

AMERUS GROUP CO/IA  
Form 10-Q  
August 06, 2004

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

**FORM 10-Q**

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(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

**Commission File Number 001-15166**

**AMERUS GROUP CO.**

(Exact name of Registrant as specified in its charter)

IOWA  
(State or other jurisdiction of  
incorporation or organization)

42-1458424  
(I.R.S. Employer  
Identification No.)

**699 Walnut Street**  
**Des Moines, Iowa 50309-3948**  
(Address of principal executive offices)

Registrant's telephone number, including area code (515) 362-3600

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

The number of shares outstanding of each of the Registrant's classes of common stock on August 3, 2004 was as follows:

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**SAFE HARBOR STATEMENT**

This Quarterly Report on Form 10-Q, including the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains statements which constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements relating to trends in operations and financial results and the business and the products of the Registrant and its subsidiaries, as well as other statements including words such as "anticipate", "believe", "plan", "estimate", "expect", "intend", and other similar expressions. Forward-looking statements are made based upon management's current expectations and beliefs concerning future developments and their potential effects on the Company. Such forward-looking statements are not guarantees of future performance. Factors that may cause our actual results to differ materially from those contemplated by these forward-looking statements include, among others, the following possibilities: (a) general economic conditions and other factors, including prevailing interest rate levels and stock and bond market performance, which may affect our ability to sell our products, the market value of our investments and the lapse rate and profitability of policies; (b) our ability to achieve anticipated levels of operational efficiencies and cost-saving initiatives and to meet cash requirements based upon projected liquidity sources; (c) customer response to new products, distribution channels and marketing initiatives; (d) mortality, morbidity, and other factors which may affect the profitability of our insurance products; (e) our ability to develop and maintain effective risk management policies and procedures and to maintain adequate reserves for future policy benefits and claims; (f) changes in the federal income tax and other federal laws, regulations, and interpretations, including federal regulatory measures that may significantly affect the insurance business including limitations on antitrust immunity, minimum solvency requirements, and changes to the tax advantages offered by life insurance and annuity products or programs with which they are used; (g) increasing competition in the sale of insurance and annuities and the recruitment of sales representatives; (h) regulatory changes, interpretations, initiatives or pronouncements, including those relating to the regulation of insurance companies and the regulation and sale of their products; (i) our ratings and those of our subsidiaries by independent rating organizations which we believe are particularly important to the sale of our products and the programs in which they are used; (j) the performance of our investment portfolios; (k) the impact of changes in standards of accounting; (l) our ability to integrate the business and operations of acquired entities; (m) expected protection products and accumulation products margins; (n) the impact of anticipated investment transactions; and (o) unanticipated litigation or regulatory investigations or examinations.

There can be no assurance that other factors not currently anticipated by us will not materially and adversely affect our results of operations. You are cautioned not to place undue reliance on any forward-looking statements made by us or on our behalf. Forward-looking statements speak only as of the date the statement was made. We undertake no obligation to update or revise any forward-looking statement.

Table of Contents**PART I - FINANCIAL INFORMATION****Item 1. Financial Statements****AMERUS GROUP CO.****CONSOLIDATED BALANCE SHEETS**  
(\$ in thousands)

|   | <b>June 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|---|--------------------------|------------------------------|
|   | <b>(unaudited)</b>       |                              |
| Assets  |                          |                              |
| Investments:  |                          |                              |
| Securities available-for-sale at fair value:        |                          |                              |
| Fixed maturity securities                           | \$ 14,428,207            | \$ 13,944,961                |
| Equity securities                                   | 77,818                   | 74,890                       |
| Short-term investments                              | 20,426                   | 28,556                       |
| Securities held for trading purposes at fair value: |                          |                              |
| Fixed maturity securities                           | 1,848,933                | 2,089,502                    |
| Equity securities                                   | 5,507                    | 1,652                        |
| Short-term investments                              | 580                      | 591                          |
| Mortgage loans                                      | 843,624                  | 968,572                      |
| Real estate   | 33                       | 33                           |
| Policy loans  | 486,087                  | 494,646                      |
| Other investments                                   | 328,754                  | 339,436                      |
|   | <hr/>                    | <hr/>                        |
| Total investments                                   | 18,039,969               | 17,942,839                   |
| Cash and cash equivalents                           | 459,209                  | 274,150                      |
| Accrued investment income                           | 207,531                  | 205,492                      |
| Premiums, fees and other receivables                | 41,869                   | 42,761                       |
| Reinsurance receivables                             | 722,097                  | 663,452                      |
| Deferred policy acquisition costs                   | 1,266,258                | 1,021,856                    |
| Capitalized bonus interest                          | 130,865                  | 98,274                       |
| Value of business acquired                          | 408,482                  | 419,582                      |
| Goodwill  | 226,291                  | 224,075                      |
| Property and equipment                              | 48,218                   | 48,849                       |
| Other assets  | 299,125                  | 311,305                      |
| Separate account assets                             | 254,939                  | 261,657                      |
| Assets of discontinued operations                   | <hr/>                    | <hr/>                        |
|   | <hr/>                    | <hr/>                        |
| Total assets  | <b>\$22,104,853</b>      | <b>\$21,542,242</b>          |

See accompanying notes to consolidated financial statements.

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**AMERUS GROUP CO.**  
**CONSOLIDATED BALANCE SHEETS**  
(\$ in thousands)

|  | <b>June 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|--|--------------------------|------------------------------|
|  | <b>(unaudited)</b>       |                              |
| Liabilities and Stockholders' Equity   |                          |                              |
| Liabilities:   |                          |                              |
| Policy reserves and policyowner funds:   |                          |                              |
| Future life and annuity policy benefits  | \$ 17,313,623            | \$ 16,994,255                |
| Policyowner funds  | 1,423,847                | 1,306,160                    |
|  | <hr/>                    | <hr/>                        |
|  | 18,737,470               | 18,300,415                   |
| Accrued expenses and other liabilities   | 747,643                  | 443,589                      |
| Dividends payable to policyowners  | 254,378                  | 321,233                      |
| Policy and contract claims   | 47,343                   | 58,880                       |
| Income taxes payable   | 38,545                   | 50,274                       |
| Deferred income taxes  | 54,633                   | 80,861                       |
| Notes payable  | 545,838                  | 596,101                      |
| Separate account liabilities   | 254,939                  | 261,657                      |
| Liabilities of discontinued operations   | 19,421                   | 19,421                       |
|  | <hr/>                    | <hr/>                        |
| Total liabilities  | 20,680,789               | 20,132,431                   |
| Stockholders' equity:  |                          |                              |
| Preferred Stock, no par value, 20,000,000 shares authorized,<br>none issued  |                          |                              |
| Common Stock, no par value, 230,000,000 shares authorized;<br>43,919,601 shares issued and 39,084,296 shares outstanding in<br>2004; 43,836,608 shares issued and 39,194,602 shares<br>outstanding in 2003 | 43,920                   | 43,836                       |
| Additional paid-in capital   | 1,187,189                | 1,184,237                    |
| Accumulated other comprehensive income (loss)  | 22,240                   | 84,519                       |
| Unearned compensation  | (1,440)                  | (1,361)                      |
| Retained earnings  | 336,911                  | 255,006                      |
| Treasury stock, at cost (4,835,305 shares in 2004 and 4,642,006<br>shares in 2003)   | (164,756)                | (156,426)                    |
|  | <hr/>                    | <hr/>                        |
| Total stockholders' equity   | 1,424,064                | 1,409,811                    |
|  | <hr/>                    | <hr/>                        |
| Total liabilities and stockholders' equity   | \$ 22,104,853            | \$ 21,542,242                |
|  | <hr/>                    | <hr/>                        |

See accompanying notes to consolidated financial statements.



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(\$ in thousands, except share data)

|  | <b>For The Three Months Ended<br/>June 30,</b> |                | <b>For The Six Months Ended June<br/>30,</b> |                |
|--|--|----------------|--|----------------|
|  | <b>2004</b>                                    | <b>2003</b>    | <b>2004</b>                                  | <b>2003</b>    |
|  | <b>(unaudited)</b>                             |                |  |                |
| Revenues:  |  |                |  |                |
| Insurance premiums   | \$ 63,791                                      | \$ 79,637      | \$ 134,528                                   | \$ 161,242     |
| Product charges  | 54,284   | 48,703         | 103,846                                      | 95,534         |
| Net investment income  | 251,311  | 251,707        | 508,186                                      | 506,820        |
| Realized/unrealized capital gains (losses)                                       | (44,550)                                       | 58,969         | (44,635)                                     | 66,824         |
| Other income   | 19,098   | 17,257         | 38,701                                       | 33,612         |
|  | <u>343,934</u>                                 | <u>456,273</u> | <u>740,626</u>                               | <u>864,032</u> |
| Benefits and expenses:   |  |                |  |                |
| Policyowner benefits   | 168,350  | 261,765        | 406,779                                      | 485,125        |
| Underwriting, acquisition and other expenses                                     | 45,737   | 33,443         | 86,338                                       | 73,799         |
| Restructuring costs  |  | 12,670         |  | 15,864         |
| Amortization of deferred policy acquisition costs and value of business acquired | 58,278   | 45,902         | 106,189                                      | 92,975         |
| Dividends to policyowners  | 10,936   | 29,740         | 36,420                                       | 64,314         |
|  | <u>283,301</u>                                 | <u>383,520</u> | <u>635,726</u>                               | <u>732,077</u> |
| Income from continuing operations  | 60,633   | 72,753         | 104,900                                      | 131,955        |
| Interest expense   | 7,936  | 7,575          | 16,334                                       | 14,374         |
|  | <u>52,697</u>                                  | <u>65,178</u>  | <u>88,566</u>                                | <u>117,581</u> |
| Income before income tax expense   | 52,697   | 65,178         | 88,566                                       | 117,581        |
| Income tax expense   | 3,921  | 22,002         | 10,050                                       | 39,102         |
|  | <u>48,776</u>                                  | <u>43,176</u>  | <u>78,516</u>                                | <u>78,479</u>  |
| Net income from continuing operations  | 48,776   | 43,176         | 78,516                                       | 78,479         |
| Income from discontinued operations, net of tax                                  |  | 535            | 3,899  | 1,022          |
|  | <u></u>  | <u>535</u>     | <u>3,899</u>                                 | <u>1,022</u>   |

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|   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|
| Net income before cumulative effect of change in accounting | 48,776            | 43,711            | 82,415            | 79,501            |
| Cumulative effect of change in accounting, net of tax       |                   |                   | (510)             |                   |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Net income  | \$ 48,776         | \$ 43,711         | \$ 81,905         | \$ 79,501         |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Net income from continuing operations per common share:     |                   |                   |                   |                   |
| Basic   | \$ 1.24           | \$ 1.10           | \$ 2.00           | \$ 2.01           |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Diluted   | \$ 1.20           | \$ 1.10           | \$ 1.93           | \$ 1.99           |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Net income per common share:                                |                   |                   |                   |                   |
| Basic   | \$ 1.24           | \$ 1.12           | \$ 2.08           | \$ 2.03           |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Diluted   | \$ 1.20           | \$ 1.11           | \$ 2.02           | \$ 2.02           |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Weighted average common shares outstanding:                 |                   |                   |                   |                   |
| Basic   | 39,327,182        | 39,161,780        | 39,342,363        | 39,112,346        |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Diluted   | 40,760,364        | 39,404,467        | 40,619,242        | 39,354,894        |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| For The Three Months Ended |      | For The Six Months Ended |      |
|----------------------------|------|--------------------------|------|
| June 30,                   |      | June 30,                 |      |
| 2004                       | 2003 | 2004                     | 2003 |

See accompanying notes to consolidated financial statements.

**Table of Contents****AMERUS GROUP CO.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

For the Six Months Ended June 30, 2004 and the Year Ended December 31, 2003  
(\$ in thousands)

|  | <b>Common<br/>Stock</b> | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income<br/>(Loss)</b> | <b>Unearned<br/>Compensation<br/>Shares</b> | <b>Unallocated<br/>ESOP<br/>Shares</b> | <b>Retained<br/>Earnings</b> | <b>Treasury<br/>Stock</b> | <b>Total<br/>Stockholders'<br/>Equity</b> |
|--|-------------------------|---|--|---|--|------------------------------|---------------------------|---|
| Balance at<br>December 31, 2002  | \$43,656                | \$1,179,646                               | \$ 88,522  | \$ (458)                                    | \$(1,443)                              | \$109,517                    | \$(156,492)               | \$1,262,948                               |
| 2003:  |                         |   |  |   |  |                              |                           |   |
| Net income   |                         |   |  |   |  | 161,147                      |                           | 161,147                                   |
| Net unrealized gain<br>(loss) on securities  |                         |   | 1,971  |   |  |                              |                           | 1,971                                     |
| Net unrealized gain<br>(loss) on derivatives<br>designated as cash<br>flow hedges                        |                         |   | 2,476  |   |  |                              |                           | 2,476                                     |
| Change in<br>accounting transfer<br>of unrealized gain<br>on available-for-sale<br>securities to trading |                         |   | (5,204)  |   |  |                              |                           | (5,204)                                   |
| Stock issued under<br>various incentive<br>plans, net of<br>forfeitures                                  | 180                     | 11,717                                    |  | (903)                                       |  |                              | 66                        | 11,060                                    |
| PRIDES purchase<br>contract adjustments<br>and allocated fees<br>and expenses                            |                         | (7,280)                                   |  |   |  |                              |                           | (7,280)                                   |
| Dividends declared<br>on common stock  |                         |   |  |   |  | (15,658)                     |                           | (15,658)                                  |
| Allocation of shares<br>in leveraged ESOP  |                         | 154                                       |  |   | 1,443                                  |                              |                           | 1,597                                     |
| Minimum pension<br>liability adjustment  |                         |   | (3,246)  |   |  |                              |                           | (3,246)                                   |
| Balance at<br>December 31, 2003  | 43,836                  | 1,184,237                                 | 84,519   | (1,361)                                     |  | 255,006                      | (156,426)                 | 1,409,811                                 |
| 2004 (unaudited):  |                         |   |  |   |  |                              |                           |   |
| Net income   |                         |   |  |   |  | 81,905                       |                           | 81,905                                    |
| Net unrealized gain<br>(loss) on securities  |                         |   | (62,679)   |   |  |                              |                           | (62,679)                                  |

|   |                   |                   |                   |                   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| Net unrealized gain<br>(loss) on derivatives<br>designated as cash<br>flow hedges |                   |                   | 400               |                   |                   |                   |                   | 400               |
| Stock issued under<br>various incentive<br>plans, net of<br>forfeitures           | 84                | 2,952             |                   | (79)              |                   |                   | 823               | 3,780             |
| Purchase of treasury<br>stock   |                   |                   |                   |                   |                   |                   | (9,153)           | (9,153)           |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Balance at June 30,<br>2004   | \$43,920          | \$1,187,189       | \$ 22,240         | \$(1,440)         | \$                | \$336,911         | \$(164,756)       | \$1,424,064       |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

See accompanying notes to consolidated financial statements.

Table of Contents**AMERUS GROUP CO.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(\$ in thousands)

|   | <b>For The Six Months Ended<br/>June 30,</b> |                |
|---|--|----------------|
|   | <b>2004</b>                                  | <b>2003</b>    |
|   | <b>(unaudited)</b>                           |                |
| Cash flows from operating activities  |  |                |
| Net income  | \$ 81,905                                    | \$ 79,501      |
| Adjustments to reconcile net income to net cash provided by operating activities:                                 |  |                |
| Cumulative effect of change in accounting   | 510  |                |
| Gain on sale of discontinued operations   | (3,899)                                      |                |
| Product charges   | (103,846)                                    | (95,534)       |
| Interest credited to policyowner account balances   | 233,800                                      | 251,959        |
| Change in option value of equity indexed products and market value adjustments on total return strategy annuities | (13,555)                                     | 27,209         |
| Realized/unrealized capital (gains) losses  | 44,635                                       | (66,824)       |
| DAC and VOBA amortization   | 106,189                                      | 92,975         |
| DAC and VOBA capitalized  | (186,658)                                    | (192,274)      |
| Change in:  |  |                |
| Accrued investment income   | (2,039)                                      | (777)          |
| Reinsurance receivables   | (84,928)                                     | (14,526)       |
| Securities held for trading purposes:   |  |                |
| Fixed maturities  | 209,725                                      | 18,566         |
| Equity securities   | (3,883)                                      | (1,813)        |
| Liabilities for future policy benefits  | 34,302                                       | 96,694         |
| Accrued expenses and other liabilities  | 304,053                                      | 474,559        |
| Policy and contract claims and other policyowner funds  | 105,585                                      | 57,126         |
| Income taxes:   |  |                |
| Current   | (14,301)                                     | (22,528)       |
| Deferred  | 7,654  | 29,269         |
| Other, net  | (13,898)                                     | 2,264          |
| Net cash provided by operating activities   | <u>701,351</u>                               | <u>735,846</u> |
| Cash flows from investing activities:   |  |                |
| Purchase of fixed maturities available-for-sale   | (3,192,310)                                  | (5,601,015)    |
| Proceeds from sale of fixed maturities available-for-sale   | 1,627,612                                    | 4,175,359      |
| Maturities, calls and principal reductions of fixed maturities available-for-sale                                 | 700,210                                      | 1,157,234      |
| Purchase of equity securities   | (42,255)                                     | (7,155)        |
| Proceeds from sale of equity securities   | 39,429                                       | 12,180         |
| Change in short-term investments, net   | 19,859                                       | (1,933)        |
| Purchase of mortgage loans  | (54,242)                                     | (80,332)       |



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**AMERUS GROUP CO.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS - (Continued)**  
(\$ in thousands)

|  | <b>For The Six Months Ended<br/>June 30,</b> |             |
|--|--|-------------|
|  | <b>2004</b>                                  | <b>2003</b> |
|  | <b>(unaudited)</b>                           |             |
| Proceeds from repayment and sale of mortgage loans             | 185,341                                      | 55,689      |
| Purchase of real estate and other invested assets              | (37,473)                                     | (200,854)   |
| Proceeds from sale of real estate and other invested assets    | 77,024                                       | (4,153)     |
| Change in policy loans, net                                    | 8,559  | 4,746       |
| Proceeds from sale of discontinued operations                  | 15,000                                       |             |
| Other assets, net  | 611  | (798)       |
|  | <hr/>  | <hr/>       |
| Net cash used in investing activities                          | (652,635)                                    | (491,032)   |
|  | <hr/>  | <hr/>       |
| Cash flows from financing activities:                          |  |             |
| Deposits to policyowner account balances                       | 1,099,912                                    | 1,030,023   |
| Withdrawals from policyowner account balances                  | (907,933)                                    | (773,630)   |
| Change in debt, net  | (50,263)                                     | (102,517)   |
| Stock issued under various incentive plans, net of forfeitures | 3,780  | 7,099       |
| Purchase of treasury stock                                     | (9,153)                                      |             |
| Proceeds from issuance of PRIDES                               |  | 137,398     |
| Adoption and allocation of shares in leveraged ESOP            |  | 37          |
|  | <hr/>  | <hr/>       |
| Net cash provided by financing activities                      | 136,343                                      | 298,410     |
|  | <hr/>  | <hr/>       |
| Net increase in cash   | 185,059                                      | 543,224     |
| Cash and cash equivalents at beginning of period               | 274,150                                      | 102,612     |
|  | <hr/>  | <hr/>       |
| Cash and cash equivalents at end of period                     | \$ 459,209                                   | \$ 645,836  |
|  | <hr/>  | <hr/>       |
| Supplemental disclosure of cash activities:                    |  |             |
| Interest paid  | \$ 16,261                                    | \$ 15,449   |
|  | <hr/>  | <hr/>       |
| Income taxes paid  | \$ 18,372                                    | \$ 15,967   |
|  | <hr/>  | <hr/>       |



See accompanying notes to consolidated financial statements.

Table of Contents**AMERUS GROUP CO.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)****(1) CONSOLIDATION AND BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All adjustments were of a normal recurring nature, unless otherwise noted in the Notes to Consolidated Financial Statements. Operating results for the six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. The consolidated balance sheet at December 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. For further information and for capitalized terms not defined in this Form 10-Q, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

The accompanying consolidated financial statements include the accounts and operations of the Company and its wholly-owned subsidiaries, principally AmerUs Life Insurance Company (ALIC), AmerUs Annuity Group Co. and its subsidiaries (collectively, AAG), AmerUs Capital Management Group, Inc. (ACM), and ILICO Holdings, Inc., the holding company of Indianapolis Life Insurance Company (ILIC) and its subsidiaries (collectively, ILICO). All significant intercompany transactions and balances have been eliminated in consolidation.

The Company has certain stock-based employee compensation plans which are accounted for under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. The plans are stock option plans for which no stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

|   | <b>For The Three Months<br/>Ended June 30,</b> |                 | <b>For The Six Months Ended<br/>June 30,</b> |                  |
|---|--|-----------------|--|------------------|
|   | <b>2004</b>                                    | <b>2003</b>     | <b>2004</b>                                  | <b>2003</b>      |
|   | <b>(\$ in thousands, except share data)</b>    |                 |  |                  |
| Net income, as reported   | \$48,776                                       | \$43,711        | \$ 81,905                                    | \$ 79,501        |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (919)  | (980)           | (2,081)                                      | (2,078)          |
| Pro forma net income  | <u>\$47,857</u>                                | <u>\$42,731</u> | <u>\$ 79,824</u>                             | <u>\$ 77,423</u> |

|                       |                   |                   |                   |                   |
|-----------------------|-------------------|-------------------|-------------------|-------------------|
| Earnings per share:   |                   |                   |                   |                   |
| Basic - as reported   | \$ 1.24           | \$ 1.12           | \$ 2.08           | \$ 2.03           |
|                       | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Basic - pro forma     | \$ 1.22           | \$ 1.09           | \$ 2.03           | \$ 1.98           |
|                       | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Diluted - as reported | \$ 1.20           | \$ 1.11           | \$ 2.02           | \$ 2.02           |
|                       | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| Diluted - pro forma   | \$ 1.17           | \$ 1.08           | \$ 1.97           | \$ 1.97           |
|                       | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

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Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 financial statement presentation.

**(2) EARNINGS PER SHARE**

Basic earnings per share of common stock are computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share assumes the issuance of common shares applicable to stock options calculated using the treasury stock method.

Diluted earnings per share applicable to the Company's Optionally Convertible Equity-linked Accreting Notes (OCEANs<sup>SM</sup>) are determined using the if-converted method for the number of days in the period in which the common stock price conversion condition is met. The common stock price conversion condition was not met for the six months ended June 30, 2004 and 2003. No undistributed net income has been allocated to the convertible securities holders since their participation in dividends with common stockholders is limited to the amount of the annual regular dividend.

Diluted earnings per share applicable to the Company's PRIDES<sup>SM</sup> securities are determined using the treasury stock method as it is currently anticipated that holders of the PRIDES are more likely to tender cash in the future for the securities' forward contract. The PRIDES added 777,528 and 650,534 shares to the diluted earnings per share calculation for the three and six months ended June 30, 2004, respectively.

**(3) CLOSED BLOCK**

The Company has established two closed blocks, which we refer to as the Closed Block. The first was established on June 30, 1996 in connection with the reorganization of ALIC from a mutual company to a stock company. The second was established as of March 31, 2000 in connection with the reorganization of ILIC from a mutual company to a stock company. Insurance policies which had a dividend scale in effect as of each Closed Block establishment date were included in the Closed Block. The Closed Block was designed to provide reasonable assurance to owners of insurance policies included therein that, after the reorganization of ALIC and ILIC, assets would be available to maintain the dividend scales and interest credits in effect prior to the reorganization if the experience underlying such scales and credits continues.

Summarized financial information of the Closed Block as of June 30, 2004 and December 31, 2003 and for the three months and six months ended June 30, 2004 and 2003 are as follows:

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|  | <b>June 30,<br/>2004</b> | <b>December 31,<br/>2003</b> |
|--|--------------------------|------------------------------|
|  | <b>(\$ in thousands)</b> |                              |
| <b>Liabilities:</b>  |                          |                              |
| Future life and annuity policy benefits  | \$2,816,832              | \$2,845,365                  |
| Policyowner funds  | 8,573                    | 9,232                        |
| Accrued expenses and other liabilities   | 60,299                   | 44,473                       |
| Dividends payable to policyowners  | 173,314                  | 173,703                      |
| Policy and contract claims   | 11,732                   | 22,694                       |
| Policyowner dividend obligation  | 70,152                   | 134,386                      |
|  | <hr/>                    | <hr/>                        |
| Total Liabilities  | 3,140,902                | 3,229,853                    |
|  | <hr/>                    | <hr/>                        |
| <b>Assets:</b>   |                          |                              |
| Fixed maturity securities available-for-sale at fair value                               | 1,946,412                | 2,027,177                    |
| Mortgage loans   | 77,065                   | 80,170                       |
| Policy loans   | 337,434                  | 346,823                      |
| Cash and cash equivalents  | 1,052                    | 3,492                        |
| Accrued investment income  | 32,178                   | 32,629                       |
| Premiums and fees receivable   | 85,993                   | 55,134                       |
| Other assets   | 17                       | 17                           |
|  | <hr/>                    | <hr/>                        |
| Total Assets   | 2,480,151                | 2,545,442                    |
|  | <hr/>                    | <hr/>                        |
| Maximum future earnings to be recognized from assets and liabilities of the Closed Block | \$ 660,751               | \$ 684,411                   |
|  | <hr/>                    | <hr/>                        |

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|  | <b>For The Three Months Ended June 30,</b> |             |
|--|--|-------------|
|  | <b>2004</b>                                | <b>2003</b> |
|  | <b>(\$ in thousands)</b>                   |             |
| <b>Operations:</b>                                     |  |             |
| Insurance premiums                                     | \$ 44,684                                  | \$ 55,009   |
| Product charges  | 1,311                                      | 2,685       |
| Net investment income                                  | 36,235                                     | 37,577      |
| Realized gains (losses) on investments                 | (4,473)                                    | 275         |
| Policyowner benefits                                   | (58,495)                                   | (56,690)    |
| Underwriting, acquisition and other expenses           | (918)                                      | (1,115)     |
| Dividends to policyowners                              | (9,019)                                    | (27,738)    |
|  | <hr/>                                      | <hr/>       |
| Contribution from the Closed Block before income taxes | \$ 9,325                                   | \$ 10,003   |
|  | <hr/>                                      | <hr/>       |

|  | <b>For The Six Months Ended June 30,</b> |             |
|--|--|-------------|
|  | <b>2004</b>                              | <b>2003</b> |
|  | <b>(\$ in thousands)</b>                 |             |
| <b>Operations:</b>                                     |  |             |
| Insurance premiums                                     | \$ 97,280                                | \$ 117,815  |
| Product charges  | 1,401                                    | 6,224       |
| Net investment income                                  | 71,969                                   | 77,316      |
| Realized/unrealized gains (losses) on investments      | (3,643)                                  | 7,344       |
| Policyowner benefits                                   | (113,665)                                | (128,519)   |
| Underwriting, acquisition and other expenses           | (2,007)                                  | (2,246)     |
| Dividends to policyowners                              | (32,418)                                 | (57,649)    |
|  | <hr/>                                    | <hr/>       |
| Contribution from the Closed Block before income taxes | \$ 18,917                                | \$ 20,285   |
|  | <hr/>                                    | <hr/>       |

**Table of Contents****(4) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES**

The Company accounts for derivatives, including certain derivative instruments embedded in other contracts, at fair value. Accounting for gains and losses resulting from changes in the values of derivatives is dependent upon the use of the derivative and its qualification for special hedge accounting. During the first six months of 2004 and 2003, realized/unrealized capital gains (losses) included an unrealized loss of \$19.5 million and an unrealized gain of \$19.4 million, respectively, from the change in fair value on the trading securities primarily backing the total return strategy products. Additionally, the first six months of 2004 and 2003 included an unrealized gain of \$12.1 million and \$15.7 million, respectively, from the change in fair value on call options used as a natural hedge of embedded options within equity indexed products. Policyowner benefits included an offsetting adjustment to contract liabilities for fair value changes in options embedded within the equity indexed products and fair value changes on total return strategy annuity contracts amounting to a decrease in expense of \$13.6 million and an increase in expense of \$27.2 million for the first six months of 2004 and 2003, respectively. In 2002, the Company undesignated a cash flow hedge and is now amortizing the amount in accumulated other comprehensive income (AOCI) to earnings over the remaining life of the swap, which amounted to \$0.8 and \$2.5 million in expense in the first six months of 2004 and 2003, respectively. The Company estimates that less than \$0.1 million of after-tax derivative losses, included in AOCI, will be reclassified into earnings within the next twelve months. AOCI included an unrealized gain of \$0.4 million and \$1.8 million from the fair value change in interest rate swaps used to hedge the floating rate funding agreement liability during the first six months of 2004 and 2003, respectively.

The following table summarizes the income (loss) impact of the market value adjustments on trading securities, derivatives and the cash flow hedge amortization for the six months ended June 30, 2004 and 2003:

**For the Six Months Ended June 30, 2004**

|  | <b>Total Return<br/>Products</b> | <b>Equity<br/>Linked<br/>Products</b> | <b>Other</b>      | <b>Total</b>  |
|--|----------------------------------|---------------------------------------|-------------------|---------------|
|  | <b>(\$ in thousands)</b>         |                                       |                   |               |
| Fixed maturity securities held for trading       | \$(16,092)                       | \$                                    | \$(3,407)         | \$(19,499)    |
| Options on equity indexed products               |                                  | 14,297                                | (2,209)           | 12,088        |
| Market value adjustment to liabilities           | 9,244                            | 481                                   | 3,830             | 13,555        |
| Cash flow hedge amortization                     |                                  |                                       | (813)             | (813)         |
| DAC amortization impact of net adjustments above | 147                              | (5,095)                               | 573               | (4,375)       |
| Pre-tax total                                    | (6,701)                          | 9,683                                 | (2,026)           | 956           |
| Income taxes                                     | 2,345                            | (3,389)                               | 710               | (334)         |
| After-tax total                                  | <u>\$ (4,356)</u>                | <u>\$ 6,294</u>                       | <u>\$ (1,316)</u> | <u>\$ 622</u> |

**For the Six Months Ended June 30, 2003**

|   | <b>Total Return<br/>Products</b> | <b>Equity<br/>Linked<br/>Products</b> | <b>Other</b> | <b>Total</b> |
|---|----------------------------------|---------------------------------------|--------------|--------------|
|   | <b>(\$ in thousands)</b>         |                                       |              |              |
| Fixed maturity securities held for trading          | \$ 18,160                        | \$                                    | \$ 1,196     | \$ 19,356    |
| Options on equity indexed products                  |                                  | 13,565                                | 2,106        | 15,671       |
| Market value adjustment to liabilities              | (12,327)                         | (14,882)                              |              | (27,209)     |
| Cash flow hedge amortization                        |                                  |                                       | (2,478)      | (2,478)      |
| DAC amortization impact of net adjustments<br>above | (439)                            | 624                                   | (794)        | (609)        |
| Pre-tax total                                       | 5,394                            | (693)                                 | 30           | 4,731        |
| Income taxes  | (1,889)                          | 244                                   | (11)         | (1,656)      |
| After-tax total                                     | \$ 3,505                         | \$ (449)                              | \$ 19        | \$ 3,075     |



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**(5) FEDERAL INCOME TAXES**

The effective income tax rate for the six months ending June 30, 2004 and 2003 varied from the prevailing corporate rate as a result of tax exempt interest and dividends received deduction. The effective tax rate for the six months ending June 30, 2004 was also reduced by a reduction in the income tax accrual and a change in the deferred tax asset valuation allowance. The accrual reduction, amounting to \$5.2 million recorded in the first quarter of 2004 and \$2.7 million recorded in the second quarter of 2004, was for the release of provisions originally established for potential tax adjustments which have been settled or eliminated. In addition, during the second quarter of 2004, a deferred tax valuation allowance was reduced \$10.4 million as a result of the realization of capital loss carryforwards.

**(6) COMMITMENTS AND CONTINGENCIES**

In recent years, the life insurance industry, including the Company and its subsidiaries, have been subject to an increase in litigation pursued on behalf of purported classes of insurance purchasers, questioning the conduct of insurers in the marketing of their products. The Company is routinely involved in litigation and other proceedings, including class actions (such as pending class action lawsuits related to the use of purportedly inappropriate sales techniques and products for the senior market), reinsurance claims and regulatory proceedings arising in the ordinary course of its business. Some of these claims and legal actions are in jurisdictions where juries are given substantial latitude in assessing damages, including punitive and exemplary damages. In addition, regulatory bodies, such as state insurance departments and attorneys general, periodically make inquiries and conduct examinations concerning our compliance with insurance and other laws. We respond to such inquiries and cooperate with regulatory examinations in the ordinary course of business.

Our litigation is subject to many uncertainties, and given its complexity and scope, the outcomes cannot be predicted. It is possible that our results of operations or cash flow in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation and regulatory matters depending, in part, upon the results of operations or cash flow for such period. Management believes, however, that the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves, should not have a material adverse effect on our financial position.

**(7) EMPLOYEE BENEFIT PLANS**

The Company has a frozen defined benefit pension plan and also has defined benefit plans which provide supplemental retirement benefits to certain agents and executives. In addition to pension benefits, the Company also provides certain health care and life insurance benefits for retired employees. The following is a summary of net periodic benefit cost for these plans for the six months ended June 30, 2004 and 2003:

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|  | <b>Six Months Ended June 30,</b> |             |
|--|----------------------------------|-------------|
|  | <b>2004</b>                      | <b>2003</b> |
|  | <b>(\$ in thousands)</b>         |             |
| Components of net periodic benefit cost: |                                  |             |
| Service cost                             | \$ 163                           | \$ 142      |
| Interest cost                            | 3,100                            | 3,100       |
| Expected return on plan assets           | (2,428)                          | (2,453)     |
| Amortization of prior service cost       | 44                               | 20          |
| Amortization of actuarial loss           | 124                              | 22          |
|  | <hr/>                            | <hr/>       |
| Net periodic benefit cost                | 1,003                            | 831         |
| Curtailment                              | (951)                            |             |
|  | <hr/>                            | <hr/>       |
| Total (income) expense                   | \$ 52                            | \$ 831      |
|  | <hr/>                            | <hr/>       |

During the first six months of 2004, a gain of \$1.0 million was recognized as a result of curtailing health care and life insurance benefits associated with the sale of the discontinued operations in January 2004.

**(8) ASSETS HELD FOR SALE**

The Company listed its office building located in Indianapolis, Indiana, with a real estate broker during the second quarter of 2003. On June 30, 2003, the Company determined that the plan of sale criteria in SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, had been met. Accordingly, the carrying value of the building was adjusted to its estimated fair value less costs to sell, amounting to \$15.5 million, which was based upon comparable properties marketed in Indianapolis at that time. The resulting \$7.7 million pre-tax impairment loss was recorded as a restructuring cost in the consolidated statement of income in the second quarter of 2003.

As provided by SFAS 144, the Company determined in the first quarter of 2004 that the fair value of the building required further adjustment based on prevailing market conditions for the property which have extended the time required to sell the building. The resulting change in fair value of the building was an additional \$12.2 million pre-tax impairment loss which has been recorded in realized/unrealized capital losses in the consolidated statement of income. The carrying value of the building that is held for sale is included in the other assets line item of the consolidated balance sheet and amounted to \$3.3 million at June 30, 2004 and \$15.5 million at December 31, 2003.

**(9) DISCONTINUED OPERATIONS**

In November 2003, the Company entered into an agreement to sell a wholly-owned subsidiary which conducts residential financing operations. The assets, liabilities and results of the residential financing operations have been classified as discontinued operations. The sale was completed in January 2004, resulting in an after-tax gain of \$3.9 million. Income from discontinued operations net of tax was as follows:



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|  | For The Three Months Ended<br>June 30, |            | For The Six Months Ended June<br>30, |            |
|--|--|------------|--------------------------------------|------------|
|  | 2004                                   | 2003       | 2004                                 | 2003       |
| (\$ in thousands, except share data)   |  |            |                                      |            |
| Operating income from discontinued operations, net of income taxes of \$357 and \$682 for second quarter and year to date 2003, respectively | \$                                     | \$ 535     | \$                                   | \$ 1,022   |
| Gain on sale of discontinued operations, net of income taxes of \$2,571 in 2004  |  |            | 3,899                                |            |
|  | \$                                     | \$ 535     | \$ 3,899                             | \$ 1,022   |
| Net income from discontinued operations per common share:  |  |            |                                      |            |
| Basic  | \$                                     | \$ 0.02    | \$ 0.10                              | \$ 0.02    |
| Diluted  | \$                                     | \$ 0.01    | \$ 0.10                              | \$ 0.03    |
| Weighted average common shares outstanding:  |  |            |                                      |            |
| Basic  | 39,327,182                             | 39,161,780 | 39,342,363                           | 39,112,346 |
| Diluted  | 40,760,364                             | 39,404,467 | 40,619,242                           | 39,354,894 |

**(10) ADOPTION OF SOP 03-1**

Effective January 1, 2004, the Company adopted Statement of Position 03-1 (SOP 03-1), Accounting and Reporting by Insurance Enterprises for Certain Non-Traditional Long-Duration Insurance Contracts and for Separate Accounts, issued by the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. The adoption of SOP 03-1 resulted in establishing additional policy reserve liabilities for fees charged for insurance benefit features which are assessed in a manner that is expected to result in profits in earlier years and losses in subsequent years. The total effect of adopting SOP 03-1 (including reinsurance recoverables) as of January 1, 2004 and the establishment of reinsurance recoveries, amounted to a decrease of \$0.8 million (\$0.5 million after-tax) in net income which has been reflected as a cumulative effect of a change in accounting. The basic and diluted earnings per common share for the change in accounting amounted to \$0.01 for the six months ended June 30, 2004.

In addition, the adoption of SOP 03-1 established guidance for the accounting and presentation of costs related to sales inducements. There was no change to the Company's method of accounting for sales inducements; however, the capitalized costs are now separately disclosed in the consolidated balance sheet and the related amortization expense is included in policyowner benefits in the consolidated statement of income. Prior to 2004, the capitalized costs were included in deferred policy acquisition costs and the amortization expense was included in the amortization of deferred policy acquisition costs. The 2003 amounts have been reclassified to conform with the 2004 presentation.

**(11) OPERATING SEGMENTS**

The Company has two operating segments: Protection Products and Accumulation Products. Products generally distinguish a segment. A brief description of each segment follows:

Protection Products. The primary product offerings consist of interest-sensitive whole life, term life, universal life and equity indexed life insurance policies. These products are marketed on a national basis primarily through a Preferred Producer agency system, a Personal Producing General Agent (PPGA) distribution system and Independent Marketing Organizations (IMOs).

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Accumulation Products. The primary product offerings consist of traditional fixed annuities and equity indexed annuities, marketed on a national basis primarily through IMOs and independent brokers, and insurance contracts issued through funding agreements.

The product offerings within each segment are of a very similar nature. Insurance premiums of the protection products segment primarily include term life products. Product charges of the protection products segment include interest-sensitive whole life, universal life and equity indexed life insurance products. Product charges of the accumulation products segment include traditional fixed and equity indexed annuities. Due to the similarity of products within each segment, premiums and product charges are shown by segment and not by specific product type.

The Company uses the same accounting policies and procedures to measure operating segment income and assets as it uses to measure its consolidated income from operations and assets with the exception of the elimination of certain items which management believes are not necessarily indicative of overall operating trends. These items are shown between segment pre-tax operating income and net income on the following operating segment tables and are as follows:

- 1) Realized gains and losses on open block assets.
- 2) Market value changes and amortization of assets and liabilities associated with the accounting for derivatives, such as:

Unrealized gains and losses on open block options and securities held for trading.

Change in option value of equity indexed products and market value adjustments on total return strategy annuities.

Cash flow hedge amortization.

- 3) Amortization of deferred policy acquisition costs (DAC), value of business acquired (VOBA) and bonus interest related to the unrealized and realized gains and losses on the open block investments and the derivative adjustments.
- 4) Restructuring costs.
- 5) Certain reinsurance adjustments.
- 6) Other income from non-insurance operations.
- 7) Interest expense.
- 8) Income tax expense.
- 9) Income from discontinued operations.
- 10) Cumulative effect of change in accounting.

These items will fluctuate from period to period depending on the prevailing interest rate and economic environment or are not part of the core insurance operations. As a result, management believes they do not reflect the ongoing earnings capacity of the Company's operating segments.

Premiums, product charges, policyowner benefits, insurance expenses, amortization of DAC and VOBA and dividends to policyowners are attributed directly to each operating segment. Net investment income and closed block realized gains and losses on investments are allocated based on directly-related assets required for transacting the business of that segment. Other revenues and benefits and expenses which are deemed not to be associated with any specific segment are grouped together in the All Other category. These items primarily consist of holding company revenues and expenses, operations of the Company's real estate management subsidiary, and accident and health insurance.

Assets are segmented based on policy liabilities directly attributable to each segment. There are no significant intersegment transactions. Depreciation and amortization, excluding amortization of DAC and VOBA as previously discussed, are not significant. There have been no material changes in segment assets since December 31, 2003.

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Operating Segment Income  
(\$ in thousands)

|   | <b>Three Months Ended June 30, 2004</b> |                                  |                   |                               |
|---|---|----------------------------------|-------------------|-------------------------------|
|   | <b>Protection<br/>Products</b>          | <b>Accumulation<br/>Products</b> | <b>All Other</b>  | <b>Total<br/>Consolidated</b> |
| Revenues:   |   |                                  |                   |                               |
| Insurance premiums  | \$ 62,427                               | \$ 859                           | \$ 505            | \$ 63,791                     |
| Product charges   | 41,640                                  | 12,644                           |                   | 54,284                        |
| Net investment income   | 81,186                                  | 168,218                          | 1,907             | 251,311                       |
| Realized/unrealized gains (losses) on closed block investments  | (4,473)                                 |                                  |                   | (4,473)                       |
| Other income  | 928                                     | 16,847                           | (37)              | 17,738                        |
|   | <u>181,708</u>                          | <u>198,568</u>                   | <u>2,375</u>      | <u>382,651</u>                |
| Benefits and expenses:  |   |                                  |                   |                               |
| Policyowner benefits  | 91,205                                  | 114,261                          | (179)             | 205,287                       |
| Underwriting, acquisition, and other expenses   | 19,115                                  | 20,219                           | 6,403             | 45,737                        |
| Amortization of DAC and VOBA, net of open block loss adjustment of \$7,002  | 25,527                                  | 25,749                           |                   | 51,276                        |
|   | <u>146,781</u>                          | <u>160,231</u>                   | <u>6,224</u>      | <u>313,236</u>                |
| Dividends to policyowners   | 10,934                                  | 2                                |                   | 10,936                        |
|   | <u>146,781</u>                          | <u>160,231</u>                   | <u>6,224</u>      | <u>313,236</u>                |
| Segment pre-tax operating income  | <u>\$ 34,927</u>                        | <u>\$ 38,337</u>                 | <u>\$ (3,849)</u> | 69,415                        |
| Realized/unrealized gains (losses) on open block assets   |   |                                  |                   | (8,851)                       |
| Unrealized gains (losses) on open block options and trading investments   |   |                                  |                   | (31,226)                      |
| Change in option value of equity indexed products and market value adjustments on total return strategy annuities |   |                                  |                   | 37,288                        |
| Cash flow hedge amortization  |   |                                  |                   | (351)                         |
| Amortization of DAC and VOBA due to open block gains and losses   |   |                                  |                   | (7,002)                       |
| Other income from non-insurance operations  |   |                                  |                   | <u>1,360</u>                  |



|                                   |                  |
|-----------------------------------|------------------|
| Income from continuing operations | 60,633           |
| Interest (expense)                | (7,936)          |
| Income tax (expense)              | <u>(3,921)</u>   |
| Net income                        | <u>\$ 48,776</u> |

**Table of Contents**Operating Segment Income  
(\$ in thousands)

|   | <b>Three Months Ended June 30, 2003</b> |                     |               |                     |
|---|---|---------------------|---------------|---------------------|
|   | <b>Protection</b>                       | <b>Accumulation</b> | <b>All</b>    | <b>Total</b>        |
|   | <b>Products</b>                         | <b>Products</b>     | <b>Other</b>  | <b>Consolidated</b> |
| Revenues:   |   |                     |               |                     |
| Insurance premiums  | \$ 76,512                               | \$ 1,059            | \$ 485        | \$ 78,056           |
| Product charges   | 39,804                                  | 8,899               |               | 48,703              |
| Net investment income   | 80,706                                  | 168,183             | 2,818         | 251,707             |
| Realized/unrealized gains (losses) on closed block investments  | 275                                     |                     |               | 275                 |
| Other income  | 993                                     | 15,647              | 391           | 17,031              |
|   | <u>198,290</u>                          | <u>193,788</u>      | <u>3,694</u>  | <u>395,772</u>      |
| Benefits and expenses:  |   |                     |               |                     |
| Policyowner benefits  | 92,614                                  | 126,512             | (130)         | 218,996             |
| Underwriting, acquisition, and other expenses   | 21,175                                  | 16,779              | 3,655         | 41,609              |
| Amortization of DAC and VOBA, net of open block gain adjustment of \$3,907  | 20,918                                  | 21,077              |               | 41,995              |
| Dividends to policyowners   | 29,740                                  |                     |               | 29,740              |
|   | <u>164,447</u>                          | <u>164,368</u>      | <u>3,525</u>  | <u>332,340</u>      |
| Segment pre-tax operating income  | <u>\$ 33,843</u>                        | <u>\$ 29,420</u>    | <u>\$ 169</u> | 63,432              |
| Realized/unrealized gains (losses) on open block assets   |   |                     |               | 16,374              |
| Unrealized gains (losses) on open block options and trading investments   |   |                     |               | 42,320              |
| Change in option value of equity indexed products and market value adjustments on total return strategy annuities |   |                     |               | (35,811)            |
| Cash flow hedge amortization  |   |                     |               | (1,065)             |
| Amortization of DAC and VOBA due to open block gains and losses   |   |                     |               | (3,907)             |
| Reinsurance adjustments   |   |                     |               | 3,854               |
| Restructuring costs   |   |                     |               | (12,670)            |
| Other income from non-insurance operations  |   |                     |               | 226                 |

|   |                  |
|---|------------------|
| Income from continuing operations               | 72,753           |
| Interest (expense)                              | (7,575)          |
| Income tax (expense)                            | (22,002)         |
| Income from discontinued operations, net of tax | <u>535</u>       |
| Net income                                      | <u>\$ 43,711</u> |

**Table of Contents**Operating Segment Income  
(\$ in thousands)

|   | Six Months Ended June 30, 2004 |                          |            |                       |
|---|--------------------------------|--------------------------|------------|-----------------------|
|   | Protection<br>Products         | Accumulation<br>Products | All Other  | Total<br>Consolidated |
| Revenues:   |                                |                          |            |                       |
| Insurance premiums  | \$ 132,143                     | \$ 1,582                 | \$ 803     | \$ 134,528            |
| Product charges   | 77,099                         | 26,747                   |            | 103,846               |
| Net investment income   | 162,444                        | 342,481                  | 3,261      | 508,186               |
| Realized/unrealized gains (losses) on closed block investments  | (3,643)                        |                          |            | (3,643)               |
| Other income  | 1,834                          | 34,235                   | 1,471      | 37,540                |
|   | <hr/>                          | <hr/>                    | <hr/>      | <hr/>                 |
|   | 369,877                        | 405,045                  | 5,535      | 780,457               |
| Benefits and expenses:  |                                |                          |            |                       |
| Policyowner benefits  | 184,600                        | 235,079                  | (158)      | 419,521               |
| Underwriting, acquisition, and other expenses   | 36,073                         | 38,948                   | 11,317     | 86,338                |
| Amortization of DAC and VOBA, net of open block loss adjustment of \$5,742  | 44,768                         | 55,679                   |            | 100,447               |
| Dividends to policyowners   | 36,418                         | 2                        |            | 36,420                |
|   | <hr/>                          | <hr/>                    | <hr/>      | <hr/>                 |
|   | 301,859                        | 329,708                  | 11,159     | 642,726               |
|   | <hr/>                          | <hr/>                    | <hr/>      | <hr/>                 |
| Segment pre-tax operating income  | \$ 68,018                      | \$ 75,337                | \$ (5,624) | 137,731               |
|   | <hr/>                          | <hr/>                    | <hr/>      |                       |
| Realized/unrealized gains (losses) on open block assets   |                                |                          |            | (33,581)              |
| Unrealized gains (losses) on open block options and trading investments   |                                |                          |            | (7,411)               |
| Change in option value of equity indexed products and market value adjustments on total return strategy annuities |                                |                          |            | 13,555                |
| Cash flow hedge amortization  |                                |                          |            | (813)                 |
| Amortization of DAC and VOBA due to open block gains and losses   |                                |                          |            | (5,742)               |
| Other income from non-insurance operations  |                                |                          |            | 1,161                 |
|   |                                |                          |            | <hr/>                 |
| Income from continuing operations   |                                |                          |            | 104,900               |
| Interest (expense)  |                                |                          |            | (16,334)              |

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|   |                  |
|---|------------------|
| Income tax (expense)                                  | (10,050)         |
| Income from discontinued operations, net of tax       | 3,899            |
| Cumulative effect of change in accounting, net of tax | <u>(510)</u>     |
| Net income  | <u>\$ 81,905</u> |

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Operating Segment Income  
(\$ in thousands)

|   | <b>Six Months Ended June 30, 2003</b> |                                  |                  |                               |
|---|---------------------------------------|----------------------------------|------------------|-------------------------------|
|   | <b>Protection<br/>Products</b>        | <b>Accumulation<br/>Products</b> | <b>All Other</b> | <b>Total<br/>Consolidated</b> |
| Revenues:   |                                       |                                  |                  |                               |
| Insurance premiums  | \$ 156,673                            | \$ 2,242                         | \$ 747           | \$ 159,662                    |
| Product charges   | 76,142                                | 19,392                           |                  | 95,534                        |
| Net investment income   | 164,452                               | 337,856                          | 4,512            | 506,820                       |
| Realized/unrealized gains (losses) on closed block investments  | 7,344                                 |                                  |                  | 7,344                         |
| Other income  | 2,046                                 | 30,413                           | 531              | 32,990                        |
|   | <u>406,657</u>                        | <u>389,903</u>                   | <u>5,790</u>     | <u>802,350</u>                |
| Benefits and expenses:  |                                       |                                  |                  |                               |
| Policyowner benefits  | 193,282                               | 256,374                          | (110)            | 449,546                       |
| Underwriting, acquisition, and other expenses   | 41,616                                | 32,714                           | 7,635            | 81,965                        |
| Amortization of DAC and VOBA, net of open block gain adjustment of \$10,452                                       | 40,482                                | 42,041                           |                  | 82,523                        |
| Dividends to policyowners   | 64,314                                |                                  |                  | 64,314                        |
|   | <u>339,694</u>                        | <u>331,129</u>                   | <u>7,525</u>     | <u>678,348</u>                |
| Segment pre-tax operating income  | <u>\$ 66,963</u>                      | <u>\$ 58,774</u>                 | <u>\$(1,735)</u> | 124,002                       |
| Realized/unrealized gains (losses) on open block assets   |                                       |                                  |                  | 24,453                        |
| Unrealized gains (losses) on open block options and trading investments   |                                       |                                  |                  | 35,027                        |
| Change in option value of equity indexed products and market value adjustments on total return strategy annuities |                                       |                                  |                  | (27,209)                      |
| Cash flow hedge amortization  |                                       |                                  |                  | (2,478)                       |
| Amortization of DAC and VOBA due to open block gains and losses   |                                       |                                  |                  | (10,452)                      |
| Reinsurance adjustments   |                                       |                                  |                  | 3,854                         |
| Restructuring costs   |                                       |                                  |                  | (15,864)                      |
| Other income from non-insurance operations  |                                       |                                  |                  | 622                           |

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|   |                  |
|---|------------------|
| Income from continuing operations               | 131,955          |
| Interest (expense)                              | (14,374)         |
| Income tax (expense)                            | (39,102)         |
| Income from discontinued operations, net of tax | <u>1,022</u>     |
| Net income                                      | <u>\$ 79,501</u> |

**Table of Contents****Item 2. Management's Discussion And Analysis Of Financial Condition And Results Of Operations**

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) addresses the consolidated financial condition of AmerUs Group Co. as of June 30, 2004, compared with December 31, 2003, and our consolidated results of operations for the three months and six months ended June 30, 2004 and 2003. You should read the following analysis of our consolidated financial condition and results of operations in conjunction with our MD&A and audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2003, and Unaudited Consolidated Financial Statements included elsewhere in this Quarterly Report on Form 10-Q.

**NATURE OF OPERATIONS**

We are a holding company whose subsidiaries are primarily engaged in the business of marketing, underwriting and distributing a broad range of individual life, annuity and insurance deposit products to individuals and businesses in 50 states, the District of Columbia and the U.S. Virgin Islands. We have two reportable operating segments: protection products and accumulation products. The primary offerings of the protection products segment are interest-sensitive whole life, term life, universal life and equity indexed life insurance policies. The primary offerings of the accumulation products segment are individual fixed annuities (comprised of traditional fixed annuities and equity indexed annuities) and funding agreements.

**FINANCIAL HIGHLIGHTS**

Our financial highlights are as follows:

|  | <b>For The Three Months<br/>Ended June 30,</b>  |             | <b>For The Six Months Ended<br/>June 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2004</b>                                     | <b>2003</b> | <b>2004</b>                                  | <b>2003</b> |
|  | <hr/>   |             |  |             |
|  | <b>(\$ in thousands, except per share data)</b> |             |  |             |
| Segment pre-tax operating income:      |   |             |  |             |
| Protection Products                    | \$34,927  | \$33,843    | \$ 68,018                                    | \$ 66,963   |
| Accumulation Products                  | 38,337  | 29,420      | 75,337                                       | 58,774      |
| Other operations                       | (3,849)   | 169         | (5,624)                                      | (1,735)     |
|  | <hr/>   | <hr/>       | <hr/>  | <hr/>       |
| Total segment pre-tax operating income | 69,415  | 63,432      | 137,731                                      | 124,002     |
| Non-segment expense, net (A)           | 20,639  | 19,721      | 55,826                                       | 44,501      |
|  | <hr/>   | <hr/>       | <hr/>  | <hr/>       |
| Net income                             | \$48,776  | \$43,711    | \$ 81,905                                    | \$ 79,501   |
|  | <hr/>   | <hr/>       | <hr/>  | <hr/>       |
| Diluted net income per share           | \$ 1.20   | \$ 1.11     | \$ 2.02                                      | \$ 2.02     |
|  | <hr/>   | <hr/>       | <hr/>  | <hr/>       |
|  | <b>June 30,</b>                                 |             | <b>December 31,</b>                          |             |
|  | <b>2004</b>                                     |             | <b>2003</b>                                  |             |
|  | <hr/>   |             | <hr/>  |             |



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|                      |              |              |
|----------------------|--------------|--------------|
| Total assets         | \$22,104,853 | \$21,542,242 |
| Stockholders' equity | \$ 1,424,064 | \$ 1,409,811 |

(A) Non-segment expense, net consists primarily of open block realized/unrealized gains and losses, derivative related market value adjustments, reinsurance adjustments, non-insurance operations, restructuring costs, interest expense, income taxes, discontinued operations and cumulative effect of change in accounting.

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Operating segment income increased for both the protection products and accumulation products segments in the 2004 periods, compared to the respective periods in 2003. Protection products earnings were primarily impacted by increased open block product margins and lower operating expenses in 2004. Our accumulation products pre-tax operating segment income increased primarily due to the continued shift in our business from traditional fixed annuities to higher margin equity indexed annuities and more assets under management.

Net income increased in the 2004 periods compared to the respective 2003 periods primarily as a result of higher operating segment income, reductions in income tax accruals and deferred income tax asset valuation allowances, and the gain on the sale of our residential financing subsidiary. The increase was partially offset by realized and unrealized losses on assets.

Total assets increased \$563 million during the first six months of 2004 primarily as a result of net cash received from collected premiums and deposits, positive cash flows from operating activities and the utilization of securities lending and borrowing arrangements and dollar-roll repurchase investment transactions. Liabilities increased primarily due to policy reserves and policyowner funds which increased due to the higher volume of insurance in force. Stockholders' equity increased \$14 million for the first six months of 2004 primarily as a result year-to-date net income of \$82 million. The net income added to equity was reduced by the change in unrealized gains on available-for-sale investments and treasury stock purchases which decreased equity \$62 million and \$9 million, respectively. The unrealized gains included in accumulated other comprehensive income are presented after related adjustments to DAC, VOBA, capitalized bonus interest, closed block policyowner dividend obligation, unearned revenue reserves and deferred income taxes.

## **PROTECTION PRODUCTS**

Our protection products segment primarily consists of interest-sensitive whole life, term life, universal life and equity indexed life insurance policies. These products are marketed on a national basis primarily through a Preferred Producer agency system, PPGA distribution system and IMOs. Included in protection products is the closed block of ALIC and the closed block of ILIC established when the companies reorganized from mutual companies to stock companies. When protection products are sold, we invest the premiums we receive in our investment portfolio and establish a liability representing our commitment to the policyowner. We manage investment spread by seeking to maximize the return on these invested assets, consistent with our asset/liability and credit quality needs. We enter into reinsurance arrangements in order to reduce the effects of mortality risk and the statutory capital strain from writing new business. All income statement line items are presented net of reinsurance amounts. Protection products in force totaled \$98.9 billion at June 30, 2004 and \$98.6 billion at December 31, 2003. Protection products in force is a performance measure utilized by investors, analysts and the Company to assess the Company's position in the industry. A summary of our protection products segment operations follows:

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|  | For The Three Months<br>Ended June 30, |           | For The Six Months Ended<br>June 30, |            |
|--|--|-----------|--------------------------------------|------------|
|  | 2004                                   | 2003      | 2004                                 | 2003       |
|  | (\$ in thousands)                      |           |                                      |            |
| Revenues:  |  |           |                                      |            |
| Insurance premiums   | \$ 62,427                              | \$ 76,512 | \$ 132,143                           | \$ 156,673 |
| Product charges  | 41,640                                 | 39,804    | 77,099                               | 76,142     |
| Net investment income  | 81,186                                 | 80,706    | 162,444                              | 164,452    |
| Realized gains (losses) on closed block investments  | (4,473)                                | 275       | (3,643)                              | 7,344      |
| Other income   | 928                                    | 993       | 1,834                                | 2,046      |
| Total revenues   | 181,708                                | 198,290   | 369,877                              | 406,657    |
| Benefits and expenses:   |  |           |                                      |            |
| Policyowner benefits (bonus interest amortization, net of open block gain/loss adjustment) | 91,205                                 | 92,614    | 184,600                              | 193,282    |
| Underwriting, acquisition and other expenses   | 19,115                                 | 21,175    | 36,073                               | 41,616     |
| Amortization of DAC and VOBA, net of open block gain/loss adjustment                       | 25,527                                 | 20,918    | 44,768                               | 40,482     |
| Dividends to policyowners  | 10,934                                 | 29,740    | 36,418                               | 64,314     |
| Total benefits and expenses  | 146,781                                | 164,447   | 301,859                              | 339,694    |
| Pre-tax operating income - Protection Products segment                                     | \$ 34,927                              | \$ 33,843 | \$ 68,018                            | \$ 66,963  |

Pre-tax operating income from our protection products increased 3.2% in the second quarter of 2004 and 1.6% in the first six months of 2004 compared to the respective 2003 periods. The increase was primarily due to higher open block product margins and lower operating expenses. The increase was partially reduced by higher DAC and VOBA amortization. The key drivers of our protection products business include sales, persistency, net investment income, mortality and expenses.

**Sales.** Sales are a key driver of our business as they are a leading indicator of future revenue trends to emerge in segment operating income. Sales are presented as annualized premium, which is in accordance with industry practice, and represent the amount of new business sold during the period. Sales are a performance metric which we use to measure the productivity of our distribution network and for compensation of sales and marketing employees and agents. The following table summarizes annualized premium by life insurance product:

|                                  | Sales Activity by Product  |           |                          |           |
|----------------------------------|----------------------------|-----------|--------------------------|-----------|
|                                  | For The Three Months Ended |           | For The Six Months Ended |           |
|                                  | June 30,                   |           | June 30,                 |           |
|                                  | 2004                       | 2003      | 2004                     | 2003      |
|                                  | (\$ in thousands)          |           |                          |           |
| Traditional life insurance:      |                            |           |                          |           |
| Whole life                       | \$ 3                       | \$ 18     | \$ 8                     | \$ 220    |
| Interest-sensitive whole life    | 1,411                      | 5,818     | 4,829                    | 12,838    |
| Term life                        | 3,577                      | 3,628     | 7,147                    | 7,340     |
| Universal life                   | 9,235                      | 9,438     | 16,769                   | 16,378    |
| Equity indexed life              | 19,291                     | 11,750    | 36,594                   | 25,227    |
|                                  | <hr/>                      | <hr/>     | <hr/>                    | <hr/>     |
| Direct                           | 33,517                     | 30,652    | 65,347                   | 62,003    |
| Private label term life premiums |                            | 1,756     |                          | 3,693     |
|                                  | <hr/>                      | <hr/>     | <hr/>                    | <hr/>     |
| Total                            | \$ 33,517                  | \$ 32,408 | \$ 65,347                | \$ 65,696 |
|                                  | <hr/>                      | <hr/>     | <hr/>                    | <hr/>     |

Direct first year annualized premiums increased 9.3% in the second quarter of 2004 and 5.4% on a year-to-date basis in 2004 compared to the respective 2003 periods. We continue to focus our marketing efforts on equity indexed life products. In the first six months of 2004, sales of equity indexed life products were \$36.6 million as compared to \$25.2 million for 2003 and comprised 56% of total direct sales in the first six months of 2004 compared to 41% in the first six months of 2003. We are a leading writer of equity indexed life products in the United States. Interest-sensitive whole life insurance sales decreased in both periods of 2004 compared to 2003 due to uncertainty in government tax policy and regulation.

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**Premiums and Product Charges.** We recognize premiums on traditional life insurance policies as revenues when the premiums are due. Amounts received as payments for universal life and equity indexed life insurance policies are not recorded as premium revenue, but are instead recorded as a policyowner liability. Revenues from the universal life and equity indexed life policies consist of charges for the cost of insurance, policy administration and policy surrender and are included on the line item product charges. All revenue is reported net of reinsurance ceded.

Insurance premium revenue was lower in the second quarter and first six months of 2004 as compared to the same periods in 2003 primarily due to lower sales of traditional products and the continued decline in closed block in force business. Product charge revenue was higher in the second quarter and first six months of 2004 as compared to the same periods in 2003 due to growth in the equity indexed life block of business which was partially offset by higher reinsurance premiums as we reinsure this block of business.

**Persistency.** Persistency is a key driver of our business because it shows the policies which remain in our block of business and is measured by the lapse rate. A low lapse rate means higher persistency indicating more business is remaining in force to generate future revenues. Annualized lapse rates, based on a rolling four quarter period, were 6.3% in the first six months of 2004 and 2003. Our persistency experience remains within our pricing assumptions.

**Net Investment Income.** Net investment income is a key driver of our business as it reflects earnings on our invested assets. Net investment income increased for the second quarter and decreased for the first six months of 2004 as compared to the same periods a year ago. The year-to-date earned rate of the investment portfolio was 6.42% compared to 6.84% a year ago. Lower yields primarily contributed to the decrease in net investment income as compared to a year ago. For the quarter, the decrease in yields was offset by the growth in protection products assets which increased approximately \$252 million from 2003.

**Mortality and Benefit Expense.** Mortality is a key driver of our business as it impacts the amount of our benefit expense. We utilize reinsurance to reduce the effects of mortality risk. Benefit expense was lower in the second quarter of 2004 and year-to-date 2004 as compared to the respective prior periods of 2003, due to the continued decline in closed block in force business.

**Underwriting, Acquisition and Other Expenses.** Underwriting, acquisition and other expenses are a key driver of our business as they are costs of our operations. Expenses decreased for the second quarter and first six months of 2004 compared to the same periods of 2003 primarily due to lower operating expenses resulting from the restructuring activities that took place in 2003 and in prior years to integrate the ILICO life operations.

**Amortization of DAC and VOBA.** The amortization of DAC and VOBA increased for the second quarter and first six months of 2004 as compared to the respective periods in 2003. DAC and VOBA are generally amortized in proportion to policy gross margins which increased in 2004, resulting in higher amortization expense.

**Dividends to Policyowners.** In addition to basic policyowner dividends, dividend expense includes increases or decreases to the closed block policyowner dividend obligation liability carried on the consolidated balance sheet. The actual results of the closed block are adjusted to equal the expected earnings based on the actuarial calculation at the time of formation of the closed block (which we refer to as the closed block glide path). The adjustment to have the closed block operating results equal the closed block glide path is made to dividend expense. If the actual results for the period exceed the closed block glide path, increased dividend expense is recorded as a policyowner dividend obligation to reduce the actual closed block results. For actual results less than the closed block glide path, dividend expense is reduced to increase the actual closed block results. As a result of this accounting treatment, operating earnings only include the predetermined closed block glide path.



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Dividend expense decreased for the second quarter and first six months of 2004 compared to the same periods of 2003. This reduction was primarily the result of realized losses on closed block investments in 2004 as compared to realized gains in 2003 and lower closed block net investment income for both periods. These reductions decreased closed block earnings.

**Outlook.** We expect to continue to shift our sales to higher return products, in particular the equity indexed life products. We also expect to continue to realize operating efficiencies created by the restructuring of the protection products operations and centralization of our administrative functions.

**ACCUMULATION PRODUCTS**

Our accumulation products segment primary offerings consist of individual fixed annuities and funding agreements. The fixed annuities are marketed on a national basis primarily through IMOs and independent brokers. Similar to our protection products segment, we invest the premiums we receive from accumulation product deposits in our investment portfolio and establish a liability representing our commitment to our policyowner. We manage investment spread by seeking to maximize the return on our invested assets consistent with our asset/liability management and credit quality needs. When appropriate, we periodically reset the interest rates credited to our policyowner liability. Accumulation products reserves totaled \$11.9 billion at June 30, 2004 and \$11.7 billion at December 31, 2003. A summary of our accumulation products segment operations follows:

|   | For The Three Months<br>Ended June 30, |          | For The Six Months Ended<br>June 30, |          |
|---|--|----------|--------------------------------------|----------|
|   | 2004                                   | 2003     | 2004                                 | 2003     |
|   | (\$ in thousands)                      |          |                                      |          |
| Revenues:   |  |          |                                      |          |
| Immediate annuity and supplementary contract premiums | \$ 859                                 | \$ 1,059 | \$ 1,582                             | \$ 2,242 |
| Product charges                                       | 12,644                                 | 8,899    | 26,747                               | 19,392   |
| Net investment income                                 | 168,218                                | 168,183  | 342,481                              | 337,856  |
| Other income  | 2,626                                  | 2,780    | 5,377                                | 5,855    |
| Total revenues  | 184,347                                | 180,921  | 376,187                              | 365,345  |
| Benefits and expenses:                                |  |          |                                      |          |
| Policyowner benefits                                  | 114,261                                | 126,512  | 235,079                              | 256,374  |
| Underwriting, acquisition and other expenses          | 8,006                                  | 6,666    | 15,238                               | 13,135   |
| Amortization of DAC and VOBA                          | 25,749                                 | 21,077   | 55,679                               | 42,041   |
| Dividends to policyowners                             | 2                                      |          | 2                                    |          |
| Total benefits and expenses                           | 148,018                                | 154,255  | 305,998                              | 311,550  |
| IMO Operations:                                       |  |          |                                      |          |
| Other income  | 14,221                                 | 12,867   | 28,858                               | 24,558   |

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Other expenses  | <u>12,213</u>    | <u>10,113</u>    | <u>23,710</u>    | <u>19,579</u>    |
| Net IMO operating income                                    | <u>2,008</u>     | <u>2,754</u>     | <u>5,148</u>     | <u>4,979</u>     |
| Pre-tax operating income - Accumulation<br>Products segment | <u>\$ 38,337</u> | <u>\$ 29,420</u> | <u>\$ 75,337</u> | <u>\$ 58,774</u> |

Pre-tax operating income from our accumulation products operations increased 30.3% in the second quarter of 2004 and 28.2% in the first six months of 2004 compared to the respective 2003 periods primarily due to higher assets under management and increased product spreads from our higher margin products. The drivers of profitability in our accumulation products business include deposits, persistency, product spread, expenses and IMO operations.

**Deposits.** Deposits are a key driver of our business as this is a measure which represents collected premiums to be deposited to policyowner accounts for which we will earn a future product spread. Deposits are presented as collected premiums, which are measured in accordance with industry practice, and represent the amount of new business sold during the period. Deposits are a performance metric which we use to measure the productivity of our distribution network and for compensation of sales and marketing employees and agents. The following table summarizes our accumulation products segment deposits:



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|                                    | Deposits by Product        |           |                               |           |
|------------------------------------|----------------------------|-----------|-------------------------------|-----------|
|                                    | For The Three Months Ended |           | For The Six Months Ended June |           |
|                                    | June 30,                   |           | 30,                           |           |
|                                    | 2004                       | 2003      | 2004                          | 2003      |
|                                    | (\$ in thousands)          |           |                               |           |
| Annuities                          |                            |           |                               |           |
| Deferred fixed annuities:          |                            |           |                               |           |
| Traditional fixed annuities        | \$ 78,577                  | \$101,200 | \$160,747                     | \$243,862 |
| Equity indexed annuities           | 348,482                    | 367,255   | 645,357                       | 600,445   |
| Variable annuities                 | 806                        | 901       | 1,658                         | 1,888     |
|                                    | <hr/>                      | <hr/>     | <hr/>                         | <hr/>     |
| Total annuities                    | 427,865                    | 469,356   | 807,762                       | 846,195   |
| Funding agreements                 | 85,000                     |           | 85,000                        |           |
|                                    | <hr/>                      | <hr/>     | <hr/>                         | <hr/>     |
| Total                              | 512,865                    | 469,356   | 892,762                       | 846,195   |
| Reinsurance ceded                  | (3,871)                    | (7,551)   | (7,067)                       | (15,619)  |
|                                    | <hr/>                      | <hr/>     | <hr/>                         | <hr/>     |
| Total deposits, net of reinsurance | \$508,994                  | \$461,805 | \$885,695                     | \$830,576 |
|                                    | <hr/>                      | <hr/>     | <hr/>                         | <hr/>     |

Direct annuity deposits decreased 8.8% in the second quarter of 2004 and 4.5% year-to-date for 2004 compared to the respective periods of 2003. Deposits decreased in 2004 as compared to 2003 primarily due to lower traditional fixed annuity deposits caused by the low interest rate environment. We have shifted our product mix towards our higher returning equity indexed annuities. Equity indexed annuities comprised 80% of total direct annuity deposits in the first six months of 2004 compared to 71% in the first six months of 2003. Our wholly-owned and proprietary organizations accounted for approximately 77% of our annuity deposits in the first six months of 2004 compared to 75% in the first six months of 2003.

**Product Charges.** The deposits we receive on accumulation products are not recorded as revenue but instead as a policyowner liability. Surrender charges collected on accumulation products are recorded as revenue and shown as a product charge. Product charges increased in the second quarter and first six months of 2004 as compared to the respective 2003 periods due to the growth in the business.

**Persistency.** Persistency is a key driver of our business as it refers to the policies which remain in our block of business and is measured by a withdrawal rate. A low withdrawal rate means higher persistency indicating more business is remaining in force to generate future revenues. Withdrawals represent funds taken out of accumulation products by policyowners not including those due to the death of policyowners. Annuity withdrawal rates without internal replacements, based on a rolling four quarter period, increased in 2004 and amounted to 9.0% and 8.7% for the first six months of 2004 and 2003, respectively. Annuity withdrawals without internal replacements totaled \$582.3 million and \$652.9 million for the first six months of 2004 and 2003, respectively. Our withdrawal experience remained within our pricing assumptions. Withdrawal rates increased for the first six months of 2004 as compared to 2003 as prior year withdrawals were reduced as a result of the low interest rate environment.

**Product Spread.** Product spread is a key driver of our business as it measures the difference between the income earned on our invested assets and the rate which we credit to policyowners, with the difference reflected as segment operating income. Asset earned rates and liability crediting rates, based on a rolling four quarter period, were as follows for accumulation segment products:

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|                         | <b>June 30,</b> |             |
|-------------------------|-----------------|-------------|
|                         | <b>2004</b>     | <b>2003</b> |
| Asset earned rate       | 5.74%           | 6.27%       |
| Liability credited rate | 3.67%           | 4.25%       |
|                         | <hr/>           | <hr/>       |
| Product spread          | 2.07%           | 2.02%       |
|                         | <hr/>           | <hr/>       |

The product spread, based on a rolling four quarter period, increased five basis points to 207 basis points for the first six months of 2004 compared to the first six months of 2003. Liability crediting rates were lowered throughout 2003 and the first six months of 2004 to correspond with the decline in investment yields caused by lower rates on new and reinvested funds.

At June 30, 2004, the account value of traditional annuities totaled \$6.8 billion of which approximately 96% have minimum guarantee rates ranging from 3% to 4%. For traditional annuities with an account value of \$5.0 billion, the credited rate was equal to the minimum guarantee rate, and as a result, the credited rate cannot be lowered. We also offer an interest rate crediting strategy that credits the policy with a return generally based upon the interest rates it earns on assets supporting the respective policies less management fees. Traditional annuities with an account value of \$5.3 billion had a one-year interest guarantee period while annuities with an account value of \$1.2 billion had a multi-year guarantee for which the credited rate cannot be decreased until the end of the multi-year period. At the end of the multi-year period, we will have the ability to lower the crediting rate to the minimum guaranteed rate by an average of approximately 275 basis points. The remaining multi-year period is generally either one or two years. Due to these limitations on the ability to lower interest crediting rates and the potential for additional credit defaults and lower reinvestment rates on investments, we could experience spread compression in future periods.

**Amortization of DAC and VOBA.** The amortization of DAC and VOBA increased for the second quarter and first six months of 2004 compared to the respective periods in 2003. DAC and VOBA are generally amortized in proportion to policy gross margins which increased in 2004, resulting in higher amortization expense.

**IMO Operations.** IMO Operations are a key driver of our business as the earnings from the IMOs are a significant component of the accumulation products segment operating income. IMOs have contractual arrangements to promote our insurance products to their networks of agents and brokers. Additionally, they also contract with third party insurance companies. We own five such IMOs. The income from IMO operations primarily represents annuity commissions received by our IMOs from those third party insurance companies. Net IMO operating income in 2004 remained consistent with 2003 levels.

**Outlook.** We anticipate increased product sales from our IMOs but decreased product sales from other distribution channels as we manage our sales in this current low interest rate environment. We also expect to continue the shift of our product mix to higher return products, in particular the equity indexed annuity products. We will continue to manage our spreads as we strive for our desired profitability in this economic environment.

**OTHER**

The other segment is our non-core lines of business outside of protection and accumulation products. These lines of business include holding company revenues and expenses, operations of our real estate management subsidiary, and accident and health insurance. The pre-tax operating loss in the first six months of 2004 increased compared to the

same period of 2003 primarily due to increased holding company expenses related to compliance with Sarbanes-Oxley internal control regulations and lower investment income of our real estate management subsidiary.

**Table of Contents****INCOME STATEMENT RECONCILIATION**

A reconciliation of our segment pre-tax operating income to net income as shown in our consolidated statements of income follows:

|  | <b>For The Three Months Ended<br/>June 30,</b> |               | <b>For The Six Months Ended June<br/>30,</b> |                |
|--|--|---------------|--|----------------|
|  | <b>2004</b>                                    | <b>2003</b>   | <b>2004</b>                                  | <b>2003</b>    |
|  | <b>(\$ in thousands)</b>                       |               |  |                |
| Segment pre-tax operating income:  |  |               |  |                |
| Protection Products  | \$ 34,927                                      | \$ 33,843     | \$ 68,018                                    | \$ 66,963      |
| Accumulation Products  | 38,337   | 29,420        | 75,337                                       | 58,774         |
| Other operations   | (3,849)  | 169           | (5,624)                                      | (1,735)        |
|  | <u>69,415</u>                                  | <u>63,432</u> | <u>137,731</u>                               | <u>124,002</u> |
| Total segment pre-tax operating income   |  |               |  |                |
| Non-segment items increases<br>(decreases) to income:  |  |               |  |                |
| Realized and unrealized losses on assets<br>and liabilities:   |  |               |  |                |
| Realized/unrealized gains (losses) on<br>open block assets   | (8,851)  | 16,374        | (33,581)                                     | 24,453         |
| Unrealized gains (losses) on open block<br>options and trading investments   | (31,226)                                       | 42,320        | (7,411)                                      | 35,027         |
| Change in option value of equity<br>indexed products and market value<br>adjustments on total return strategy<br>annuities | 37,288   | (35,811)      | 13,555                                       | (27,209)       |
| Cash flow hedge amortization   | (351)  | (1,065)       | (813)  | (2,478)        |
| Amortization of DAC & VOBA due to<br>open block realized gains and losses  | (7,002)  | (3,907)       | (5,742)                                      | (10,452)       |
| Reinsurance adjustments  |  | 3,854         |  | 3,854          |
| Restructuring costs  |  | (12,670)      |  | (15,864)       |
| Other income from non-insurance<br>operations  | 1,360  | 226           | 1,161  | 622            |
|  | <u>60,633</u>                                  | <u>72,753</u> | <u>104,900</u>                               | <u>131,955</u> |
| Income from continuing operations  |  |               |  |                |
| Interest expense   | (7,936)  | (7,575)       | (16,334)                                     | (14,374)       |
| Income tax expense   | (3,921)  | (22,002)      | (10,050)                                     | (39,102)       |
|  | <u>48,776</u>                                  | <u>43,176</u> | <u>78,516</u>                                | <u>78,479</u>  |
| Net income from continuing operations  |  |               |  |                |
| Income from discontinued operations,<br>net of tax   |  | 535           | 3,899  | 1,022          |
| Cumulative effect of change in<br>accounting, net of tax   |  |               | (510)  |                |

|            |                             |                             |                             |                             |
|------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |
| Net income | \$ 48,776                   | \$ 43,711                   | \$ 81,905                   | \$ 79,501                   |
|            | <u>                    </u> | <u>                    </u> | <u>                    </u> | <u>                    </u> |

**Realized and Unrealized Gains (Losses) on Assets and Liabilities.** Realized gains (losses) on open block assets will fluctuate from period to period depending on the prevailing interest rate, the economic environment and the timing of investment sales and credit events. As part of managing our invested assets, we routinely sell securities and realize gains and losses. In addition, in the first quarter of 2004, we had a pre-tax impairment loss on our Indianapolis, Indiana office building of \$12.2 million. We listed this office building with a real estate broker during the second quarter of 2003 as part of our restructuring plan and recorded a pre-tax impairment loss of \$7.7 million at that time. As provided by SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we determined in the first quarter of 2004 that the fair value of the building required further adjustment based on current offering prices for the property. The carrying value of the building that is held for sale is included in the other assets line item of the consolidated balance sheet and amounted to \$3.3 million at June 30, 2004 and \$15.5 million at December 31, 2003.

Unrealized gains (losses) on open block options and trading investments also will fluctuate from period to period depending on the prevailing interest rate, the economic environment, the timing of investment sales and credit events. We use options to hedge our equity indexed products. In accounting for derivatives, we adjusted our options to market value, which, due to the economic environment and stock market conditions, resulted in an unrealized gain of \$5.9 million and \$12.1 million in the second quarter and first six months of 2004, respectively, and an unrealized gain of \$25.0 million and \$15.7 million in the second quarter and first six months of 2003, respectively. In addition, we also have trading securities that back our total return strategy traditional annuity products. The market value adjustment on the trading securities resulted in a loss of \$37.1 million and \$19.5 million in the second quarter and first

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six months of 2004, respectively, and a gain of \$17.3 million and \$19.4 million in the second quarter and first six months of 2003, respectively. Most of the unrealized gains and losses on the options and trading securities are offset by similar adjustments to the option portion of the equity indexed product reserves and to the total return strategy annuity reserves. The reserve adjustments are reflected in policyowner benefits expense in the consolidated statements of income and are included in the fair value change as decreased expense of \$37.3 million and \$13.6 million in the second quarter and first six months of 2004, respectively, and additional expense of \$35.8 million and \$27.2 million in the second quarter and first six months of 2003, respectively, explained in the following paragraph.

The fair value change in options embedded within our equity indexed products and the fair value changes on our total return strategy fixed annuity contracts are being recorded at fair value. As previously discussed, these fair value changes are offset by similar adjustments to unrealized gains (losses) on investments related to the fair value changes on the options that hedge the equity indexed products and on the trading securities that back the total return strategy products. The reduction in such contract expense is less than the change in investment income primarily due to the inability to lower crediting rates below minimum guaranteed rates.

**Reinsurance Adjustments.** Reinsurance related adjustments in the first six months of 2003 consist of the release of an \$8.2 million liability in conjunction with the settlement and amendment of a reinsurance arrangement and a \$4.3 million true-up of pre-2003 reinsurance settlements under a reinsurance arrangement between ILIC's open block and closed block. Both of the reinsurance adjustments were recorded in the second quarter of 2003.

**Restructuring Costs.** Restructuring costs relate to our consolidation of various functions in connection with a restructuring of our protection products and accumulation products operations and investment activities which began in the third quarter of 2001. The restructuring charges expensed in the first six months of 2003 included pre-tax severance and termination benefits of \$0.8 million for severance accrual adjustments and other pre-tax costs of \$15.0 million primarily related to the impairment loss on the Indianapolis office building, expenses associated with the merger of IL Annuity into ILICO and systems conversion costs. Charges for all restructuring activities were completed in 2003.

**Income Tax Expense.** The effective income tax rate for the first six months of 2004 varied from the prevailing corporate rate primarily as a result of reductions in the income tax accrual and deferred tax asset valuation allowances. The accrual reductions, amounting to \$5.2 million in the first quarter of 2004 and \$2.7 million in the second quarter of 2004, were for the release of provisions originally established for potential tax adjustments which have been settled or eliminated. In addition, the deferred tax asset valuation allowance was reduced \$10.4 million in the second quarter of 2004 as a result of the realization of capital loss carryforwards.

**Discontinued Operations.** In November 2003, we entered into an agreement to sell our residential financing operations. The results of the residential financing operations have been classified as discontinued operations. The sale was completed in January 2004, resulting in an after-tax gain of \$3.9 million.

**Change in Accounting.** Effective January 1, 2004, the Company adopted SOP 03-1 resulting in the establishment of additional policy reserve liabilities for fees charged for insurance benefit features which are assessed in a manner that is expected to result in profits in earlier years and losses in subsequent years. The total effect of adopting SOP 03-1 (including reinsurance recoverables) as of January 1, 2004, amounted to a decrease of \$0.8 million (\$0.5 million after-tax) in net income which has been reflected as a cumulative effect of a change in accounting.

## **ACCOUNTING DEVELOPMENTS**

The Financial Accounting Standards Board's Emerging Issues Task Force (EITF) has reached a tentative conclusion on EITF No. 04-8, The Effect of Contingently Convertible Debt on Diluted Earnings Per Share, that contingently

convertible debt instruments are subject to the if-converted method for earnings per share calculations regardless of whether the instrument has met its contingent conversion features. If the EITF should become effective in its current form, our Optionally Convertible Equity-



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linked Accreting Notes would be subject to the new earnings per share guidance proposed by the EITF, and if the Company did not take action to mitigate the effect of the pronouncement, would result in more shares being outstanding in the diluted earnings per share calculation. We will continue to monitor the status of the EITF as the project is finalized.

## **LIQUIDITY AND CAPITAL RESOURCES**

### ***AmerUs Group Co.***

As a holding company, AmerUs Group Co.'s cash flows from operations consist of dividends from subsidiaries, if declared and paid, interest from income on loans and advances to subsidiaries (including a surplus note issued to us by ALIC), investment income on our assets and fees which we charge our subsidiaries, offset by the expenses incurred for debt service, salaries and other expenses.

The payment of dividends by our insurance subsidiaries is regulated under various state laws. Generally, under the various state statutes, our insurance subsidiaries' dividends may be paid only from the earned surplus arising from their respective businesses and must receive the prior approval of the respective state regulator to pay any dividend that would exceed certain statutory limitations. The current statutes generally limit any dividend, together with dividends paid out within the preceding 12 months, to the greater of (i) 10% of the respective company's policyowners' statutory surplus as of the preceding year end or (ii) the statutory net gain from operations for the previous calendar year. Generally, the various state laws give the state regulators discretion to approve or disapprove requests for dividends in excess of these limits. Based on these limitations and 2003 results, our life insurance subsidiaries could pay us an estimated \$50 million in dividends in 2004 without obtaining regulatory approval. Our subsidiaries paid no dividends in the first six months of 2004. We also consider risk-based capital levels, capital and liquidity operating needs, and other factors prior to paying dividends from the insurance subsidiaries. We have a \$200 million revolving credit facility with a syndicate of lenders (which we refer to as the Revolving Credit Agreement). As of June 30, 2004, there was no outstanding loan balance under the facility. The Revolving Credit Agreement provides for typical events of default and covenants with respect to the conduct of business and requires the maintenance of various financial levels and ratios. Among other covenants, we (a) cannot have a leverage ratio greater than 0.35:1.0, (b) cannot have an interest coverage ratio less than 2.50:1.0, (c) are prohibited from paying cash dividends on common stock in excess of an amount equal to 3% of consolidated net worth as of the last day of the preceding fiscal year, (d) must cause our insurance subsidiaries to maintain certain levels of risk-based capital, and (e) are prohibited from incurring additional indebtedness for borrowed money in excess of certain limits typical for such lines of credit. We closely monitor all of these covenants to ensure continued compliance.

The Company has several options for deploying excess capital, including supporting higher sales growth, reducing debt levels, pursuing acquisitions and buying back common stock. Our Board of Directors approved a stock purchase program effective August 9, 2002, under which we may purchase up to three million shares of our common stock at such times and under such conditions, as we deem advisable. The purchases may be made in the open market or by such other means as we determine to be appropriate, including privately negotiated purchases. The purchase program supercedes all prior purchase programs. We plan to fund the purchase program from a combination of our internal sources, dividends from insurance subsidiaries and the Revolving Credit Agreement. Approximately 2.0 million shares remain available for repurchase under this program. There were 244,400 shares purchased in the first six months of 2004 for \$9.2 million. Holding company cash was utilized to purchase the shares.

We manage liquidity on a continuing basis. One way is to minimize our need for capital. We accomplish this by attempting to use our capital as efficiently as possible and by developing capital-efficient products in our insurance subsidiaries. We also manage our mix of sales by focusing on the more capital-efficient products. In addition, we use reinsurance agreements, where cost-effective, to reduce capital strain in the insurance subsidiaries. We also focus on



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optimizing the consolidated capital structure to properly balance the levels and sources of borrowing and the issuance of equity securities.

***Insurance Subsidiaries***

The sources of cash of our insurance subsidiaries consist primarily of premium receipts; deposits to policyowner account balances; income from investments, sales, maturities and calls of investments and repayments of investment principal. The uses of cash are primarily related to withdrawals of policyowner account balances, investment purchases, payment of policy acquisition costs, payment of policyowner benefits, payment of debt, income taxes and current operating expenses. Insurance companies generally produce a positive cash flow from operations, as measured by the amount by which cash flows are adequate to meet benefit obligations to policyowners and normal operating expenses as they are incurred. The remaining cash flow is generally used to increase the asset base to provide funds to meet the need for future policy benefit payments and for writing new business.

Management believes that the current level of cash and available-for-sale, held for trading and short-term securities, combined with expected net cash inflows from operations, maturities of fixed maturity investments, principal payments on mortgage-backed securities and sales of its insurance products, will be adequate to meet the anticipated short-term cash obligations of the life insurance subsidiaries.

Matching the investment portfolio maturities to the cash flow demands of the type of insurance being provided is an important consideration for each type of protection product and accumulation product. We continuously monitor benefits and surrenders to provide projections of future cash requirements. As part of this monitoring process, we perform cash flow testing of assets and liabilities under various scenarios to evaluate the adequacy of reserves. In developing our investment strategy, we establish a level of cash and securities which, combined with expected net cash inflows from operations and maturities and principal payments on fixed maturity investment securities, are believed adequate to meet anticipated short-term and long-term benefit and expense payment obligations. There can be no assurance that future experience regarding benefits and surrenders will be similar to historic experience since withdrawal and surrender levels are influenced by such factors as the interest rate environment and general economic conditions and the claims-paying and financial strength ratings of the insurance subsidiaries.

We take into account asset/liability management considerations in the product development and design process. Contract terms for the interest-sensitive products include surrender and withdrawal provisions which mitigate the risk of losses due to early withdrawals. These provisions generally do one or more of the following: limit the amount of penalty-free withdrawals, limit the circumstances under which withdrawals are permitted, or assess a surrender charge or market value adjustment relating to the underlying assets.

In addition to the interest-sensitive products, our insurance subsidiaries have issued funding agreements totaling \$960 million outstanding as of June 30, 2004, consisting primarily in six to ten year fixed rate insurance contracts. The assets backing the funding agreements are legally segregated and are not subject to claims that arise out of any other business of the insurance subsidiaries. The funding agreements are further backed by the general account assets of the insurance subsidiaries. The segregated assets and liabilities are included with general account assets in the financial statements. The funding agreements may not be cancelled by the holders unless there is a default under the agreements, but the insurance subsidiaries may terminate the agreements at any time.

We also have variable separate account assets and liabilities representing funds that are separately administered, principally for variable annuity contracts, and for which the contractholder bears the investment risk. Separate account assets and liabilities are reported at fair value and amounted to \$255 million at June 30, 2004. Separate account contractholders have no claim against the assets of the general account. The operations of the separate accounts are not included in the accompanying consolidated financial statements.



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Through their respective memberships in the Federal Home Loan Banks (FHLB) of Des Moines and Topeka, ALIC and American are eligible to borrow under variable-rate short term federal funds arrangements to provide additional liquidity. These borrowings are secured and interest is payable at the current rate at the time of each advance. There were no borrowings under these arrangements outstanding at June 30, 2004. In addition, ALIC has long-term fixed rate advances from FHLB outstanding of \$12.9 million at June 30, 2004.

The insurance subsidiaries may also obtain liquidity through sales of investments. The investment portfolio as of June 30, 2004 had a carrying value of \$18.0 billion, including closed block investments.

The level of capital in the insurance companies is regulated by risk-based capital formulas and is monitored by rating agencies. On June 21, 2004, Moody's Investors Service changed its outlook to stable from negative for all of our insurance subsidiaries. In order to maintain appropriate capital levels, it may be necessary from time to time for AmerUs Group Co. to provide additional capital to the insurance companies.

We participate in a securities lending program whereby certain fixed maturity securities from the investment portfolio are loaned to other institutions for a short period of time. We receive a fee in exchange for the loan of securities and require initial collateral equal to 102 percent of the market value of the loaned securities to be separately maintained. Securities with a market value of approximately \$324.8 million and \$154.6 million were on loan under the program and we were liable for cash collateral under our control of approximately \$332.5 million and \$158.8 million at June 30, 2004 and December 31, 2003, respectively. The collateral held under the securities lending program has been included in cash and cash equivalents in the consolidated balance sheet and the obligation to return the collateral upon the return of the loaned securities has been included in accrued expenses and other liabilities.

We may also enter into securities borrowing arrangements from time to time whereby we borrow securities from other institutions and pay a fee. Securities borrowed amounted to \$133 million and none at June 30, 2004, and December 31, 2003, respectively, and are also included in accrued expenses and other liabilities in the consolidated balance sheet.

At June 30, 2004, the statutory surplus of the insurance subsidiaries was approximately \$836 million. Management believes that each life insurance company has statutory capital which provides adequate risk based capital that exceeds required levels.

In the future, in addition to cash flows from operations and borrowing capacity, the insurance subsidiaries may obtain their required capital from AmerUs Group Co.

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

The main objectives in managing our investment portfolios and our insurance subsidiaries are to maximize investment income and total investment returns while minimizing credit risks in order to provide maximum support to the insurance underwriting operations. Investment strategies are developed based on many factors including asset liability management, regulatory requirements, fluctuations in interest rates and consideration of other market risks. Investment decisions are centrally managed by investment professionals based on guidelines established by management and approved by the board of directors.

Market risk represents the potential for loss due to adverse changes in the fair value of financial instruments. The market risks related to our financial instruments primarily relate to the investment portfolio, which exposes us to risks related to interest rates, credit quality and prepayment variation. Analytical tools and monitoring systems are in place to assess each of these elements of market risk.

Interest rate risk is the price sensitivity of a fixed income security to changes in interest rates. Management views these potential changes in price within the overall context of asset and liability management. Actuarial

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professionals estimate the payout pattern of our liabilities, primarily lapses, to determine duration, which is the present value of the fixed income investment portfolios after consideration of the duration of these liabilities and other factors, which management believes mitigates the overall effect of interest rate risk.

For variable and equity indexed products, profitability on the portion of the policyowner's account balance invested in the fixed general account option, if any, is also affected by the spreads between interest yields on investments and rates credited to the policies. For the variable products, the policyowner assumes essentially all the investment earnings risk for the portion of the account balance invested in the separate accounts. For the equity indexed products, we purchase primarily call options that are designed to match the return owed to contract holders who elect to participate in one or more market indices. Profitability on the portion of the equity indexed products tied to market indices is significantly impacted by the spread on interest earned on investments and the sum of (1) the cost of underlying call options purchased to match the returns owed to contract holders and (2) the minimum interest guarantees owed to the contract holder, if any. Profitability on the equity indexed products is also impacted by changes in the fair value of the embedded option which provides the contract holder the right to participate in market index returns after the next anniversary date of the contract. This impacts profitability as we only purchase one-year call options to fund the returns owed to the contract holders at the inception of each contract year. This practice matches with the contract holders' rights to switch to different indices on each anniversary date. The value of the forward starting options embedded in the equity indexed products can fluctuate with changes in assumptions as to future volatility of the market indices, risk free interest rates, market returns and the lives of the contracts.

The following table provides information about our fixed maturity investments and mortgage loans for both our trading and other than trading portfolios at June 30, 2004. The table presents amortized cost and related weighted average interest rates by expected maturity dates. The amortized cost approximates the cash flows of principal amounts in each of the periods. The cash flows are based on the earlier of the call date or the maturity date or, for mortgage-backed securities, expected payment patterns. Actual cash flows could differ from the expected amounts.

**Expected Cash Flows**

|   | <b>6 months</b>         |             |             |             |             |             |                   | <b>Expected Cash Flows</b> | <b>Fair Value</b> |
|---|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------------|----------------------------|-------------------|
|   | <b>2004</b>             | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>Thereafter</b> |                            |                   |
|   | <b>(\$ in millions)</b> |             |             |             |             |             |                   |                            |                   |
| Fixed maturity securities                           |                         |             |             |             |             |             |                   |                            |                   |
| available-for-sale                                  | \$530                   | \$1,059     | \$ 911      | \$1,068     | \$1,169     | \$ 917      | \$8,623           | \$14,277                   | \$14,428          |
| Average interest rate                               | 6.1%                    | 6.0%        | 6.8%        | 7.7%        | 5.5%        | 5.5%        | 5.7%              |                            |                   |
| Fixed maturity securities held for trading purposes | \$ 61                   | \$ 199      | \$ 188      | \$ 191      | \$ 278      | \$ 198      | \$ 734            | \$ 1,849                   | \$ 1,849          |
| Average interest rate                               | 4.3%                    | 2.9%        | 2.9%        | 4.3%        | 3.3%        | 2.9%        | 4.4%              |                            |                   |
| Mortgage loans                                      | \$ 30                   | \$ 62       | \$ 59       | \$ 55       | \$ 67       | \$ 63       | \$ 508            | \$ 844                     | \$ 874            |
| Average interest rate                               | 7.5%                    | 7.6%        | 7.6%        | 7.5%        | 7.5%        | 7.5%        | 7.3%              |                            |                   |
| Total   | \$621                   | \$1,320     | \$1,158     | \$1,314     | \$1,514     | \$1,178     | \$9,865           | \$16,970                   | \$17,151          |

In accordance with our strategy of minimizing credit quality risk, we consistently invest in high quality marketable securities. Fixed maturity securities are comprised of U.S. Treasury, government agency, mortgage-backed and corporate securities. Approximately 62% of our fixed maturity securities are issued by the U.S. Treasury or U.S. government agencies or are rated A or better by Moody's, Standard and Poor's, or the NAIC. Less than 7.7% of the bond portfolio is below investment grade. Fixed maturity securities have an average life of approximately 8.13 years.

Prepayment risk refers to the changes in prepayment patterns that can either shorten or lengthen the expected timing of the principal repayments and thus the average life and the effective yield of a security. Such risk exists primarily within the portfolio of mortgage-backed securities. Management monitors such risk regularly. We invest primarily in those classes of mortgage-backed securities that have average or lower prepayment risk.



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Our use of derivatives is generally limited to hedging purposes and has principally consisted of using interest rate swaps and options. These instruments, viewed separately, subject us to varying degrees of market and credit risk. However when used for hedging, the expectation is that these instruments would reduce overall market risk. Credit risk arises from the possibility that counterparties may fail to perform under the terms of the contracts.

Equity price risk is the potential loss arising from changes in the value of equity securities. In general, equities have more year-to-year price variability than intermediate term grade bonds. However, returns over longer time frames have been consistently higher.

All of the above risks are monitored on an ongoing basis. A combination of in-house systems and proprietary models and externally licensed software are used to analyze individual securities as well as each portfolio. These tools provide the portfolio managers with information to assist them in the evaluation of the market risks of the portfolio.

**Item 4. Controls and Procedures**

(a) Based upon their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, are effective for recording, processing, summarizing and reporting the information we are required to disclose in our reports filed under such act.

(b) There was no change in our internal control over financial reporting during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II - OTHER INFORMATION****Item 1. Legal Proceedings**

In recent years, the life insurance industry, including the Company and its subsidiaries, have been subject to an increase in litigation pursued on behalf of purported classes of insurance purchasers, questioning the conduct of insurers in the marketing of their products. The Company is routinely involved in litigation and other proceedings, including class actions (such as pending class action lawsuits related to the use of purportedly inappropriate sales techniques and products for the senior market), reinsurance claims and regulatory proceedings arising in the ordinary course of its business. Some of these claims and legal actions are in jurisdictions where juries are given substantial latitude in assessing damages, including punitive and exemplary damages. In addition, regulatory bodies, such as state insurance departments and attorneys general, periodically make inquiries and conduct examinations concerning our compliance with insurance and other laws. We respond to such inquiries and cooperate with regulatory examinations in the ordinary course of business.

Our litigation is subject to many uncertainties, and given its complexity and scope, the outcomes cannot be predicted. It is possible that our results of operations or cash flow in a particular quarterly or annual period could be materially affected by an ultimate unfavorable resolution of pending litigation and regulatory matters depending, in part, upon the results of operations or cash flow for such period. Management believes, however, that the ultimate outcome of all pending litigation and regulatory matters, after consideration of applicable reserves, should not have a material adverse effect on our financial position.

**Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities**

The following table sets forth information regarding purchases of equity securities for the six months ended June 30, 2004:

| <b>Period</b>         | <b>(a) Total<br/>number of<br/>shares (or units)<br/>purchased (1)</b> | <b>(b) Average<br/>price paid<br/>per share<br/>(or units)</b> | <b>(c) Total<br/>number<br/>of shares (or<br/>units)<br/>purchased<br/>as part of<br/>publicly<br/>announced<br/>plans<br/>or programs</b> | <b>(d) Maximum<br/>number<br/>(or approximate<br/>dollar<br/>value) of shares<br/>(or units) that may<br/>yet be purchased<br/>under<br/>the plans or<br/>programs (2)</b> |
|-----------------------|--|--|--|--|
| 01/01/2004-01/31/2004 |  | \$   |  | 2,271,900  |
| 02/01/2004-02/29/2004 |  |  |  | 2,271,900  |
| 03/01/2004-03/31/2004 |  |  |  | 2,271,900  |
| 04/01/2004-04/30/2004 |  |  |  | 2,271,900  |
| 05/01/2004-05/31/2004 | 244,400(2)   | 37.45  | 244,400  | 2,027,500  |
| 06/01/2004-06/30/2004 |  |  |  | 2,027,500  |

|       |                   |                   |                   |
|-------|-------------------|-------------------|-------------------|
| Total | 244,400           | \$ 37.45          | 244,400           |
|       | <u>          </u> | <u>          </u> | <u>          </u> |

- (1) Does not include shares withheld from employee stock awards to satisfy applicable tax withholding obligations.
- (2) In August 2002, our board of directors authorized a repurchase program of up to 3 million shares of our outstanding common stock. There is no expiration date for this program.

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**Item 4. Submission of Matters to a Vote of Security Holders**

At the annual meeting of the Company's shareholders on May 13, 2004, the Company's shareholders approved (1) the reelection of Roger K. Brooks, Thomas C. Godlasky, Stephen Strome, and F.A. Wittern, Jr.; (2) the amendment of the Company's articles of incorporation; (3) the issuance of shares in connection with the Company's management incentive plan; and (4) the ratification of the appointment by the Board of Directors of the Company of Ernst & Young LLP as the Company's independent auditors. The result of the vote is as follows:

Election of Roger K. Brooks

|           |            |
|-----------|------------|
| For:      | 25,772,051 |
| Withheld: | 899,675    |

Election of Thomas C. Godlasky

|           |            |
|-----------|------------|
| For:      | 26,251,455 |
| Withheld: | 420,271    |

Election of Stephen Strome

|           |            |
|-----------|------------|
| For:      | 26,380,453 |
| Withheld: | 291,273    |

Election of F.A. Wittern

|           |            |
|-----------|------------|
| For:      | 26,369,453 |
| Withheld: | 302,273    |

Amend the Company's Articles of Incorporation

|             |            |
|-------------|------------|
| For:        | 24,820,151 |
| Against:    | 1,409,436  |
| Abstaining: | 442,139    |

Issue Shares in Conjunction with the Company's Management Incentive Plan

|             |            |
|-------------|------------|
| For:        | 19,566,467 |
| Against:    | 3,996,192  |
| Abstaining: | 440,647    |

Ratification of Ernst & Young LLP

|      |            |
|------|------------|
| For: | 26,055,559 |
|------|------------|

|             |         |
|-------------|---------|
| Against:    | 429,574 |
| Abstaining: | 186,593 |

The term of the following other directors of the Company continued after the meeting: David A. Arledge; Alecia A. DeCoudreaux; Thomas F. Gaffney; John W. Norris, Jr.; Andrew J. Paine, Jr.; Jack C. Pester; and John A. Wing.

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

(a) Exhibits

A list of exhibits included as part of this report is set forth in the Exhibit Index which immediately precedes such exhibits and is hereby incorporated by reference herein.

(b) The following reports on Form 8-K were filed during the quarter ended June 30, 2004:

Form 8-K dated May 4, 2004 announcing the release of first quarter 2004 earnings and furnishing supplemental financial information of AmerUs Group Co.

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**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.

DATED: August 6, 2004

AMERUS GROUP CO.

By /s/ Melinda S. Urion

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Melinda S. Urion  
Executive Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)

By /s/ Brenda J. Cushing

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Brenda J. Cushing  
Senior Vice President and Controller  
(Principal Accounting Officer)

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**AMERUS GROUP CO. AND SUBSIDIARIES**

**INDEX TO EXHIBITS**

| <b>Exhibit<br/>No.</b> | <b>Description</b>   |
|------------------------|--|
| 2.1                    | Combination and Investment Agreement, dated February 18, 2000, among American Mutual Holding Company, AmerUs Life Holdings, Inc., Indianapolis Life Insurance Company and The Indianapolis Life Group of Companies, Inc., filed as Exhibit 2.1 to AmerUs Life Holdings, Inc.'s report on Form 8-K/A on March 6, 2000, is hereby incorporated by reference.                           |
| 2.2                    | Purchase Agreement, dated as of February 18, 2000, by and between American Mutual Holding Company and AmerUs Life Holdings, Inc., filed as Exhibit 2.5 on Form 10-K, dated March 8, 2000, is hereby incorporated by reference.   |
| 2.3                    | Agreement and Plan of Merger, dated December 17, 1999, by and between American Mutual Holding Company and AmerUs Life Holdings, Inc., filed as Exhibit 2.6 on Form 10-K, dated March 8, 2000, is hereby incorporated by reference.   |
| 2.4                    | Amendment No. 1 to Agreement and Plan of Merger, dated February 18, 2000, by and between American Mutual Holding Company and AmerUs Life Holdings, Inc., filed as Exhibit 2.7 on Form 10-K, dated March 8, 2000, is hereby incorporated by reference.  |
| 2.5                    | Letter Agreement, dated December 17, 1999, by and between American Mutual Holding Company and AmerUs Life Holdings, Inc., filed as Exhibit 2.8 on Form 10-K, dated March 8, 2000, is hereby incorporated by reference.   |
| 2.6                    | Notification Agreement, dated as of February 18, 2000, by and among American Mutual Holding Company, AmerUs Life Holdings, Inc. and Bankers Trust Company, filed as Exhibit 2.9 on Form 10-K, dated March 8, 2000, is hereby incorporated by reference.  |
| 2.7                    | Amendment No. 2 to Agreement and Plan of Merger, dated April 3, 2000, by and between American Mutual Holding Company and AmerUs Life Holdings, Inc., filed as Exhibit 2.10 on Form 10-Q, dated May 15, 2000, is hereby incorporated by reference.  |
| 2.8                    | Amendment No. 1 to the Purchase Agreement, dated April 3, 2000, by and between American Mutual Holding Company and AmerUs Life Holdings, Inc., filed as Exhibit 2.11 on Form 10-Q, dated May 15, 2000, is hereby incorporated by reference.  |
| 2.9                    | Amendment to Combination and Investment Agreement dated February 18, 2000 among American Mutual Holding Company, AmerUs Life Holdings, Inc., Indianapolis Life Insurance Company and The Indianapolis Life Group of Companies, Inc., dated September 18, 2000, filed as Exhibit 2.2 to Form 8-K12G3 of the Registrant dated September 21, 2000, is hereby incorporated by reference. |
| 2.10                   | Stock Purchase Agreement, dated January 1, 2002, by and among AmerUs Annuity Group Co., and the Stockholders of Family First Advanced Estate Planning and Family First Insurance Services, filed as  |



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Exhibit 2.13 on Form 10-Q dated August 12, 2002, is hereby incorporated by reference.

- 3.1\* Amended and Restated Articles of Incorporation of the Registrant dated May 21, 2004.
- 3.2\* Amended and Restated Bylaws of the Registrant dated May 21, 2004.
- 4.1 Amended and Restated Trust Agreement dated as of February 3, 1997 among AmerUs Life Holdings, Inc., Wilmington Trust Company, as property trustee, and the administrative trustees named therein (AmerUs Capital I business trust), filed as Exhibit 3.6 to the registration statement of AmerUs Life Holdings, Inc. and AmerUs Capital I on Form S-1, Registration Number 333-13713, is hereby incorporated by reference.
- 4.2 Indenture dated as of February 3, 1997 between AmerUs Life Holdings, Inc. and Wilmington Trust Company relating to the Company's 8.85% Junior Subordinated Debentures, Series A, filed as Exhibit 4.1 to the registration statement of AmerUs Life Holdings, Inc. and AmerUs Capital I on Form S-1, Registration Number, 333-13713, is hereby incorporated by reference.
- 4.3 Guaranty Agreement dated as of February 3, 1997 between AmerUs Life Holdings, Inc., as guarantor, and Wilmington Trust Company, as trustee, relating to the 8.85% Capital Securities, Series A, issued by AmerUs Capital I, filed as Exhibit 4.4 to the registration statement on Form S-1, Registration Number, 333-13713, is hereby incorporated by reference.
- 4.4 Certificate of Trust of AmerUs Capital III filed as Exhibit 4.7 to the registration statement of AmerUs Life Holdings, Inc., AmerUs Capital II and AmerUs Capital III, on Form S-3 (No.

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| <b>Exhibit<br/>No.</b> | <b>Description</b>   |
|------------------------|--|
|                        | 333-50249), is hereby incorporated by reference.   |
| 4.5                    | Senior Indenture, dated as of June 16, 1998, by and between AmerUs Life Holdings, Inc. and First Union National Bank, as Indenture Trustee, relating to the AmerUs Life Holdings, Inc. s 6.95% Senior Notes, filed as Exhibit 4.14 on Form 10-Q, dated August 13, 1998, is hereby incorporated by reference.   |
| 4.6                    | Subordinated Indenture, dated as of July 27, 1998, by and between AmerUs Life Holdings, Inc. and First Union National Bank, as Indenture Trustee, relating to AmerUs Life Holdings, Inc. s 6.86% Junior Subordinated Deferrable Interest Debentures, filed as Exhibit 4.15 on Form 10-Q, dated August 13, 1998, is hereby incorporated by reference.                 |
| 4.7                    | First Supplement to Indenture dated February 3, 1997 among American Mutual Holding Company, AmerUs Life Holdings, Inc. and Wilmington Trust Company as Trustee, relating to the Company s 8.85% Junior Subordinated Debentures, Series A, dated September 20, 2000, filed as Exhibit 4.14 on Form 10-Q dated November 14, 2000, is hereby incorporated by reference. |
| 4.8                    | Assignment and Assumption Agreement to Amended and Restated Trust Agreement, dated February 3, 1997 between American Mutual Holding Company and AmerUs Life Holdings, Inc., dated September 20, 2000, filed as Exhibit 4.15 on Form 10-Q dated November 14, 2000, is hereby incorporated by reference.   |
| 4.9                    | Assignment and Assumption to Guaranty Agreement, dated February 3, 1997 between American Mutual Holding Company and AmerUs Life Holdings, Inc., dated September 20, 2000, filed as Exhibit 4.16 on Form 10-Q, dated November 14, 2000, is hereby incorporated by reference.  |
| 4.10                   | First Supplement to Senior Indenture dated June 16, 1998, relating to AmerUs Life Holdings, Inc. s 6.95% Senior Notes, among American Mutual Holding Company, AmerUs Life Holdings, Inc. and First Union National Bank, as Trustee, dated September 20, 2000, filed as Exhibit 4.23 on Form 10-Q, dated November 14, 2000, is hereby incorporated by reference.      |
| 4.11                   | Indenture dated as of March 6, 2002 between AmerUs Group Co. and BNY Midwest Trust Company, as Trustee, filed as Exhibit 4.1 on form 8-K/A, dated February 28, 2002, is hereby incorporated by reference.  |
| 4.12                   | Form of Purchase Contract Agreement between AmerUs Group Co. and Wachovia Bank, National Association (formerly known as First Union National Bank), as Purchase Contract Agent, filed as Exhibit 4.1 on Form 8-A12B, dated May 22, 2003, is hereby incorporated by reference.  |
| 4.13                   | Form of Pledge Agreement among AmerUs Group Co., BNY Midwest Trust Company, as Collateral Agent, Custodial Agent and Securities Intermediary and Wachovia Bank, National Association (formerly known as First union National Bank), as Purchase Contract Agent, filed as Exhibit 4.2 on Form 8-A12B dated May 22, 2003, is hereby incorporated by reference.         |
| 4.14                   | Form of Remarketing Agreement among AmerUs Group Co., Wachovia Bank, National Association (formerly known as First Union National Bank), as Purchase Contract Agent, and the Remarketing Agent named therein, filed as Exhibit 4.3 on Form 8-A12B dated May 22, 2003, is hereby incorporated by reference.   |

- 4.15 Form of Income PRIDES (included in Exhibit 4.1 as Exhibit A thereto), filed as Exhibit 4.1 on Form 8-A12B, dated May 22, 2003, is hereby incorporated by reference.
  - 4.16 Officer's Certificate attaching form of Senior Notes initially due 2008, filed as Exhibit 4.7 on Form 8-A12B, dated May 22, 2003, is hereby incorporated by reference.
  - 10.1\* Amended and Restated Retirement Agreement, dated August 22, 2003, by and between Victor N. Daley and AmerUs Group Co.
  - 11\* Statement Re: Computation of Earnings Per Share.
  - 12\* Computation of Ratios of Earnings to Fixed Charges.
  - 31.1\* Certification of Chief Executive Officer of Periodic Report Pursuant to Rule 13a-15(e) or Rule 15d-15(e).
  - 31.2\* Certification of Chief Financial Officer of Periodic Report Pursuant to Rule 13a-15(e) or Rule 15d-15(e).
  - 32.1\* Certification of Chief Executive Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350.
  - 32.2\* Certification of Chief Financial Officer of Periodic Report Pursuant to 18 U.S.C. Section 1350.
- \* Included herein