



Kansas City Life Insurance Company (NASDAQ:KCLI)

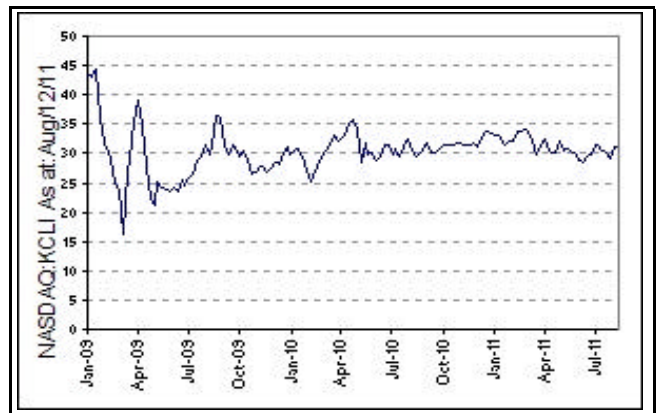
THE COMPANY

Kansas City Life Insurance Company (KCLI) is a financial services company. The Company primarily consists of three life insurance companies: Kansas City Life Insurance Company the parent company, and wholly owned subsidiaries Sunset Life Insurance Company of America and Old American Insurance Company. KCLI offers traditional, interest sensitive and variable life and annuity insurance products, in addition to a variety of group life and group accident and health insurance products. The Company markets its products through a nationwide sales force of over 1400 independent general agents, group brokers and third party marketing agreements. KCLI insures more than half a million policyholders coast to coast and does business in 48 states.

FINANCIAL DATA

	2008	2009	2010
Earnings per Share (\$)	1.46	1.50	1.92
Price to Earnings (times)	21.0	20.5	16.0
Dividend (\$)	1.08	2.16	1.08
Dividend Yield (%)	3.5	6.7	3.5
Book Value (\$)	46.11	54.33	59.25
Price to Book Value (times)	0.7	0.6	0.5

HISTORICAL SHARE PRICES



WHY ABC FUNDS BOUGHT KANSAS CITY LIFE

While the financial services industry in Canada has seen consolidation over the last ten to fifteen years, the US market has remained relatively fragmented. Consequently, we are finding more investment opportunities south of the border. There are more than twenty life insurers in the US with market capitalizations under \$1 billion. Many are overlooked, small regional players with little or no research coverage from brokerage firms. And unlike their larger Canadian peers, some can be found trading below their book or net asset value. KCLI is one of these companies. With roots dating back to the nineteenth century, KCLI is currently run by fourth generation members of the Bixby family. This includes Philip Bixby, the company's current Chairman and CEO. As a group, the family owns approximately 60% of the company's stock. Another 10% is held by other insiders and 6% is owned by the company's employees. This leaves just 24%, or roughly 2.5 million shares in the public float. Trading in the stock is therefore relatively thin and this can present buying opportunities from time to time.

Shares of KCLI have recently declined to around \$44 after trading above \$50 for most of 2006. At their current price, KCLI shares look attractive. They currently sell at a 23% discount to their book value of \$55 per share. They also pay a dividend of \$1.08 per year which represents a yield of 2.5%. In addition, the company is debt free and has excess capital at its disposal. This could be used to write more business, increase the dividend or repurchase shares. On June 1st, 2006, KCLI announced it had signed a marketing agreement with American Republic Insurance. Under the agreement, American Republic agents will sell KCLI life products. This could result in a meaningful boost to top line sales and poise the company for future growth. Finally, with its strong regional presence, experienced sales force and well capitalized business, KCLI could make an attractive acquisition for a larger industry player. While the Bixby family has publicly stated that the company is not for sale, investors should not rule out a "change of heart" due to a premium price, estate planning issues, etc. If the company was put up for sale, we believe it would be worth considerably more than its current stock price.

ABC Funds
June 30, 2006

UPDATE

Kansas City Life Insurance (KCLI) is benefiting from a decline in long term interest rates. When we last checked, the yield on ten year US government bonds was around 4.6%, which is down from 5.2% in June. KCLI, like most life insurers, has a large portion of its portfolio invested in fixed income securities. As interest rates fall, the market value of these securities increase and are adjusted on its balance sheet. Therefore, we were pleased, but not that surprised when we discovered that KCLI's book value per share had increased from \$53.77 to \$57.43 in the third quarter.

Although investment gains are nice to have, KCLI is, after all, in the business of selling life insurance policies. From this perspective the company reported a decent third quarter. Earnings, which excludes unrealized investment gains, increased from \$0.75 to \$0.80 per share. Renewal premiums were essentially flat, but new premiums increased 10%. This includes a

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17% increase in accident and health premiums which had been declining earlier in the year.

Also, it was good see that AM Best recently affirmed its rating on KCLI of 'A' (excellent). According to AM Best, the rating reflects the group's "continued strengthening in its capital and risk-based capital position, conservative balance sheet management, stable cash flow from operations and strong statutory profitability"

Although shares of KCLI are now trading around its \$57 book value, the shares are clearly not expensive. KCLI still trades well below the price-to-book multiples enjoyed by many of its peers. In addition, we feel that the insurance industry in the US will eventually experience a consolidation similar to the Canadian market in the late 1990s/ early 2000s. With its strong regional presence, excellent balance sheet and strong sales force, KCLI, we believe, would make an attractive acquisition target. If it were put up for sale, it is our opinion that the company could fetch a considerable premium to its public market value.

ABC Funds

November 17, 2006

Kansas City Life Insurance Company (KCLI) recorded a 16% increase in net income for the first quarter of 2007. The Company earned \$8.3 million or \$0.70 per share, an increase from \$7.2 million or \$0.60 per share a year earlier. Although insurance revenues declined 2% for the period, premiums from accident and health products increased 2%, including a 12% increase in new group dental sales. New sales of deposit products, including universal life, fixed deferred annuity and variable life and annuity products increased 9% versus the prior year.

One highlight of the Company's first quarter was the payment of a special dividend of \$2.00 per share to shareholders in February. This payment was in addition to the company's regular quarterly dividend of \$0.27 per share. According to KCLI, "the special dividend was supported by the Company's steady earnings and strong balance sheet." With a market cap of \$533 million, KCLI has only \$14 million in long term debt. In addition, KCLI remains overcapitalized as it has more equity than required to support its current book of business. Recently, management has been using this excess liquidity to repurchase shares, pay dividends and write new insurance policies.

We believe shares of KCLI are undervalued as they currently trade at a 21% discount to their book value of \$56.79 per share. As a comparison, most public life companies trade between 1 ½ to 2 times book value. Admittedly, many of these firms earn higher returns on equity – around 12% or higher. However, KCLI's ROE, which is currently around 6%, should eventually improve as excess capital is more efficiently deployed. If KCLI can show an increase in its ROE, Wall Street may soon discover this underfollowed company.

On a final note, while the controlling Bixby family has stated the company is not for sale, investors should not rule out a "change of heart" due to a premium offer or the need for estate planning. With its strong regional presence, experienced sales force and well capitalized business, KCLI would make an attractive acquisition candidate for a larger insurer. If the company were put up for sale we believe it would be worth considerably more than its current sock price.

ABC Funds

June 22, 2007

The Dow Jones U.S. Financial Services Index is down 10% so far in 2008, and is off 30% since June 1st 2007. Meanwhile, shares of Kansas City Life Insurance Company are up 8.8% in 2008 and are virtually flat since June 2007. Why has KCLI held up so well while other financial stocks have fared so poorly? We believe that KCLI's relatively good performance is due to a number of factors.

First of all, KCLI has virtually no exposure to sub-prime, Alt-A, or CDO investments. In fact, only 14% of KCLI's investments were in mortgages and approximately 97% of these are commercial loans on warehouses and office properties. Therefore, KCLI has only small exposure to residential loans.

Second, KCLI maintains a very strong balance sheet. It has \$668 million in equity and only \$8.7 million in long term debt. This is considerably low for an insurance company. In addition, KCLI's statutory capital exceeds the minimum capital deemed necessary to support its insurance business. In other words it has put aside significantly more money than required to pay future claims. Although this surplus provides a cushion of sorts, the company could eventually use it to pay additional special dividends, repurchase shares, or write new business.

Finally, the yield curve in the US has recently become more upward sloping and this should benefit KCLI. As short term rates fall, annuity holders are less likely to surrender their policies. At the same time, new deposits will earn lower rates, and KCLI

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can invest the proceeds in higher yielding longer term bonds. This improved "spread" should eventually lead to improving earnings per share at KCLI. With its stock currently trading at a 22% discount to its \$56.50 book value, we believe this valuation gap should eventually narrow as margins improve and excess capital is effectively redeployed.

ABC Funds
February 8, 2008

As we have discussed in the past, the credit and equity markets have gone a wild ride over the past 12 months. Although the shares of fundamentally sound stocks are well off their lows, most are still (and rightly so) below previous highs. Kansas City Life Insurance fell from a 52-week high of \$57.93 to a low of \$15.20 in March, a decline of almost 75%. The shares bounced about 150% from the low to reach \$40 by early April. However the shares then rolled over and now trade at approximately \$25.85 per share.

We are mildly puzzled at magnitude of the second dip. Perhaps the recent financial results and the thinly-traded nature of the stock can explain at least part of the move. In 2008, KCLI recorded a net loss of \$17.1 million or \$1.47 per share compared to net income of \$35.7 million or \$3.01 per year in 2007. Unsurprisingly, the bulk of the decline was a result of realized net after-tax losses on investments, which totaled \$24 million in 2008. Net income also fell as net investment income declined \$13 million on a year over year basis. The losses continued in the first quarter of 2009, as conditions in the equity and credit markets remained extremely difficult. The Company reported additional losses of \$4.5 million or \$0.40 per share, including \$6.1 million in net realized losses on investments from writedowns on "formerly investment grade securities that had become credit impaired". Again, with the second quarter rebound in the equity and debt markets, we believe that Q1/09 will prove to be the trough in terms of investment performance.

Once the investment performance stabilizes, we will turn our focus to the Company's insurance and annuity operations. Although revenue showed gains in both fiscal 2008 and the first quarter of 2009, total benefits and expenses are also rising. We plan to monitor the situation closely to insure that in a more normalized investment environment, the underlying insurance business can get back on track. Thankfully, we can highlight two key points that allow us to remain optimistic. First, on April 28, the Company's Board declared a regular quarterly dividend of \$0.27, which implies the Directors feel that KCLI is adequately capitalized in the near-term. Second, on June 3, A.M. Best "affirmed excellent ratings and stable outlook for Kansas City Life Insurance Company".

With the shares trading at only 0.57 times the current book value of \$45.40, we believe that the market has been unfairly punitive. At current price levels, the stock offers an attractive 4.2% yield and is debt free. Hopefully, the release of the Company's second quarter results will demonstrate stabilizing investment returns and improving insurance and annuity profitability.

ABC Funds
July 3, 2009

It has been quite some time since we last updated our commentary on Kansas City Life Insurance Company (KCLI). The market also seems to have overlooked this story, with the stock currently trading at half its tangible book value despite a debt-free balance sheet and an attractive 3.6% dividend yield.

In the interim, KCLI returned to profitability and reported vastly improved financial results for fiscal 2009 compared to the difficult 2008 period. Net income for 2009 was \$10.7 million, or \$0.93 per share, compared with a net loss of \$17.1 million, or (\$1.47) per share for 2008. Importantly, realized investment losses improved by \$42.2 million on a year over year basis as the financial markets stabilized.

In 2009, new premiums increased 26% or \$10.0 million and total revenues reached \$419.6 million versus \$374.3 million in 2008. Annuity sales were particularly strong and grew \$7.5 million or 75% and life insurance sales grew \$1.5 million or 20% on a year over year basis. These gains were marginally offset by declines in new group life and group accident and health products. Total assets were \$4.2 billion and life insurance in force totaled \$30.7 billion at December 31, 2009.

Interestingly, in a type of positive feedback loop, stabilizing capital markets led to better earnings for financial companies and higher share prices. During 2009, KCLI's investment securities portfolio appreciated \$192.3 million and ended the year in an unrealized gain position of \$0.2 million. The relatively conservative nature of the portfolio, with 94% of the investments rated investment grade, served the Company, its shareholders and its policy holders well over the tumultuous period.

As a direct result of the solid operating and financial performance, A.M. Best recently affirmed the ratings of KCLI and its

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subsidiaries. The ratings agency affirmed the financial strength rating of "A (Excellent)" and an issuer credit rating of "a" for Kansas City Life and its subsidiary Sunset Life Insurance Company of America with a "stable" outlook. Further, A.M. Best revised the outlook to "positive" from "stable" and affirmed the financial strength rating of "B++ (GOOD)" and an issuer credit rating of "bbb+" for the Old American Insurance Company subsidiary. The ratings reflect the Company's solid capitalization, conservative balance sheet and consistently profitable operating results.

After the relatively solid year, shareholders' equity improved \$101.3 million to \$628.4 million or \$54.33 per share. Currently trading at approximately \$30.00, we believe that KCLI has simply fallen under the radar of most investors. Over the past ten years, KCLI has traded between 0.7 and 0.9 times book value, with an average multiple of 0.78 times. We believe that getting paid a \$1.08 annual dividend while we wait for the stock to return to its historical trading range between \$38 and \$48 per share is an excellent risk/reward proposition.

June 18, 2010
ABC Funds

On July 29th, 2011 KCLI reported strong Q2 2011 financial results, with EPS increasing to \$0.97/share versus \$0.88/share in Q2 2010. Improved results were driven primarily by a \$3.2 million increase in investment revenue and a \$4.5 million decrease in total benefits. At June 30th, KCLI had total investments of US\$3.5 billion, with 18% of its invested assets in commercial mortgage loans. Going forward, KCLI continues to remain focused on sales development, enhanced marketing support and additions to the product portfolio. For example, in response to consumer demand, the company recently introduced Lifetime Income Rider, which provides guaranteed income for life and income flexibility from a Kansas City Life fixed annuity. To enhance future sales, KCLI is also seeking third-party marketing relationships such as those established with American Republic and GuideOne.

From a valuation perspective, we continue to believe KCLI is extremely inexpensive. At current levels, KCLI is trading at a 50% discount to its book value of \$61.58/share, has no debt, and provides a 3.5% dividend yield.

August 12, 2011
ABC Funds