LICOA
Life Insurance Company of Alabama

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Life Insurance Company of Alabama
Management's Discussion and Analysis
NAIC Group Code 0000
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Objective

This discussion provides an analysis by management of the current financial position, results of operations, cash flows and liquidity, and changes in financial position for the Company. All information in this discussion supplements the financial statements, schedules and exhibits in the 2018 Annual Statement.

The Company offers coverage in life and accident and health insurance. The Company is licensed in Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina and Tennessee. The percent of direct gross premium collected by state in 2018 and 2017 was:

	2018 %	2017 %
Alabama	29.96	30.73
Arkansas	3.45	3.15
Florida	1.03	1.03
Georgia	14.68	15.26
Kentucky	7.48	7.74
Louisiana	1.44	1.26
Mississippi	18.86	17.49
North Carolina	2.38	2.49
Oklahoma	0.22	0.23
South Carolina	6.20	6.50
Tennessee	14.29	14.10
	100.00	100.00

The Company engages independent agents, general agents, and regional directors to sell and service its policyholders on a commission basis.

Financial Position

(1) Assets

The admitted value of bonds increased $1.5 million in 2018 compared to 2017. Page 5 of the Annual Statement (The Cash Flow Statement) reflects the purchase of $30.4 million in bonds in 2018 and the call, maturity, or sale of $27.2 million. The Company switched investment managers from Stifel to New England Asset Management, Inc. (NEAM) effective January 1, 2018. NEAM has worked to rebalance the Company's portfolio during 2018 in an effort to improve the quality. All of the lower quality bonds have been weeded out and replaced with higher quality bonds. As a result of rebalancing, the Company incurred a loss on the disposal of bonds of approximately $1.5 million, most of which ran through the net realized capital gains/loss line on the Summary of Operations page. The bond portfolio currently has a net unrealized loss of $1.5 million, and there are no bonds on the bond watch list as of the 2018 year-end

The SVO classification of bonds table below is evidence of improved quality of the Company's bond portfolio.

	2018 %	2017 %
SVO Class 1	52.2	30.3
SVO Class 2	47.8	59.6
SVO Class 3	0.0	4.3
SVO Class 4	0.0	3.8
SVO Class 5	0.0	1.9
SVO Class 6	0.0	0.1

The Company continues to invest called or matured bonds and excess cash flow generated from operations in SVO Class 1 and 2 bonds.

The Company has a wholly owned subsidiary (LICOA Brokerage Service) whose stock is nonadmitted, but the Company no longer owns any other preferred or common stock. Another step in reworking the Company's investment portfolio includes the decision to dispose of all stock (with the exception of LICOA Brokerage Service subsidiary stock) during 2018 and reinvest the proceeds in good quality bonds. The timing was right to make a move like this so that the $1.8 million gain from the disposal of stock could be offset by realized capital losses incurred from bond disposals and also by the Company's current net operating loss for tax purposes.

The cash and cash equivalents balance is $1.7 million and decreased $1.3 million compared to the balance as of December 31, 2017. Cash equivalents were higher for the 2017 year-end because the Company froze all investment transactions during the last couple of months of 2017 in preparation of the switch to NEAM effective January 1, 2018. Interest collected on bonds during that period built up the cash and cash equivalents balance for year-end.

Other invested assets increased by $4.2 million during 2018 to $4.6 million. The Company transferred $4.4 million in securities from Schedule D, Part 1 to Schedule BA, Part 1 during 2018. During the Company's recent examination by the Alabama Department of Insurance, examiners pointed out that five securities on Schedule D, Part 1 are, in fact, surplus notes and should be reported on Schedule BA. In order to comply, the Company disposed of the securities in question from Schedule D, Part 1 at book value and repurchased them back at book value on Schedule BA, Part 1. Furthermore, the principal balance of the CAPCO bond (Aegis Alabama Venture Fund found on Schedule BA) decreased by $208,556 during 2018 due to the transfer of tax credits associated with the bond. This bond's principal is to be collected in the form of Alabama premium tax credits. However, the

Company signed an agreement in 2010 with Colonial Life and Accident Company to sell these premiums tax credits to Colonial. Thus, there will be a decrease in the principal balance of this bond each year as the Company receives payments from Colonial in exchange for Alabama premium tax credits. The sale of all premium tax credits associated with this security will be complete by March of 2019.

Accrued investment income decreased $244,630 down to $1 million during 2018. This decrease is attributed to the changes made to the investment portfolio during 2018. There are lower yields with a higher quality bond portfolio which leads to lower accrued investment income. This figure will increase as the investment portfolio increases.

Real estate property is carried at cost plus improvements less depreciation and encumbrances. Properties with a fair value less than book/adjusted value is carried at fair value on the Asset Page, and the difference between the book/adjusted value and fair value is nonadmitted. Properties not occupied by the Company and not held for investment are also nonadmitted. Total nonadmitted real estate is $994,673. Total net admitted real estate has increased by $387,936 since December 31, 2017 to $1.1 million. The Company is in the middle of a major renovation of the home office. This renovation will be complete later in 2019. The amount put into the renovation has caused the adjusted book value to exceed appraised values leading to a large non-admitted asset. A new appraisal will be performed after the renovation is complete, and the appraised value is expected to increase significantly which will cause the non-admitted portion to go back down.

The Five Year Historical data on page 22 of the Annual Statement reflects the investment trend of the Company's invested assets. Bonds are 90.1% of invested assets and increased 0.8% since 2014 while other invested assets increased 2.8% since 2014 up to 4.0% of invested assets. Stocks were disposed of completely in 2018.

The admitted deferred tax asset is $1.4 million as of December 31, 2018 and decreased $89,894 compared to the balance as of December 31, 2017.

(2) Liabilities

Total liabilities at December 31, 2018 were $82.6 million versus $82.4 million on December 31, 2017; a $214,833 increase. Significant changes in liabilities are as follows:

A. Life insurance reserves increased $1.6 million. This is a normal change.

B. Accident and Health insurance reserves increased $466,117. This is a normal change.

C. Liability for deposit type contracts decreased $114,128.

D. Unpaid life claims decreased by $38,326 while accident and health contract claims increased $232,017.

E. There is no federal tax payable for 2018 or 2017.

F. The asset valuation reserve decreased $2 million to $753,450 during 2018. This decrease is due to the improved quality of the bond portfolio along with the disposal of common stock investments during 2018. The interest maintenance reserve decreased by $500,960 during the same timeframe to $1.5 million. There were net losses on the disposal of bonds (net of taxes) transferred to the IMR during 2018 totaling $277,022.

G. Other liabilities as a whole increased $553,777 in 2018 compared to 2017.

(3) Capital and Surplus

Page 4 of the Annual Statement reflects an analysis of the capital and surplus accounts, which decreased $1.1

million. The analysis reflects the following:

A. Net loss was $276,302.

B. Change in net unrealized capital gains/losses decreased surplus by $1,475,363.

C. Deferred income tax change increased surplus by $922,390.

D. Increase in nonadmitted assets decreased surplus by $1.9 million.

E. A decrease in AVR increased surplus by $2.0 million.

F. Dividends paid to stockholders reduced surplus by $413,229.

Risk-based total adjusted capital is $42.1 million. The authorized control level risk-based capital is $2.2 million, indicating the Company has adequate capital to operate its business.

Results of Operation

(1) Revenues in 2018 were $42.1 million and increased $115,568 compared to 2017. Premiums and considerations for supplementary contracts with life contingencies increased $497,005. The increase in premiums is a result of increased life business. Net investment income decreased $494,724 down to $4.6 million. This decrease is due to investing in better quality bonds versus lower quality corporate bonds that pay higher interest rates. Amortization of IMR increased $9,338. Other miscellaneous items increased $103,949 compared to 2017.

(2) Total policyholder benefits increased $1.3 million compared to 2017. Death benefits increased $252,785 in 2018 compared to 2017. Disability benefits and benefits under accident and health contracts increased $624,555 in 2018 compared to 2017. Increase in aggregate reserves increased $390,723 compared to 2017 results. As a result of increased premium revenue, commissions increased $561,886 compared to 2017. General insurance expenses increased $1.5 million compared to 2017. Most of the expense increase is attributed to the cost of implementing a new policy administrative system throughout 2018. LICOA went live with this new system on the first business day of 2019. While the costs for the new policy administrative system will not go away completely after the conversion due to monthly maintenance fees and working out any kinks in the system, costs are expected to drop during 2019. Taxes, licenses, and fees are $1,235,181 and decreased $20,176 compared to 2017. Taxes, licenses, and fees were higher in 2017 due to large assessments paid to several state guaranty associations in relation to Penn Treaty Network America Insurance Company and American Network Insurance Company during 2017. Please also note LICOA incurred $356,317 in state exam fees by the Alabama Department of Insurance during 2018. Exam fees may be taken as a credit against gross premium due on the Alabama premium tax return. However, the amount of exam fees and other credits exceed premium tax due for Alabama by $203,508, and those credits are not allowed to be rolled forward. Furthermore, the increase in loading decreased $19,136 in 2018 compared to 2017.

(3) Federal taxes are ($45,669) while net realized capital gains (excluding gains/losses transferred to the IMR) less capital gains tax (excluding taxes transferred to the IMR) is $521,404.

Cash Flow and Liquidity

(1) The cash flow requirements for the Company are provided primarily by premium and investment income, and maturities and sales of invested assets. Cash is applied to the payment of policy benefits, commissions, operating expenses and the purchase of new investments.

In order for the Company to meet its commitments to its policyholders in the payment of benefits and other expenses, the Company depends on current cash flow and liquidity of its investments. Approximately 88% of invested assets are in cash and investment grade fixed income bonds. The value of bonds and securities are subject to the conditions of the market on which they are traded. Prior market conditions have had little effect on the Company not being able to readily convert these investments into cash.

(2) The Company realizes that any adverse litigation in 2018 could adversely affect cash flow.
(3) The Company had no debt as of December 31, 2018.
(4) The Company has no material commitments for capital expenditures.

Trends

The Company was pleased to experience an increase in premium during 2018. The Company's premium generally increases each year primarily due to new business and rate increases where possible on some of its accident and health products. The Company projects that 2019 premiums will exceed 2018 premiums.

Although the Company saw an increase in premiums during 2018, the Company still experienced a net loss for the year. Decreased investment income was the result of rebalancing the bond portfolio into a state of improved quality, and it will take a little time to implement a new investment strategy and get the investment income back up where it was before these changes. Also, while the Company is pleased to show increased business, costs associated with new business are higher up front with increased commissions and reserves, but those costs will go down in future years leaving the Company with profitable business. Claims are higher this year, but that is beyond the Company's control. Then there have been increased general expenses for a few years now as a result of implementing a new policy administrative system, but the Company expects those expenses to go down during 2019. The Company also incurred high Alabama Department of Insurance examination fees for which only about half could be carried against the 2018 premium tax return. LICOA did have positive operating results during the last quarter of 2018 though, and improved operating results are expected to continue into 2019.

J. Steven Keck
Senior Vice President, Chief Operating Officer, and Secretary