

INDEPENDENCE HOLDING CO
Form 10-Q
November 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended **September 30, 2007**

Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from: _____ to _____

Commission File Number: **0-10306**

INDEPENDENCE HOLDING COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

58-1407235

(I.R.S. Employer Identification No.)

96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT

06902

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(203) 358-8000**

NOT APPLICABLE

Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether 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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Class
Common stock, \$ 1.00 par value

Outstanding at November 6, 2007
15,209,171 Shares

INDEPENDENCE HOLDING COMPANY

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Copies of the Company's SEC filings can be found on its website at www.independenceholding.com.

Forward-Looking Statements

Certain statements in this document are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to the financial condition, results of operations, cash flows, plans, objectives, future performance and business of the Company. In this context, forward-looking statements often address the Company's expected future business and financial performance, and often (but not always) contain words such as expect, anticipate, intend, plan, believe, seek, or will. Forward-looking statements by their nature are matters that are, to differing degrees, uncertain. With respect to the Company, particular uncertainties that could adversely or positively affect its future results include, but are not limited to, economic conditions in the markets in which the Company operates, new federal or state governmental regulation, the Company's ability effectively to operate, integrate and leverage any past or future strategic acquisition, and other factors which can be found in the Company's news releases and filings with the Securities and Exchange Commission. These uncertainties may cause the Company's actual future results to be materially different than those expressed in its forward-looking statements. The Company does not undertake to update its forward-looking statements.

PART I - FINANCIAL INFORMATION**Item 1.****Financial Statements**

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

| | September 30, 2007 (Unaudited) | December 31, 2006 |
|--|---|----------------------------------|
| ASSETS: | | |
| Investments: | | |
| Short-term investments | \$ 10,677 | \$ 9,910 |
| Securities purchased under agreements to resell | 18,805 | 68,849 |
| Fixed maturities | 668,339 | 665,340 |
| Equity securities | 93,595 | 60,043 |
| Other investments | 46,117 | 55,034 |
| Total investments | 837,533 | 859,176 |
| Cash and cash equivalents | 8,487 | 17,543 |
| Due from securities brokers | 1,191 | 660 |
| Investment in American Independence Corp. ("AMIC") | 40,220 | 39,942 |
| Deferred acquisition costs | 53,922 | 55,021 |
| Due and unpaid premiums | 61,166 | 23,860 |
| Due from reinsurers | 129,056 | 111,476 |
| Premium and claim funds | 55,827 | 51,244 |
| Notes and other receivables | 16,074 | 13,994 |
| Goodwill | 52,088 | 46,603 |
| Other assets | 52,071 | 40,165 |
| Total assets | \$ 1,307,635 | \$ 1,259,684 |

LIABILITIES AND STOCKHOLDERS' EQUITY:**LIABILITIES:**

| | | | | |
|--|----|------------------|----|------------------|
| Insurance reserves-health | \$ | 218,547 | \$ | 175,048 |
| Insurance reserves-life and annuity | | 248,967 | | 252,860 |
| Funds on deposit | | 382,845 | | 387,757 |
| Unearned premiums | | 19,644 | | 19,982 |
| Policy claims-health | | 2,119 | | 7,407 |
| Policy claims-life | | 10,371 | | 6,799 |
| Other policyholders' funds | | 18,022 | | 18,299 |
| Due to securities brokers | | 3,546 | | - |
| Due to reinsurers | | 43,256 | | 38,109 |
| Accounts payable, accruals and other liabilities | | 80,888 | | 69,127 |
| Debt | | 12,500 | | 15,000 |
| Junior subordinated debt securities | | 38,146 | | 38,146 |
| Total liabilities | | 1,078,851 | | 1,028,534 |

STOCKHOLDERS' EQUITY:

| | | | | |
|--|----|------------------|----|------------------|
| Preferred stock (none issued) | | - | | - |
| Common stock \$1.00 par value, 20,000,000 shares authorized; 15,342,031 and 15,293,862 shares issued, respectively; 15,204,271 and 15,175,467 shares outstanding, respectively | | 15,342 | | 15,294 |
| Paid-in capital | | 99,257 | | 97,873 |
| Accumulated other comprehensive loss | | (12,438) | | (9,302) |
| Treasury stock, at cost, 137,760 and 118,395 shares, respectively | | (2,626) | | (2,237) |
| Retained earnings | | 129,249 | | 129,522 |
| Total stockholders' equity | | 228,784 | | 231,150 |
| Total liabilities and stockholders' equity | \$ | 1,307,635 | \$ | 1,259,684 |

The accompanying notes are an integral part of these consolidated financial statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| REVENUES: | | | | |
| Premiums earned: | | | | |
| Health | \$ 72,950 | \$ 60,711 | \$ 214,892 | \$ 176,495 |
| Life and annuity | 10,603 | 10,840 | 33,292 | 32,634 |
| Net investment income | 11,345 | 11,855 | 35,800 | 35,188 |
| Fee income | 11,007 | 8,791 | 31,540 | 23,904 |
| Net realized investment gains | 471 | 253 | 1,473 | 720 |
| Equity income (loss) from AMIC | (696) | 47 | 401 | 406 |
| Other income | 534 | 597 | 3,008 | 2,056 |
| | 106,214 | 93,094 | 320,406 | 271,403 |
| EXPENSES: | | | | |
| Insurance benefits, claims and reserves: | | | | |
| Health | 63,705 | 38,673 | 160,566 | 115,763 |
| Life and annuity | 13,262 | 13,693 | 39,321 | 39,404 |
| Selling, general and administrative expenses | 38,521 | 31,716 | 109,395 | 90,530 |
| Amortization of deferred acquisitions costs | 2,966 | 2,352 | 8,266 | 7,541 |
| Interest expense on debt | 1,051 | 990 | 3,169 | 2,821 |
| | 119,505 | 87,424 | 320,717 | 256,059 |
| Income (loss) before income taxes | (13,291) | 5,670 | (311) | 15,344 |

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| | | | | |
|--|-----------------|---------------|---------------|---------------|
| Income tax expense (benefit) | (4,868) | 1,601 | (419) | 4,880 |
| Net income (loss) | \$ (8,423) | \$ 4,069 | \$ 108 | \$ 10,464 |
| Basic income (loss) per common share | \$ (.55) | \$.27 | \$.01 | \$.71 |
| Weighted average shares outstanding | 15,195 | 15,028 | 15,190 | 14,797 |
| Diluted income (loss) per common share | \$ (.55) | \$.27 | \$.01 | \$.69 |
| Weighted average diluted shares outstanding | 15,195 | 15,235 | 15,302 | 15,117 |

The accompanying notes are an integral part of these consolidated financial statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | Nine Months Ended | |
|--|--------------------------|-------------|
| | September | |
| | 2007 | 2006 |
| CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES: | | |
| Net income | \$ 108 | \$ 10,464 |
| Adjustments to reconcile net income to net change in cash from operating activities: | | |
| Amortization of deferred acquisition costs | 8,266 | 7,541 |
| Net realized investment gains | (1,473) | (720) |
| Equity income from AMIC and other equity method investments | (726) | (1,169) |
| Depreciation and amortization | 3,521 | 2,013 |
| Share-based compensation expenses | 1,163 | 1,136 |
| Deferred tax expense | (870) | 283 |
| Other | 646 | 982 |
| Changes in assets and liabilities: | | |
| Net sales of trading securities | 516 | 705 |
| Change in insurance liabilities | 31,140 | (20,134) |
| Deductions from (additions to) deferred acquisition costs, net | (6,781) | 322 |
| Change in net amounts due from and to reinsurers | (12,434) | 15,958 |
| Change in premium and claim funds | (4,583) | (9,821) |
| Change in income tax liability | (6,217) | (643) |
| Change in due and unpaid premiums | (37,306) | 1,128 |
| Change in other assets | (3,402) | (404) |
| Change in other liabilities | 13,065 | 3,150 |
| Net change in cash from operating activities | (15,367) | 10,791 |

**CASH FLOWS PROVIDED BY (USED BY) INVESTING
ACTIVITIES:**

| | | |
|--|-----------|-----------|
| Change in net amount due from and to securities brokers | 3,015 | (140) |
| Net (purchases) sales of short-term investments | (678) | 8,178 |
| Net (purchases) sales of securities under resale and repurchase agreements | 50,044 | (830) |
| Sales of equity securities | 47,388 | 88,613 |
| Purchases of equity securities | (82,590) | (94,843) |
| Sales of fixed maturities | 183,652 | 184,973 |
| Maturities and other repayments of fixed maturities | 37,758 | 33,775 |
| Purchases of fixed maturities | (227,438) | (210,700) |
| Sales of other investments | 13,334 | 3,611 |
| Additional investments in other investments, net of distributions | (4,092) | (1,836) |
| Cash paid in acquisitions of companies, net of cash acquired | (9,034) | (20,950) |
| Cash paid in purchases of policy blocks | - | (224) |
| Change in notes and other receivables | (1,692) | (3,456) |
| Other | (1,278) | (4,735) |
| Net change in cash from investing activities | 8,389 | (18,564) |

**CASH FLOWS PROVIDED BY (USED BY) FINANCING
ACTIVITIES:**

| | | |
|--|----------|-----------|
| Proceeds from issuance of common stock | - | 2,500 |
| Repurchases of common stock | (398) | (670) |
| Increase in long-term debt | - | 2,500 |
| Repayment of long-term debt | (2,500) | - |
| Exercises of common stock options | 309 | 2,119 |
| Excess tax benefits from exercise of stock options | 48 | 1,252 |
| Proceeds of investment-type insurance contracts | 1,223 | 9,361 |
| Dividends paid | (760) | (730) |
| Net change in cash from financing activities | (2,078) | 16,332 |
| Net change in cash and cash equivalents | (9,056) | 8,559 |
| Cash and cash equivalents, beginning of year | 17,543 | 12,659 |
| Cash and cash equivalents, end of period | \$ 8,487 | \$ 21,218 |

The accompanying notes are an integral part of these consolidated financial statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1.

Significant Accounting Policies and Practices

(A)

Business and Organization

Independence Holding Company, a Delaware corporation ("IHC"), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); and (ii) its marketing and administrative companies, including Insurers Administrative Corporation (IAC), managing general underwriters ("MGUs") in which it owns a significant voting interest, Health Plan Administrators, Inc. (HPA), GroupLink, Inc. (GroupLink), IHC Health Solutions, Inc. (IHC Health Solutions) and Community America Insurance Services, Inc. (CAIS). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." The Company also owns a 48% equity interest in American Independence Corp. ("AMIC"), which owns Independence American Insurance Company (Independence American) and several MGUs.

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 54% of IHC's outstanding common stock at September 30, 2007.

(B)

Basis of Presentation

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The preparation of financial statements in conformity with U.S. generally

accepted accounting principles requires management to make estimates and assumptions that affect: (i) the reported amounts of assets and liabilities; (ii) the disclosure of contingent assets and liabilities at the date of the financial statements; and (iii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. IHC's annual report on Form 10-K as filed with the Securities and Exchange Commission should be read in conjunction with the accompanying consolidated financial statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The consolidated results of operations for the three months and nine months ended September 30, 2007 are not necessarily indicative of the results to be anticipated for the entire year.

(C)

Reclassifications

Certain amounts in prior years' Consolidated Financial Statements and Notes thereto have been reclassified to conform to the 2007 presentation.

(D)

Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 would create a fair value option of accounting for qualifying financial assets and liabilities under which an irrevocable election could be made at inception to measure such assets and liabilities initially and

subsequently at fair value, with all changes in fair value reported in earnings. SFAS 159 is effective as of the beginning of the first fiscal year beginning after November 15, 2007. The adoption of SFAS 159 is optional. The Company is in the process of analyzing the effects of adoption of SFAS 159 on the Company's consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS 155), which amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133) and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140). SFAS 155 simplifies the accounting for certain derivatives embedded in other financial instruments by allowing them to be accounted for as a whole if the holder elects to account for the whole instrument on a fair value basis. SFAS 155 also clarifies and amends certain other provisions of SFAS 133 and SFAS 140. SFAS 155 is effective for all financial instruments acquired, issued or subject to a re-measurement event occurring in fiscal years beginning after September 15, 2006. The adoption of SFAS 155 did not have a material impact on the Company's consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" ("Interpretation 48"), which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The recognition threshold is based on a determination of whether it is more likely than not that a tax position will be sustained upon examination based on the technical merits of the position. Only tax positions that meet the more-likely-than-not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. Interpretation 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Interpretation 48 is effective for fiscal years beginning after December 15, 2006. The cumulative effect of applying the provisions of Interpretation 48 is reported as an adjustment to retained earnings as of the beginning of the year of adoption. The amount of the cumulative-effect adjustment is the difference between the net amount of assets and liabilities recognized in the balance sheet prior to the application of Interpretation 48 and the net amount of assets and liabilities recognized as a result of applying Interpretation 48. The adoption of Interpretation 48 on January 1, 2007 did not have a material impact on the Company's consolidated financial statements and the Company believes there are no significant tax positions that would require disclosure under Interpretation 48. The Internal Revenue Service is currently auditing our 2003 and 2004 consolidated income tax returns. It is anticipated that this examination will be completed within the next twelve months. Management believes that it has made adequate provision for all income tax uncertainties, such that the outcome of any unresolved issues or claims will not result in a material change to our financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157), which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The adoption of SFAS 157 is not expected to have a material effect on the Company's consolidated financial statements.

In September 2005, the AICPA's Accounting Standards Executive Committee issued Statement of Position 05-1, "Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts" ("SOP 05-1"). SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in SFAS 97, "Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments". SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a

contract. A replacement contract that is substantially changed will be accounted for as an extinguishment of the replaced contract resulting in a release of the unamortized deferred acquisition costs, unearned revenue, and deferred sales inducements associated with the replaced contract. SOP 05-1 is effective for internal replacements occurring in fiscal years beginning after December 15, 2006. The adoption of SOP 05-1 did not have a material impact on the Company's consolidated financial statements.

Note 2.

American Independence Corp.

AMIC is an insurance holding company engaged in the insurance and reinsurance business as a result of its acquisition of First Standard Holdings Corp. ("FSHC") from the Company in November 2002. AMIC does business with the Insurance Group, including reinsurance treaties under which, in 2006, Standard Security Life and Madison National Life ceded to Independence American an average of 22% of their medical stop-loss business, 10% of certain of their fully insured health business and 20% of their New York Statutory Disability business. IHC owned 48% of AMIC's outstanding common stock at September 30, 2007 and December 31, 2006, which was purchased in various transactions from 2002 through 2005. IHC accounts for its investment in AMIC under the equity method. At September 30, 2007 and December 31, 2006, IHC's investment in AMIC had a total carrying value of \$44,690,000 and \$44,412,000, respectively, including goodwill of \$4,470,000 at both dates. This goodwill represents the excess of IHC's cost over the underlying equity in AMIC's net assets at the respective purchase dates. At September 30, 2007 and December 31, 2006, based on the closing market price of AMIC's common stock, the fair value of the AMIC shares owned by IHC was approximately \$41,388,000 and \$43,866,000, respectively.

For the three months ended September 30, 2007 and 2006, IHC recorded equity income (loss) of \$(696,000) and \$47,000, respectively, from its investment in AMIC, representing IHC's proportionate share of AMIC's income (loss) based on its ownership interests during those periods. IHC's equity income (loss) from AMIC for the nine months ended September 30, 2007 and 2006 was \$401,000 and \$406,000, respectively. AMIC paid no dividends on its common stock in the three-month and nine-month periods ended September 30, 2007 and 2006.

IHC and its subsidiaries earned \$188,000 and \$138,000 for the quarters ended September 30, 2007 and 2006, respectively, and \$568,000 and \$394,000 for the nine months ended September 30, 2007 and 2006, respectively, from service agreements with AMIC and its subsidiaries. These are reimbursements to IHC and its subsidiaries, at agreed upon rates including an overhead factor, for certain services provided by IHC and its subsidiaries, including general management, corporate strategy, accounting, legal, compliance, underwriting and claims. The Company ceded premiums to AMIC of \$16,226,000 and \$14,279,000 for the three months ended September 30, 2007 and 2006, respectively, and \$52,381,000 and \$41,527,000 for the nine months ended September 30, 2007 and 2006, respectively. Benefits to policyholders on business ceded to AMIC were \$14,084,000 and \$10,398,000, in the third quarter of 2007 and 2006, respectively, and \$39,217,000 and \$29,164,000 for the nine months ended September 30, 2007 and 2006, respectively. Additionally, AMIC subsidiaries market, underwrite and provide administrative services (including premium collection, medical management and claims adjudication) for a substantial portion of the medical stop-loss business written by the insurance subsidiaries of IHC. IHC recorded net commission expense of \$995,000 and

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\$1,281,000 in the third quarter of 2007 and 2006, respectively, and \$3,069,000 and \$3,866,000 for the nine months ended September 30, 2007 and 2006, respectively, for these services. The Company also contracts for several types of insurance coverage (e.g. directors and officers and professional liability converge) jointly with AMIC. The cost of this coverage is allocated between the Company and AMIC according to the type of risk, and IHC's portion is recorded in Selling, General and Administrative Expenses.

Included in the Company's Consolidated Balance Sheets at September 30, 2007 and December 31, 2006, respectively, are the following balances arising from transactions in the normal course of business with AMIC and its subsidiaries: Due from reinsurers \$19,580,000 and \$15,324,000; Other assets \$7,457,000 and \$5,971,000; and Other liabilities \$40,000 and \$518,000.

Note 3.**Income (Loss) Per Common Share**

Included in the diluted income per share calculations are 207,000 shares for the three months ended 2006, and 112,000 and 320,000 shares for the nine months ended September 30, 2007 and 2006, respectively, from the assumed dilution due to the exercise of options and vesting of restricted stock, using the treasury stock method. For the third quarter of 2007, such shares were deemed anti-dilutive. Net income does not change as a result of the assumed dilution.

Note 4.**Investments**

The following tables summarize, for all securities in an unrealized loss position at September 30, 2007 and December 31, 2006, respectively, the aggregate fair value and gross unrealized loss by length of time those securities had continuously been in an unrealized loss position:

| | Less than 12 Months | | 12 Months or Longer | | Total | |
|-----------------------------------|---------------------|-------------------|---------------------|-------------------|------------|-------------------|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| September 30, 2007 | | | | | | |
| | (In thousands) | | | | | |
| Corporate securities | \$ 65,709 | \$ 2,345 | \$ 195,223 | \$ 10,138 | \$ 260,932 | \$ 12,483 |
| CMO and ABS ⁽¹⁾ | 59,302 | 943 | 77,101 | 2,640 | 136,403 | 3,583 |
| U.S. Government obligations | - | - | 30,768 | 537 | 30,768 | 537 |
| Agency MBS ⁽²⁾ | 23,662 | 108 | 16,759 | 548 | 40,421 | 656 |
| GSE ⁽³⁾ | 33,330 | 168 | 45,173 | 1,701 | 78,503 | 1,869 |
| States and political subdivisions | 25,684 | 517 | 5,609 | 241 | 31,293 | 758 |
| Total fixed maturities | 207,687 | 4,081 | 370,633 | 15,805 | 578,320 | 19,886 |
| Common stock | 7,195 | 993 | - | - | 7,195 | 993 |
| Preferred stock | 58,929 | 2,708 | 4,817 | 299 | 63,746 | 3,007 |

| | | | | | | |
|--|------------|----------|------------|-----------|------------|-----------|
| Total temporarily i m p a i r e d securities | \$ 273,811 | \$ 7,782 | \$ 375,450 | \$ 16,104 | \$ 649,261 | \$ 23,886 |
|--|------------|----------|------------|-----------|------------|-----------|

considered by management in its regular review include, but are not limited to: the length of time and extent to which the fair value has been less than cost; the financial condition and near-term prospects of the issuer; adverse changes in ratings announced by one or more rating agencies; whether the issuer of a debt security has remained current on principal and interest payments; whether the decline in fair value appears to be issuer specific or, alternatively, a reflection of general market or industry conditions (including, in the case of fixed maturities, the effect of changes in market interest rates); and the Company's intent and ability to hold the security for a period of time sufficient to allow for a recovery in fair value. For securities within the scope of Emerging Issues Task Force Issue 99-20, such as purchased interest-only securities, an impairment loss is recognized when there has been a decrease in expected cash flows combined with a decline in the security's fair value below cost. Based on management's review of the portfolio, which considered these factors, the Company did not consider these investments to be other-than-temporarily impaired at September 30, 2007 and December 31, 2006. For the three months and nine months ended September 30, 2007, the Company did not record any realized losses for other-than-temporary impairments.

Substantially all of the unrealized losses at September 30, 2007 and December 31, 2006 relate to investment grade securities and are attributable to changes in market interest rates subsequent to purchase. There were no securities with unrealized losses that were individually significant dollar amounts at September 30, 2007 and December 31, 2006. At September 30, 2007 and December 31, 2006, a total of 96 and 76 securities, respectively, were in a continuous unrealized loss position for less than 12 months and 84 and 76 securities, respectively, had continuous unrealized losses for 12 months or longer. For fixed maturities, there are no securities past due or securities for which the Company currently believes it is not probable that it will collect all amounts due according to the contractual terms of the investment.

Note 5.

Other Investments

The Company had invested \$8,288,000 at December 31, 2006 in Dolphin Limited Partnership A ("DLP-A"), a domestic feeder fund for Dolphin Limited Partnership I L.P., a Delaware limited partnership. The Company liquidated its investment in DLP-A in February 2007. The Company's net investment income includes \$46,000 for the two months ended February 28, 2007 and nine months ended September 30, 2007, and \$57,000 and \$457,000 for the three and nine months ended September 30, 2006, respectively, for its proportionate share of net income of DLP-A.

Note 6.

Acquisitions

The Company completed the following acquisitions in 2007. The results of operations of the acquired companies are included in IHC's Consolidated Financial Statements from the respective acquisition dates. Pro forma results of operations for the three months and nine months ended September 30, 2006, as though these acquisitions had been completed at the beginning of such period, have not been presented since the effect of the acquisitions was not material.

CA Marketing and Management Services, LLC

In January 2007, IHC Health Holdings Corp. ("IHC Health Holdings"), a wholly owned subsidiary of IHC, acquired 100% of the outstanding membership interests in CA Marketing and Management Services, LLC ("CAM") for a total purchase price of \$3,500,000. Immediately thereafter, CAM was merged into IHC Health Solutions, Inc., a wholly owned subsidiary of IHC Health Holdings. The Company recorded goodwill of \$640,000 and other intangible assets of \$2,860,000 primarily for the fair value of agent and management services relationships, which is being amortized over a weighted average period of 9.06 years. CAM was previously 100% owned by a senior officer of IHC. The Audit Committee of the Board of Directors of IHC unanimously approved the transaction, and upon recommendation by the Audit Committee, it was unanimously approved by the Board of Directors.

Actuarial Management Corporation

Effective April 2, 2007, the Company acquired 100% of the outstanding shares of capital stock of Actuarial Management Corporation ("AMC") for a total purchase price of \$5,000,000. The Company recorded goodwill of \$4,324,000 and other intangible assets of \$800,000, primarily for the fair value of customer relationships, which is being amortized over a weighted average period of 5.7 years. AMC is currently responsible for all actuarial aspects of

the Company's fully insured health business. AMC was previously owned by an individual who became a senior officer of IHC prior to the acquisition.

Majestic Underwriters LLC

The Company purchased an additional 10.3% interest in Majestic Underwriters LLC ("Majestic"), effective as of June 30, 2007 and pursuant to terms set forth in the Limited Liability Company Agreement of Majestic, thereby increasing its controlling interest in the medical stop-loss MGU to 62.3%. The interest was purchased from an officer of Majestic for a total purchase price of \$649,000 and was settled on July 2, 2007. The Company recorded goodwill of \$521,000 and other intangible assets of \$62,000 for the fair value of broker relationships, which is being amortized over 10.0 years. In addition, AMIC holds a 23.0% interest in Majestic and the remaining 14.7% of minority interest is owned by a current senior officer of the MGU.

Note 7.**Goodwill and Other Intangible Assets**

At September 30, 2007 and December 31, 2006, the Company had goodwill of \$52,088,000 and \$46,603,000, respectively, and other intangible assets (included in other assets in the Consolidated Balance Sheets) of \$17,802,000 and \$13,984,000 (which includes \$1,308,000 capitalized software classified in Fixed Assets at December 31, 2006), respectively. The change in the carrying amount of goodwill and other intangible assets for the nine months of 2007 is as follows (in thousands):

| | Goodwill | Other Intangible Assets |
|--------------------------------------|-----------------|------------------------------------|
| Balance at December 31, 2006 | \$ 46,603 | \$ 13,984 |
| CAM acquisition | 640 | 2,860 |
| Majestic acquisition | 521 | 62 |
| AMC acquisition | 4,324 | 800 |
| Capitalized software development | - | 2,364 |
| Amortization expense | - | (2,268) |
| Balance at September 30, 2007 | \$ 52,088 | \$ 17,802 |

Note 8.**Share-Based Compensation**

Effective January 1, 2006, under the modified prospective method, the Company adopted the provisions of SFAS No. 123R, "Share-Based Payment" ("SFAS 123R"), which revises SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123) and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees and its related interpretations (APB 25). SFAS 123R applies to all awards granted after its effective date and to modifications, repurchases or cancellations of existing awards after that date. Additionally, under the modified prospective method of adoption, the Company recognizes compensation expense for the portion of outstanding awards on the adoption date for which the requisite service period has not yet been rendered based on the grant-date fair value of those awards.

Total share-based compensation expense was \$366,000 and \$428,000 for the three months ended September 30, 2007 and 2006, respectively, and \$1,163,000 and \$1,136,000 for the nine months ended September 30, 2007 and 2006, respectively. Related tax benefits of \$146,000 and \$171,000 were recognized for the three months ended September 30, 2007 and 2006, respectively, and \$464,000 and \$453,000 for the nine months ended September 30, 2007 and 2006, respectively.

Under the terms of the Company's stock-based compensation plans, option exercise prices are equal to the quoted market price of the shares at the date of grant; option terms range from five to ten years; and vesting periods are three years for employee options. The Company may also grant shares of restricted stock, share appreciation rights (SARs) and share-based performance awards. Restricted shares are valued at the quoted market price of the shares at the date of grant, and have a three year vesting period. Exercise prices of SARs are equal to the quoted market price of the shares at the date of grant and have three year vesting periods. There were 990,300 shares available for future stock-based compensation grants under the shareholder-approved plans at September 30, 2007. Substantially, all of these available shares relate to the Company's 2006 Stock Incentive Plan that was approved by shareholders in June 2006.

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The Company's stock option activity for the nine months ended September 30, 2007 is as follows:

| | Shares Under Option | Weighted- Average Exercise Price |
|---------------------------|--------------------------------|---|
| December 31, 2006 | 858,351 | \$ 17.03 |
| Granted | 32,000 | 21.49 |
| Exercised | (28,040) | 11.02 |
| September 30, 2007 | 862,311 | 17.39 |

The following table summarizes information regarding outstanding and exercisable options as of September 30, 2007:

| | Outstanding | Exercisable |
|---|--------------------|--------------------|
| Number of options | 862,311 | 656,974 |
| Weighted average exercise price per share | \$ 17.39 | \$ 16.20 |
| Aggregate intrinsic value of options | \$ 3,141,000 | \$ 2,983,000 |
| Weighted average contractual term remaining | 1.9 years | 1.4 years |

The fair value of each option award is estimated on the date of grant using the Black Scholes option valuation model. The weighted average grant-date fair-value of options granted during the first nine months of 2007 and 2006 was \$6.51 and \$7.25 per share, respectively. The assumptions set forth in the table below were used to value the stock options granted during the nine month period ended September 30:

| | 2007 | 2006 |
|--|-------------|-------------|
| Weighted-average risk-free interest rate | 4.44% | 4.93% |
| Annual dividend rate per share | \$.05 | \$.05 |
| Weighted-average volatility factor of the Company's common stock | 30.3% | 32.1% |
| Weighted-average expected term of options | 4.5 years | 4.5 years |

Compensation expense of \$176,000 and \$264,000 was recognized in the three months ended September 30, 2007 and 2006, respectively, and \$660,000 and \$839,000 in the nine months ended September 30, 2007 and 2006, respectively, for the portion of the grant-date fair value of stock options vesting during that period.

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The total intrinsic value of options exercised during the three month periods ended September 30, 2007 and 2006 was \$141,000 and \$536,000, respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2007 and 2006 was \$268,000 and \$4,607,000, respectively. Cash proceeds received from those options exercised during the three months ended September 30, 2007 and 2006 were \$178,000 and \$337,000, respectively. Cash proceeds received from those options exercised during the nine months ended September 30, 2007 and 2006 were \$309,000 and \$2,119,000, respectively.

The Company issued 7,050 and 49,325 restricted stock awards during the nine months ended September 30, 2007 and 2006, respectively, with weighted-average grant-date fair values of \$20.67 and \$22.20 per share, respectively. The total fair value of restricted stock that vested during the first nine months of 2007 and 2006 was \$372,000 and \$26,000, respectively. Restricted stock expense was \$102,000 and \$93,000, for the three months ended September 30, 2007 and 2006, respectively and \$294,000 and \$226,000 for the nine months ended September 30, 2007 and 2006, respectively.

The following table summarizes restricted stock activity for the nine months ended September 30, 2007:

| | No. of Shares | | Weighted-Average Grant-Date Fair Value |
|---------------------------|--------------------------|----|---|
| December 31, 2006 | 50,325 | \$ | 22.11 |
| Granted | 7,050 | | 20.67 |
| Vested | (16,906) | | 22.07 |
| Forfeited | (1,660) | | 22.69 |
| September 30, 2007 | 38,809 | | 21.88 |

As of September 30, 2007, there was \$1,150,000 and \$625,000 of total unrecognized compensation expense related to non-vested options and non-vested restricted stock awards, respectively, which will each be recognized over the remaining requisite weighted-average service periods of 1.6 years.

The fair value of SARs is calculated using the Black-Scholes valuation model at the grant date and each subsequent reporting period until settlement. Compensation cost is based on the proportionate amount of the requisite service that has been rendered to date. Once fully vested, changes in fair value of the SARs continue to be recognized as compensation expense in the period of the change until settlement. Other liability-classified awards include share-based performance awards. Compensation costs for these plans are recognized and accrued as performance conditions are met, based on the current share price. Included in Other Liabilities on the Company's Consolidated Balance Sheets at September 30, 2007 and December 31, 2006 are \$252,000 and \$143,000, respectively, pertaining to SARs and other share-based performance awards.

Note 9.

Debt

On August 22, 2007, the Company made a \$2,500,000 principal repayment on its outstanding line of credit with a commercial bank reducing both the outstanding balance and the available credit line from \$15,000,000 to \$12,500,000 in accordance with the terms of the credit agreement, as amended.

Note 10.

Income Taxes

The provision (benefit) for income taxes shown in the Consolidated Statements of Operations was computed based on the Company's actual results which approximates the effective tax rate expected to be applicable for the balance of the current fiscal year in accordance with the consolidated life/non-life group income tax regulations. Such regulations adopt a subgroup method to determining consolidated taxable income, whereby taxable income is determined separately for the life insurance company group and the non-life insurance company group.

The deferred income tax benefit for the nine months ended September 30, 2007 allocated to stockholders' equity (principally for net unrealized gains on investment securities) was \$1,816,000, representing the increase in the related net deferred tax asset to \$6,954,000 at September 30, 2007 from \$5,138,000 at December 31, 2006.

Note 11.**Supplemental Disclosures of Cash Flow Information**

Cash payments for income taxes were \$6,153,000 and \$4,220,000 for the nine months ended September 30, 2007 and 2006, respectively. Cash payments for interest were \$3,020,000 and \$2,638,000 for the nine months ended September 30, 2007 and 2006, respectively.

Note 12.**Comprehensive Income (Loss)**

The components of comprehensive income (loss) include (i) net income or loss reported in the Consolidated Statements of Operations, and (ii) certain amounts reported directly in stockholders' equity, principally the after-tax net unrealized gains and losses on securities available for sale (net of deferred acquisition costs). The comprehensive income (loss) for the three months and nine months ended September 30, 2007 and 2006 is summarized as follows:

| | Three Months Ended | | Nine Months Ended | |
|-----------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Net income (loss) | \$ (8,423) | \$ 4,069 | \$ 108 | \$ 10,464 |
| Unrealized gains (losses) arising | | | | |
| during the period, net of income | 1,337 | 11,580 | (3,136) | (3,329) |
| taxes | | | | |
| Comprehensive income (loss) | \$ (7,086) | \$ 15,649 | \$ (3,028) | \$ 7,135 |

Note 13.**Segment Reporting**

The Insurance Group principally engages in the life and health insurance business. Information by business segment for the three months and nine months ended September 30, 2007 and 2006 is presented below:

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2007 | 2006 | 2007 | 2006 |
| Revenues: | | | | |
| Medical Stop-Loss ^(A) | \$ 46,017 | \$ 42,165 | \$ 129,743 | \$ 121,292 |
| Fully Insured Health ^(B) | 28,102 | 16,251 | 84,426 | 45,155 |
| Group disability, life, annuities and DBL ^(C) | 12,646 | 13,203 | 41,084 | 39,521 |
| Individual life, annuities and other | 13,939 | 15,208 | 46,289 | 46,560 |
| Credit Life and disability | 5,649 | 5,750 | 16,905 | 16,807 |
| Corporate | (610) | 264 | 486 | 1,348 |
| | 105,743 | 92,841 | 318,933 | 270,683 |
| Net realized investment gains | 471 | 253 | 1,473 | 720 |
| | \$ 106,214 | \$ 93,094 | \$ 320,406 | \$ 271,403 |
| Income (Loss) Before Income Taxes: | | | | |
| Medical Stop-Loss ^(A) | \$ (10,773) | \$ 2,954 | \$ (2,870) | \$ 9,616 |
| Fully Insured Health ^{(B) (D)} | (794) | (134) | (1,353) | (7) |
| Group disability, life, annuities and DBL ^(C) | 655 | 2,819 | 4,009 | 4,525 |
| Individual life, annuities and other | 807 | 2,375 | 6,702 | 7,060 |
| Credit Life and disability | (193) | (139) | (791) | (489) |
| Corporate | (2,413) | (1,468) | (4,312) | (3,260) |
| | (12,711) | 6,407 | 1,385 | 17,445 |
| Net realized investment gains | 471 | 253 | 1,473 | 720 |
| Interest expense | (1,051) | (990) | (3,169) | (2,821) |
| | \$ (13,291) | \$ 5,670 | \$ (311) | \$ 15,344 |

(A)

The amount includes equity income (loss) from AMIC of \$(432,000) and \$47,000 for the three months ended September 30, 2007 and 2006, respectively, and \$249,000 and \$406,000 for the nine months ended September 30, 2007 and 2006, respectively.

(B)

The amount includes equity income (loss) from AMIC of \$(216,000) and \$124,000 for the three months and nine months ended September 30, 2007, respectively. In 2006, the equity income (loss) from AMIC in this line of business was insignificant.

(C)

The amount includes equity income (loss) from AMIC of \$(48,000) and \$28,000 for the three months and nine months ended September 30, 2007, respectively. In 2006, the equity income (loss) from AMIC in this line of business was insignificant.

(D)

The Fully Insured Health segment includes amortization of intangible assets recorded as a result of purchase accounting for the recent acquisitions. Total amortization expense was \$736,000 and \$435,000 for the three months ended September 30, 2007 and 2006, respectively, and \$2,122,000 and \$1,172,000 for the nine months ended September 30, 2007 and 2006, respectively. Amortization expense for the other segments is insignificant.

ITEM 2.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

CONDITION AND RESULTS OF OPERATIONS

The following discussion of the financial condition and results of operations of Independence Holding Company ("IHC") and its subsidiaries (collectively, the "Company") should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements of the Company and the related Notes thereto appearing in our annual report on Form 10-K for the fiscal year ended December 31, 2006, as filed with the Securities and Exchange Commission, and our unaudited Consolidated Financial Statements and related Notes thereto appearing elsewhere in this quarterly report.

Overview

Independence Holding Company, a Delaware corporation (NYSE: IHC), is a holding company principally engaged in the life and health insurance business through: (i) its wholly owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); and (ii) its marketing and administrative companies, including Insurers Administrative Corporation (IAC), managing general underwriters in which it owns a significant voting interest (Affiliated MGUs), Health Plan Administrators, Inc. (HPA), GroupLink Inc. (GroupLink), IHC Health Solutions, Inc. (IHC Health Solutions), and Community America Insurance Services Inc. (CAIS). These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." The Company also owns a 48% equity interest in American Independence Corp. (NASDAQ:AMIC) which owns Independence American Insurance Company (Independence American) and several MGUs.

While management considers a wide range of factors in its strategic planning and decision-making, underwriting profit is consistently emphasized as the primary goal in all decisions as to whether or not to increase the Company's retention in a core line, expand into new products, acquire an entity or a block of business, or otherwise change the Company's business model. Management's assessment of trends in healthcare and morbidity, with respect to medical stop-loss, fully insured medical, disability and DBL; mortality rates with respect to life insurance; and changes in market conditions in general play a significant role in determining the rates charged, deductibles and attachment points quoted, and the percentage of business retained. The Company believes that the acquisition of Actuarial Management Corp. (AMC) in the second quarter of 2007 will further enable it to make these assessments. The Company seeks transactions that permit it to leverage its vertically integrated organizational structure by generating fee income from production and administrative operating companies as well as risk income for its carriers and profit commissions. Management has always focused on managing costs of its operations and providing its insureds with the best cost containment tools available.

The following is a summary of key performance information and events:

-

Net income (loss) of \$(8.4) million or \$(.55) per share, for the three months ended September 30, 2007 and \$.1 million or \$.01 per share, diluted, for the nine months ended September 30, 2007. This loss is primarily attributable to reserve strengthening of \$14.9 million, before income taxes, or \$10.5 million after taxes, in the Medical Stop-Loss segment as more fully described in the Reserve Strengthening discussion under Results of Operations for the Three Months Ended September 30, 2007;

-

Consolidated investment yields of 5.2% and 5.4% for the three months and nine months ended September 30, 2007 compared to 5.3% for both of the comparable periods in 2006;

-

Revenues of \$106.2 million and \$320.4 million for the three months and nine months ended September 30, 2007, respectively, representing increases of 14.1% and 18.1% over the respective three-month and nine-month periods in 2006; primarily due to an increase in revenues from the Fully Insured Health segment and an increase in assumed premiums in the Medical Stop-Loss segment;

-

Book value of \$15.05 per common share; a 1.2% decrease from December 31, 2006;

-

Acquired CA Marketing and Management Services, LLC and merged this company with IHC Health Solutions, Inc. ("IHC Health Solutions") as of January 2, 2007;

-

Effective April 2, 2007, acquired Actuarial Management Corporation ("AMC"); and

-

Effective June 30, 2007, increased the Company's controlling interest in Majestic Underwriters LLC ("Majestic"), a medical stop-loss MGU, to 62.3% with the purchase of an additional 10.3% interest from a retired senior officer.

The following is a summary of key performance information by segment:

-

Income (loss) before taxes from the Medical Stop-Loss segment decreased \$13.8 million for the three months ended September 30, 2007 and \$12.5 million for the nine months ended September 30, 2007, compared to the same periods in 2006 primarily as a result of a \$14.9 million charge in the 2007 third quarter as more fully described in the Reserve Strengthening discussion under Results of Operations for the Three Months Ended September 30, 2007;

-

The Fully Insured Health segment reported income (loss) before taxes of \$(.8) million and \$(1.4) million for the three months and nine months ended September 30, 2007, respectively, as compared to \$(.1) million and breakeven for the three months and nine months ended September 30, 2006, respectively.

○

Premiums earned from this segment have increased \$9.8 million and \$30.8 million, respectively, for the three months and nine months ended September 30, 2007 over the comparable periods in 2006. Included in the nine-month results of 2007 is \$1.3 million of adverse development recorded in the second quarter of 2007 on premiums earned in 2006 on certain fully insured programs and an increase of \$.9 million in the amortization expense of intangible assets recorded as a result of purchase accounting related to acquisitions.

●

Income before taxes from the Group disability, life annuities and DBL segment decreased \$2.1 million for the three months ended September 30, 2007 and \$.5 million for the nine months ended September 30, 2007, primarily due to a refund of DBL premiums as Standard Security Life experienced loss ratios below mandated minimums in this line of business;

●

Income before taxes from the Individual life, annuities and other segment decreased \$1.6 million for the three months ended September 30, 2007 compared to the prior year as a result of an increase in amortization and other expenses, and \$.4 million for the nine months ended September 30, 2007, due to an increase in amortization and other expenses slightly offset by an increase in other income due to adjustments in settlement of a reinsurance agreement;

●

Loss before taxes from the Credit life and disability segment remained flat for the three months ended September 30, 2007. For the nine months ended September 30, 2007 the loss before taxes increased \$.3 million, primarily due to higher death and disability claims;

- Loss before taxes from the Corporate segment increased \$.9 million for the three months ended September 30, 2007 and \$1.0 million for the nine months ended September 30, 2007, primarily due to lower income from partnership investments in 2007;

- Net realized investment gains were \$.5 million and \$.3 for the third quarter ended September 30, 2007 and 2006, respectively, and \$1.5 million and \$.7 million for the nine months ended September 30, 2007 and 2006, respectively; and

- Premiums by principal product for the three months and nine months 2007 and 2006 are as follows (in thousands):

| Gross Direct and Assumed Earned Premiums: | Three Months Ended September 30, | | Nine months Ended September 30, | |
|--|---|-------------|--|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| Medical Stop-Loss | \$ 73,109 | \$ 71,277 | \$ 210,586 | \$ 204,570 |
| Fully Insured Health | 48,963 | 20,129 | 159,402 | 56,190 |
| Group disability, life, annuities and DBL | 17,537 | 21,086 | 58,079 | 61,507 |
| Individual, life, annuities and other | 7,103 | 7,712 | 23,016 | 24,116 |
| Credit life and disability | 5,467 | 5,800 | 16,826 | 16,917 |
| | \$ 152,179 | \$ 126,004 | \$ 467,909 | \$ 363,300 |

| Net Premiums Earned: | Three Months Ended September 30, | | Nine months Ended September 30, | |
|-----------------------------|---|-------------|--|-------------|
| | 2007 | 2006 | 2007 | 2006 |
| | | | | |

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| | | | | | | | | |
|--|----|--------|----|--------|----|---------|----|---------|
| Medical Stop-Loss | \$ | 44,535 | \$ | 40,304 | \$ | 124,777 | \$ | 115,654 |
| Fully Insured Health | | 17,501 | | 7,747 | | 53,457 | | 22,693 |
| Group disability, life, annuities and DBL | | 9,810 | | 10,848 | | 32,781 | | 32,523 |
| Individual, life, annuities and other | | 6,411 | | 7,072 | | 20,972 | | 22,067 |
| Credit life and disability | | 5,296 | | 5,580 | | 16,197 | | 16,192 |
| | \$ | 83,553 | \$ | 71,551 | \$ | 248,184 | \$ | 209,129 |

CRITICAL ACCOUNTING POLICIES

The accounting and reporting policies of the Company conform to U.S. generally accepted accounting principles ("GAAP"). The preparation of the Consolidated Financial Statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. A summary of the Company's significant accounting policies and practices is provided in Note 1 of the Notes to the Consolidated Financial Statements included in Item 8 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2006. Management has identified the accounting policies related to *Insurance Premium Revenue Recognition and Policy Charges*, *Insurance Reserves*, *Deferred Acquisition Costs*, and *Investments* as those that, due to the judgments, estimates and assumptions inherent in those policies, are critical to an understanding of the Company's Consolidated Financial Statements and this Management's Discussion and Analysis. A full discussion of these policies is included under the heading, *Critical Accounting Policies* in Item 7 of the Annual Report on Form 10-K for the fiscal year ended December 31, 2006. During the nine months ended September 30, 2007, there were no additions to or changes in the critical accounting policies disclosed in the 2006 Form 10-K.

Results of Operations for the Three Months Ended September 30, 2007 Compared to the Three Months Ended September 30, 2006

Net income (loss) was \$(8.4) million, or \$(.55) per share, for the three months ended September 30, 2007, a decrease of \$12.5 million compared to \$4.1 million, or \$.27 per share, diluted, for the three months ended September 30, 2006. The Company's income (loss) before taxes decreased \$19.0 million to \$(13.3) million for the three months ended September 30, 2007 from \$5.7 million for the three months ended September 30, 2006. Information by business segment for the three months ended September 30, 2007 and 2006 is as follows:

| <u>September 30,</u> <u>2007</u> | <u>Premiums</u> <u>Earned</u> | <u>Investment</u> <u>Income</u> | <u>Equity</u> <u>Loss</u> <u>From</u> <u>AMIC</u> | <u>Fee and</u> <u>Other</u> <u>Income</u> | <u>Benefits</u> <u>Claims</u> <u>and</u> <u>Reserves</u> | <u>Amortization</u> <u>of</u> <u>Deferred</u> <u>Costs</u> | <u>Selling,</u> <u>General</u> <u>And</u> <u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|------------------------------------|--|---|---|---|--|--------------|
| (In thousands) | | | | | | | | |
| Medical Stop-Loss | \$ 44,535 | 1,482 | (432) | 432 | 44,321 | - | 12,469 | \$ (10,773) |
| Fully Insured Health | 17,501 | 176 | (216) | 10,641 | 12,654 | 48 | 16,194 | (794) |
| Group disability, life, annuities and DBL | 9,810 | 2,781 | (48) | 103 | 8,420 | 36 | 3,535 | 655 |
| Individual life, annuities and other | 6,411 | 7,173 | - | 355 | 8,803 | 1,592 | 2,737 | 807 |
| Credit life and disability | 5,296 | 343 | - | 10 | 2,769 | 1,290 | 1,783 | (193) |
| Corporate | - | (610) | - | - | - | - | 1,803 | (2,413) |
| Sub total | \$ 83,553 | \$ 1,345 | \$ (696) | \$ 11,541 | \$ 76,967 | \$ 2,966 | \$ 38,521 | (12,711) |
| Net realized investment gains | | | | | | | | 471 |
| Interest expense | | | | | | | | (1,051) |
| (Loss) before income taxes (benefit) | | | | | | | | (13,291) |
| Income taxes (benefit) | | | | | | | | (4,868) |
| Net (loss) | | | | | | | | \$ (8,423) |

| <u>September 30,</u> <u>2006</u> (In thousands) | <u>Premiums</u> <u>Earned</u> | <u>Net</u> <u>Investment</u> <u>Income</u> | <u>Equity</u> <u>Income</u> <u>From</u> <u>AMIC</u> | <u>Fee</u> <u>and</u> <u>Other</u> <u>Income</u> | <u>Benefits,</u> <u>Claims</u> <u>and</u> <u>Reserves</u> | <u>Amortization</u> <u>of</u> <u>Deferred</u> <u>Acquisition</u> <u>Costs</u> | <u>Selling,</u> <u>General</u> <u>And</u> <u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|--|--|---|--|---|--|--------------|
| Medical Stop-Loss | \$ 40,304 | 1,146 | 47 | 668 | 28,847 | - | 10,364 | \$ 2,954 |
| Fully Insured Health | 7,747 | 58 | - | 8,446 | 4,365 | 13 | 12,007 | (134) |
| Group disability, life, annuities and DBL | 10,848 | 2,253 | - | 102 | 6,826 | 43 | 3,515 | 2,819 |
| Individual life, annuities and other | 7,072 | 7,977 | - | 159 | 9,716 | 1,035 | 2,082 | 2,375 |
| Credit life and disability | 5,580 | 157 | - | 13 | 2,612 | 1,261 | 2,016 | (139) |
| Corporate | - | 264 | - | - | - | - | 1,732 | (1,468) |
| Sub total | \$ 71,551 | \$ 11,855 | \$ 47 | \$ 9,388 | \$ 52,366 | \$ 2,352 | \$ 31,716 | 6,407 |
| Net realized investment gains | | | | | | | | 253 |
| Interest expense | | | | | | | | (990) |
| Income before income taxes | | | | | | | | 5,670 |
| Income taxes | | | | | | | | 1,601 |
| Net income | | | | | | | | \$ 4,069 |

Premiums Earned

Total premiums earned grew \$12.0 million to \$83.6 million in the third quarter of 2007 from \$71.6 million in the comparable period of 2006. The increase is primarily due to the Fully Insured Health segment which had a \$9.8 million increase in premiums in the third quarter of 2007 compared to the third quarter of 2006, comprised of a \$6.1 million increase in small group premiums as a result of the acquisition of a block of business which transitioned to the Company in the third quarter of 2006, a \$2.3 million increase in dental premiums primarily due to new business, a \$1.2 million increase due to new vision and limited medical products in 2007 and, a \$.2 million increase in short-term medical premiums. In the Medical Stop-Loss segment, premiums earned grew \$4.2 million in the third quarter of 2007 compared to the same period in 2006 due to an increase in assumed premiums. A \$1.0 decrease in premiums from the Group segment is primarily due to a refund of DBL premiums as Standard Security Life experienced loss ratios below mandated minimums in this line of business. Premiums earned by the other segments for the third quarter of 2007 were relatively comparable to the same period in 2006.

Net Investment Income

Total net investment income decreased \$.6 million primarily due to lower investment income from partnerships in the third quarter of 2007 compared to the same period in 2006, in addition to lower investable assets due to the acquisition of CAM and AMC. The overall investment yield was 5.2% and 5.3% in the third quarter of 2007 and 2006, respectively.

Net Realized Investment Gains

Net realized investment gains in the third quarter of 2007 increased \$.2 million over the comparable period in 2006. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale, as well as trading securities and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

Equity Income (Loss) from AMIC

Equity income (loss) from AMIC decreased \$.7 million in the third quarter of 2007 compared to the third quarter of 2006 due to lower income earned by AMIC as a result of medical stop-loss reserve strengthening which largely relates to the business it assumed from IHC.

Fee Income and Other Income

Fee income increased \$2.2 million to \$11.0 million in the third quarter of 2007 from \$8.8 million in the third quarter of 2006, primarily due to an increase in administrative fees in the Fully Insured Health segment including \$.9 million of fees earned by IHC Health Solutions, Inc. and AMC as a result of their acquisitions by the Company in 2007.

Total other income remained comparable to the third quarter of 2006.

Insurance Benefits, Claims and Reserves

Benefits, claims and reserves increased \$24.6 million. The increase is mainly due to: (i) an increase of \$15.5 million in the Medical Stop-Loss segment, primarily resulting from an increase in claims experience and reserve strengthening as described in further detail below; (ii) an increase of \$8.3 million in the Fully Insured Health segment, primarily due to the increase in volume; (iii) an increase of \$1.6 million in the Group segment primarily due to higher loss ratios in the group disability line of business; and (iv) a \$.8 million decrease in all other lines.

Reserve Strengthening:

Medical Stop-Loss

In accordance with its reserving methodology, the Company initially establishes its medical stop-loss reserves based on its best estimate of the Projected Net Loss Ratio, which is set based on underlying pricing assumptions developed using completed prior experience trended forward ("Projected Net Loss Ratio"). This use of projections reflects the fact that actual claims on medical stop-loss cases typically are not fully reported until after the end of the policy period. The Company uses the Projected Net Loss Ratio to set reserves until developing losses provide a better indication of ultimate results and it is feasible to set reserves based on claim development patterns. It is then the common practice of the Company to increase or decrease claims reserves once the actual claims experience becomes known. Projected Net Loss Ratios and claim development patterns are reviewed quarterly as reserve estimates are developed and are based on recent claim development history ("Claim Development Patterns").

Medical stop-loss business is excess coverage with a short duration. Predicting ultimate claims and estimating reserves in medical stop-loss is especially complicated due to the excess of loss nature of these products with very high deductibles applying to specific claims on any individual claimant and in the aggregate for a given group. Fluctuations in results for specific coverage are primarily due to the severity and frequency of individual claims. Due to the short-term nature of medical stop-loss, redundancies and deficiencies will typically emerge during the following year rather than over a number of years.

Consistent with our experience, the industry as a whole has succumbed to the pricing pressures caused by an unexpectedly long down cycle (or "soft" market) for medical stop-loss business. The medical stop-loss market has been soft for the past four years, including cases written in 2006 and 2007, which means that many of the Company's competitors have been willing to write business at little or no margin. The Company has been aware of these market conditions and has curtailed its growth in order to attempt to achieve higher profit margins. The Company believed that it had taken sufficient action to insure that business written in 2006 produced better margins than that written in 2005 and formulated a Projected Net Loss Ratio reflecting such expectations. As is typical with medical stop-loss business, MGUs do have some discretion within the Company's underwriting guidelines to make pricing concessions on certain cases, particularly as it relates to maintain their core renewal business and production sources.

In the third quarter of 2007, during the Company's quarterly review of its Claim Development Patterns, the Company identified a material increase in claims and reserves with respect to business written in 2006. Such adverse development was primarily driven by the frequency of claims relative to the business written in that year proving significantly higher than predicted by prior loss development patterns. This increased frequency of medical stop-loss claims was, in part, due to increased severity of primary claims. The Company has determined that the increase in claims was an indication of a pattern of higher loss frequency. While claims related to business written in 2007 have not yet developed to a level where Claim Development Patterns would provide reliable estimates of ultimate claim levels, the Company believes that it is appropriate to re-estimate the 2007 Projected Net Loss ratios in this quarter to mirror developing losses with respect to business written in 2006.

As a result of these actions, the Company has recognized a \$14.9 million charge, before income taxes, in the third quarter of 2007 relating to both the 2006 and 2007 Business. This resulted in a Net Loss Ratio (defined as insurance benefits, claims and reserves divided by (premiums earned less underwriting expenses)) for the medical stop-loss line in the three and nine month-period ended September 30, 2007 of 138.8% and 122.3%, respectively, compared with 94.6% and 94.9% in the prior period, respectively. The loss ratios in the third quarter and nine months of 2007 are significantly affected by the \$14.9 million charge recognized in this quarter, and are not indicative of the net loss ratios anticipated in our medical stop-loss line on an underwriting year basis. Approximately \$3.8 million of the charge, relates to the 2007

Business and \$11.1 million relates to the 2006 Business and prior.

Fully Insured Health

The adverse development in the Fully Insured Health segment is largely related to overestimating the value of certain new initiatives started in 2006 intended to manage and reduce claims costs, including medical care management services to insureds, negotiation of out-of-network claims, and auditing provider bills ("Cost Containment Program") and underestimating in 2006 the seasonality patterns that are a result of an increasing portion of the business having high deductible health plans (HDHPs). Although this Cost Containment Program did have a positive impact on the results of the small group major medical line, during 2007 the Company determined that the impact was not as large as it had anticipated when setting reserves in 2006. With respect to the seasonality patterns, HDHPs have fewer claims in the first quarter of a plan year and higher claims in the last quarter of the plan year. Primarily as a result of these two factors during 2006, the Company believed that its small group block of business had significantly better loss ratios than have now been determined.

Amortization of Deferred Acquisition Costs

Amortization of deferred acquisition costs increased \$.6 million in third quarter of 2007 over the same period in 2006.

Interest Expense on Debt

Interest expense increased \$.1 million, primarily due to interest on a line of credit paid at 6.65% in 2007 compared to 3.96% in 2006.

Selling, General and Administrative Expenses

Total selling, general and administrative expenses increased \$6.8 million in the third quarter of 2007 as compared to the third quarter of 2006. The increase is primarily due to (i) a \$4.2 million increase in commission and administrative expenses associated with the operation of the Fully Insured Health segment, primarily due to (a) \$1.8 million from the acquisitions of CAM and AMC in 2007; (b) an overall increase in operating costs of \$2.1 million (reported as SGA expense as described below); and (c) an increase of \$.3 million in amortization expense as a result of purchase accounting; (ii) a \$2.1 million increase in the Medical Stop-loss segment; and (iii) a \$.5 million increase in all other segments.

The higher operating expenses in our Fully Insured Health segment is largely attributable to (i) the costs of development and implementation for the new fully insured programs being initiated in 2007 and 2008, and (ii) higher costs of implementing new administration systems. Costs associated with new programs include product development, pricing, product filing and staffing, and are often incurred during a three to twelve month period prior to the effective date of the first policy sold.

Income Taxes (Benefit)

Income tax expense decreased \$6.5 million resulting in a benefit of \$(4.9) million for the quarter ended September 30, 2007 from \$1.6 million in the third quarter of 2006 primarily due to the pre-tax loss in the third quarter of 2007. The effective tax rates were 36.6% and 28.2% for the third quarter of 2007 and 2006, respectively.

Results of Operations for the Nine Months Ended September 30, 2007 Compared to the Nine Months Ended September 30, 2006

Net income was \$.1 million, or \$.01 per share, diluted, for the nine months ended September 30, 2007, a decrease of \$10.4 million compared to net income of \$10.5 million, or \$.69 per share, diluted, for the nine months ended September 30, 2006. The Company's income (loss) before taxes decreased \$15.6 million to \$(.3) million for the nine months ended September 30, 2007 from \$15.3 million for the nine months ended September 30, 2006. Information by business segment for the nine months ended September 30, 2007 and 2006 is as follows:

| | Net | Equity | Fee and | Benefits, Amortization | Selling, | of | General | |
|---|-----------------|-------------------|----------------|-------------------------------|-----------------|--------------------|-----------------------|--------------|
| | Premiums | Investment | From | Other | Claims | Deferred | And | |
| September 30, | Earned | Income | AMIC | Income | And | Acquisition | Administrative | Total |
| 2007 | | | | | Reserves | Costs | | |
| (In | | | | | | | | |
| thousands) | | | | | | | | |
| Medical Stop-Loss | \$ 124,777 | 3,370 | 249 | 1,347 | 99,075 | - | 33,538 | \$ (2,870) |
| Fully Insured Health | 53,457 | 444 | 124 | 30,401 | 38,565 | 185 | 47,029 | (1,353) |
| Group disability, life, annuities and DBL | 32,781 | 7,964 | 28 | 311 | 25,949 | 105 | 11,021 | 4,009 |
| Individual life, annuities and other | 20,972 | 22,854 | - | 2,463 | 28,152 | 4,304 | 7,131 | 6,702 |
| Credit life and disability | 16,197 | 682 | - | 26 | 8,146 | 3,672 | 5,878 | (791) |
| Corporate | - | 486 | - | - | - | - | 4,798 | (4,312) |
| Sub total | \$ 248,184 | 35,800 | \$ 401 | \$ 34,548 | \$ 199,887 | \$ 8,266 | \$ 109,395 | 1,385 |
| Net realized investment gains | | | | | | | | 1,473 |
| Interest expense | | | | | | | | (3,169) |
| (Loss) before income taxes (benefit) | | | | | | | | (311) |
| | | | | | | | | (419) |

| | | | | | | | | |
|---------------------------|--|--|--|--|--|--|--|--------|
| Income taxes (benefit) | | | | | | | | |
| Net income | | | | | | | | \$ 108 |

| <u>September 30,</u> <u>2006</u> | <u>Premiums</u> <u>Earned</u> | <u>Net</u> <u>Investment</u> <u>Income</u> | <u>Equity</u> <u>Income</u> <u>From</u> <u>AMIC</u> | <u>Fee</u> <u>and</u> <u>Other</u> <u>Income</u> | <u>Benefits</u> <u>Claims</u> <u>and</u> <u>Reserves</u> | <u>Amortization</u> <u>of</u> <u>Deferred</u> <u>Acquisition</u> <u>Costs</u> | <u>Selling,</u> <u>General</u> <u>And</u> <u>Administrative</u> | <u>Total</u> |
|---|----------------------------------|--|--|---|---|---|--|--------------|
| (In thousands) | | | | | | | | |
| Medical Stop-Loss | \$ 115,654 | 2,928 | 406 | 2,304 | 81,436 | - | 30,240 | \$ 9,616 |
| Fully Insured Health | 22,693 | 123 | - | 22,339 | 13,103 | 89 | 31,970 | (7) |
| Group disability, life, annuities and DBL | 32,523 | 6,671 | - | 327 | 23,819 | 124 | 11,053 | 4,525 |
| Individual life, annuities and other | 22,067 | 23,558 | - | 935 | 29,214 | 3,671 | 6,615 | 7,060 |
| Credit life and disability | 16,192 | 560 | - | 55 | 7,595 | 3,657 | 6,044 | (489) |
| Corporate | - | 1,348 | - | - | - | - | 4,608 | (3,260) |
| Sub total | \$ 209,129 | \$ 35,188 | \$ 406 | \$5,960 | \$55,167 | \$ 7,541 | \$ 90,530 | 17,445 |
| Net realized investment gains | | | | | | | | 720 |
| Interest expense | | | | | | | | (2,821) |
| Income before income taxes | | | | | | | | 15,344 |
| Income taxes | | | | | | | | 4,880 |
| Net income | | | | | | | | \$ 10,464 |

Premiums Earned

Total premiums earned grew \$39.1 million to \$248.2 million in the first nine months of 2007 from \$209.1 million in the comparable period of 2006. The increase is primarily due to: (i) the Fully Insured Health segment which increased \$30.8 million in the first nine months of 2007 compared to the first nine months of 2006 (comprised of a \$20.5 million increase in small group premiums as a result of the acquisition of a block of business which transitioned to the Company's paper in the third quarter of 2006, a \$3.8 million increase in short-term medical premiums, a \$3.3 million increase in dental premiums primarily due to new business, and a \$3.2 million increase due to new vision and limited medical products in 2007); and (ii) the Medical Stop-Loss segment which increased \$9.1 million primarily due to an increase in assumed business.

Net Investment Income

Total net investment income increased \$.6 million primarily due to slightly higher yields on the bond portfolio in the first nine months of 2007 compared to the same period in 2006, offset by lower investable assets due to the acquisitions of CAM and AMC in 2007 and lower investment income from partnerships. The overall investment yield was 5.4% and 5.3% in the first nine months of 2007 and 2006, respectively.

Net Realized Investment Gains

Net realized investment gains increased \$.8 million in the first nine months of 2007 compared to the same period in 2006. These amounts include gains and losses from sales of fixed maturities and equity securities available-for-sale, as well as trading securities and other investments. Decisions to sell securities are based on management's ongoing evaluation of investment opportunities and economic and market conditions, thus creating fluctuations in gains and losses from period to period.

Equity Income from AMIC

Equity income from AMIC remained comparable to the same period in 2006.

Fee Income and Other Income

Fee income increased \$7.6 million to \$31.5 million in the first nine months of 2007 from \$23.9 million in the first nine months of 2006, primarily due to an increase in administrative fees in the Fully Insured Health segment including an increase of \$3.4 million earned by IAC in addition to \$2.4 million of fees earned by IHC Health Solutions, Inc. and AMC as a result of their acquisitions by the Company in 2007.

Total other income increased \$.9 million in the first nine months of 2007 to \$3.0 million from \$2.1 million in the first nine months of 2006, primarily due to adjustments in 2007 in settlement of a reinsurance agreement.

Insurance Benefits, Claims and Reserves

Benefits, claims and reserves increased \$44.7 million. The increase is primarily due to: (i) an increase of \$17.7 million in the Medical Stop-Loss segment, primarily resulting from an increase in claims experience and reserve strengthening of \$14.9 million as described previously in Reserve Strengthening; and (ii) an increase of \$25.5 million in the Fully Insured Health segment, primarily due to the increase in volume and adverse development of \$1.3 million related to the 2006 year as described previously in Reserve Strengthening.

Amortization of Deferred Acquisition Costs

Amortization of deferred acquisition costs increased \$.8 million in the first nine months of 2007 compared to the same period in 2006.

Interest Expense on Debt

Interest expense increased \$.4 million, primarily due to a \$2.5 million increase in outstanding debt under a line of credit from \$12.5 million to \$15.0 million during the third quarter of 2006. The interest rate paid on that line was 6.65% in 2007 compared to 3.96% in 2006. In addition, the interest rate on \$12.4 million of floating rate junior subordinated debt averaged 9.4% in the first nine months of 2007 as compared to 9.0% in the first nine months of 2006.

Selling, General and Administrative Expenses

Total selling, general and administrative expenses increased \$18.9 million in the first nine months of 2007 as compared to the first nine months of 2006. The increase is primarily due to (i) a \$15.0 million increase in commission and administrative expenses associated with the operation of the Fully Insured Health segment, primarily due to (a) \$4.5 million from the acquisition of CAM and AMC; (b) an overall increase in operating costs of \$9.6 million (reported as SGA expense, as previously described); and (c) a \$.9 million increase in amortization expense as a result of purchase accounting; and (ii) a \$3.3 million increase in commissions and other general expenses in the Medical Stop-Loss segment due to higher volume.

Income Taxes (Benefit)

Income tax expense decreased \$5.3 million for the nine months ended September 30, 2007 from \$4.9 million for the first nine months of 2006 primarily due to the decrease in pre-tax income in 2007. The resulting benefit of \$(.4) million is primarily related to state income taxes causing an effective rate of 134.7%. The effective tax rate for the first nine months of 2006 was 31.8%.

LIQUIDITY

Insurance Group

The Insurance Group normally provides cash flow from: (i) operations; (ii) the receipt of scheduled principal payments on its portfolio of fixed maturities; and (iii) earnings on investments. Such cash flow is partially used to fund liabilities for insurance policy benefits. These liabilities represent long-term and short-term obligations. The Company reported a net use of cash from operations of \$15.4 million primarily due to the settlement of two reinsurance contracts. Neither the Company's current period net loss, nor its net use of cash from operations, are reasonably likely to have a material adverse impact on its liquidity.

Corporate

Corporate derives its funds principally from: (i) dividends from the Insurance Group; (ii) management fees from its subsidiaries; and (iii) investment income from Corporate liquidity. Regulatory constraints historically have not affected the Company's consolidated liquidity, although state insurance laws have provisions relating to the ability of the parent company to use cash generated by the Insurance Group.

BALANCE SHEET

Total investments and cash and cash equivalents decreased \$30.7 million during the nine months ended September 30, 2007 largely due to \$9.0 million in cash used for acquisitions, an increase of \$5.2 million in unrealized losses on available for sale securities, and a \$12.4 million increases in amounts due to and from reinsurers, partially offset by a \$3.0 million decrease in amounts due from and to brokers.

The Company had net receivables from reinsurers of \$85.8 million at September 30, 2007. Substantially all of the business ceded to such reinsurers is of short duration. All of such receivables are either due from the Company's affiliate, Independence American, highly rated companies or are adequately secured. No allowance for doubtful accounts was necessary at September 30, 2007.

During the third quarter of 2007, the Company recorded reserve strengthening of \$11.1 million primarily related to its 2006 Business due to emerging Claim Development Patterns, which are applied to generate reasonably reliable estimates of ultimate claim levels. These are reviewed quarterly as reserve estimates are developed and are based on recent claim development history. The Company must determine whether changes in development represent true indications of emerging experience or are simply due to random claim fluctuations. The adverse development to the Claim Development Patterns was due to the frequency of claims reported in the quarter being significantly higher than predicted by prior loss development patterns. This frequency of medical stop-loss claims was due, in part, to the increasing severity of primary claims. The Company has determined that this increase in claims is an indication of a pattern of higher loss frequency.

In addition, the Company recorded reserve strengthening of \$3.8 million on its 2007 Business primarily as a result of the Company's review of the Claim Development Patterns of the 2006 Business. This business was reserved using the Projected Net Loss Ratio. This change represents a deviation of approximately eight Net Loss Ratio points from the Projected Net Loss Ratio.

Major factors that affect the Projected Net Loss Ratio assumption in reserving for medical stop-loss relate to: (i) frequency and severity of claims; (ii) changes in medical trend resulting from the influences of underlying cost inflation, changes in utilization and demand for medical services, the impact of new medical technology and changes in medical treatment protocols; and (iii) the adherence by the MGUs that produce and administer this business to the Company's underwriting guidelines. Changes in these underlying factors are what determine the reasonably likely changes in the Projected Net Loss Ratio. The Company had estimated that a reasonably likely deviation would fall between three to five points, although believed that larger deviations were possible as was the case this quarter. The Company is currently reevaluating the impact of the third quarter 2007 loss development on the reasonably likely deviation from its Projected Net Loss Ratio and on its Claim Development Patterns as it appears in our 2006 Annual Report on Form 10-K.

The Company's health reserves by segment are as follows (in thousands):

| | Total Health Reserves | |
|--------------------------|-------------------------------|------------------------------|
| | September 30, 2007 | December 31, 2006 |
| Medical Stop-Loss | \$ 95,845 | \$ 86,265 |
| Fully Insured Health | 39,585 | 14,526 |
| Group Disability | 68,982 | 64,786 |
| Credit A&H | 7,562 | 7,426 |
| Individual A&H and Other | 8,692 | 9,452 |
| | \$ 220,666 | \$ 182,455 |

The \$2.4 million decrease in total stockholders' equity in the first nine months of 2007 is primarily due to a \$3.1 million increase in net unrealized losses on investments.

Asset Quality

The nature and quality of insurance company investments must comply with all applicable statutes and regulations, which have been promulgated primarily for the protection of policyholders. Of the aggregate carrying value of the Insurance Group's investment assets, approximately 86.5% was invested in investment grade fixed maturities, resale agreements, policy loans and cash and cash equivalents at September 30, 2007. Also at such date, approximately 98.8% of the Insurance Group's fixed maturities were investment-grade. These investments carry less risk and, therefore, lower interest rates than other types of fixed maturity investments. At September 30, 2007, approximately 1.2% of the carrying value of fixed maturities was invested in diversified non-investment grade fixed maturities (investments in such securities have different risks than investment grade securities, including greater risk of loss upon default, and thinner trading markets). The Company does not have any mortgage loans or non-performing fixed maturities at September 30, 2007. The Company's mortgage security portfolio has no exposure to sub-prime mortgages.

The Company reviews its investments regularly and monitors its investments continually for impairments. The Company did not record any losses for other-than-temporary impairments for the three months or nine months ended September 30, 2007. In 2006, the Company recorded a realized loss of \$247,000 for other-than-temporary impairments in the nine months ended September 30.

The Company's gross unrealized losses on fixed maturities totaled \$19.9 million at September 30, 2007. Substantially

all of these securities were investment grade. The Company holds all fixed maturities as available-for-sale securities and, accordingly, marks all of its fixed maturities to market through accumulated other comprehensive income or loss. The unrealized losses on all available-for-sale securities have been evaluated in accordance with the Company's policy and were determined to be temporary in nature at September 30, 2007.

The Company has chosen to carry all of its debt securities as available-for-sale. In the first nine months of 2007, the Company experienced an increase in net unrealized losses of \$5.3 million which, net of deferred tax benefits of \$1.8 million and net of deferred policy acquisition costs of \$.4 million, reduced stockholders' equity by \$3.1 million (reflecting net unrealized losses of \$12.4 million at September 30, 2007 compared to net unrealized losses of \$9.3 million at December 31, 2006). From time to time, as warranted, the Company employs investment strategies to mitigate interest rate and other market exposures.

CAPITAL RESOURCES

Due to its strong capital ratios, broad licensing and excellent asset quality and credit-worthiness, the Insurance Group remains well positioned to increase or diversify its current activities. It is anticipated that future acquisitions or other expansion of operations will be funded internally from existing capital and surplus and parent company liquidity. In the event additional funds are required, it is expected that they would be borrowed or raised in the public or private capital markets to the extent determined to be necessary or desirable.

IHC enters into a variety of contractual obligations with third parties in the ordinary course of its operations, including liabilities for insurance reserves, funds on deposit, debt and operating lease obligations. However, IHC does not believe that its cash-flow requirements can be fully assessed based solely upon an analysis of these obligations. Future cash outflows, whether they are contractual obligations or not, also will vary based upon IHC's future needs. Although some outflows are fixed, others depend on future events. The maturity distribution of the Company's obligations, as of September 30, 2007, is not materially different from that reported in the schedule of such obligations at December 31, 2006.

The chart below reflects the maturity distribution of Contractual Obligations at December 31, 2006 and was modified from that reported in Item 7 of the Company's Report on Form 10-K to include estimated interest payments.

| | Debt | Junior Subordinated Debt | Interest on Debt | Leases | Insurance Reserves | Funds On Deposit | Total |
|------------------------|-------------|---|-----------------------------|---------------|-------------------------------|---------------------------------|--------------|
| 2007 | \$ 2,500 | \$ - | \$ 3,957 | \$ 2,950 | \$ 140,180 | \$ 43,391 | \$ 192,978 |
| 2008 | 2,500 | - | 3,942 | 2,872 | 36,151 | 40,894 | 86,359 |
| 2009 | 10,000 | - | 3,650 | 2,110 | 29,780 | 39,494 | 85,034 |
| 2010 | - | - | 3,481 | 1,676 | 26,197 | 38,260 | 69,614 |
| 2011 | - | - | 3,481 | 1,556 | 24,213 | 35,943 | 65,193 |
| 2012 and Thereafter | - | 38,146 | 77,223 | 3,766 | 180,599 | 180,563 | 480,297 |
| Totals | \$ 15,000 | \$ 38,146 | \$ 95,734 | \$ 14,930 | \$ 437,120 | \$ 378,545 | \$ 979,475 |

OUTLOOK

For 2007, IHC's business plan is for its two insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life") to: (i) emphasize leveraging IHC's existing vertically integrated fully insured health operations and policy filings in order to generate fee income at multiple levels of marketing and administration, as well as risk profit and profit commission income, (ii) continue to improve the profitability of their core lines of business, while expanding distribution, (iii) to continue to examine various options with respect to its credit lines of business, (iv) diversify the distribution of their life and disability products, and (v) acquire blocks of life and annuity business to the extent opportunities arise. The Company initially anticipated that it would have \$800 million of annualized premiums, including those of AMIC, at December 31, 2007. Due to delays in some policy filings, timing and implementation of certain programs which were expected to be effective in 2007 but will not be effective until 2008, the Company will not achieve that level of annualized premiums during 2007. The following summarizes IHC's outlook for the remainder of the year and 2008, given the results of the third quarter of 2007, by segment:

Fully Insured Health

Based on premiums written to date, the Company believes that during 2008, on an annualized basis, gross fully insured health premiums will approach those generated by its medical stop-loss line. As a result of its multiple product filings, distribution sources, and the sheer size of the market, the Company is optimistic that its fully insured health business will continue to grow and yield profitable underwriting results. In addition, the Company has expended significant time and money in bringing to market several new programs that will start to produce premiums in 2008. Although, as demonstrated by the reserve strengthening in the second quarter of 2007, the Fully Insured Health segment results may change on a quarterly basis, in general, this segment tends to be less volatile and cyclical in nature than medical stop-loss business on an annual basis. High deductible health plans (HDHPs), which are an increasing portion of the small group major medical line, have fewer claims in the first quarter of a plan year and higher claims in the last quarter of the plan year, which will result in fluctuations in quarterly results.

Medical Stop-Loss

The medical stop-loss market is generally cyclical in nature. When a product experiences several consecutive years of underwriting profitability, it is not unusual for there to be more competitors entering that line which can increase pressure on pricing and create a softer market. Consistent with our experience, the industry as a whole has succumbed to the pricing pressures caused by an unexpectedly long down cycle (or "soft" market) for medical stop-loss business. A leading rating agency recently commented that this market condition has placed considerable downward pressure on operational margins. As a result of these market conditions, the rate that the Company's carriers were able to charge for medical stop-loss increased at a lesser rate in recent years. Considering historical trends, consolidation in the industry, and early indications as to January 2008 pricing, many in the industry are hopeful that the medical stop-loss market will see improved underwriting results on business written in 2008. In addition, the Company has cancelled or significantly reduced retention on several MGUs that have produced unfavorable loss ratios and contributed disproportionately to the reserve strengthening this quarter. This, in conjunction with greater adherence by the MGUs to our underwriting guidelines, should produce improved underwriting results for the Company on business incepting in 2008.

Group Disability, Life, Annuities and DBL

The Company anticipates modest growth in its group disability, life, annuities and DBL segment.

Individual Life, Annuities and Other

IHC did not acquire any life or annuity blocks in the first nine months of 2007, but will continue to consider financially viable life and annuity blocks in the future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company manages interest rate risk by seeking to maintain a portfolio with a duration and average life that falls within the band of the duration and average life of the applicable liabilities. Options may be utilized to modify the duration and average life of such assets.

The Company monitors its investment portfolio on a continuous basis and believes that the liquidity of the Insurance Group will not be adversely affected by its current investments. This monitoring includes the maintenance of an asset-liability model that matches current insurance liability cash flows with current investment cash flows.

The expected change in fair value as a percentage of the Company's fixed income portfolio at September 30, 2007 given a 100 to 200 basis point rise or decline in interest rates is not materially

different than the expected change at December 31, 2006 included in Item 7A of the Company's Annual Report on Form 10-K. In the Company's analysis of the asset-liability model, a 100 to 200 basis point change in interest rates on the Insurance Group's liabilities would not be expected to have a material adverse effect on the Company. With respect to its liabilities, if interest rates were to increase, the risk to the Company is that policies would be surrendered and assets would need to be sold. This is not a material exposure to the Company since many of the Insurance Group's interest sensitive policies are burial policies that are not subject to the typical surrender patterns of other interest sensitive policies, and many of the Insurance Group's universal life and annuity policies were issued by liquidated companies which tend to exhibit lower surrender rates than such policies of continuing companies. For the remaining policies that exhibit the typical interest sensitive characteristics, the Company manages the risk by adjusting crediting interest rates and monitoring the surrender rates. Additionally, there are charges to help offset the benefits being surrendered. If interest rates were to decrease substantially, the risk to the Company is that some of its investment assets would be subject to early redemption. This is not a material exposure because the Company would have additional unrealized gains in its investment portfolio to help offset the future reduction of investment income.

ITEM 4.

CONTROLS AND PROCEDURES

IHC's Chief Executive Officer and Chief Financial Officer supervised and participated in IHC's evaluation of its disclosure controls and procedures as of the end of the period covered by this report. Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in IHC's periodic reports filed or submitted under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based upon that evaluation, IHC's Chief Executive Officer and Chief Financial Officer concluded that IHC's disclosure controls and procedures are effective.

There has been no change in IHC's internal control over financial reporting during the fiscal quarter ended September 30, 2007 that has materially affected, or is reasonably likely to materially affect, IHC's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1.

LEGAL PROCEEDINGS

The Company is involved in legal proceedings and claims that arise in the ordinary course of its businesses. The Company has established reserves that it believes are sufficient given information presently available related to its outstanding legal proceedings and claims. The Company believes the results of pending legal proceedings and claims

are not expected to have a material adverse effect on its financial condition or cash flows, although there could be such an effect on its results of operations for a particular period.

ITEM 1A.

RISK FACTORS

There were no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 in Item 1A to Part 1 of Form 10-K.

ITEM 2.

UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not Applicable

Share Repurchase Program

IHC has a program, initiated in 1991, under which it repurchases shares of its common stock. In August 2007, the Board of Directors authorized an additional 100,000 shares to be purchased under the 1991 plan. As of September 30, 2007, 131,657 shares were still authorized to be repurchased under the plan. Share repurchases during the third quarter of 2007 are summarized as follows:

| | 2007 | | | |
|--------------------------------|-------------------------------|--|--|--|
| Month of Repurchase | Shares Repurchased | Average Price of Repurchased Shares | Maximum Number Of Shares Which Can be Repurchased | |
| July | 10,964 | \$19.88 | 31,657 | |
| August | - | - | 131,657 | |
| September | - | - | 131,657 | |

ITEM 3.**DEFAULTS UPON SENIOR SECURITIES**

Not applicable

ITEM 4.**SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable

ITEM 5.**OTHER INFORMATION**

Not applicable

ITEM 6.

EXHIBITS

31.1

Certification of the Chief Executive Officer and President Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2

Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1

Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2

Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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.

INDEPENDENCE HOLDING COMPANY

(REGISTRANT)

By:

/s/Roy T. K. Thung_____

Date:

November 9, 2007

Roy T.K. Thung

Chief Executive Officer and President

By:

/s/Teresa A. Herbert_____

Date:

November 9, 2007

Teresa A. Herbert

Senior Vice President and

Chief Financial Officer