan portfolio totals $989 million at March 31, 2020. The majority of our mortgage loans amortize principal, with 2.2% that are interest-only. At quarter end, the average loan-to-value ratio was 51.4% and the weighted average debt service coverage ratio was 1.7. Additionally, we have a high-quality portfolio, with 82% carrying a CM-1 rating, compared to 58% for the industry. We have a long history of extremely low delinquency rates. All commercial mortgage loans are currently performing, with none past due.

Our commercial mortgage loan portfolio is diversified by property type, location and loan size, and is collateralized by the related properties. They are a mix of office, retail and industrial. Our retail exposure is $334 million and is primarily focused on grocery or drug store anchored shopping centers. We do not have any loans on mall properties, nor any hotel properties.

FBL's energy investments have a carrying value of $345 million. Despite a significant drop in the price of crude oil in the first quarter, we continue to have 75% of our energy portfolio rated investment grade. 40% of our energy portfolio is in the midstream sector, which is driving a large portion of the unrealized losses in our energy book. However, at quarter end our underlying midstream energy positions are at an average market-to-book price of 85%.

Given the dislocation in the financial markets, in the first quarter we capitalized on the opportunity to invest in private credit and high yield bonds. We also were able to acquire relatively inexpensive long A-rated corporate bonds. The tax-adjusted yield on new investment acquisitions backing our long-term business was 4.53% for the first quarter of 2020.

Next, I'll comment on our capital levels.

Even in these challenging times, we are committed to returning capital to shareholders. In February we announced an increase in our regular quarterly dividend rate to $0.50 per share. Based on yesterday's closing stock price, this gives us an indicated annual dividend yield of 5.5%. On top of that, we also paid a $1.50 per share special dividend in March. We returned $50 million of capital to shareholders in the first quarter with the regular quarterly dividend, the special dividend and limited Class A common stock repurchases.

At March 31, 2020, our subsidiary, Farm Bureau Life, had an estimated company action level risk-based capital ratio of 525%. This is a decrease from year end 2019 and was expected due to the dividend paid from Farm Bureau Life to the holding company to fund the dividends paid to shareholders.

Even with these significant shareholder dividends, FBL continues to have excess capital. Using 425% RBC as a base, Farm Bureau Life had excess capital of approximately $128 million at March 31, 2020. Additionally, we estimate that we have $14 million of excess capital at quarter end at the holding company level.

Our liquidity position remains strong with cash being generated by operations and financing activities. In addition, at quarter end our investment portfolio included $30 million of short-term investments, $18 million of cash and cash equivalents and $588 million in carrying value of U.S. Government and U.S. Government agency backed securities that could be readily converted to cash at or near carrying value.

These strong capital and liquidity positions allow us to be prepared for many scenarios. We perform stress tests as part of our annual ORSA report. We have a variety of scenarios including those that reflect a pandemic, an economic disruption, increased defaults and various combined scenarios. Our modeling indicates we have adequate capital and liquidity in stress situations.

To conclude, we are well prepared for these challenging times. I expect the current economic headwinds and the low market interest rate environment to continue to cause near-term earnings pressure. We have the financial strength to withstand these pressures and to maintain our strength over the long term.

I will now turn the call over to the operator and open it up to any questions you may have.