

Kansas City Life Insurance Company

2012 Fourth Quarter Report

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Includes our subsidiaries:

Sunset Life Insurance Company of America

Old American Insurance Company

Sunset Financial Services, Inc.

Post Office Box 219139
Kansas City, Missouri 64121-9139
Listing: NASDAQ
Stock Symbol:KCLI
www.kclife.com



Message *from the President, CEO and Chairman of the Board*

Kansas City Life Insurance Company recorded net income of \$7.9 million or \$0.71 per share in the fourth quarter of 2012, a \$2.2 million or \$0.20 per share increase versus the same quarter in the prior year. The increase in earnings was primarily due to increases in realized investment gains and insurance revenues, as well as reduced amortization of deferred acquisition costs (DAC) and lower operating expenses. These improvements were partially offset by an increase in policyholder benefits and income tax expense.

Net income for the twelve months was \$39.9 million or \$3.59 per share, an increase of \$13.7 million or \$1.30 per share compared to 2011. This increase was largely due from an increase in realized investment gains of \$15.3 million. Other significant factors for the year included an increase in insurance revenues, a reduction in interest credited to policyholder account balances, and a decrease in amortization of DAC. These were partially offset by increases in operating expenses, policyholder benefits, and income tax expense.

Total investment revenues, which combines net investment income and net realized gains, increased \$1.0 million or 2% for the fourth quarter and \$14.2 million or 8% for the year. These increases were the result of realized gains that the Company earned during the year, as several real estate properties were sold during both the fourth quarter and earlier in the year. Net investment income was flat for the fourth quarter but decreased \$1.0 million or 1% for the year, as the decrease in yields more than offset an increase in average invested assets. Both the quarter and twelve months were negatively affected by lower yields on fixed-rate investments.

Insurance revenues combine both premiums, net of reinsurance ceded, and contract charges for the Company's insurance products. Net premiums increased 19% for the fourth quarter, primarily reflecting improvements in both immediate annuity and traditional insurance products. Immediate annuity sales increased \$3.9 million in the fourth quarter and \$5.3 million for the year, compared with the same periods one year earlier. The traditional products continue to reflect positive sales results from Old American Insurance Company, which increased sales 7% in the fourth quarter and 5% for the twelve months, compared with the prior year.

New deposits from the Company's interest sensitive products increased 15% in the fourth quarter. However, these deposits decreased 3% for the year. New variable annuity sales increased \$2.4 million



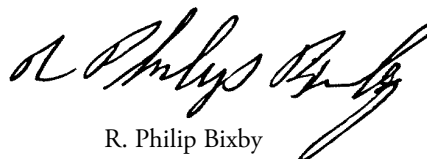
and more than doubled in the fourth quarter, and new universal life sales increased \$1.0 million or 47% in the same period. New variable annuity and universal life sales each increased 11% for the year, while new fixed deferred annuity deposits decreased 8% versus the prior year.

Policyholder benefits increased \$7.8 million or 24% in the fourth quarter and \$4.4 million or 3% for the year. The largest factor in the change was an increase in immediate annuity sales for both the fourth quarter and year. The sale of immediate annuity products requires the corresponding establishment of policy reserves on a virtual one-for-one basis. Also contributing to the increases was a reduction in reserves in the fourth quarter of 2011, related to the release of reserves for non-guaranteed interest on certain products. These unfavorable changes in policyholder benefits were partially offset in both periods by reduced reserves on the Company's guaranteed minimum withdrawal benefits, associated with variable annuity products, and reduced death benefits paid, net of reinsurance.

The amortization of DAC decreased \$4.2 million or 35% in the fourth quarter and \$5.9 million or 17% for the twelve months. These decreases were primarily the result of changes in 2011 for refinements in estimates and unlocking of assumptions regarding universal life and traditional products.

Finally, operating expenses decreased \$1.0 million or 3% in the quarter but increased \$4.0 million or 4% for the year. The decrease in operating expenses in the fourth quarter was largely due to a decrease in employee benefits and the reduction in the allowance for uncollectible receivables. However, operating expenses increased for the year, reflecting higher depreciation expense, increased employee salary and benefit costs, and increased legal fees.

On January 28, 2012, the Kansas City Life Board of Directors declared a quarterly dividend of \$0.27 per share that was paid on February 13, 2013 to stockholders of record on February 7, 2013.


R. Philip Bixby



KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

	December 31	
	2012	2011
ASSETS		
Investments:		
Fixed maturity securities available for sale, at fair value	\$ 2,788,141	\$ 2,682,142
Equity securities available for sale, at fair value	20,061	36,689
Mortgage loans	674,034	601,923
Real estate	124,742	127,962
Policy loans	77,133	80,375
Short-term investments	24,902	49,316
Other investments	2,572	3,364
Total investments	3,711,585	3,581,771
Cash	7,026	10,436
Accrued investment income	34,747	34,705
Deferred acquisition costs	176,275	181,564
Reinsurance recoverables	190,613	189,885
Property and equipment	18,343	22,671
Other assets	47,063	60,601
Separate account assets	340,093	316,609
Total assets	\$ 4,525,745	\$ 4,398,242
LIABILITIES		
Future policy benefits	\$ 889,107	\$ 879,015
Policyholder account balances	2,128,002	2,089,452
Policy and contract claims	29,813	36,511
Other policyholder funds	155,749	152,125
Other liabilities	232,580	213,825
Separate account liabilities	340,093	316,609
Total liabilities	3,775,344	3,687,537
STOCKHOLDERS' EQUITY		
Common stock, par value \$1.25 per share		
Authorized 36,000,000 shares,		
issued 18,496,680 shares	23,121	23,121
Additional paid in capital	40,969	41,101
Retained earnings	805,730	780,918
Accumulated other comprehensive income	54,094	30,086
Treasury stock, at cost (2012 - 7,463,823 shares;		
2011 - 7,187,315 shares)	(173,513)	(164,521)
Total stockholders' equity	750,401	710,705
 Total liabilities and stockholders' equity	 \$ 4,525,745	 \$ 4,398,242

Please refer to the Company's Annual Report on Form 10-K.



KANSAS CITY LIFE INSURANCE COMPANY
CONSOLIDATED STATEMENTS OF INCOME

(amounts in thousands, except share data)

	Year Ended December 31		
	2012	2011	2010
REVENUES			
Insurance revenues:			
Net premiums	\$ 136,089	\$ 127,338	\$ 139,811
Contract charges	99,894	101,061	106,019
Total insurance revenues	<u>235,983</u>	<u>228,399</u>	<u>245,830</u>
Investment revenues:			
Net investment income	176,154	177,228	175,859
Net realized investment gains, excluding other-than-temporary impairment losses	20,154	5,151	4,355
Net impairment losses recognized in earnings:			
Total other-than-temporary impairment losses	(2,526)	(2,952)	(4,129)
Portion of impairment losses recognized in other comprehensive income	808	943	309
Net other-than-temporary impairment losses recognized in earnings	<u>(1,718)</u>	<u>(2,009)</u>	<u>(3,820)</u>
Total investment revenues	194,590	180,370	176,394
Other revenues	9,354	10,274	9,139
Total revenues	<u>439,927</u>	<u>419,043</u>	<u>431,363</u>
BENEFITS AND EXPENSES			
Policyholder benefits	160,178	155,813	182,997
Interest credited to policyholder account balances	82,043	83,446	85,949
Amortization of deferred acquisition costs	28,042	33,966	27,033
Operating expenses	110,169	106,120	100,625
Total benefits and expenses	<u>380,432</u>	<u>379,345</u>	<u>396,604</u>
Income before income tax expense	59,495	39,698	34,759
Income tax expense	<u>19,628</u>	<u>13,565</u>	<u>12,457</u>
NET INCOME	<u>\$ 39,867</u>	<u>\$ 26,133</u>	<u>\$ 22,302</u>
COMPREHENSIVE INCOME, NET OF TAXES			
Change in net unrealized gains on securities available for sale	\$ 35,088	\$ 43,266	\$ 47,691
Change in future policy benefits	(8,562)	(5,721)	(4,615)
Change in policyholder account balances	(362)	(162)	(214)
Change in benefit plan obligations	(2,156)	(15,104)	1,422
Other comprehensive income	<u>24,008</u>	<u>22,279</u>	<u>44,284</u>
COMPREHENSIVE INCOME	<u>\$ 63,875</u>	<u>\$ 48,412</u>	<u>\$ 66,586</u>
Basic and diluted earnings per share:			
Net income	<u>\$ 3.59</u>	<u>\$ 2.29</u>	<u>\$ 1.95</u>

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