

KANSAS CITY LIFE INSURANCE CO  
 Form 10-Q  
 May 09, 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 March 31, 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

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 28, 2003</u> |
|--------------------------------|-----------------------------------|
| Common Stock, \$1.25 par value | 11,937,970 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   |                 |
|-------------------------------|-----------------|-----------------|
|                               | March 31        |                 |
|                               | <u>2003</u>     | <u>2002</u>     |
| Revenues                      |                 |                 |
| Insurance revenues:           |                 |                 |
| Premiums and contract charges | \$ 73,176       | 70,713          |
| Reinsurance ceded             | <u>(10,267)</u> | <u>(10,488)</u> |
| Net insurance revenues        | 62,909          | 60,225          |
| Investment revenues:          |                 |                 |
| Investment income, net        | 47,340          | 48,955          |
| Realized losses, net          | (21,774)        | (3,079)         |
| Other                         | <u>2,632</u>    | <u>5,000</u>    |
| Total revenues                | <u>91,107</u>   | <u>111,101</u>  |

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|  |                   |                |
|--|-------------------|----------------|
| Benefits and expenses                                    |                   |                |
| Policyholder benefits (net of reinsurance ceded):        |                   |                |
| \$13,144 - 2003, \$11,256 - 2002)                        | 70,342            | 67,936         |
| Amortization of deferred acquisition costs               | 9,009             | 7,914          |
| Insurance operating expenses (net of commissions ceded): |                   |                |
| \$949 - 2003, \$1,126 - 2002)                            | <u>26,012</u>     | <u>26,549</u>  |
| Total benefits and expenses                              | <u>105,363</u>    | <u>102,399</u> |
| Pretax income (loss)                                     | <u>(14,256)</u>   | <u>8,702</u>   |
| Federal income taxes:                                    |                   |                |
| Current  | 1,289             | (1,209)        |
| Deferred   | <u>(8,087)</u>    | <u>3,394</u>   |
|  | <u>(6,798)</u>    | <u>2,185</u>   |
| Net income (loss)  | \$ <u>(7,458)</u> | <u>6,517</u>   |
| Per common share:  |                   |                |
| Net income (loss), basic and diluted                     | \$ (0.62)         | 0.54           |
| Cash dividends   | \$ 0.27           | 0.27           |

See accompanying Notes to Consolidated Financial Statements.

**Consolidated  
Balance Sheet**

|   | March 31<br>2003<br><u>(Unaudited)</u> | December 31<br><u>2002</u> |
|---|--|----------------------------|
| Assets  |  |                            |
| Investments:  |  |                            |
| Fixed maturities securities<br>available for sale, at fair value \$ | 2,130,967                              | 2,141,439                  |
| Equity securities available<br>for sale, at fair value              | 51,667                                 | 57,587                     |
| Mortgage loans, net   | 456,814                                | 463,150                    |
| Short-term investments  | 288,401                                | 186,770                    |
| Other investments   | <u>209,139</u>                         | <u>206,043</u>             |
| Total investments   | 3,136,988                              | 3,054,989                  |
| Cash  | 10,233                                 | 2,532                      |
| Deferred acquisition costs  | 242,639                                | 246,286                    |
| Other assets  | 301,992                                | 306,578                    |
| Separate account assets   | <u>238,177</u>                         | <u>244,862</u>             |
| \$  | <u>3,930,029</u>                       | <u>3,855,247</u>           |
| Liabilities and equity  |  |                            |
| Future policy benefits  | \$ 816,962                             | 811,634                    |
| Accumulated contract values   | 1,820,805                              | 1,784,635                  |
| Notes payable   | 96,201                                 | 97,241                     |
| Current income taxes payable  | 989                                    | 1,902                      |
| Other liabilities   | 347,852                                | 317,476                    |
| Separate account liabilities  | <u>238,177</u>                         | <u>244,862</u>             |
| Total liabilities   | <u>3,320,986</u>                       | <u>3,257,750</u>           |

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|  |                     |                  |
|--|---------------------|------------------|
| Stockholders' equity:                            |                     |                  |
| Common stock                                     | 23,121              | 23,121           |
| Paid in capital                                  | 22,757              | 22,605           |
| Retained earnings                                | 676,151             | 686,847          |
| Accumulated other comprehensive loss, net of tax | (835)               | (24,437)         |
| Less treasury stock                              | <u>(112,151)</u>    | <u>(110,639)</u> |
| Total stockholders' equity                       | <u>609,043</u>      | <u>597,497</u>   |
|  | \$ <u>3,930,029</u> | <u>3,855,247</u> |

See accompanying Notes to Consolidated Financial Statements.

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

|   | Quarter ended    |                |
|---|------------------|----------------|
|   | March 31         |                |
|   | <u>2003</u>      | <u>2002</u>    |
| Operating activities  |                  |                |
| Net cash provided   | \$ <u>34,112</u> | <u>471</u>     |
| Investing activities  |                  |                |
| Purchases of security investments available for sale:                         |                  |                |
| Fixed maturities  | (188,009)        | (200,716)      |
| Equity securities   | (839)            | (3,697)        |
| Sales of security investments available for sale                              | 65,824           | 119,549        |
| Maturities and principal paydowns of security investments available for sale: |                  |                |
| Fixed maturities  | 152,673          | 72,842         |
| Equity securities   | 2,807            | 5,607          |
| Purchases of other investments  | (21,969)         | (10,076)       |
| Sales, maturities and principal paydowns of other investments                 | 24,694           | 22,684         |
| Net (purchase) sale of short-term investments                                 | <u>(101,631)</u> | <u>4,793</u>   |
| Net cash provided (used)  | <u>(66,450)</u>  | <u>10,986</u>  |
| Financing activities  |                  |                |
| Policyholder contract deposits  | 57,325           | 45,817         |
| Withdrawals of policyholder contract deposits                                 | (20,577)         | (27,228)       |
| Change in other deposits  | 8,929            | 2,609          |
| Dividends paid to stockholders  | (3,238)          | (3,245)        |
| Proceeds from borrowings  | -                | 1,444          |
| Repayment of borrowings   | (1,040)          | -              |
| Other, net  | <u>(1,360)</u>   | <u>(1,803)</u> |
| Net cash provided   | <u>40,039</u>    | <u>17,594</u>  |
| Increase in cash  | 7,701            | 29,051         |
| Cash at beginning of year   | <u>2,532</u>     | <u>4,365</u>   |
| Cash at end of period   | \$ <u>10,233</u> | <u>33,416</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) and Old American Insurance Company (Old American). 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 March 31, 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 market 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.

***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 \$16.1 million for first quarter versus a comprehensive loss of \$2.9 million for last year's first quarter. For the periods presented, comprehensive income varies from net income solely due to changes in unrealized gains and losses on securities, net of applicable taxes.

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## *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 11,977,317 and 12,010,103 for the first quarters ended March 31, 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 47.7 percent for this year's first quarter versus an expense of 25.1 percent last year. 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 March 31, 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 \$107.0 million. The Company has a \$0.7 million real estate loan due December 2010, with an interest rate of 7.50 percent, secured by the property. Finally, the Company has a \$0.5 million construction loan related to an investment property due July 2003 with an interest rate of 8.00 percent. This note will be forgiven in total if certain construction terms are met by that date. Total borrowings equaled \$96.2 million at quarter end.

## **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 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.

The following schedule addresses, in thousands, the financial performance of each of the Company's four reportable operating segments for the first quarter of 2003 and 2002.

|                         |      | Kansas City Life  |              | Sunset      | Old             |              |
|-------------------------|------|-------------------|--------------|-------------|-----------------|--------------|
|                         |      | <u>Individual</u> | <u>Group</u> | <u>Life</u> | <u>American</u> | <u>Total</u> |
| Net insurance revenues: |      |                   |              |             |                 |              |
|                         | 2003 | \$29,768          | 11,423       | 4,299       | 17,419          | 62,909       |
|                         | 2002 | 23,876            | 13,857       | 4,726       | 17,766          | 60,225       |
| Investment income, net: |      |                   |              |             |                 |              |
|                         | 2003 | \$35,902          | 80           | 7,602       | 3,756           | 47,340       |
|                         | 2002 | 36,461            | 113          | 8,297       | 4,084           | 48,955       |
| Net income (loss):      |      |                   |              |             |                 |              |
|                         | 2003 | \$ (5,424)        | (985)        | (63)        | (986)           | (7,458)      |
|                         | 2002 | 3,905             | 108          | 1,234       | 1,270           | 6,517        |

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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.

The Company had open purchase commitments for the funding of \$21.2 million in mortgage loans, \$0.6 million in joint ventures and \$4.6 million in affordable housing as of March 31, 2003.

### Note 5 - Subsequent Event

On March 31, 2003, the Company filed an 8-K announcing that it had signed a definitive Stock Purchase Agreement under which the Company would buy all of the issued and outstanding shares of common stock of GuideOne Life Insurance Company for approximately \$78 million. Funds will be derived from cash that has been accumulated for acquisition purposes. The sale is subject to, among other things, the approval of the Iowa and Missouri Insurance Departments. Closing is expected in the second quarter of 2003.

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

## 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

### Note 3 - Business Segments

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Commission.

### Results of Operations

Kansas City Life's basic and diluted net loss per share in the first quarter equaled \$0.62. This is a decline from last year's net income per share of \$0.54. The decline in earnings can primarily be attributed to a substantial increase in realized investment losses, which rose \$12.2 million, net of applicable taxes, versus last year. The Company had sizeable investments in the highly distressed airline industry, primarily including airline equipment trust securities with aircraft leased or owned by various airline carriers and manufacturers. United Airlines, American Airlines and Delta Airlines were among the airlines whose leased or owned aircraft provide the collateral for the debt securities that primarily made up the Company's realized losses during the first quarter of 2003. Approximately 94 percent of the first quarter's investment losses resulted from the sale or write down of securities in this sector. Additionally, the weak economy continued to contribute to depressed market yields, making it difficult for already troubled companies and sectors to recover as well as difficult for new favorable yields to be achieved.

Total insurance revenues rose 4 percent in the first quarter. Gross life premiums increased 17 percent, largely due to strong immediate annuity sales as consumers continue to seek the safety of fixed return products. Conversely, accident and health premiums declined 17 percent, primarily attributable to a decline in group dental premiums.

Net investment income declined 3 percent versus a year ago. Factors contributing to this decline were the historically low market yields, the volatile financial markets and an increase in the Company's short-term position.

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

|   | Quarter ended<br>March 31 |                |
|---|---------------------------|----------------|
|   | 2003                      | 2002           |
| Gross gains resulting from:               |                           |                |
| Sales of securities                       | \$ 1,606                  | 2,904          |
| Securities called or matured              | 371                       | 238            |
| Sales of real estate and joint ventures   | <u>166</u>                | <u>-</u>       |
| Total gross gains                         | <u>2,143</u>              | <u>3,142</u>   |
| Gross losses resulting from:              |                           |                |
| Sales of securities                       | (4,880)                   | (1,095)        |
| Adjustment in book value of securities    | (18,859)                  | (4,721)        |
| Securities called or matured              | <u>(174)</u>              | <u>(438)</u>   |
| Total gross losses                        | <u>(23,913)</u>           | <u>(6,254)</u> |
| Related deferred policy acquisition costs | <u>(4)</u>                | <u>33</u>      |
| Net realized losses                       | \$ <u>(21,774)</u>        | <u>(3,079)</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 market 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 first quarter analysis identified \$18.9 million in other than temporary declines in value in the first quarter, all resulting from investments in the airline industry.

Policyholder benefits rose 4 percent versus last year. This increase is primarily the result of increased sales of immediate annuities with life contingencies, which by their nature, rise nearly as much as the premiums received.

### Segment Results

The following section addresses the financial performance of each of the Company's four reportable operating segments.

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

|                                       | <u>Kansas City Life</u><br><u>Individual</u> | <u>Group</u>   | <u>Sunset</u><br><u>Life</u> | <u>Old</u><br><u>American</u> |
|---------------------------------------|--|----------------|------------------------------|-------------------------------|
| 2003:                                 |  |                |                              |                               |
| Premiums:                             |  |                |                              |                               |
| Life                                  | \$12,189                                     | 3,737          | 1,671                        | 18,124                        |
| Accident and Health                   | 1,423  | 8,968          | 5                            | 944                           |
| Contract Charges                      | 20,355                                       | -              | 5,760                        | -                             |
| Reinsurance Ceded                     | <u>(4,199)</u>                               | <u>(1,282)</u> | <u>(3,137)</u>               | <u>(1,649)</u>                |
| Net Insurance Revenues                | <u>29,768</u>                                | <u>11,423</u>  | <u>4,299</u>                 | <u>17,419</u>                 |
| Policy Benefits:                      |  |                |                              |                               |
| Death Benefits                        | 12,416                                       | 1,661          | 649                          | 11,402                        |
| Surrenders of Life Insurance          | 1,917  | -              | 239                          | 1,037                         |
| Other Benefits                        | 7,746  | 6,613          | 741                          | 211                           |
| Benefit and Contract Reserve Increase | <u>20,021</u>                                | <u>92</u>      | <u>4,684</u>                 | <u>913</u>                    |
| Net Policyholder Benefits             | <u>\$42,100</u>                              | <u>8,366</u>   | <u>6,313</u>                 | <u>13,563</u>                 |
| 2002:                                 |  |                |                              |                               |
| Premiums:                             |  |                |                              |                               |
| Life                                  | \$ 6,502                                     | 3,876          | 1,561                        | 18,561                        |
| Accident and Health                   | 1,414  | 11,206         | 5                            | 1,071                         |
| Contract Charges                      | 20,185                                       | -              | 6,332                        | -                             |
| Reinsurance Ceded                     | <u>(4,225)</u>                               | <u>(1,225)</u> | <u>(3,171)</u>               | <u>(1,867)</u>                |
| Net Insurance Revenues                | <u>23,876</u>                                | <u>13,857</u>  | <u>4,727</u>                 | <u>17,765</u>                 |
| Policy Benefits:                      |  |                |                              |                               |
| Death Benefits                        | 14,425                                       | 1,354          | 796                          | 11,523                        |
| Surrenders of Life Insurance          | 2,207  | -              | 240                          | 905                           |
| Other Benefits                        | 7,754  | 8,220          | 742                          | 256                           |
| Benefit and Contract Reserve Increase | <u>13,344</u>                                | <u>(7)</u>     | <u>4,910</u>                 | <u>1,267</u>                  |
| Net Policyholder Benefits             | <u>\$37,730</u>                              | <u>9,567</u>   | <u>6,688</u>                 | <u>13,951</u>                 |

### ***Kansas City Life - Individual***

Total insurance revenues for this segment rose 25 percent in the first quarter. Life premiums rose 87 percent, largely due to increased immediate annuity sales as discussed earlier. Also contributing to the increase in insurance revenues, contract charges rose 1 percent and reinsurance ceded premiums declined slightly. This segment provided 47 percent of consolidated insurance revenues, up from 40 percent last year, reflecting the immediate annuity sales growth.

Policyholder benefits rose 12 percent year-to-year. The largest factor in this increase was a 50 percent increase in benefit and contract reserve increase. This can largely be attributed to the increase in immediate annuity sales. Partially offsetting this, surrenders of life insurance declined 13 percent and other policyholder benefits remained flat.

This segment incurred a net loss of \$5.4 million in the first quarter versus \$3.9 million in net income a year ago. As previously mentioned, the major factor in this decline was the increase in net realized investment losses, which rose from \$2.1 million last year to \$16.3 million this year.

### ***Kansas City Life - Group***

Total insurance revenues for the Group segment declined 18 percent in the first quarter, primarily in the dental line. A major factor in the decline in dental revenues was the loss of a block of dental business in late 2002. This segment provided 18 percent of consolidated insurance revenues, down from 23 percent a year ago.

Policyholder benefits declined 13 percent versus last year. This decline is primarily attributable to the dental line whose benefit payments significantly declined. This decline is also attributable to the loss of the group mentioned above. However, the claims ratio for this segment



deteriorated, resulting in poorer benefit performance.

This segment incurred a \$1.0 million net loss in the first quarter compared to \$0.1 million in net income last year.

#### *Sunset Life*

Life insurance premiums rose 7 percent, reflecting improved immediate annuity sales in this segment. However, total insurance revenues declined 9 percent as contract charges on interest sensitive products declined 9 percent. Reduced contract charges primarily resulted from a decline in surrender charges. This segment contributed 7 percent of consolidated insurance revenues versus 8 percent last year.

Total policyholder benefits declined 6 percent, in part reflecting favorable mortality in the first quarter.

Sunset Life incurred a net loss of \$0.1 million in the first quarter compared to \$1.2 million in net income last year. Net realized investment losses totaled \$3.5 million in the first quarter versus \$0.4 million a year ago. Investment income declined 8 percent, reflecting lower interest rates and the difficult market environment. Insurance operating expenses declined \$1.3 million, partially offsetting these items.

#### *Old American*

Total insurance revenues declined 2 percent in the first quarter as accident and health premiums decreased 12 percent. This was partially offset by a 12 percent decrease in reinsurance ceded. Policyholder benefits decreased 3 percent versus the prior year, partially reflecting favorable mortality in the first quarter.

This segment incurred a net loss of \$1.0 million compared to \$1.3 million in net income last year. The primary factor in this decline was an increase in net realized investment losses of \$1.4 million versus last year. This segment provided 28 percent of consolidated insurance revenues versus 29 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.

Funds provided from operations rose \$33.6 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. Funds received from the sales, maturities and principal pay downs of investments totaled \$246.0 million, an 11 percent increase from last year. Funds received from financing activities increased \$22.4 million primarily reflecting a net increase in policyholder contract deposits and other deposits.

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 could be sold if liquidity is needed. At March 31, 2003, the Company had short-term borrowings with the FHLB totaling \$95.0 million and total borrowings from all sources of \$96.2 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 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 March 31, 2003, separate account assets totaled \$238.2 million, a 3 percent decline from year-end 2002.

Stockholders' equity increased \$11.5 million from year-end. Accumulated other comprehensive income rose \$23.6 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. Book value per share equaled \$50.92, a 2 percent increase from year-end.

As previously mentioned, the Company has signed a definitive agreement to purchase GuideOne Life Insurance Company for \$78 million and the transaction is expected to be completed in the second quarter of 2003. Cash and short-term investments are adequate to fund this acquisition.

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Consolidated insurance in force totaled \$26.3 billion, a 4 percent decrease on an annualized basis.

During the first 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.

The Board of Directors declared a quarterly dividend of \$0.27 per share, unchanged from last year, will be paid May 27, 2003 to stockholders of record as of May 12, 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 March 31, 2003, the Company had a net unrealized investment gain of \$25.0 million, net of related taxes and deferred policy acquisition costs, compared to a \$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.

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 4: Results of Votes of Security Holders**

On April 24, 2003, the Annual Stockholders Meeting was held at 3520 Broadway, Kansas City, Missouri. At this meeting, there were 11,961,270 shares outstanding and eligible to vote, and 11,311,316 shares were represented at the meeting either in person or by proxy.

The following Directors received the number of votes indicated and were elected for a three year term:

|                     |            |
|---------------------|------------|
| J. R. Bixby         | 10,849,420 |
| R. Philip Bixby     | 10,713,269 |
| Warren J. Hunzicker | 12,073,782 |
| Tracy W. Knapp      | 10,822,552 |
| E. Larry Winn, Jr.  | 11,947,797 |

The following Directors continued their term of office after this meeting:

|                      |                       |
|----------------------|-----------------------|
| Walter E. Bixby      | Nancy Bixby Hudson    |
| Cecil R. Miller      | William R. Blessing   |
| Michael J. Ross      | Bruce W. Gordon       |
| Elizabeth T. Solberg | William A. Schalekamp |
| Daryl D. Jensen      | Webb R. Gilmore       |

**Item 6: Reports on 8-K**

There was one report on Form 8-K filed for the three months ended March 31, 2003. It announced the signing of a definitive Stock Purchase Agreement for the acquisition of GuideOne Life Insurance Company and was filed on March 31, 2003.

**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: May 9, 2003

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

**KANSAS CITY LIFE INSURANCE COMPANY**  
**SECTION 302 CERTIFICATION**  
First 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
  - 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)

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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: May 9, 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 First 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;
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

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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: May 9, 2003

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