

KANSAS CITY LIFE INSURANCE CO  
Form 10-Q  
August 06, 2004

United States  
Securities and Exchange Commission  
Washington, D.C. 20549

Form 10-Q

Quarterly Report Under Section 13 or 15 (d) of the  
Securities Exchange Act of 1934

For the Quarter ended June 30, 2004

Commission File No. 2-40764

Kansas City Life Insurance Company  
3520 Broadway  
Kansas City, Missouri 64111-2565

Phone: (816) 753-7000

IRS Number: 44-0308260

Incorporated in the State of Missouri

The Registrant (1) has filed all reports required to be filed by section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.

Yes   X   No \_\_\_\_\_

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the most recent date available.

| <u>Class</u>                   | <u>Outstanding April 29, 2004</u> |
|--------------------------------|-----------------------------------|
| Common Stock, \$1.25 par value | 11,927,064 shares                 |

KANSAS CITY LIFE INSURANCE COMPANY  
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**Part I Financial Information**  
**Item 1. Financial Statements**

**KANSAS CITY LIFE INSURANCE COMPANY**  
**CONSOLIDATED BALANCE SHEETS**  
(amounts in thousands, except share data)

|   | June 30<br>2004<br><u>(Unaudited)</u> | December 31<br>2003<br><u></u> |
|---|---------------------------------------|--------------------------------|
| <b>ASSETS</b>                                       |                                       |                                |
| Investments:  |                                       |                                |
| Fixed maturities available for sale, at fair value  | \$ 2,902,074                          | \$ 2,814,485                   |
| Equity securities available for sale, at fair value | 62,229                                | 63,808                         |
| Mortgage loans                                      | 426,401                               | 456,656                        |
| Real estate   | 110,050                               | 112,691                        |
| Policy loans  | 110,805                               | 114,420                        |
| Short-term investments                              | 37,209                                | 71,823                         |
| Other investments                                   | 821                                   | 903                            |
| Total investments                                   | <u>3,649,589</u>                      | <u>3,634,786</u>               |
| Cash  | 1,698                                 | 20,029                         |
| Accrued investment income                           | 40,794                                | 39,132                         |
| Deferred acquisition costs                          | 239,852                               | 241,057                        |
| Value of business acquired                          | 102,441                               | 106,334                        |
| Reinsurance recoverable                             | 150,796                               | 151,577                        |
| Other assets  | 52,550                                | 54,306                         |
| Separate account assets                             | 321,250                               | 304,691                        |
| Total assets  | <u>\$ 4,558,970</u>                   | <u>\$ 4,551,912</u>            |
| <b>LIABILITIES</b>                                  |                                       |                                |
| Future policy benefits                              | \$ 870,124                            | \$ 872,114                     |
| Policyholder account balances                       | 2,258,740                             | 2,239,223                      |
| Policy and contract claims                          | 31,899                                | 33,012                         |
| Other policyholder funds                            | 98,980                                | 101,084                        |
| Notes payable                                       | 129,217                               | 133,670                        |
| Income taxes  | 22,202                                | 36,918                         |
| Other liabilities                                   | 206,027                               | 186,762                        |
| Separate account liabilities                        | 321,250                               | 304,691                        |
| Total liabilities                                   | <u>3,938,439</u>                      | <u>3,907,474</u>               |
| <b>STOCKHOLDERS' EQUITY</b>                         |                                       |                                |
| Common stock, par value \$1.25 per share            |                                       |                                |
| Authorized 36,000,000 shares,                       |                                       |                                |
| issued 18,496,680 shares                            | 23,121                                | 23,121                         |
| Additional paid in capital                          | 23,708                                | 23,310                         |
| Retained earnings                                   | 695,372                               | 688,800                        |

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|  |                     |                     |
|--|---------------------|---------------------|
| Accumulated other comprehensive income (loss)                                      | (7,200)             | 23,418              |
| Less treasury stock, at cost (2004 - 6,569,467 shares;<br>2003 - 6,572,087 shares) | <u>(114,470)</u>    | <u>(114,211)</u>    |
| Total stockholders' equity   | <u>620,531</u>      | <u>644,438</u>      |
| Total liabilities and stockholders' equity   | \$ <u>4,558,970</u> | \$ <u>4,551,912</u> |

See accompanying Notes to Consolidated Financial Statements.

**KANSAS CITY LIFE INSURANCE COMPANY**  
**CONSOLIDATED STATEMENTS OF INCOME (Unaudited)**  
(amounts in thousands, except share data)

|  | <u>Quarter ended June 30</u> |                 | <u>Six Months</u> |
|--|------------------------------|-----------------|-------------------|
|  | <u>2004</u>                  | <u>2003</u>     | <u>2004</u>       |
| <b>REVENUES</b>  |                              |                 |                   |
| Insurance revenues:  |                              |                 |                   |
| Premiums   | \$ 47,319                    | \$ 54,337       | \$ 94,379         |
| Contract charges   | 29,381                       | 25,251          | 58,531            |
| Reinsurance ceded  | <u>(14,342)</u>              | <u>(11,143)</u> | <u>(26,866)</u>   |
| Total insurance revenues   | 62,358                       | 68,445          | 126,044           |
| Investment revenues:   |                              |                 |                   |
| Net investment income  | 48,391                       | 45,823          | 99,114            |
| Realized investment gains (losses)   | 724                          | (9,229)         | 1,522             |
| Other revenues   | <u>1,734</u>                 | <u>2,362</u>    | <u>4,266</u>      |
| Total revenues   | <u>113,207</u>               | <u>107,401</u>  | <u>230,950</u>    |
| <b>BENEFITS AND EXPENSES</b>   |                              |                 |                   |
| Policyholder benefits  | 45,656                       | 51,992          | 96,222            |
| Interest credited to policyholder account balances                           | 23,038                       | 21,807          | 47,344            |
| Amortization of deferred acquisition costs<br>and value of business acquired | 10,446                       | 7,875           | 20,199            |
| Operating expenses   | <u>23,872</u>                | <u>24,502</u>   | <u>49,611</u>     |
| Total benefits and expenses  | <u>103,012</u>               | <u>106,176</u>  | <u>213,376</u>    |
| Income (loss) before income tax expense (benefit)                            | 10,195                       | 1,225           | 17,574            |
| Income tax expense (benefit)   | <u>2,673</u>                 | <u>(310)</u>    | <u>4,463</u>      |
| <b>NET INCOME (LOSS)</b>   | \$ <u>7,522</u>              | \$ <u>1,535</u> | \$ <u>13,111</u>  |
| Basic and diluted earnings per share:  |                              |                 |                   |
| Net income (loss)  | \$ <u>0.63</u>               | \$ <u>0.13</u>  | \$ <u>1.11</u>    |

See accompanying Notes to Consolidated Financial Statements.

**KANSAS CITY LIFE INSURANCE COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)**  
(amounts in thousands)

Six Months ended June

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|   | 2004      | 2003      |
|---|-----------|-----------|
| <b>OPERATING ACTIVITIES</b>                                   |           |           |
| Net cash provided   | \$ 38,744 | \$ 38,744 |
| <b>INVESTING ACTIVITIES</b>                                   |           |           |
| Purchases of investment securities:                           |           |           |
| Fixed maturities  | (475,685) | (475,685) |
| Equity securities   | (2,077)   | (2,077)   |
| Sales of investment securities:                               |           |           |
| Fixed maturities  | 80,424    | 80,424    |
| Equity securities   | 2,211     | 2,211     |
| Maturities and principal paydowns of investment securities:   |           |           |
| Fixed maturities  | 247,509   | 247,509   |
| Equity securities   | 265       | 265       |
| Purchases of other investments                                | (32,327)  | (32,327)  |
| Sales, maturities and principal paydowns of other investments | 69,478    | 69,478    |
| Net sales (purchases) of short-term investments               | 34,614    | 34,614    |
| Net additions to property and equipment                       | (712)     | (712)     |
| Insurance business acquired                                   | -         | -         |
| Net cash used   | (76,300)  | (76,300)  |
| <b>FINANCING ACTIVITIES</b>                                   |           |           |
| Proceeds from borrowings                                      | 1,306     | 1,306     |
| Repayment of borrowings                                       | (5,759)   | (5,759)   |
| Deposits on policyholder contracts                            | 139,090   | 139,090   |
| Withdrawals from policyholder account balances                | (103,294) | (103,294) |
| Net transfers to separate accounts                            | (7,805)   | (7,805)   |
| Change in other deposits                                      | 2,093     | 2,093     |
| Cash dividends to stockholders                                | (6,545)   | (6,545)   |
| Net disposition (acquisition) of treasury stock               | 139       | 139       |
| Net cash provided   | 19,225    | 19,225    |
| Increase (decrease) in cash                                   | (18,331)  | (18,331)  |
| Cash at beginning of year                                     | 20,029    | 20,029    |
| Cash at end of period   | \$ 1,698  | \$ 1,698  |

*See accompanying Notes to Consolidated Financial Statements.*

**Kansas City Life Insurance Company**  
**Notes to Consolidated Financial Statements**  
(amounts in thousands, except share data)

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of Presentation**

The unaudited consolidated financial statements, the accompanying notes to these financial statements and the accompanying Management's Discussion and Analysis of Operations of Kansas City Life Insurance Company include the accounts of the Company and its subsidiaries, principally Sunset Life Insurance Company of America (Sunset Life), and Old American Insurance Company (Old American). These items have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial reporting and with the instructions to Form 10-Q of Regulation S-X. Accordingly, they do not include all of the disclosures required by GAAP for complete financial statements and as such, these unaudited interim financial statements should be read in conjunction with the Company's 2003 Form 10-K and the 2003 Annual Report to Stockholders. Management believes that the disclosures are adequate to make the information presented not misleading, and all normal and recurring adjustments necessary to present fairly the financial position at June 30, 2004 and the results of its operations for all periods presented have been made. The results of operations for any interim period are not necessarily indicative of the Company's operating results for a full year.

Significant intercompany transactions have been eliminated in consolidation and certain reclassifications have been made to the prior year results to conform with the current year's presentation.

### **Insurance Company Acquisition**

On June 30, 2003, the Company acquired all of the issued and outstanding stock of GuideOne Life Insurance Company (GuideOne) from GuideOne Financial Group, Inc. and GuideOne Mutual Company. The purchase price of the acquisition was \$59.4 million and added \$393.1 million in assets on the acquisition date, including an identifiable intangible asset called the value of business acquired (VOBA) of \$38.0 million. The financial position and results of operations of GuideOne have been included in these financial statements on a GAAP basis using the purchase method of accounting since July 1, 2003. As of October 1, 2003, GuideOne was merged into Kansas City Life Insurance Company. For segment reporting purposes, GuideOne is included in the Kansas City Life - Individual segment.

### **Significant Accounting Policies**

These significant accounting policies should be read in conjunction with statements and disclosures made in the Company's 2003 Form 10-K as filed with the United States Securities and Exchange Commission.

The preparation of the consolidated financial statements requires management of the Company to make estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period. These estimates are inherently subject to change and actual results could differ from these estimates.

The Company establishes liabilities for amounts payable under insurance policies, including traditional life insurance, annuities and accident and health insurance. Generally, amounts are payable over an extended period of time and the profitability of the products is dependent on the assumptions used in the pricing of the products. Principal assumptions used in pricing policies and in the establishment of liabilities for future policy benefits are mortality, morbidity, expenses, persistency, investment returns and inflation. Differences between actual experience and assumptions used in the pricing of these policies and in the establishment of liabilities may result in variability of net income.

Policyholder account balances include universal life insurance, fixed deferred annuity contracts and investment-type contracts. The account balances for universal life contracts are equal to cumulative premiums, less contract charges, plus interest credited. The account balances for fixed deferred annuities and investment contracts are equal to the cumulative deposits less any applicable contract charges plus interest credited. The profitability of these products is also dependent on principal assumptions similar to traditional insurance products, and differences between actual experience and pricing assumptions may result in variability of net income.

Deferred acquisition costs (DAC), principally agent commissions and other selling, selection and issue costs, which vary with and are directly related to the production of new business, are capitalized as incurred. These deferred costs are then amortized in proportion to future premium revenues or the expected future profits of the business, depending upon the type of product. Profit expectations are based upon assumptions of future interest spreads, mortality margins, expense margins and policy and premium persistency experience. These assumptions involve judgment and are compared to actual experience on an ongoing basis. If it is determined that the assumptions related to the profit expectations for interest sensitive and variable insurance products should be revised, the impact of the change is reported in the current period's income as an unlocking adjustment.

When new business is acquired, a portion of the purchase price is allocated to a separately identifiable intangible asset, called the value of business acquired (VOBA). VOBA is established as the actuarially determined present value of future gross profits of the business acquired and is amortized in proportion to future premium revenues or the expected future profits, depending on the type of business acquired. Similar to DAC, the assumptions regarding future experience can affect the carrying value of VOBA, including interest spreads, mortality, expense margins and policy and premium persistency experience. Significant changes in these assumptions can impact the carrying balance of VOBA and produce changes that must be reflected in the current period's income as an unlocking adjustment.

The Company maintains a diversified securities portfolio. The Company's securities available for sale are carried at fair value in the Company's balance sheet. The Company receives fair values for its securities portfolio from a variety of external sources. Various measures have been taken to manage the portfolio's credit and interest rate risks, as discussed in the Company's 2003 Form 10-K and the 2003 Annual Report to Stockholders. The Company performs a review of its securities' fair values on an ongoing basis to determine changes in the value of the portfolio. Several factors are analyzed in evaluating these securities, including an analysis of the issuing company, its industry, valuation levels and subsequent developments. Based upon these inputs, the Company establishes its securities values in accordance with GAAP.

Premiums for traditional life insurance products are reported as revenue when due. Premiums on accident and health, disability and dental insurance are reported as earned over the contract period. A reserve is provided for the portion of premiums written which relates to unexpired terms of coverage.

Deposits related to universal life, fixed deferred annuity contracts and investment-type products are credited to policyholder account balances. Revenues from such contracts consist of amounts assessed against policyholder account balances for mortality, policy administration and surrender charges, and are recognized in the period in which the services are provided.

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In the normal course of business, the Company cedes risks to other insurers primarily to protect the Company against adverse fluctuations in mortality experience. The Company also assumes risks ceded by other companies. Reinsurance is effected on individual risks and through various pooling arrangements. Business is reinsured primarily through yearly renewable term and coinsurance agreements. Under yearly renewable term insurance, the Company pays annual premiums and the reinsurer reimburses claims paid related to this coverage. Under coinsurance, the reinsurer receives a proportionate share of the premiums less applicable commissions and is liable for a corresponding share of policy benefits. The Company remains contingently liable if the reinsurer should be unable to meet obligations assumed under the reinsurance contract.

Reinsurance recoverable includes amounts related to paid benefits and estimated amounts related to unpaid policy and contract claims, future policy benefits and policyholder account balances. The cost of reinsurance is accounted for over the terms of the underlying reinsured policies using assumptions consistent with those used to account for the policies.

### **New Accounting Pronouncements**

FASB Interpretation (FIN) 46, "Consolidation of Variable Interest Entities," was issued in January 2003. This is an interpretation of Accounting Research Bulletin (ARB) No. 51, "Consolidated Financial Statements." This interpretation requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual terms or other financial interests in the entity. This interpretation was adopted July 1, 2003 and had no material impact. Subsequently, in December 2003, the FASB issued a revision known as FIN 46R, which replaces FIN 46. The Company will be required to apply FIN 46R to variable interest entities created after December 31, 2003. This revised interpretation was adopted on January 1, 2004, with no material impact.

Statement of Position (SOP) 03-01, "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts," was issued in July 2003 by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. The SOP addresses: 1) separate account presentation; 2) accounting for an insurance company's proportionate interest in separate accounts; 3) transfers of assets from the general account to a separate account; 4) valuation of certain insurance liabilities and policy features such as guaranteed minimum death benefits and annuitization benefits; and 5) accounting for sales inducements. This SOP was adopted on January 1, 2004, with no material impact.

All other Standards and Interpretations of those Standards issued during 2004 did not relate to accounting policies and procedures pertinent to the Company at this time.

### **Comprehensive Income**

Comprehensive income is comprised of net income and other comprehensive income, which includes unrealized investment gains or losses on securities available for sale and the change in the additional minimum pension liability. For the second quarter, comprehensive loss was \$49.0 million in 2004, and comprehensive income was \$44.5 million in 2003. Excluding the second quarter 2004 net income of \$7.5 million, other comprehensive loss was \$56.5 million. This other comprehensive loss amount consisted of unrealized investment losses on securities, which was net of reclassification adjustments of investment losses realized in net income, and net of applicable deferred acquisition costs and income taxes.

For the six months, comprehensive loss was \$17.5 million in 2004, and comprehensive income was \$60.6 million for 2003. Excluding the six months ended 2004 net income of \$13.1 million, other comprehensive loss was \$30.6 million. This other comprehensive loss amount consisted of unrealized investment losses on securities, which was net of reclassification adjustments of investment losses realized in net income, and net of applicable deferred acquisition costs and income taxes.

### **Income Per Share**

Due to the Company's capital structure and the absence of other potentially dilutive securities, there is no difference between basic and diluted earnings per common share for any of the periods reported. The weighted average number of shares outstanding were 11,926,817 and 11,959,345 for the six months of 2004 and 2003, respectively.

### **Income Taxes**

Deferred income taxes are recorded on the differences between the tax bases of assets and liabilities and the amounts at which they are reported in the consolidated financial statements. Recorded amounts are adjusted to reflect changes in income tax rates and other tax law provisions as they become enacted. For the second quarter, the effective tax rate was an expense of 26.2% for 2004, versus a benefit of 25.3% for 2003. For the six months, the effective tax rate was an expense of 25.4% for 2004, versus a benefit of 54.5% for 2003. Actual tax rates differ from the enacted rates primarily due to tax credits received from affordable housing investments and, in 2003, a reversal of taxes accrued related to a recently closed tax year.

## **2. SEGMENT INFORMATION**

Company operations have been classified and summarized into four reportable segments. The segments, while generally classified along Company lines, are based upon distribution method, product portfolio and target market. The Parent Company is divided into two segments. The

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Kansas City Life - Individual segment consists of sales of variable life and annuities, interest sensitive products and traditional life insurance products through a nationwide sales force of independent general agents. GuideOne is included in the Kansas City Life Individual Segment. The Kansas City Life - Group segment consists of sales of group life, disability, dental products and administrative services only. Group segment products and services are marketed by a nationwide sales force of independent general agents and group brokers, along with third party marketing arrangements. The Sunset Life segment consists of sales of interest sensitive and traditional products through a nationwide sales force of independent general agents. The Old American segment sells final expense insurance products nationwide through its general agency system, using direct response marketing to supply agents with leads in their exclusive territories.

Separate investment portfolios are maintained for each of the companies. However, investments are allocated to the group segment based upon its cash flows. Its investment income is modeled using the year of investment method. Home office functions are fully integrated for the three companies in order to maximize economies of scale. Therefore, operating expenses are allocated to the segments based upon internal cost studies, which are consistent with industry cost methodologies.

Inter-segment revenues are not material. The Company operates solely in the United States and no individual customer accounts for 10% or more of the Company's revenue.

The following schedule provides, in thousands, the financial performance of each of the four reportable operating segments of the Company.

|                        |                 | Kansas City Life  |           | Sunset       |           | Old         |  |                 |  |
|------------------------|-----------------|-------------------|-----------|--------------|-----------|-------------|--|-----------------|--|
|                        |                 | <u>Individual</u> |           | <u>Group</u> |           | <u>Life</u> |  | <u>American</u> |  |
| Insurance revenues:    |                 |                   |           |              |           |             |  |                 |  |
|                        | Second quarter: | 2004              | \$ 31,533 | \$ 10,597    | \$ 3,279  | \$ 16,949   |  |                 |  |
|                        |                 | 2003              | 36,082    | 11,664       | 3,417     | 17,282      |  |                 |  |
|                        | Six months:     | 2004              | \$ 63,179 | \$ 21,620    | \$ 7,229  | \$ 34,012   |  |                 |  |
|                        |                 | 2003              | 66,090    | 23,087       | 7,708     | 34,701      |  |                 |  |
| Net investment income: |                 |                   |           |              |           |             |  |                 |  |
|                        | Second quarter: | 2004              | \$ 37,834 | \$ 69        | \$ 7,221  | \$ 3,267    |  |                 |  |
|                        |                 | 2003              | 34,853    | 74           | 7,491     | 3,405       |  |                 |  |
|                        | Six months:     | 2004              | \$ 78,239 | \$ 149       | \$ 14,185 | \$ 6,545    |  |                 |  |
|                        |                 | 2003              | 70,951    | 154          | 15,093    | 7,161       |  |                 |  |
| Net income (loss):     |                 |                   |           |              |           |             |  |                 |  |
|                        | Second quarter: | 2004              | \$ 4,370  | \$ (1,041)   | \$ 2,562  | \$ 1,631    |  |                 |  |
|                        |                 | 2003              | 332       | (666)        | 1,187     | 682         |  |                 |  |
|                        | Six months:     | 2004              | \$ 8,319  | \$ (1,351)   | \$ 3,912  | \$ 2,237    |  |                 |  |
|                        |                 | 2003              | (5,092)   | (1,651)      | 1,124     | (304)       |  |                 |  |

### 3. CONTINGENT LIABILITIES

The life insurance industry, including the Company, has been subject to an increase in litigation in recent years. Such litigation has been pursued on behalf of purported classes of policyholders and other claims and legal actions in jurisdictions where juries often award punitive damages which are grossly disproportionate to actual damages. Although no assurances can be given and no determinations can be made at this time, management believes that the ultimate liability, if any, with respect to these claims and actions, would have no material effect on the Company's business, results of operations or financial position.

### 4. GUARANTEES AND INDEMNIFICATIONS

The Company is subject to various indemnification obligations issued in conjunction with certain transactions, primarily assumption reinsurance agreements, stock purchase agreements, mortgage servicing agreements and borrowing agreements whose terms range in duration and often are not explicitly defined. Generally, a maximum obligation is not explicitly stated; therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe the likelihood is remote that material payments would be required under such indemnifications and therefore such indemnifications would not result in a material adverse effect on our business, financial position or results of operations.

### 5. COMMITMENTS

In the normal course of business the Company has open purchase and sale commitments. At June 30, 2004, the Company had open purchase commitments of \$10.1 million and open sales commitments of \$4.3 million. Subsequent to June 30, 2004, the Company entered into purchase

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commitments of \$2.8 million and sales commitments of \$9.6 million. Typically, these purchase and sales commitments are for securities, mortgage loans, real estate, affordable housing and other investments. The ultimate financial impact of these commitments is not presently determinable.

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **Cautionary Statement on Forward-Looking Information**

This report reviews the Company's financial condition and results of operations, and historical information is presented and discussed. Where appropriate, factors that may affect future financial performance are also identified and discussed. Certain statements made in this report include forward-looking statements that fall within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include any statement that may predict, forecast, indicate or imply future results, performance or achievements rather than historical facts and may contain words like believe, expect, estimate, project, forecast, anticipate, plan, will, shall, and other words, phrases or expressions of similar meaning.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that may cause actual results to differ materially from those contemplated by the forward-looking statements. Factors that could cause the Company's future results to differ materially from expected results include, but are not limited to:

- Changes in general economic conditions, including the performance of financial markets and interest rates;
- Increasing competition, which may affect the Company's ability to sell its products;
- Customer and agent response to new products, distribution channels and marketing initiatives;
- Fluctuations in experience regarding current mortality, morbidity, persistency and interest rates relative to expected amounts used in pricing the Company's products;
- Changes in assumptions related to deferred acquisition costs and the value of business acquired;
- Regulatory, accounting or tax changes that may affect the cost of, or the demand for, the Company's products or services;
- Unanticipated changes in industry trends and ratings assigned by nationally recognized rating organizations.

The Company cannot give assurances that such statements will prove to be correct. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

#### **Consolidated Results of Operations**

In the second quarter of 2004, the Company's net income increased \$6.0 million versus the prior year, to a total of \$7.5 million. Net income per share increased to \$0.63 per share versus \$0.13 per share in last year's second quarter. For the first six months of 2004, net income increased \$19.0 million to equal \$13.1 million and net income per share increased to \$1.10 per share compared to a loss of \$0.50 per share in the prior year. The largest factor in the increase was the improvement in realized investment gains and losses. In the second quarter, the Company recorded realized investment gains of \$0.7 million, a \$10.0 million increase over last year's second quarter loss. For the six months, net realized investment gains totaled \$1.5 million, versus a net realized investment loss of \$31.0 million in the prior year. This improvement was the result of a general improvement in the overall economy and credit markets. Additionally, contributing to this improvement year-to-year was an improvement in investment income due to increased invested assets, which resulted from the acquisition of GuideOne and the sizable sales of annuity products in the prior year. Partially offsetting this improvement was a decrease in premiums due to reduced sales of immediate annuities and an increase in income tax expense.

#### ***Sales***

The Company measures sales in terms of new premiums and deposits. Premiums are included in insurance revenues in the Consolidated Statements of Income, while deposits are shown in the Consolidated Statements of Cash Flows. The first set of tables below reconciles premiums included in insurance revenues and provides detail by new and renewal business. New premiums are also detailed by product. The second set of tables provided reconciles deposits with the Consolidated Statements of Cash Flows and provides detail by new and renewal deposits. New deposits are also detailed by product.

For the second quarter, new premiums declined 46% due to a 75% decrease in immediate annuity sales. New premiums for the six months decreased 33% versus last year, primarily due to a 69% decrease in the sale of immediate annuities. These sales have been slowing since the second half of 2003, due in part to an emphasis on life insurance sales and changes in the marketplace.

Individual life insurance premiums increased 26% for the second quarter and 16% for the six months versus 2003. For the second quarter, group life sales increased 61% and group accident and health sales grew 28%. For the six months, group life sales increased 54%, and group accident and health sales grew 47%. Third party marketing arrangements continue to generate strong sales in both the long-term disability and stop loss lines. Renewal premiums grew 5% for the second quarter and 4% in the six months, largely due to the acquisition of GuideOne.



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|  | Quarter ended June 30 |       |           |       |
|--|-----------------------|-------|-----------|-------|
|  | 2004                  | % chg | 2003      | % chg |
| New premiums:                            |                       |       |           |       |
| Individual life insurance                | \$ 3,538              | 26    | \$ 2,809  | (4)   |
| Immediate annuities                      | 3,429                 | (75)  | 13,611    | 163   |
| Group life insurance                     | 394                   | 61    | 244       | (24)  |
| Group accident and health insurance      | 3,351                 | 28    | 2,613     | (11)  |
| Individual accident and health insurance | (334)                 | -     | -         | -     |
| Total new premiums                       | 10,378                | (46)  | 19,277    | 70    |
| Renewal premiums                         | 36,941                | 5     | 35,060    | (7)   |
| Total premiums                           | \$ 47,319             | (13)  | \$ 54,337 | 11    |

|  | Six Months ended June 30 |       |            |       |
|--|--------------------------|-------|------------|-------|
|  | 2004                     | % chg | 2003       | % chg |
| New premiums:                            |                          |       |            |       |
| Individual life insurance                | \$ 6,196                 | 16    | \$ 5,323   | (12)  |
| Immediate annuities                      | 6,307                    | (69)  | 20,436     | 245   |
| Group life insurance                     | 811                      | 54    | 525        | (11)  |
| Group accident and health insurance      | 7,171                    | 47    | 4,888      | (13)  |
| Individual accident and health insurance | 308                      | -     | -          | -     |
| Total new premiums                       | 20,793                   | (33)  | 31,172     | 72    |
| Renewal premiums                         | 73,577                   | 4     | 70,458     | (6)   |
| Total premiums                           | \$ 94,370                | (7)   | \$ 101,630 | 9     |

Total new deposits declined 27% for both the second quarter and six months largely due to a 45% decrease in fixed deferred annuity sales for the second quarter and a 40% decrease in fixed deferred annuity sales for the six months. As mentioned earlier, sales declined for immediate and fixed deferred annuities in the second half of 2003, and that trend has continued during the first half of 2004. New deposits on universal life products increased 60% in the second quarter and 29% for the six months. For the second quarter, new variable annuities increased 17% and new variable universal life sales increased 117%. Variable annuity deposits and variable universal life deposits each increased 12% for the six months, reflecting renewed interest in variable products due to improvement in the overall market. Renewal deposits increased 13% for the second quarter and 14% for the six months, primarily due to contracts received in the GuideOne acquisition.

|                                   | Quarter ended June 30 |       |           |       |
|-----------------------------------|-----------------------|-------|-----------|-------|
|                                   | 2004                  | % chg | 2003      | % chg |
| New deposits:                     |                       |       |           |       |
| Universal life insurance          | \$ 3,306              | 60    | \$ 2,069  | 15    |
| Variable universal life insurance | 1,350                 | 117   | 621       | (77)  |
| Fixed deferred annuities          | 18,223                | (45)  | 33,098    | 100   |
| Variable annuities                | 9,008                 | 17    | 7,696     | 18    |
| Total new deposits                | 31,887                | (27)  | 43,484    | 58    |
| Renewal deposits                  | 38,861                | 13    | 34,356    | 3     |
| Total deposits                    | \$ 70,748             | (9)   | \$ 77,840 | 28    |

|                                   | Six Months ended June 30 |       |            |       |
|-----------------------------------|--------------------------|-------|------------|-------|
|                                   | 2004                     | % chg | 2003       | % chg |
| New deposits:                     |                          |       |            |       |
| Universal life insurance          | \$ 5,547                 | 29    | \$ 4,289   | 11    |
| Variable universal life insurance | 1,981                    | 12    | 1,773      | (64)  |
| Fixed deferred annuities          | 37,605                   | (40)  | 63,161     | 91    |
| Variable annuities                | 16,202                   | 12    | 14,410     | 14    |
| Total new deposits                | 61,335                   | (27)  | 83,633     | 53    |
| Renewal deposits                  | 77,755                   | 14    | 68,087     | (2)   |
| Total deposits                    | \$ 139,090               | (8)   | \$ 151,720 | 23    |

**Insurance Revenues**

Insurance revenues consist of premiums and contract charges, less reinsurance ceded. Insurance revenues decreased 9% in the second quarter and 4% in the first half. Overall premiums decreased 13% in the second quarter and 7% for the six months, primarily due to the decrease in immediate annuities. Contract charges increased 16% for the second quarter and 14% for the six months, largely due to the addition of GuideOne's portfolio of universal life and annuity products. Reinsurance ceded increased 29% in the second quarter and 26% in the six months. The Company has expanded its use of reinsurance over the past few years to help mitigate potential adverse exposure in virtually all individual and group life and accident and health lines of business. In addition, the GuideOne acquisition accounted for 22% of the growth in reinsurance premiums paid in the first half.

The volatility of the equity markets continues to influence consumers' preferences favorably toward interest sensitive products and more traditional life and annuity insurance products. Consumers continue to desire a broad portfolio of products with safety and competitive return objectives, which the Company strives to provide. Variable insurance products allow policyholders to participate in both the equity and fixed income markets; interest sensitive and traditional insurance products combine safety of principal with competitive interest returns.

Insurance revenues may be affected by the persistency of policyholders, which may be influenced by economic conditions as well as competitive forces and fluctuations in mortality experience. The Company's persistency and mortality experience have been consistent with expectations over time.

**Investment Revenues**

Net investment income increased 6% in both the second quarter and first half. While the Company's overall yield declined due to lower available market yields, the Company's investable assets were significantly greater than a year ago due to both the acquisition of GuideOne and the sizable sales of annuity products in the prior year.

As discussed above, the Company recorded realized investment gains for the second quarter of \$0.7 million. This was a \$10.0 million increase over realized investment losses of \$9.2 million in the prior year. The Company recorded realized investment gains for the first half of \$1.5 million, a \$32.5 million improvement over a loss of \$31.0 million one year earlier. The Company continues to improve its portfolio quality while seeking to maximize its overall returns. The overall improvement in the economy and credit markets have been the primary reason for the decline in realized losses. The following table provides detail concerning realized investment gains and losses for the second quarter and six month periods of 2004 and 2003.

| <b>Realized Investment Gains and Losses</b> | Quarter ended  |                   | Six Months      |                    |
|---|----------------|-------------------|-----------------|--------------------|
|   | June 30        |                   | June 30         |                    |
|   | 2004           | 2003              | 2004            | 2003               |
| Gross gains resulting from:                 |                |                   |                 |                    |
| Sales of investment securities              | \$ 1,894       | \$ 3,104          | \$ 4,659        | \$ 3,104           |
| Investment securities called                | 41             | 572               | 349             | 572                |
| Sales of real estate                        | 1,304          | 963               | 1,590           | 963                |
| Total gross gains                           | <u>3,239</u>   | <u>4,639</u>      | <u>6,598</u>    | <u>4,639</u>       |
| Gross losses resulting from:                |                |                   |                 |                    |
| Sales of investment securities              | (2,075)        | (5,607)           | (3,781)         | (5,607)            |
| Write-downs of investment securities        | (555)          | (8,066)           | (555)           | (8,066)            |
| Investment securities called                | (94)           | (276)             | (1,009)         | (276)              |
| Total gross losses                          | <u>(2,724)</u> | <u>(13,949)</u>   | <u>(5,345)</u>  | <u>(13,949)</u>    |
| Amortization of deferred acquisition costs  | 209            | 81                | 274             | 81                 |
| Realized investment gains (losses)          | <u>\$ 724</u>  | <u>\$ (9,229)</u> | <u>\$ 1,527</u> | <u>\$ (13,868)</u> |

The Company regularly evaluates the quality of its investment portfolio. Occasionally, in a diversified portfolio, certain investments may suffer market price deterioration due to a wide variety of factors. Distressed securities are placed onto watch lists that are then further analyzed to identify any specific securities that the Company believes may have experienced other than temporary declines in fair value. To the extent that the Company believes that these fluctuations represent an other than temporary decline in value, the value of the investment is adjusted by charging off the loss against income. The Company's analysis identified \$0.6 million in other than temporary declines in value in the second quarter and first half. In the first half of 2003, the Company recorded \$26.9 million in other than temporary declines in value, which were largely due to investments in the airline industry.

While the credit markets have generally improved over the reporting period, the recent rise in interest rates resulted in a general decline in market values for fixed maturity type securities at June 30, 2004. Accordingly, investments of \$1.5 billion in fair value had unrealized losses of \$49.2 million. At year-end 2003, investments of \$1.0 billion had unrealized losses of \$28.9 million.

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### ***Policyholder Benefits and Interest Credited to Policyholder Account Balances***

Policyholder benefits decreased 12% or \$6.3 million in the second quarter and 5% or \$5.5 million in the first half. Policyholder benefits decreased in the first half primarily due to lower immediate annuity sales, which resulted in lower required reserves. This decline was partially offset by an increase in incurred individual death benefit payments, primarily due to the GuideOne acquisition and other benefits. Other benefits include individual accident and health payments from the GuideOne acquisition, along with group and accident and health payments. For the first half, mortality experience on the non-GuideOne business was better than expected and mortality on the GuideOne acquisition was consistent with expectations.

Interest credited to policyholder account balances increased 6% in the second quarter and 12% in the first half. This increase was largely the result of interest credited on policyholder account balances received in the GuideOne acquisition.

### ***Deferred Acquisition Costs (DAC) and Value of Business Acquired (VOBA)***

For the second quarter, the amortization of DAC was \$8.8 million and \$6.2 million for 2004 and 2003, respectively. The amortization of DAC for the first half totaled \$16.6 million in 2004 versus \$15.2 million in 2003. This increase is largely due to the unlocking of DAC assumptions in 2003, which reduced the amortization of DAC by \$1.8 million. The Company evaluates the assumptions used in the amortization of deferred acquisition costs on a regular basis. As warranted by a combination of historical results and expected future trends, the Company unlocks these assumptions and accordingly increases or decreases the deferred acquisition costs. For the first six months of 2004, the unlocking of DAC assumptions was not material to the financial statements.

The amortization of VOBA was \$1.7 million in the second quarter of 2004 and \$1.6 million for the same period in 2003. VOBA amortization was \$3.6 million for the first six months of 2004 compared to \$3.3 million in 2003. Further, additional VOBA was established on June 30, 2003 at \$38.0 million due to the acquisition of GuideOne.

### ***Operating Expenses***

Insurance operating expenses decreased 3% in the second quarter of 2004 but were level for the first half. The Company strives to contain its operating expenses in the face of rising costs on a variety of fronts. Increases in government regulations such as Sarbanes-Oxley, employee benefits, the need to continually maintain and improve its computer environment and processing systems, as well as the general rise in inflation are all forces that the Company must manage. This level of expense control was achieved even with the inclusion of operating expenses related to the GuideOne acquisition.

### ***Income Taxes***

The effective income tax rate was an expense of 26.2% for the second quarter of 2004 versus a benefit of 25.3% for the prior year period. The effective income tax rates for the first half were an expense of 25.4% and a benefit of 54.5% in 2004 and 2003, respectively. The income tax rate in both years was affected by tax credits generated from the Company's investments in affordable housing. Also, in 2003 the Company benefited from the reversal of taxes accrued related to a recently closed tax year.

### **Operating Results by Segment**

The following schedules provide key supplemental financial information for each of the Company's four reportable operating segments for the first quarters of 2004 and 2003 and are reconciled to the financial statements contained herein (in thousands):

|  | Kansas City Life  |                   | Sunset          |            |
|--|-------------------|-------------------|-----------------|------------|
|  | <u>Individual</u> | <u>Group</u>      | <u>Life</u>     |            |
| <b>2004 (second quarter):</b>  |                   |                   |                 |            |
| Premiums:  |                   |                   |                 |            |
| New premiums   | \$ 4,555          | \$ 3,745          | \$ 102          | \$         |
| Renewal premiums   | <u>9,445</u>      | <u>9,619</u>      | <u>1,296</u>    | <u></u>    |
| Total premiums   | 14,000            | 13,364            | 1,398           |            |
| Contract charges   | 23,641            | -                 | 5,740           |            |
| Reinsurance ceded  | <u>(6,109)</u>    | <u>(2,767)</u>    | <u>(3,859)</u>  | <u></u>    |
| Total insurance revenues   | \$ <u>31,532</u>  | \$ <u>10,597</u>  | \$ <u>3,279</u> | \$ <u></u> |
| Net investment income  | 37,833            | 69                | 7,222           |            |
| Realized investment gains (losses)   | 565               | -                 | 557             |            |
| Other revenues   | 1,081             | 585               | 26              |            |
| Policyholder benefits and interest credited to policyholder account balances | 44,830            | 7,839             | 4,894           |            |
| Expenses and taxes   | <u>21,812</u>     | <u>4,452</u>      | <u>3,628</u>    | <u></u>    |
| Net income (loss)  | <u>\$ 4,369</u>   | <u>\$ (1,040)</u> | <u>\$ 2,562</u> | <u>\$</u>  |

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|                  |                  |             |                 |             |
|------------------|------------------|-------------|-----------------|-------------|
| Deposits:        |                  |             |                 |             |
| New deposits     | \$ 30,546        | \$ -        | \$ 1,341        | \$ -        |
| Renewal deposits | <u>30,767</u>    | <u>-</u>    | <u>8,094</u>    | <u>-</u>    |
| Total deposits   | <u>\$ 61,313</u> | <u>\$ -</u> | <u>\$ 9,435</u> | <u>\$ -</u> |

|   | <u>Individual</u> | Kansas City Life<br><u>Group</u> | <u>Sunset<br/>Life</u> |             |
|---|-------------------|----------------------------------|------------------------|-------------|
| <b>2003 (second quarter):</b>   |                   |                                  |                        |             |
| Premiums:   |                   |                                  |                        |             |
| New premiums  | \$ 14,340         | \$ 2,857                         | \$ 190                 | \$ -        |
| Renewal premiums  | <u>6,411</u>      | <u>10,065</u>                    | <u>1,361</u>           | <u>-</u>    |
| Total premiums  | 20,751            | 12,922                           | 1,551                  | -           |
| Contract charges  | 19,587            | -                                | 5,664                  | -           |
| Reinsurance ceded   | <u>(4,257)</u>    | <u>(1,259)</u>                   | <u>(3,797)</u>         | <u>-</u>    |
| Total insurance revenues  | <u>\$ 36,081</u>  | <u>\$ 11,663</u>                 | <u>\$ 3,418</u>        | <u>\$ -</u> |
| Net investment income   | 34,853            | 74                               | 7,491                  | -           |
| Realized investment gains (losses)  | (6,537)           | -                                | (1,395)                | -           |
| Other revenues  | 1,495             | 724                              | 80                     | -           |
| Policyholder benefits and interest credited<br>to policyholder account balances | 47,968            | 8,226                            | 5,610                  | -           |
| Expenses and taxes  | <u>17,592</u>     | <u>4,901</u>                     | <u>2,797</u>           | <u>-</u>    |
| Net income (loss)   | <u>\$ 332</u>     | <u>\$ (666)</u>                  | <u>\$ 1,187</u>        | <u>\$ -</u> |

|                  |                  |             |                  |             |
|------------------|------------------|-------------|------------------|-------------|
| Deposits:        |                  |             |                  |             |
| New deposits     | \$ 40,519        | \$ -        | \$ 2,965         | \$ -        |
| Renewal deposits | <u>26,412</u>    | <u>-</u>    | <u>7,944</u>     | <u>-</u>    |
| Total deposits   | <u>\$ 66,931</u> | <u>\$ -</u> | <u>\$ 10,909</u> | <u>\$ -</u> |

|   | <u>Individual</u> | Kansas City Life<br><u>Group</u> | <u>Sunset<br/>Life</u> |             |
|---|-------------------|----------------------------------|------------------------|-------------|
| <b>2004 (six months):</b>   |                   |                                  |                        |             |
| Premiums:   |                   |                                  |                        |             |
| New premiums  | \$ 9,078          | \$ 7,982                         | \$ 213                 | \$ -        |
| Renewal premiums  | <u>18,618</u>     | <u>18,771</u>                    | <u>2,697</u>           | <u>-</u>    |
| Total premiums  | 27,696            | 26,753                           | 2,910                  | -           |
| Contract charges  | 47,068            | -                                | 11,462                 | -           |
| Reinsurance ceded   | <u>(11,586)</u>   | <u>(5,132)</u>                   | <u>(7,143)</u>         | <u>-</u>    |
| Total insurance revenues  | <u>\$ 63,178</u>  | <u>\$ 21,621</u>                 | <u>\$ 7,229</u>        | <u>\$ -</u> |
| Net investment income   | 78,238            | 149                              | 14,186                 | -           |
| Realized investment gains (losses)  | 1,333             | -                                | 412                    | -           |
| Other revenues  | 2,510             | 1,272                            | 424                    | -           |
| Policyholder benefits and interest credited<br>to policyholder account balances | 94,009            | 15,193                           | 11,120                 | -           |
| Expenses and taxes  | <u>42,932</u>     | <u>9,199</u>                     | <u>7,219</u>           | <u>-</u>    |
| Net income (loss)   | <u>\$ 8,318</u>   | <u>\$ (1,350)</u>                | <u>\$ 3,912</u>        | <u>\$ -</u> |

|                  |                   |             |                  |             |
|------------------|-------------------|-------------|------------------|-------------|
| Deposits:        |                   |             |                  |             |
| New deposits     | \$ 58,921         | \$ -        | \$ 2,414         | \$ -        |
| Renewal deposits | <u>61,511</u>     | <u>-</u>    | <u>16,244</u>    | <u>-</u>    |
| Total deposits   | <u>\$ 120,432</u> | <u>\$ -</u> | <u>\$ 18,658</u> | <u>\$ -</u> |

|                           | <u>Individual</u> | Kansas City Life<br><u>Group</u> | <u>Sunset<br/>Life</u> |  |
|---------------------------|-------------------|----------------------------------|------------------------|--|
| <b>2003 (six months):</b> |                   |                                  |                        |  |

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|  |    |                |    |                |    |                |    |
|--|----|----------------|----|----------------|----|----------------|----|
| Premiums:  |    |                |    |                |    |                |    |
| New premiums   | \$ | 21,937         | \$ | 5,413          | \$ | 465            | \$ |
| Renewal premiums   |    | <u>12,667</u>  |    | <u>20,214</u>  |    | <u>2,753</u>   |    |
| Total premiums   |    | 34,604         |    | 25,627         |    | 3,218          |    |
| Contract charges   |    | 39,942         |    | -              |    | 11,424         |    |
| Reinsurance ceded  |    | <u>(8,456)</u> |    | <u>(2,541)</u> |    | <u>(6,934)</u> |    |
| Total insurance revenues   | \$ | <u>66,090</u>  | \$ | <u>23,086</u>  | \$ | <u>7,708</u>   | \$ |
| Net investment income  |    | 70,951         |    | 154            |    | 15,093         |    |
| Realized investment gains (losses)   |    | (22,847)       |    | -              |    | (4,890)        |    |
| Other revenues   |    | 3,108          |    | 1,513          |    | 211            |    |
| Policyholder benefits and interest credited to policyholder account balances |    | 90,068         |    | 16,592         |    | 11,675         |    |
| Expenses and taxes   |    | <u>32,326</u>  |    | <u>9,812</u>   |    | <u>5,323</u>   |    |
| Net income (loss)  | \$ | <u>(5,092)</u> | \$ | <u>(1,651)</u> | \$ | <u>1,124</u>   | \$ |
| Deposits:  |    |                |    |                |    |                |    |
| New deposits   | \$ | 74,032         | \$ | -              | \$ | 9,601          | \$ |
| Renewal deposits   |    | <u>53,293</u>  |    | -              |    | <u>14,794</u>  |    |
| Total deposits   | \$ | <u>127,325</u> | \$ | -              | \$ | <u>24,395</u>  | \$ |

***Kansas City Life Insurance Company - Individual Insurance***

Insurance revenues for this segment decreased 13% in the second quarter and 4% in the first half, as the decline in immediate annuity premiums more than offset the increase in premiums resulting from the GuideOne acquisition. New premiums decreased 59% for the six months compared with a year ago, primarily due to a 69% decrease in new sales of immediate annuity premiums. New individual life premiums increased 46%.

New deposits decreased 20%, reflecting the decrease in fixed deferred annuity sales. However, universal life deposits increased 57%. Both variable annuity deposits and variable universal life deposits increased 12%.

Contract charges increased 21% in the second quarter and 18% for the six months, largely due to the addition of the GuideOne portfolio of universal life and annuity products.

Net investment income for this segment grew 9% for the second quarter and 10% for the first half of 2004. This increase reflects the growth in investable assets from the prior year due to the GuideOne acquisition and sales growth, more than offsetting the impact of a declining interest rate environment in recent periods. Realized investment gains totaled \$0.6 million in the second quarter and were \$1.3 million for the six months ended 2004. This is an improvement of \$7.1 million over the second quarter of 2003 and \$24.2 million over the six months of 2003.

Policyholder benefits and interest credited to policyholder account balances decreased 7% in the second quarter but increased 4% for the first half relative to 2003 results. Overall mortality exceeded expectations on the non-GuideOne block of business and was within expectations for the acquisition block. Other benefits, which are included in policyholder benefits, declined 6% for the quarter but increased 29% for the six months compared with 2003. This line is mostly composed of annuity, supplemental contracts and individual accident and health benefits. The increase in this line is due in part to the high volume of immediate annuity sales in 2003 and the GuideOne acquisition, which contained certain individual accident and health business where the timing of the benefit payments lagged the premium receipt. At year-end 2003, the Company discontinued the sale of certain elements of this accident and health business. Surrender benefits, which are part of policyholder benefits, declined 21% in the second quarter and 3% for the six months compared with 2003. Interest credited to policyholder account balances was up 12% for the second quarter and 18% for the six months. The increase is driven from the GuideOne acquired block of business, which added nearly \$280 million in policyholder account balances as of June 30, 2003. These additional policyholder account balances resulted in significant policyholder benefits to the current period's results. However, excluding the effect of the acquisition, policyholder benefits were down for both the second quarter and the six month periods.

The amortization of deferred acquisition cost increased 58% in the second quarter and 6% for the six months compared with 2003. This increase is primarily the result of unlocking DAC assumptions in the prior year's second quarter of \$1.3 million. The Company regularly evaluates the assumptions used in the amortization of DAC and unlocks the assumptions when warranted.

Net income for this segment increased \$4.0 million in the second quarter and \$13.4 million for the six months versus 2003. As discussed above, this improvement was largely due to the change in realized investment gains.

***Kansas City Life Insurance Company - Group Insurance***

Insurance revenues for the Group insurance segment decreased 9% in the second quarter and 6% for the six months. This was largely attributable to lower premiums in the dental line, which experienced a loss of a third party marketing arrangement at December 31, 2003. However, new group life premiums increased 54%, for the six months, reflecting strong sales from the independent group agents. In addition, the Company's other third party marketing arrangements produced strong sales of long-term disability products and stop loss products. Direct premiums from the long-term disability line increased \$1.8 million over the six months last year. The stop loss line, which was reintroduced as a new product in the fourth quarter of 2003, generated \$1.4 million in premiums in the six months of 2004.

Policyholder benefits decreased 8% for the six months of 2004 compared with 2003, primarily due to increased reinsurance ceded benefits on group life insurance. Overall, the claims ratio (total benefits divided by total insurance revenues) for this segment improved versus last year, falling from 72% in 2003 to 70% in 2004.

For the second quarter of 2004, the net loss increased \$0.4 million to \$1.0 million. In the first half of 2004 the net loss decreased \$0.3 million to \$1.4 million.

***Sunset Life Insurance Company of America***

Insurance revenues for this segment decreased 4% in the second quarter and 6% for the six months compared with 2003. Total life and annuity premiums decreased 10% for both the second quarter and the first half, largely due to reduced immediate annuity sales.

Net investment income declined 4% in the second quarter and 6% for the six months compared with 2003, as a result of declines in both investable assets and the recent interest rate environment. However, realized investment gains improved \$2.0 million for the second quarter and \$5.3 million for the six months.

Policyholder benefits decreased 13% for the second quarter and 5% for the six months in large part due to improved mortality. Additionally, insurance operating expenses declined for both the second quarter and six months, primarily due to the release of an accrued expense associated with a legal settlement from 2001.

Net income for this segment was \$2.6 million in the second quarter, a \$1.4 million increase over 2003. Net income for the six months totaled \$3.9 million, improving \$2.8 million versus the prior year period. As discussed above, these increases are largely the result of the change in realized investment gains.

***Old American Insurance Company***

Insurance revenues decreased 2% in both the second quarter and six months. New life premiums in this segment continued to grow at a rate of 5%, the same as the first quarter. However the improved sales results were offset by renewal decreases. Policyholder benefits decreased 7% for the second quarter versus a year ago and 9% for the six months compared with 2003, largely due to improved mortality experience.

Net investment income declined 4% in the second quarter and 9% for the six months compared with 2003, as a result of declines in both investable assets and the recent interest rate environment. However, realized investment losses declined \$0.9 million in the second quarter of 2004 and \$3.0 million for the six months compared with 2003.

Net income for this segment was \$1.6 million in the second quarter, a \$0.9 million improvement versus 2003. Net income for the six months increased \$2.5 million versus the prior year and totaled \$2.2 million. This change largely reflected reduced realized losses and improved mortality experience.

**Liquidity and Capital Resources**

***Liquidity***

Statements made in the Company's Form 10-K and the 2003 Annual Report to Stockholders remain pertinent, as the Company's liquidity position is materially unchanged from year-end.

The Company and each insurance subsidiary meets liquidity requirements primarily through positive cash flows from its operations. The Company has sufficient sources of liquidity to satisfy operational requirements. Primary sources of cash flow are premiums, other insurance considerations and deposits, receipts for policyholder accounts, investment sales and maturities, investment income and access to credit from other financial institutions. The principal uses of cash are for the insurance operations, including the purchase of investments, payments of insurance benefits, operating expenses, withdrawals from policyholder accounts, costs related to acquiring new business, dividends and income taxes.

Cash provided from operations totaled \$38.7 million for the six months ended June 30, 2004, down from \$53.9 million a year ago. This decrease is primarily due to two factors. First, net cash premium receipts for the first six months of 2004 declined \$5.2 million versus the same period of

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2003. This decrease is largely the result of a decrease in the receipts of immediate annuities. However, additional premium from the GuideOne acquired business offset most of the decline in premium receipts from immediate annuities. Second, net cash benefit payments increased \$11.2 million for the six month period of 2004 relative to 2003. This increase is primarily due to the GuideOne acquired business.

Net cash used in investing activities was \$76.3 million for the six months, which was down from \$107.1 million in 2003. The decrease is largely due to the acquisition of GuideOne in 2003.

Net cash provided from financing activities was \$19.2 million in 2004, versus \$64.2 million in 2003. This decrease is primarily the result of three factors. First, reduced fixed deferred annuity sales resulted in decreased cash flow of \$12.6 million. Second, withdrawals on policyholder account balances increased \$20.0 million. And, third, net transfers to separate accounts have increased \$6.0 million over the same time last year.

Asset and liability maturities and yields are closely managed and exposure to changing interest rates is minimized so that funds will be available as needed to meet future policyholder obligations. Cash flow testing is performed to ensure sufficient interest spreads are earned.

This information excludes net proceeds from variable insurance products. These proceeds are segregated into separate accounts and are not held in the Company's general investments because the policyholders, rather than the Company, assume the underlying investment risks.

### ***Debt and short-term borrowing***

The Company and certain subsidiaries have access to borrowing capacity through their membership affiliation with the Federal Home Loan Bank. At June 30, 2004, outstanding balances under this agreement totaled \$108.5 million in maturities of less than one year. The primary purpose for these borrowings is to ensure access to liquidity. This is accomplished through the purchase of highly liquid, marketable securities from the proceeds of these borrowings.

The Company established a two-year note payable for \$2.0 million associated with the GuideOne purchase, due in June 2005. Outstanding borrowings of \$18.3 million are related to real estate ownership, and the Company has one construction loan totaling \$0.5 million.

Borrowings totaled \$129.2 million at June 30, 2004, down \$4.5 million from year-end 2003. The Company has unsecured revolving lines of credit of \$60 million with two major commercial banks with no balances outstanding.

### ***Capital resources***

The Company considers existing capital resources to be more than adequate to support the current level of business activities.

The following table shows the capital adequacy for the Company.

|   | <u>June 30</u><br>2004 | <u>December 31</u><br>2003 |
|---|------------------------|----------------------------|
| Total assets less separate accounts                               | \$ 4,237,720           | \$ 4,247,221               |
| Total stockholders' equity  | 620,531                | 644,438                    |
| Ratio of stockholders' equity<br>to assets less separate accounts | 15%                    | 15%                        |

The ratio of equity to assets less separate accounts has remained relatively constant as identified above. Unrealized investment gains on available for sale securities, which are included as a part of stockholders' equity, totaled \$16.3 million at June 30, 2004, a \$30.6 million decrease from year-end 2003. This change is the result of an increase in interest rates during the second quarter.

Stockholders' equity decreased \$23.9 million from year-end. This decline is the result of the change in accumulated other comprehensive income, which decreased \$30.6 million from year-end. This is reflective of the decrease in unrealized investment gains on securities, as described above. Consolidated book value per share equaled \$52.03 at June 30, 2004, a 4% decrease from year-end 2003.

During the first half of 2004, the Company did not purchase any of its shares under the stock repurchase program. Under this program, the Company may purchase up to one million shares on the open market during 2004.

On July 26, 2004, the Board of Directors declared a quarterly dividend of \$0.27 per share, unchanged from the prior year, that will be paid August 23, 2004 to stockholders of record as of August 9, 2004.

Current legislative activities are not expected to have a significant impact on the ongoing operations of the Company.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

#### Liquidity and Capital Resources

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Statements made in the Company's Form 10-K and the 2003 Annual Report to Stockholders regarding the market and interest rate risk analysis remain pertinent.

The Company holds a diversified portfolio of investments that includes cash, bonds, preferred stocks, mortgage-backed securities, commercial mortgages and real estate. Each of these investments is subject, in varying degree, to market risks that can affect their return and their fair value. A majority of these assets are debt instruments of corporations or U.S. Government Sponsored Enterprises (GSE) and are considered fixed income investments. Thus, the primary market risks affecting the Company's portfolio are interest rate risk, credit risk and liquidity risk.

Interest rate risk arises from the price sensitivity of investments to changes in interest rates. Coupon and dividend income represent the greatest portion of an investment's total return for most fixed income instruments in stable interest rate environments. The changes in the fair market price of such investments are inversely related to changes in market interest rates. As interest rates fall, the coupon and dividend streams of existing fixed rate investments become more valuable and market values rise. As interest rates rise, the opposite effect occurs.

Market changes rarely follow a linear pattern in one direction for any length of time. Within any diversified portfolio, an investor will likely find embedded options, both puts and calls, that change the structure of the cash flow stream. Mortgage-backed securities are particularly sensitive to interest rate changes. As long-term interest rates fall, homeowners become more likely to refinance their mortgage or move up to a larger home, causing a prepayment of the outstanding mortgage principal, which must then be reinvested at a lower rate. Should interest rates rise suddenly, prepayments expected by investors may decrease, extending the duration of a mortgage pool. This represents a further interest rate risk to investors.

As interest rates rise, policyholders may become more likely to surrender policies or to borrow against cash values, often to meet sudden needs in an inflationary environment or to invest in higher yielding opportunities elsewhere. This risk of disintermediation may force the Company to liquidate parts of its portfolio at a time when the fair market value of fixed income investments is falling. If interest rates fall, the Company may also be forced to invest new cash receipts at levels below the minimum guaranteed rates payable to policyholders, eroding profit margins. The Company can usually adapt to small sudden changes in interest rates, or even large changes that occur over longer periods of time. Cash flow may increase or decrease over the course of the business cycle. Therefore, the Company takes steps to ensure that adequate liquidity is available to meet obligations in a timely manner. To this end, the Company maintains lines of credit with commercial banks and other short-term borrowing arrangements with financial institutions.

The majority of the Company's investments are exposed to varying degrees of credit risk. Credit risk is the risk that the value of the investment may decline due to deterioration in the financial strength of the issuer and that the timely payment of principal or interest might not occur.

Over the past three years, credit defaults in the marketplace have increased significantly relative to historical norms. The increase in the default rate has been attributed to several factors, including the economic slowdown experienced by the U.S. economy, the increased use of leverage by corporate issuers, fraud and adverse legal judgments against corporations, among others. A default by a rated issuer usually involves some loss of principal to the investor, as evidenced by the write-downs taken by the Company. Losses can be mitigated by timely sales of affected securities or by active involvement in a restructuring process. However, there can be no assurance that the efforts of an investor will lead to favorable outcomes in a bankruptcy or restructuring.

The Company mitigates credit risk by diversifying the investment portfolio across a broad range of issuers, investment sectors and security types, and by limiting the amount invested in any particular entity. With the exception of certain GSE's, there is no exposure to any single issuer greater than one percent of assets on a book value basis. The Company also invests in securities carrying a lien against physical assets. These securities can improve the likelihood of payment according to contractual terms and increase recovery amounts in the case of bankruptcy or restructuring.

As market interest rates fluctuate, so will the value of the Company's investment portfolio and its stockholders' equity. At June 30, 2004, the Company had an unrealized investment gain of \$16.3 million, net of related taxes, policyholder account balances and deferred acquisition costs, compared to \$46.9 million at year-end 2003. This decrease is primarily the result of changes in the term structure of interest rates and the volatility in credit spreads within the corporate bond market. The Company continues its practice of the limited use of derivatives as a form of risk mitigation.

The Company markets certain variable products. The policyholder assumes essentially all the investment earnings risk for the portion of the account balance invested in the separate accounts. However, the Company assesses certain charges based on the policy account values and changes to the account values can affect the Company's earnings. The portion of the policyholder's account balance invested in the fixed general account, if any, is affected by the spreads between interest yields on investments and rates credited to the policyholder's accounts.

### **Item 4. Controls and Procedures**

(a) *Evaluation of disclosure controls and procedures.* The Chief Executive Officer and Chief Financial Officer of Kansas City Life Insurance Company have concluded, based on their evaluation as of the end of the period covered by this report, that the Company's disclosure controls



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and procedures are effective for gathering, analyzing and disclosing the information the Company is required to disclose in the Company's reports under the Securities Exchange Act of 1934.

(b) *Changes in internal controls.* There were no significant changes in the Company's internal controls over financial reporting or in other factors that could significantly affect those controls made during the quarter covered by this report, that have, or are reasonably likely to materially affect the Company's internal control over financial reporting.

### Part II: Other Information

#### Item 1. Legal Proceedings

The life insurance industry, including the Company and its subsidiaries, has been subject to an increase in litigation in recent years. Such litigation has been pursued on behalf of purported classes of insurance purchasers, often questioning the conduct of insurers in the marketing of their products.

In addition to the above, the Company and its subsidiaries are defendants in, or subject to other claims or legal actions. Some of these claims and legal actions are in jurisdictions where juries are given substantial latitude in assessing damages, including punitive damages. Although no assurances can be given and no determinations can be made at this time, management believes that the ultimate liability, if any, with respect to these other claims and legal actions would have no material effect on the Company's business, results of operations or financial position.

#### Item 5. Other Information.

3520 Broadway, Kansas City, MO 64111

Contact: Tracy W. Knapp, Chief Financial  
(816) 753-7299, Extension

For Immediate Release: August 6, 2004, press release reporting financial results for the second quarter of 2004.

### Kansas City Life Announces Second Quarter 2004 Results

Kansas City Life Insurance Company recorded second quarter net income of \$7.5 million or \$0.63 per share, an increase of \$6.0 million or \$0.50 per share over 2003 results. The Company posted net income of \$13.1 million or \$1.10 per share for the six months ended June 30, 2004, an improvement of \$19.0 million from the prior year. The largest factor in the improved results was the favorable change in realized investment gains and losses. In addition, increased investment income from growth in invested assets contributed to the Company's positive results.

Total revenues grew \$5.8 million or 5.4% and \$32.1 million or 16.1% for the second quarter and six-month period, respectively. These changes were driven by the Company's realized investment gains of \$0.7 million for the quarter and \$1.5 million for the six months, compared to realized investment losses of \$9.2 million and \$31.0 million for the same periods in 2003. These results reflect the improved economy and general progress in the performance of corporate credit markets. As the economy and credit markets have improved, so too has the credit quality of the Company's investment securities.

Investment revenues have also increased from the growth in invested assets, which has resulted from new product sales during the past year and the acquisition of GuideOne Life in 2003. In spite of the low interest rate environment, net investment income increased 5.6% and 6.2% for the second quarter and six-month period, respectively.

Insurance premiums decreased by \$7.0 million or 12.9% for the second quarter and \$7.3 million or 7.1% for the first half of 2004, primarily due to a decline in the sale of immediate annuities. However, included in these figures is growth in the Company's primary life insurance product lines. Life insurance premiums grew by \$2.6 million or 8.9% and \$5.2 million or 8.9% for the second quarter and six-month period, respectively, largely due to the GuideOne acquisition. The Company continues to emphasize growth in the life protection product lines.

The Company also experienced favorable benefits and expenses, which declined by 3.0% for the second quarter and were level for the six-month period.

On July 26, 2004, the Board of Directors declared a quarterly dividend of \$0.27 per share, payable on August 23, 2004 to stockholders of record on August 9, 2004.

The first half of 2004 has seen the Company benefit from the improving economy and increased sales of life insurance. This sales growth has been produced by both Kansas City Life's independent general agency sales force and the new agencies from GuideOne. This sales growth is

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the direct result of the Company's emphasis and continuing focus on its core life insurance business. We look forward to further improvements in the operating environment, along with growth in our ability to extend life protection.

Kansas City Life Insurance Company (NASDAQ: KCLI) was established in 1895 and is based in Kansas City, Missouri. The Company's primary business is providing financial protection through the sale of life insurance and annuities. The Company's revenues were \$446 million in 2003, and assets and life insurance in force were \$4.6 billion and \$32.6 billion, respectively, as of December 31, 2003. The Company operates in 48 states and the District of Columbia. For more information, please visit [www.kclife.com](http://www.kclife.com).

*(Continued on next page)*

Kansas City Life Announces  
Second Quarter 2004 Results  
August 6, 2004; Page Two

### KANSAS CITY LIFE INSURANCE COMPANY CONDENSED CONSOLIDATED INCOME STATEMENT (Unaudited) (amounts in thousands, except share data)

|   | Quarter ended<br>June 30 |                     |                   |
|---|--------------------------|---------------------|-------------------|
|   | 2004                     | 2003                | 2004              |
| Revenues  | \$ 113,207<br>=====      | \$ 107,401<br>===== | \$ 230,9<br>===== |
| Net income (loss)                                 | \$ 7,522<br>=====        | \$ 1,535<br>=====   | \$ 13,1<br>=====  |
| Net income (loss) per share,<br>basic and diluted | \$ 0.63<br>=====         | \$ 0.13<br>=====    | \$ 1.<br>=====    |
| Dividends paid                                    | \$ 0.27<br>=====         | \$ 0.27<br>=====    | \$ 0.<br>=====    |

*A quarterly dividend of \$.27 per share will be paid August 23, 2004 to shareholders of record as of August 9, 2004.*

|                                      |            |            |          |
|--------------------------------------|------------|------------|----------|
| Average number of shares outstanding | 11,928,419 | 11,941,855 | 11,926,8 |
|--------------------------------------|------------|------------|----------|

#### **Item 6. Exhibits and Reports on Form 8-K.**

(a) Exhibits:

- (31)a Rule 13a-15(e)/15d-15(e) Certifications.
- (31)b Rule 13a-15(e)/15d-15(e) Certifications.
- (32) Item 32 - Section 906 Certification.

(b) Reports on Form 8-K:

1. On May 14, 2004, the Company filed a Form 8-K Item 12, which furnished financial information mailed to stockholders on May 13, 2004 reporting results of the first quarter of 2004.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**KANSAS CITY LIFE INSURANCE COMPANY**

/s/R. Philip Bixby \_\_\_\_\_

R. Philip Bixby  
President, Chief Executive Officer  
and Vice Chairman of the Board

/s/Tracy W. Knapp \_\_\_\_\_

Tracy W. Knapp  
Senior Vice President, Finance

Date: August 6, 2004