

KANSAS CITY LIFE INSURANCE CO  
 Form 10-Q  
 August 08, 2003

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, 2003

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 July 31, 2003</u>
Common Stock, \$1.25 par value	11,925,646 shares

**Part I Financial Information**

**Item 1. Financial Statements**

All financial statements are presented in thousands, except per share data.

**Consolidated  
 Income Statement (Unaudited)**

	Quarter ended June 30	
	<u>2003</u>	<u>2002</u>
<i>Revenues</i>		
Insurance revenues:		
Premiums and contract charges	\$ 79,406	71,584
Reinsurance ceded	<u>(11,144)</u>	<u>(11,505)</u>
Net insurance revenues	68,262	60,079
Investment revenues:		
Investment income, net	45,823	49,356
Realized losses, net	<u>(9,229)</u>	<u>(7,184)</u>
Other	<u>2,154</u>	<u>3,357</u>
Total revenues	<u>107,010</u>	<u>105,608</u>

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Benefits and expenses

Policyholder benefits (net of reinsurance ceded: quarter: \$10,351 - 2003, \$6,165 - 2002; six months: \$23,495 - 2003, \$17,421 - 2002)	73,799	64,946
Amortization of deferred acquisition costs	6,237	3,808
Insurance operating expenses (net of commissions ceded: quarter: \$1,159 - 2003, \$1,314 - 2002; six months: \$2,108 - 2003, \$2,440 - 2002)	<u>25,749</u>	<u>23,704</u>
Total benefits and expenses	<u>105,785</u>	<u>92,458</u>
Pretax income (loss)	<u>1,225</u>	<u>13,150</u>
Federal income taxes:		
Current	2,663	(352)
Deferred	<u>(2,973)</u>	<u>3,765</u>
	<u>(310)</u>	<u>3,413</u>
Net income (loss)	\$ <u>1,535</u>	<u>9,737</u>
Per common share:		
Net income (loss), basic and diluted	\$ 0.13	0.81
Cash dividends	\$ 0.27	0.27

See accompanying Notes to Consolidated Financial Statements.

**Consolidated  
Balance Sheet**

	June 30 2003 <u>(Unaudited)</u>	December 31 2002
<b>Assets</b>		
Investments:		
Fixed maturity securities available for sale, at fair value	\$ 2,256,669	2,141,439
Equity securities available for sale, at fair value	49,518	57,587
Mortgage loans, net	458,149	463,150
Short-term investments	204,487	186,770
Other investments	<u>206,677</u>	<u>206,043</u>
Total investments	3,175,500	3,054,989
Cash	18,682	2,532
Deferred acquisition costs	240,396	246,286
Other assets	361,130	306,578
Separate account assets	<u>265,404</u>	<u>244,862</u>
	\$ <u>4,061,112</u>	<u>3,855,247</u>
<b>Liabilities and equity</b>		
Future policy benefits	\$ 825,675	811,634
Accumulated contract values	1,860,600	1,784,635
Notes payable	99,845	97,241
Current income taxes payable	-	1,902
Other liabilities	360,436	317,476
Separate account liabilities	<u>265,404</u>	<u>244,862</u>
Total liabilities	<u>3,411,960</u>	<u>3,257,750</u>

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Stockholders' equity:		
Common stock	23,121	23,121
Paid in capital	22,907	22,605
Retained earnings	674,462	686,847
Accumulated other		
comprehensive income (loss), net of tax	42,130	(24,437)
Less treasury stock	<u>(113,468)</u>	<u>(110,639)</u>
Total stockholders' equity	<u>649,152</u>	<u>597,497</u>
	\$	<u>4,061,112</u>
		<u>3,855,247</u>

See accompanying Notes to Consolidated Financial Statements.

**Consolidated**  
**Statement of Cash Flows (Unaudited)**

	Six Months ended June 30	
	<u>2003</u>	<u>2002</u>
<i>Operating activities</i>		
Net cash provided	\$ <u>61,554</u>	<u>15,198</u>
<i>Investing activities</i>		
Purchases of security investments available for sale:		
Fixed maturities	(497,408)	(395,990)
Equity securities	(1,447)	(5,397)
Sales of security investments available for sale	118,193	213,212
Maturities and principal paydowns		
of security investments available for sale:		
Fixed maturities	345,309	163,599
Equity securities	3,289	11,331
Purchases of other investments	(52,022)	(39,351)
Sales, maturities and principal		
paydowns of other investments	56,085	41,219
Net purchase of short-term investments	(17,958)	(22,435)
Acquisition of GuideOne Life Insurance Company	<u>(61,150)</u>	<u>-</u>
Net cash used	<u>(107,109)</u>	<u>(33,812)</u>
<i>Financing activities</i>		
Policyholder contract deposits	119,116	88,382
Withdrawals of policyholder		
contract deposits	(54,946)	(56,077)
Change in other deposits	3,920	2,912
Dividends paid to stockholders	(6,462)	(6,484)
Proceeds from borrowings	3,118	952
Repayment of borrowings	(514)	-
Other, net	<u>(2,527)</u>	<u>(1,345)</u>
Net cash provided	<u>61,705</u>	<u>28,340</u>
Increase in cash	16,150	9,726
Cash at beginning of year	<u>2,532</u>	<u>4,365</u>
Cash at end of period	\$ <u>18,682</u>	<u>14,091</u>

See accompanying Notes to Consolidated Financial Statements.

**Kansas City Life Insurance Company**  
**Notes to Consolidated Financial Statements**

**Note 1 - 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), Old American Insurance Company (Old American) and GuideOne Life Insurance Company. These items have been prepared in accordance with accounting principles generally accepted in the United States (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 2002 Form 10-K and the 2002 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, 2003, 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.

***Critical Accounting Policies and Estimates***

These critical accounting policies and estimates should be read in conjunction with statements and disclosures made in the Company's 2002 Form 10-K as filed with the Securities and Exchange Commission.

GAAP requires management to make certain estimates and assumptions, which affect amounts reported in the financial statements and accompanying notes. As such, the Company combines its actual experience with selected estimates in the preparation of its financial statements. The calculations used to estimate various components in the financial statements are necessarily complex and involve large amounts of data. Assumptions and estimates involve judgment and by their nature can be subject to revision over time.

The calculation of life insurance policy reserves is dependent upon estimates of future events. These estimates require judgments based upon the Company's past experience and estimates and assumptions about future mortality, persistency and interest rates. At any given time, earnings variability may result from changes in actual experience such as mortality or persistency, as well as changes in estimates of future experience.

Deferred acquisition costs, principally agent commissions and other selling, selection and issue costs which vary with and are directly related to the production of insurance revenue, are capitalized as incurred and amortized over future premium payments or the expected future profits of the business, depending on the type of products. Profit expectations are based upon estimates of future interest spreads, mortality margins, operating expenses and surrender experience. These estimates involve judgment, are reviewed not less than annually and are compared to actual experience on an ongoing basis. If it is determined that the assumptions related to interest sensitive and variable products should be revised as to the profit expectations for the business, the assumptions are unlocked, or changed, with the impact of the change flowing through the current period's earnings.

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 2002 Annual Report to Stockholders. The Company performs a rigorous 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 company, its industry, valuation levels and subsequent developments. Based upon these inputs, the Company establishes its securities values in accordance with GAAP.

***Accounting Developments***

The Financial Accounting Standards Board (FASB) issued Financial Accounting Standard (FAS) No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure," in December, 2002. This Standard amends FAS No. 123 "Accounting for Stock-Based Compensation," related to methods of accounting for stock-based employee compensation. This Standard was adopted on January 1, 2003 with no material impact.

FAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities," was issued in April 2003. This Standard amends and clarifies financial accounting and reporting for derivative instruments and for hedging activities under FAS No. 133, "Accounting for

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Derivative Instruments and Hedging Activities. This FAS was adopted on July 1, 2003 with no material impact.

FAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, was issued in May 2003. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. This FAS was adopted on July 1, 2003 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. This Statement affects the treatment of variable annuity contracts. This SOP will be adopted January 1, 2004, and it is anticipated that there will be no material impact.

FIN 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, was issued November 2002. This is an interpretation of FASB Statements No. 5, 57, and 107 and is a rescission of FASB interpretation No. 34. It requires certain guarantees to be recorded at fair value instead of when a loss is probably and reasonably estimated. FASB 45 also requires disclosures even when the likelihood of making any payments under the guarantee is remote. Although liability recognition only applies to guarantees issued or amended after January 1, 2003, disclosure requirements are presently effective. This interpretation was adopted January 1, 2003 and the Company is not aware of any guarantees that would have a material effect on its financial statements.

FIN 46, Consolidation of Variable Interest Entities, was issued January 2003. This is an interpretation of ARB No. 51, Consolidated Financial Statements. It concerns consolidating the assets, liabilities, and results of the activities of variable interest entities if a controlling financial interest exists. This interpretation will be adopted July 1, 2003 and the Company does not expect FIN46 to have a material impact to its financial statements.

### ***Comprehensive Income***

Comprehensive income is comprised of net income and other comprehensive income, which includes unrealized gains or losses on securities available for sale and unfunded pension liabilities. Comprehensive income equaled \$60.6 million and \$33.6 million for the first half 2003 and 2002. For the second quarter, comprehensive income was \$44.5 million and \$36.5 million for 2003 and 2002, respectively. For the periods presented, comprehensive income varied from net income solely due to changes in unrealized gains and losses on securities, net of applicable taxes.

### ***Earnings Per Share***

Due to the Company's capital structure and lack 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 numbers of shares outstanding were 11,959,345 and 12,003,889 for the six months ended June 30, 2003 and 2002, respectively.

### ***Federal Income Taxes***

Income taxes have been provided using the liability method. Under that method, deferred tax assets and liabilities are determined based on the differences between their financial reporting and their tax bases and are measured using the Federal income tax rate. The effective tax rate was a benefit of 54.5 percent for this year's first half versus an expense of 25.6 percent last year. For the second quarter, the effective tax rates were a benefit of 25.3 percent and an expense of 26.0 percent for 2003 and 2002, respectively. Actual tax rates differ from the enacted rates primarily due to tax credits received from affordable housing investments and a reversal of taxes accrued in prior years.

### **Note 2 - Notes Payable**

The Company borrows short-term funds through its membership with the Federal Home Loan Bank (FHLB) and reinvests those funds at higher rates, thereby earning an interest spread on those funds. These activities also contribute significantly to the Company's liquidity position by providing established lines of credit for borrowing and by adding high quality liquid securities that could be sold if liquidity is needed. As a member of the FHLB with a capital investment of \$9.0 million, the Company has the ability to borrow up to twenty times its capital investment, or \$179.7 million, from the FHLB when collateralized. As of June 30, 2003, the Company had short-term borrowings with the FHLB totaling \$95.0 million with various maturities and a weighted average interest rate of 1.96 percent. These borrowings are secured by mortgage-backed securities totaling \$108.8 million. The Company had a \$0.7 million real estate loan due December 2010, with an interest rate of 7.50 percent, secured by the property. The Company had a \$1.0 million real estate loan due March 2008, with an interest rate of 7.75 percent, secured by the property. The Company had overnight Federal fund borrowings totaling \$0.6 million with a daily maturity, an interest rate of 1.54 percent and secured by specific securities. The Company had a \$2.0 million note payable to GuideOne Financial Group, Inc. related to the purchase of GuideOne Life Insurance Company. This note had a 4 percent interest rate at June 30, 2003 and is due on June 30, 2005. Finally, the Company had a \$0.5 million construction loan related to an investment property with an interest rate of 8.00 percent. The full amount of the note will be forgiven when the construction is complete and a certificate of occupancy is issued. Total borrowings equaled \$99.8 million at June 30, 2003.

**Note 3 - Business Segments**

Company operations have been classified and summarized into four reportable segments. The segments, generally classified along company lines, are based upon distribution method, product portfolio and target market. The Parent Company is divided into two segments. The Kansas City Life - Individual segment consists of sales of variable life and annuities, interest sensitive products and traditional life insurance products by an agency sales force to individuals. The Kansas City Life Group segment consists of sales of group life, disability and dental products and administrative services only (ASO) by the Company's agency sales force and appointed group agents. The Sunset Life segment consists of sales of interest sensitive and traditional products by an agency sales force. The Old American segment markets whole life final expense products primarily to seniors through an agency sales force.

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 allocated to the group business segment based upon their contribution to cash flow. 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.

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

		Kansas City Life <u>Individual</u>	Kansas City Life <u>Group</u>	Sunset <u>Life</u>	Old <u>America</u>
Net insurance revenues:					
Six months:	2003	\$65,667	23,087	7,708	34,700
	2002	48,323	27,910	8,656	35,410
Second quarter:	2003	35,900	11,663	3,417	17,280
	2002	24,448	14,053	3,928	17,650
Investment income, net:					
Six months:	2003	\$70,951	154	15,093	7,160
	2002	73,585	217	16,455	8,270
Second quarter:	2003	34,853	74	7,491	3,400
	2002	36,899	104	8,158	4,190
Net income (loss):					
Six months:	2003	\$(5,092)	(1,651)	1,124	(300)
	2002	8,609	(814)	5,840	2,610
Second quarter:	2003	332	(666)	1,187	680
	2002	4,704	(922)	4,606	1,340

Intersegment revenues are not material and there has been no significant change in segment assets from last year-end. The Company operates solely in the United States and no individual customer accounts for 10 percent or more of the Company's revenue.

**Note 4 - Commitments and Contingencies**

Under state insurance guaranty fund laws, insurance companies may be assessed up to prescribed limits for policyholder losses that result from insolvent or rehabilitated companies. Mandatory assessments may be partially recovered through a reduction of future premium taxes in some states. The Company does not believe that such assessments will be materially different from amounts already provided for in the financial statement.

A contingent liability exists with respect to reinsurance, which may become a liability of the Company in the unlikely event that the reinsurers should be unable to meet obligations assumed under existing reinsurance contracts. Reinsurers' solvency is reviewed periodically.

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

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The Company had open purchase commitments for the funding of \$7.3 million in mortgage loans, \$38.3 million in bonds and \$4.2 million in affordable housing as of June 30, 2003.

### Note 5 - Insurance Company Acquisition

On June 30, 2003, Kansas City Life Insurance Company acquired all of the issued and outstanding stock of GuideOne Life Insurance Company from GuideOne Financial Group, Inc. and GuideOne Mutual Insurance Company. The purchase price, according to the terms of the Stock Purchase Agreement, was \$61.2 million. This acquisition was funded with \$59.2 million in cash and a \$2.0 million note payable due June 30, 2005.

GuideOne Life Insurance Company has previously reported its financial position on a statutory basis using the accounting practices permitted or prescribed by the Iowa Insurance Division; therefore, financial statements using Generally Accepted Accounting Principles are not available. As such, the Company has recorded the estimated net effect of \$61.2 million for the GuideOne Life Insurance Company acquisition in other assets. Once financial statements using Generally Accepted Accounting Principles are available, the acquisition will be recorded at gross assets and liabilities. The Company does not expect the purchase entry to materially impact the Company's balance sheet.

### Note 6 - 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.

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

### Cautionary Forward-Looking Statements

This filing contains forward-looking statements and information that are based on management's current expectations as of the date of this document within the meaning of the Securities Litigation Reform Act of 1995. The words "anticipate", "believe", "estimate" and "expect", and similar expressions, are intended to identify forward-looking statements which are subject to risks, uncertainties, assumptions and other factors that may cause the actual results of the Company to be materially different from those reflected in such forward-looking statements. Factors that could cause the Company's future results to differ materially from expectations include:

- (1) General economic and business conditions;
- (2) Changes in interest rates;
- (3) The performance of the stock market;
- (4) Increased competition in the sale of insurance and annuities;
- (5) Customer response to new products, distribution channels and marketing initiatives;
- (6) Changes in the Federal income tax laws and regulations which may affect the relative tax advantages of some of the Company's products;
- (7) Insurance regulatory changes or actions; and
- (8) Ratings assigned to the Company and its subsidiaries by independent rating organizations.

There can be no assurance that other factors not currently anticipated by management will not also materially and adversely affect the Company. The Company does not intend to update these forward-looking statements prior to its next required filing with the Securities and Exchange Commission.

### Results of Operations

Kansas City Life's basic and diluted net income per share declined 84 percent in the second quarter to equal \$0.13. For the first half of the year 2003, the Company incurred a net loss per share of \$0.50 versus net income per share of \$1.35 last year for the same period. The decline in earnings can primarily be attributed to a substantial increase in realized investment losses. These losses totaled \$31.0 million for the six months, an increase of \$20.7 million over last year. Two-thirds of these losses occurred in the first quarter, primarily the result of the highly distressed

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airline industry. Net realized losses in the second quarter totaled \$9.2 million, a \$2.0 million increase over last year. Losses continued in the airline industry, as well as certain companies in other industries.

Net insurance revenues rose 14 percent in the second quarter and 9 percent in the first half. Gross life premiums increased 33 percent in the second quarter and 25 percent in the six months. These increases are largely attributable to strong immediate annuity sales, reflecting a continuing consumer preference for fixed return products. Immediate annuity premiums accounted for 26 percent of the total gross premiums for the six months versus 5 percent last year and were six times larger than a year ago. Of note, life premiums declined 2 percent in the first half versus the same period last year. Conversely, accident and health premiums declined 16 percent in the second quarter and 17 percent versus a year ago, largely resulting from a decline in group dental premiums.

Net investment income declined 7 percent in the second quarter and 5 percent in the first half. Factors contributing to this decline were the historically low market yields, the volatile financial markets and an increase in the Company's short-term investment position.

Following is a table that details, in thousands, gross realized investment gains and losses for the second quarter and first half of 2003 and 2002.

	Quarter ended June 30		Six months Jun
	2003	2002	2003
Gross gains resulting from:			
Sales of securities	\$ 3,104	3,039	4,710
Securities called or matured	572	1,486	943
Sales of real estate and joint ventures	<u>963</u>	<u>-</u>	<u>1,129</u>
Total gross gains	<u>4,639</u>	<u>4,525</u>	<u>6,782</u>
Gross losses resulting from:			
Sales of securities	(5,607)	(2,492)	(10,487)
Adjustment in book value of securities	(8,066)	(8,661)	(26,925)
Securities called or matured	(276)	(263)	(450)
Sales of real estate and joint ventures	<u>-</u>	<u>(204)</u>	<u>-</u>
Total gross losses	<u>(13,949)</u>	<u>(11,620)</u>	<u>(37,862)</u>
Related deferred policy acquisition costs	<u>81</u>	<u>(89)</u>	<u>77</u>
Net realized losses	<u>\$ (9,229)</u>	<u>(7,184)</u>	<u>(31,003)</u>

The Company regularly evaluates the quality of its investment portfolio. From time-to-time, in a diversified portfolio, certain investments suffer market price deterioration due to a wide variety of factors. The Company performs an extensive evaluation process no less often than quarterly. Distressed securities are placed onto watch lists that are then further analyzed to identify any specific securities that the Company believes 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 or when the Company believes that it is more likely than not that it will not receive all of its contractual cash flows from an investment made by the Company, the investment's value is adjusted by charging off the loss against income. The Company's second quarter analysis identified \$8.1 million in other than temporary declines in value.

Policyholder benefits increased 14 percent in the second quarter and 8 percent in the first half. This increase is largely attributable to the increased sales of immediate annuities with life contingencies as benefits on these products can rise nearly as much as the premiums.

Insurance operating expenses rose 9 percent in the second quarter and 3 percent in the first half. These increases can largely be attributed to an increase in pension expenses, resulting from a combination of lower discount rate on plan liabilities and reduced future earnings assumptions on plan assets.

### Segment Results

The following schedule addresses key supplemental financial information for each of the Company's four reportable operating segments for the first half of 2003 and 2002 and is reconciled to the financial statements contained herein (in thousands):

	Kansas City Life <u>Individual</u>	Life <u>Group</u>	Sunset <u>Life</u>	Old <u>America</u>
2003:				
Premiums:				



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Life	\$ 31,252	4,629	3,208	36,288
Accident and Health	2,929	20,999	10	1,899
Contract Charges	39,942	-	11,424	
Reinsurance Ceded	<u>(8,456)</u>	<u>(2,541)</u>	<u>(6,934)</u>	<u>(3,471)</u>
Net Insurance Revenues	\$ <u>65,667</u>	<u>23,087</u>	<u>7,708</u>	<u>34,700</u>
Policy Benefits:				
Death Benefits	\$23,677	2,767	1,503	21,399
Surrenders of Life Insurance	4,328	-	410	2,133
Other Benefits	17,145	13,610	1,027	333
Benefit and Contract Reserve Increase	<u>44,917</u>	<u>215</u>	<u>8,736</u>	<u>1,699</u>
Net Policyholder Benefits	\$ <u>90,067</u>	<u>16,592</u>	<u>11,676</u>	<u>25,550</u>

	<u>Kansas City Life Individual</u>	<u>Kansas City Life Group</u>	<u>Sunset Life</u>	<u>Old Americo</u>
2002:				
Premiums:				
Life	\$14,169	5,012	3,331	37,188
Accident and Health	2,841	25,330	10	2,159
Contract Charges	40,093	-	12,177	
Reinsurance Ceded	<u>(8,780)</u>	<u>(2,432)</u>	<u>(6,862)</u>	<u>(3,911)</u>
Net Insurance Revenues	\$ <u>48,323</u>	<u>27,910</u>	<u>8,656</u>	<u>35,410</u>
Policy Benefits:				
Death Benefits	\$25,044	2,528	1,377	21,959
Surrenders of Life Insurance	4,167	-	434	1,963
Other Benefits	15,382	17,744	1,098	523
Benefit and Contract Reserve Increase	<u>27,535</u>	<u>39</u>	<u>10,633</u>	<u>2,463</u>
Net Policyholder Benefits	\$ <u>72,128</u>	<u>20,311</u>	<u>13,542</u>	<u>26,900</u>

***Kansas City Life - Individual***

Net insurance revenues for this segment rose 47 percent in the second quarter and 36 percent in the first half. Life premiums more than doubled in both the second quarter and six months, largely due to increased immediate annuity sales. Immediate annuity premiums accounted for 52 percent of total gross premiums for the first half versus 15 percent last year and were 6 times larger than a year ago. Of note, life premiums for the six months remained level with last year. This segment provided 50 percent of consolidated net insurance revenues, up from 40 percent last year, reflecting the growth in immediate annuity sales.

Policyholder benefits increased 39 percent in the second quarter and 25 percent in the first half. These increases can primarily be attributed to greater benefit and contract reserves, which rose 75 percent and 63 percent in the second quarter and first half, respectively. This is largely the result of the increase in immediate annuity sales. Death benefits rose 6 percent in the second quarter but declined 5 percent for the six months.

Net income for this segment declined from \$4.7 million in second quarter 2002 to \$0.3 million in second quarter 2003. This segment incurred a net loss of \$5.1 million in the first half versus \$8.6 million in net income last year, primarily the result of the greater realized losses on investments.

***Kansas City Life - Group***

Net insurance revenues for the Group segment declined 17 percent in both the second quarter and first half. These declines were largely in the dental line. The major factor contributing to the decline in dental revenues was the loss of a block of dental business in late 2002. This segment provided 18 percent of consolidated net insurance revenues, down from 23 percent a year ago.

Policyholder benefits declined 23 percent in the second quarter and 18 percent in the six months. These declines are also primarily attributable to the dental line, resulting from the loss of the dental block mentioned above. However, the claims ratio for this segment improved slightly versus last year.

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This segment incurred net losses of \$0.7 million in the second quarter and \$1.7 million in the first half compared to losses of \$0.9 million and \$0.8 million in last year's second quarter and first half, respectively.

### *Sunset Life*

Net insurance revenues for this segment declined 13 percent in the second quarter and 11 percent in the first half. Life insurance premiums declined 13 percent in the second quarter and 4 percent in the six months. Contract charges on interest sensitive products declined 3 percent in the second quarter and 6 percent versus last year. The reduced contract charges primarily resulted from a decline in surrender charges. This segment contributed 6 percent of consolidated net insurance revenues compared to 7 percent last year.

Total policyholder benefits declined 18 percent in both the second quarter and 14 percent in the first half. The primary factor in these decreases was a decline in benefit and contract reserves in the traditional products. This decline can largely be attributed to increases in the prior year's benefit reserves.

Net income for this segment was \$1.2 million in the second quarter and \$1.1 million in the first half versus \$4.6 million and \$5.8 million, respectively last year. Net realized investment losses totaled \$4.9 million versus \$0.9 million a year ago. Additionally, investment income declined 8 percent, primarily reflecting the lower interest rate environment.

### *Old American*

Net insurance revenues and life premiums declined 2 percent in both the second quarter and first half. This was partially offset by a decline in reinsurance ceded of 11 percent in both the second quarter and six months. Policyholder benefits decreased 7 percent in the second quarter and 5 percent versus last year, reflecting favorable mortality.

Net income for this segment declined from \$1.3 million in last year's second quarter to \$0.7 million this year. This segment incurred a net loss of \$0.3 million in the first half compared to net income of \$2.6 million last year. The primary factor in this decline was an increase in net realized investment losses of \$2.1 million versus last year. This segment provided 26 percent of net consolidated insurance revenues versus 30 percent last year.

### **Liquidity and Capital Resources**

Statements made in the Company's 2002 Annual Report to Stockholders remain pertinent, as the Company's liquidity position is materially unchanged from year-end.

Net cash provided from operating activities rose \$46.4 million from last year due in part to the increase in the sales of immediate annuities this year, the payment in 2002 of a legal settlement and an increase in 2002 in ceded reinsurance premiums. Net cash used for investing activities increased \$73.3 million, largely due to the acquisition of GuideOne Life Insurance Company. Funds received from the sales, maturities and principal pay downs of investments totaled \$522.9 million, a 22 percent increase from last year. Net cash provided from financing activities increased \$33.4 million, primarily reflecting a net increase in policyholder contract deposits.

The Company's consolidated assets topped the four billion dollar mark for the first time, as of June 30, 2003. Total assets grew more than \$200 million or 5 percent since December 31, 2002, equaling \$4.1 billion. The growth in assets was primarily driven by the increased value of fixed income investments due to lower interest rates and the sales growth in annuities and universal life insurance.

The Company invests in a variety of assets including bonds, preferred stocks, mortgage-backed securities, commercial mortgage loans and real estate. Additionally, the Company borrows short-term funds as a spread and liquidity strategy through its membership with the FHLB. The Company borrows from the FHLB and reinvests those funds at higher rates, thereby earning an interest spread on those funds. These activities also contribute significantly to the Company's liquidity position by providing established lines of credit for borrowing and by adding high quality liquid securities that can be sold if liquidity is needed. At June 30, 2003, the Company had short-term borrowings with the FHLB totaling \$95.0 million and total borrowings from all sources of \$99.8 million.

The Company believes that the current level of cash, securities available for sale, and short-term investments in combination with net cash from operations will be adequate to cover its near-term cash obligations.

Asset and liability maturities and yields are monitored as an important consideration for each type of insurance product. The Company, as an ongoing matter, monitors benefit and expense projections of future cash requirements. As part of this process, the Company performs cash flow testing under a variety of scenarios to ensure funds will be available as needed to meet current and future policyholder obligations. The Company's investment strategy is developed with these needs and requirements in mind. Additionally, the Company takes these matters into account as it develops and designs new products and as it enhances its existing product portfolio. There can be no assurances, however, that

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future experiences will be similar to historical experience due to factors such as the interest rate environment.

Funds available for investment generated from variable products are segregated into separate accounts and do not generate investment income for the Company. At June 30, 2003, separate account assets totaled \$265.4 million, an 8 percent increase from year-end 2002.

Extraordinary dividends totaling \$75.0 million were paid to Kansas City Life from two of its affiliates in June 2003. Sunset Life paid \$55.0 million of this amount and Old American paid \$20.0 million of this amount. The appropriate state insurance department approvals were received prior to each of these transactions.

Stockholders' equity increased \$51.7 million from year-end. Accumulated other comprehensive income rose \$66.6 million from year-end, due to an increase in net unrealized gains associated with securities. The Company's securities are largely fixed income securities whose values generally benefit from lower interest rates. Consolidated book value per share equaled \$54.40 at June 30, 2003, a 9 percent increase from year-end.

As previously mentioned, the Company purchased GuideOne Life Insurance Company for \$61.2 million. This acquisition was funded with \$59.2 million in cash and a \$2.0 million note payable due June 30, 2005.

Consolidated insurance in force totaled \$26.0 billion, a 4 percent decline on an annualized basis.

During the second quarter, 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 2003.

On July 28, 2003, the Board of Directors declared a quarterly dividend of \$0.27 per share, unchanged from last year, that will be paid August 25, 2003 to stockholders of record as of August 11, 2003.

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**

Statements made in the 2002 Annual Report to Stockholders regarding the market and interest rate risk analysis remain pertinent.

Kansas City Life 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 ability to earn a competitive return and the return affects their fair value. Thus, the primary market risks affecting the Company are interest rate and credit risks.

Interest rate risk arises from the price sensitivity of fixed income securities to changes in interest rates. Coupon and dividend income represents the greatest portion of an investment's total return for most fixed income instruments. As interest rates fall, the coupon and dividend streams of older, higher-paying investments become relatively more valuable than newer, lower-yielding opportunities. Therefore the market value of the older, high-paying investments increases. The opposite effect occurs when interest rates rise. The changes in fair market price of such investments are inversely related to changes in market interest rates.

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

In recent years, credit defaults in the marketplace have increased significantly. The increase in the default rate may be 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. Such loss can be mitigated by timely sales of affected securities or by active involvement in a restructuring process, which preserves the value of the underlying entity. 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 this risk by diversifying the investment portfolio across a broad range of issuers, investment sectors and security types and by investing substantial amounts of the portfolio in instruments carrying a security lien against tangible asset collateral. Pledged collateral that retains its value increases bondholder recovery amounts in the case of bankruptcy or restructuring.

As market interest rates fluctuate, so will the Company's investment portfolio and its stockholders' equity. At June 30, 2003, the Company had a net unrealized investment gain of \$68.0 million, net of related taxes and deferred policy acquisition costs, compared to \$1.4 million at year-end 2002. This increase is primarily the result of changes in the term structure of interest rates, volatility in credit spreads within the corporate bond market, and the realization of losses on certain securities. The Company continues its practice of the limited use of derivatives as a form of risk mitigation.

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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

Based on their evaluation, as of a date within 90 days of the filing of this Form 10-Q, the Company's Chief Executive Officer and Chief Financial Officer have concluded the Company's disclosure controls and procedures (as defined in Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934) are effective. There have been no significant changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

## Part II: Other Information

### Item 1: Legal Proceedings

In recent years, the life insurance industry, including the Company and its subsidiaries, has been subject to an increase in litigation pursued on behalf of purported classes of insurance purchasers, questioning the conduct of insurers in the marketing of their products. The Company believes that the action described below is part of this trend.

In the case of Charles R. Sullivan, etc., previously reported in the Company's Form 10-K Report for the Year Ended December 31, 2002, a Motion for Certification of the Class has been filed by the Plaintiff. Management believes that it is administering and has responsibility for 326 of the policies involved in the dispute.

There has been no material change in the posture or status of any other litigation previously reported by the Company as an ongoing or active case.

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 Events

On June 30, 2003, Kansas City Life Insurance Company announced that it had completed the purchase of all of the issued and outstanding stock of GuideOne Life Insurance Company from GuideOne Financial Group, Inc. and GuideOne Mutual Insurance Company. The purchase price determined at closing, according to the terms of the Stock Purchase Agreement, was \$61.2 million. This acquisition was funded with \$59.2 million in cash and a \$2.0 million note payable due June 30, 2005.

Approval of the purchase had been given by the Iowa Department of Insurance on June 24, 2003 and by the Missouri Department of Insurance on June 26, 2003.

Kansas City Life Insurance Co., founded in 1895, is a Missouri corporation with its Home Office in Kansas City, Mo. The Company's major sales emphasis is life insurance and annuities. Total revenues in 2002 were \$440.2 million. Life insurance in force, at the end of the year 2002, totaled \$26.6 billion, while assets totaled \$3.9 billion. The Company operates in 48 states and the District of Columbia.

GuideOne Life Insurance Company, an Iowa corporation, is a stock life insurer owned directly by The GuideOne Financial Group, Inc., a holding company owned by GuideOne Mutual Insurance Co. and GuideOne Specialty Mutual Insurance Company. GuideOne Life Insurance Company operations are conducted on a branch office basis and through captive and independent multiple-line agents associated with the parent company in West Des Moines, Iowa. GuideOne Life Insurance Company is licensed in 40 states selling life insurance and annuities.

In 2002 GuideOne Life Insurance Company's total direct premiums and annuity considerations totaled \$58.4 million. Net income was \$7.5 million in 2002 and total net admitted assets as of December 31, 2002 were \$347.7 million, both numbers based on Statutory Accounting Principles since Generally Accepted Accounting Principle numbers are unavailable.

**Exhibit List**

- (31)a Rule 13a-14(a)/15d-14(a) Certifications.
- (31)b Rule 13a-14(a)/15d-14(a) Certifications.
- (99) Item 99 - Section 906 Certification.

**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 8, 2003

Exhibit (31)a Rule 13a-14(a)/15d-14(a) Certifications.

**KANSAS CITY LIFE INSURANCE COMPANY**

**SECTION 302 CERTIFICATION**

Second Quarter 2003

I, R. Philip Bixby, President, Chief Executive Officer, and Vice Chairman of the Board of Kansas City Life Insurance Company, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kansas City Life Insurance Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

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- c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 8, 2003

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

Exhibit (31)b Rule 13a-14(a)/15d-14(a) Certifications.

### KANSAS CITY LIFE INSURANCE COMPANY SECTION 302 CERTIFICATION Second Quarter 2003

I, Tracy W. Knapp, Senior Vice President, Finance of Kansas City Life Insurance Company, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Kansas City Life Insurance Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
- a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: August 8, 2003

/s/Tracy W. Knapp  
Tracy W. Knapp  
Senior Vice President, Finance