1998 ANNUAL REPORT

Torchmark
Corporation

# Financial Highlights

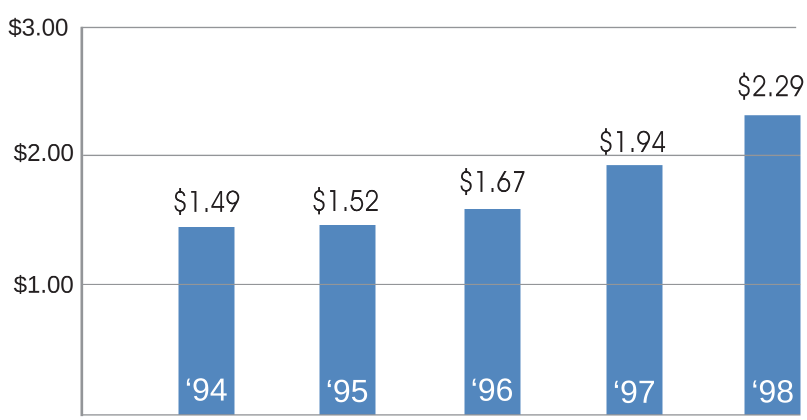
(In thousands except percent and per share amounts)

## TORCHMARK CORPORATION

| Operations: | 1998 | 1997 | % Change |
|---|---|---|---|
| Total Premium | $ 1,753,630 | $ 1,678,004 | 4.5 |
| Total Revenue | 2,157,876 | 2,071,103 | 4.2 |
| Net Operating Income From Continuing Operations* | 324,315 | 273,730 | 18.5 |
| Annualized Life Premium In Force | 1,062,647 | 1,007,379 | 5.5 |
| Annualized Health Premium In Force | 796,863 | 762,052 | 4.6 |
| Diluted Average Shares Outstanding | 141,352 | 141,431 | (0.1) |
| Return From Continuing Operations On Average Common Equity** | 15.1% | 18.2% | |
| **Per Common Share:** | | | |
| Net Operating Income From Continuing Operations* | $ 2.29 | $ 1.94 | 18.0 |
| Shareholders' Equity At Year End ** | 15.43 | 12.90 | 19.6 |

Net Operating Income Per Common Share

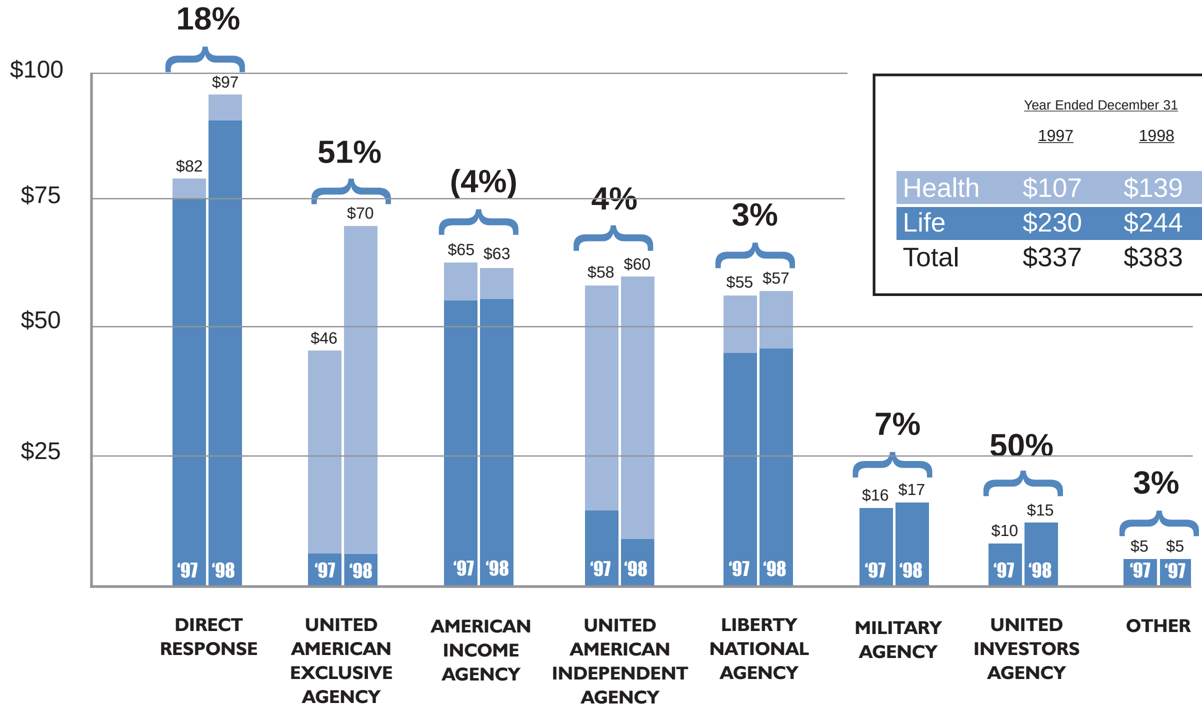
Continuing Operations*




* Excludes realized investment gains (losses) and the related adjustment to deferred acquisition costs, equity in Vesta earnings, and discontinued operations.

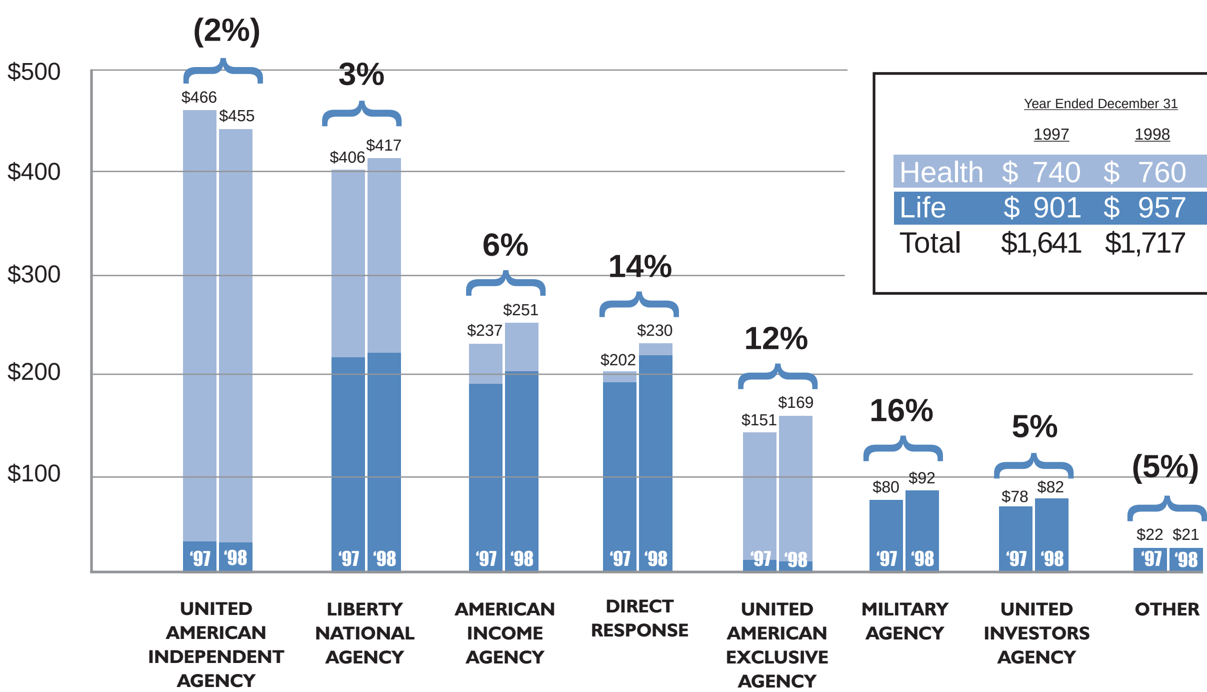
** Includes fixed maturity investments at amortized cost.

# Insurance Sales Growth *(Dollars in Millions)*
## 1998 Compared With 1997




| | Year Ended December 31 | | |
|---|---|---|---|
| | 1997 | 1998 | Increase |
| Health | $107 | $139 | 30% |
| Life | $230 | $244 | 6% |
| Total | $337 | $383 | 14% |

# Insurance Premium Income Growth* *(Dollars in Millions)*
## 1998 Compared With 1997




| | Year Ended December 31 | | |
|---|---|---|---|
| | 1997 | 1998 | Increase |
| Health | $ 740 | $ 760 | 3% |
| Life | $ 901 | $ 957 | 6% |
| Total | $1,641 | $1,717 | 5% |

*Excludes Family Service Life

# Letter To Shareholders

1998 was an excellent year for Torchmark. Our net operating income per share from continuing operations increased 18% to $2.29* per fully diluted share. We experienced growth in sales and premiums in both life and health insurance. Not only did our investment income grow, but more importantly, we experienced an even greater growth rate in free or excess investment income, which is the portion of investment income over and above that which we must earn on interest-bearing liabilities. At the same time, our insurance administrative expenses were basically unchanged from the prior year.

In March we completed the initial public offering of 34% of Waddell & Reed, and in November the spin-off of our remaining ownership to our shareholders was completed. In June we sold Family Service Life. With the cash proceeds of these transactions, we reduced our long-term debt, and reactivated our share repurchase program with the acquisition of 3.4 million shares late in the year.

Key Components of Net Operating Income Per Diluted Share

| | 1998 | 1997 | % |
|---|---|---|---|
| Continuing Operations - | | | |
| Insurance Underwriting Income | | | |
| - Excluding Family Service Life | $2.25 | $2.14 | 5 |
| - Family Service Life | .01 | .03 | |
| Excess Investment Income | 1.46 | 1.01 | 45 |
| Other | ( .26) | ( .25) | |
| Income Tax | (1.17) | ( .99) | 18 |
| Net Operating Income from Continuing Operations* | 2.29 | 1.94 | 18 |
| Equity in Earnings of Vesta | ( .03) | .08 | |
| Discontinued Operations - | | | |
| Asset Management (Net of Minority Interest) | .34 | .54 | |
| Total Net Operating Income | $2.60 | $2.56 | |

*Excluding Waddell & Reed and our passive investment in Vesta Insurance Group, Inc.

## FINANCIAL REVIEW

Net operating income per share from continuing operations increased 18% to $2.29*. Excluding Family Service Life, insurance underwriting income increased 5% to $2.25 per share. Excess investment income increased 45% to $1.46 per share.

Total annualized premium insurance sales increased 14% to $383 million. Life insurance sales increased 6% to $244 million, and health insurance sales increased 30% to $139 million.

Total premium income, excluding Family Service Life, increased 5% to $1,751 million. Life premiums increased 6% to $957 million. Health premiums increased 3% to $760 million. Annuity income increased 22% to $34 million.

Recognizing fixed maturity assets at their amortized cost, our shareholder equity increased 17% to $2,112 million, and our return on equity from continuing operations was 15%. Treating the monthly income preferred securities as debt, our debt to capitalization ratio declined to 31%.

## INSURANCE DISTRIBUTION

### Direct Response

Direct Response sales increased 18% to $97 million. Life insurance sales were $93 million, up 18%. Health insurance sales were $4 million, up 29%.

Total premium income increased 14% to $230 million. Life insurance premiums were $221 million, up 13%. Health insurance premiums were $9 million, up 36%.

The vast majority of our sales were exclusively a result of direct mail operations, but inquiries and sales were also generated as a result of advertising through television and publications. Total mailings in 1998 exceeded 265 million packages.

We have compiled a file of over 4.5 million households comprised of individuals who have responded in recent years to our solicitations, but who have not yet purchased insurance from us. Re-mailings to this file produce sales at a much higher rate than mailings to the general public. This ever-growing file has been and will continue to be an excellent source of new sales.

Over $11 million, or 12%, of our life insurance sales were add-on sales whereby our customers increased their life insurance protection as a result of offers included in their premium notice mailings. Add-on sales increased 20% in 1998.

In addition to being an outstanding insurance distribution system, our Direct Response operation provides support to other distribution systems in Torchmark. In 1998, it was responsible for generating over 550,000 life insurance and Medicare Supplement inquiries for our Exclusive Agency and Independent Agency operations at United American. Furthermore, our Liberty National agency operation began receiving direct response support in 1998, and increased support will be provided in the future.

### United American

United American's two distribution systems are our Exclusive Agency and the Independent Agency operations.

Exclusive Agency sales increased 51% to $70 million in 1998. Health insurance sales were $65 million, up 62%. Life insurance sales were $5 million, down 16%. Of the $65 million of health insurance sales, $59 million were Medicare Supplement sales, an increase of 69%.

Total premium income increased 12% to $169 million. Health insurance premiums were $151 million, up 14%. Life insurance premiums were $19 million, up 3%.

1998 was an extraordinary year for our Exclusive Agency operation. We began the year with 900 agents in 59 branch offices. We ended the year with 1,750 agents in 67 branch offices; the number of agents and branches increased 94% and 14%, respectively. In last year's Annual Report, I stated that we expected to grow the number of agents by "no less than 20%". I'm pleased I chose the words "no less than". In the future, we expect continued impressive growth in the number of Exclusive agents and branch offices.

Independent Agency sales increased 4% to $60 million. Health insurance sales were $51 million, up 18%. Life insurance sales were $9 million, down 38%. Of the $51 million of health insurance sales, $38 million were Medicare Supplement sales, an increase of 47%.

Total premium income decreased 2% to $455 million. Health insurance premiums were $418 million, down 3%. Life insurance premiums were $37 million, unchanged from 1997.

1998 was the first in several years that our Independent Agency operations had growth in Medicare Supplement sales. Levelized commissions, mandated by federal law in 1992, had an adverse effect on most general agencies; their financial ability to recruit and train new agents was weakened. As a result, many independent general agencies left the Medicare Supplement market.

We have been developing business relationships with larger agencies that have the potential of writing higher volumes of business. By generating inquiries through our Direct Response operation, and by providing financial support to these agencies, we have reversed the downward trend in sales of recent years. Independent Agency sales declined 5% in 1997 and increased, as stated above, 4% in 1998. We expect even greater growth in 1999.

### Liberty National

Liberty National agency sales increased 3% to $57 million in 1998. Life insurance sales were $46 million, up 5%. Health insurance sales were $11 million, down 4%.

Total premium income increased 3% to $417 million. Life insurance premiums were $281 million, no change from 1997. Health insurance premiums were $136 million, up 8%.

At the beginning of this decade, Liberty National was a debit operation, a system where the agents collected monthly premiums in the homes of our customers. The debit system served Liberty National well in prior decades, but for many reasons the debit business became an outmoded and inefficient method of sales and service. For most of this decade, Liberty National has been in the transformation from a debit operation to a traditional agency operation. The transformation is now complete. Debit sales ceased in 1995, and as of year end 1998 only $.8 million of Liberty National's $442 million of annualized inforce premiums are still being collected by agents.

1998 was the first year of any significant increase in agents since Liberty National ceased debit sales activity. We started the year with 1,750 agents and we ended the year with 1,829 agents. Late in the year Liberty National began receiving support from our Direct Response operation, and this support will be increased throughout 1999. With increasing Direct Response support and continued growth in agents, we expect a greater growth rate in sales for the upcoming year.

## American Income

American Income agency sales declined 4% to $63 million during 1998. Life insurance sales declined 3% to $54 million. Health insurance sales declined 9% to $9 million. Total premium income for 1998 increased 6% to $251 million. Life insurance premiums were $204 million, up 7%. Health insurance premiums were $47 million, up 2%.

American Income is a “union label” company. Our sales force and non-management home office employees are organized by the Office and Professional Employees International Union. With the cooperation and endorsement of labor unions and credit unions, our agents sell life and supplemental health insurance to their members.

1998 was a difficult year for American Income. The decline in sales was primarily due to a decline in agents from 1,366 at the beginning of the year to 1,222 at the end of the year.

Field management of an insurance sales force is commonly comprised of two levels above the agents. Although the second level of management produces a significant volume of sales, its primary responsibility is new agent training, a critical function in growing a successful sales force. Sometimes, this level of management becomes too focused on personal production and fails to provide the essential training to new recruits. It is the responsibility of both management levels to prevent this situation. Nonetheless, this situation has developed in American Income’s sales force. Our objective for the upcoming year will be to reverse the current trend and re-establish the historically strong growth of American Income’s successful agency operations.

## MIilitary

Military Agency life insurance sales increased 7% to $17 million during 1998. Premium income increased 16% to $92 million.

This independent general agency sells exclusively to commissioned and non-commissioned military officers and their families. Our business relationship dates back to 1981. They are an outstanding sales and service organization second to none in this industry, and although they already write most of their life insurance sales through our companies, we will work to earn an increasing portion of their total agency sales.

## United Investors

United Investors life sales increased 50% to $15 million in 1998. Life insurance premium income increased 5% to $82 million. Annuity income increased 22% to $34 million. The financial planners of Waddell & Reed are the primary distributors of United Investors life and annuity products. Although Waddell & Reed is no longer a part of Torchmark, we will strive to earn their business by continuing to provide products and service to their financial planners.

## INVESTMENTS

Our investment strategy is to maximize the difference between investment yield over required yield on our net liabilities, and to avoid uncompensated risk. Our investment portfolio is concentrated in high quality fixed-maturity investments, which represented 84% of our invested assets at year end. Our investment quality remains strong with the average credit quality of the fixed maturity portfolio being "A" as rated by Standard & Poor's.

Net investment income was $459.6 million. On a tax equivalent basis (i.e., recognizing that certain bonds are subject to lower state and federal taxes), net investment income was $470.7 million.

As shown in the 1998 Investment Income table, excess investment income, the portion of net investment income that contributes to our pre-tax earnings, is derived from two sources: (1) the income earned less the required income on the invested assets that support net interest-bearing liabilities, and (2) the income earned on the remaining invested assets.

### 1998 Investment Income
(Millions)

| | Total * | Required | Excess |
|---|---|---|---|
| (1) Invested Assets Supporting: | | | |
| Net Interest-Bearing Policy Liabilities: | | | |
| Life Insurance | $177.4 | $138.6 | $38.8 |
| Health Insurance | 9.4 | 9.1 | .3 |
| Annuities | 53.1 | 45.5 | 7.6 |
| Debt | 73.5 | 71.4** | 2.1 |
| (2) Remaining Invested Assets | 157.3 | - 0 - | 157.3 |
| | $470.7 | $264.6 | $206.1*** |
| Increase Over 1997 | 7% | (10%) | 44% |

* For illustrative purposes only, total investment income has been allocated pro rata based upon the net liabilities. Torchmark does not specifically allocate assets to liabilities.

** Consists of interest on debt and dividends on monthly income preferred securities.

*** $1.46 per share

Net interest-bearing liabilities are (a) policy reserves required to fund future policy benefits, less the interest-bearing deferred acquisition costs, and (b) debt.

Our net interest-bearing policy liabilities (in millions) were as follows at year end:

| | |
|---|---|
| Life Insurance | $2,366.4 |
| Health Insurance | 107.4 |
| Annuities | 550.4 |
| TOTAL | $3,024 .2 |

The required annual effective yield on these liabilities is 5.9%. Life insurance provides a significantly greater opportunity for excess investment income because the net interest bearing policy liabilities are much greater than in either health insurance or annuities.

Excess investment income increased 44%, or $63 million, in 1998 due to a 7% increase in investment income and a 10% decline in the required interest on net interest-bearing liabilities.

The 7% increase in investment income provided an additional $32 million of pre-tax income, and resulted largely from a 6% increase in invested assets. In 1998, invested assets benefited by the substantial proceeds from the initial public offering of Waddell & Reed, but were reduced by the sale of Family Service Life, a reduction in outstanding debt, and repurchases of Torchmark stock.

The 10% decrease in required interest on net interest-bearing liabilities provided an additional $31 million of pre-tax income in 1998. Interest on debt declined $16 million due to the reduction in outstanding debt and lower average borrowing costs. Interest on policy reserves, less deferred acquisition costs, declined $15 million due to the decrease in net policy reserves resulting from the sale of Family Service Life.

## ADMINISTRATION

Insurance administrative expenses decreased 1% to $103 million. Relative to premium income, administrative expenses were 5.9% compared to 6.1% last year.

We continue to work to improve customer service by simplifying and consolidating functions among our companies. In so doing, we become a more efficient operation as we grow our business.

## OUTLOOK

In 1996, only four of our eight current distribution systems grew their annualized premium sales, and total sales declined 1%. In 1997, five distribution systems grew sales, and sales increased 7%.

In last year's annual report I stated that we expected to grow sales in all eight systems in 1998. All but one of our systems produced growth in sales, and total sales increased 14%. We expect the percentage growth in sales to be no less in the coming year than in the past year. In addition to being an outstanding distribution system, our Direct Response operation provides essential support to other systems within Torchmark. This support will increase in 1999.

We expect greater growth in premium income and underwriting margins, before administrative expenses. Our administrative expenses may increase slightly, but should decline as a percentage of premium income.

As we grow our invested assets, we will work to maintain our current yields and maintain the high quality of our investment portfolio.

All in all, we expect 1999 to be another excellent year for Torchmark.

CB Hudson

C. B. Hudson
Chairman, President and Chief Executive Officer

# Directors and Officers

## DIRECTORS

**David L. Boren**
President of the University of Oklahoma
Norman, OK

**Joseph M. Farley**
Of Counsel in the Birmingham,
Alabama law firm of Balch & Bingham

**Louis T. Hagopian**
Retired Chairman of the Board and
Chief Executive Officer of NW Ayer, Inc.
New York, NY

**C.B. Hudson**
Chairman, President and Chief
Executive Officer of Torchmark

**Joseph L. Lanier, Jr.**
Chairman of the Board and Chief
Executive Officer of Dan River
Incorporated, Danville, VA

**Mark S. McAndrew**
President -United American
and Globe Life

**Harold T. McCormick**
Chairman and Chief Executive Officer
of Bay Point Yacht and Country Club
Panama City, FL

**George J. Records**
Chairman of Midland Financial Co.
Oklahoma City, OK

**R.K. Richey**
Chairman of the Executive Committee
of the Board of Directors of Torchmark

## TORCHMARK CORPORATION OFFICERS

**C.B. Hudson -** Chairman , President and Chief Executive Officer

**Tony G. Brill -** Vice President

**Gary L. Coleman** - Vice President and Chief Accounting Officer

**Michael K. Fagin** - Vice President

**Larry M. Hutchison** - Vice President and General Counsel

**Michael J. Klyce** - Vice President and Treasurer

**Joyce L. Lane** - Vice President - Investor Relations

**Carol A. McCoy** - Associate Counsel and Corporate Secretary

**Mark E. Pape** - Vice President - Planning

**Stephen W. Still -** Vice President and Associate General Counsel

**Spencer H. Stone** - Controller

**David F. Thorndike -** Vice President

**Russell B. Tucker** - Vice President

## TORCHMARK SUBSIDIARY OFFICERS

### American Income Life

**Bernard Rapoport** - Chairman and Chief Executive Officer
**Charles B. Cooper** - President
**William L. Garner** - Executive Vice President

### Globe Life

**Mark S. McAndrew** - President
**George B. Burke** - Senior Vice President, Direct Marketing
**Glenn D. Williams** - Senior Vice President, Marketing

### Liberty National Life

**Anthony L. McWhorter** - President
**Vurl E. Duce** - Executive Vice President

### United American

**Mark S. McAndrew** - President
**Gene P. Grimland** - Executive Vice President, Sales
**Andrew W. King** - Senior Vice President, Branch Office Sales
**Rosemary J. Montgomery** - Senior Vice President, Actuary

### United Investors Life

**Anthony L. McWhorter** - President

## Condensed Consolidated Statement of Operations

(Amounts in thousands except per share data)

The complete financial statements are found in the attached SEC Form 10-K with additional schedules and footnotes thereto.

# Consolidated Balance Sheet

(Dollar amounts in thousands except per share data)

The complete financial statements are found in the attached SEC Form 10-K with additional schedules and footnotes thereto.

# CORPORATE INFORMATION

## Corporate Headquarters

Torchmark Corporation
2001 Third Avenue South
Birmingham, Alabama 35233
(205) 325-4200
www.torchmarkcorp.com

## Key Insurance Subsidiaries

Liberty National Life Insurance Company
Birmingham, AL

United American Insurance Company
McKinney, TX

Globe Life and Accident Insurance Company
Oklahoma City, OK

United Investors Life Insurance Company
Birmingham, AL

American Income Life Insurance Company
Waco, TX

## Annual Meeting of Shareholders

Thursday, April 29, 1999 @ 10:00 a.m.
Corporate Headquarters
Birmingham, Alabama

## Stockholder Inquiries

For general information
regarding your Torchmark stock,
call (205) 325-4270.
For stock transfers, call (800) 446-2617.

## Dividend Reinvestment

Torchmark maintains a dividend reinvestment plan for all holders of its common stock. Under the plan, shareholders may reinvest all or part of their dividends in additional shares of common stock and may also make periodic additional cash payments of up to $3,000 toward the purchase of Torchmark stock. Participation is voluntary. More information on the plan may be obtained from the Stock Transfer Agent by calling (800) 446-2617.

## Stock Exchange Listing

New York Stock Exchange Symbol: TMK

The International Stock Exchange,
London, England

## Stock Transfer Agent and Shareholder Assistance

First Chicago Trust Company of New York
A Division of EquiServe
P.O. Box 2500
Jersey City, NJ 07303-2500
(201) 324-0313
Toll Free Number: (800) 446-2617
Hearing Impaired: (201) 222-4955
Fax: (201) 222-4892
Internet: http://www.equiserve.com
email: fctc@cm.fcnbd.com

## Indenture Trustee for Senior Debentures and Notes

The First National Bank of Chicago
One First National Plaza
Suite 0124
Chicago, Illinois 60670
(800) 524-9472

## Independent Auditors for 1998

KPMG Peat Marwick LLP
Financial Center, Suite 1200
505 North 20th Street
Birmingham, Alabama 35203

## Automatic Deposit of Dividends

Automatic deposit of dividends is available to shareholders who wish to have their dividends directly deposited into the financial institution of their choice. Authorization forms may be obtained from the Stock Transfer Agent by calling (800) 446-2617. Participation is voluntary.

# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

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

| | |
|---|---|
| For the fiscal year ended December 31, 1998 | Commission file number 1-8052 |

# TORCHMARK CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

| | |
|---|---|
| Delaware | 63-0780404 |
| (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION) | (I.R.S. EMPLOYER IDENTIFICATION NO.) |
| 2001 Third Ave. South, Birmingham, AL | 35233 |
| (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) | (ZIP CODE) |

Registrant's telephone number, including area code:
(205) 325-4200

Securities registered pursuant to Section 12(b) of the Act:

| TITLE OF EACH CLASS | CUSIP NUMBER: | NAME OF EACH EXCHANGE ON WHICH REGISTERED: |
|---|---|---|
| Common Stock, $1.00 Par Value | 891027104 | New York Stock Exchange<br>The International Stock Exchange, London, England |

Securities registered pursuant to Section 12(g) of the Act:

None

Securities reported pursuant to Section 15(d) of the Act:

| TITLE OF EACH CLASS: | CUSIP NUMBER: |
|---|---|
| 8¼% Senior Debentures due 2009 | 891027 AE 4 |
| 7⅞% Notes due 2023 | 891027 AF 1 |
| 7⅜% Notes due 2013 | 891027 AG 9 |

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) AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS.
YES ☒ NO ☐

INDICATE BY CHECK MARK IF DISCLOSURE OF DELINQUENT FILERS PURSUANT TO ITEM 405 OF REGULATION S-K (§229.405 OF THIS CHAPTER) IS NOT CONTAINED HEREIN, AND WILL NOT BE CONTAINED, TO THE BEST OF REGISTRANT'S KNOWLEDGE, IN DEFINITIVE PROXY OR INFORMATION STATEMENTS INCORPORATED BY REFERENCE IN PART III OF THIS FORM 10-K OR ANY AMENDMENT TO THIS FORM 10-K. ☐

THE AGGREGATE MARKET VALUE OF THE VOTING STOCK HELD BY NON-AFFILIATES OF THE REGISTRANT: $4,460,867,828

THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE REGISTRANT'S CLASSES OF COMMON STOCK, AS OF FEBRUARY 28, 1999: 134,667,708

## DOCUMENTS INCORPORATED BY REFERENCE

PROXY STATEMENT FOR ANNUAL MEETING OF STOCKHOLDERS TO BE HELD APRIL 29, 1999, PART III

INDEX OF EXHIBITS (PAGES 81 THROUGH 84)
TOTAL NUMBER OF PAGES INCLUDED ARE 90

## PART 1

### Item 1. Business

Torchmark Corporation (''Torchmark''), an insurance and diversified financial services holding company, was incorporated in Delaware on November 19, 1979, as Liberty National Insurance Holding Company. Through a plan of reorganization effective December 30, 1980, it became the parent company for the businesses operated by Liberty National Life Insurance Company (''Liberty'') and Globe Life And Accident Insurance Company (''Globe''). United American Insurance Company (''United American''), Waddell & Reed, Inc. (''Waddell & Reed'') and United Investors Life Insurance Company (''UILIC'') along with their respective subsidiaries were acquired in 1981. The name Torchmark Corporation was adopted on July 1, 1982. Family Service Life Insurance Company (''Family Service'') was purchased in July, 1990, and American Income Life Insurance Company (''American Income'') was purchased in November, 1994. Torchmark disposed of Family Service and Waddell & Reed during 1998.

The following table presents Torchmark's business by primary distribution method:

| Primary Distribution Method | Company | Products | Sales Force |
|---|---|---|---|
| **Direct Response** | **Globe Life And Accident Insurance Company**<br>Oklahoma City, OK | Individual life and supplemental health insurance including juvenile and senior life coverage, Medicare Supplement, long-term care. | Direct response, television, magazine; nationwide. |
| **Liberty National Exclusive Agency** | **Liberty National Life Insurance Company**<br>Birmingham, Alabama | Individual life and supplemental health insurance. | 1,829 full-time sales representatives ; 108 district offices in the Southeastern U.S. |
| **American Income Exclusive Agency** | **American Income Life Insurance Company**<br>Waco, Texas | Individual life and supplemental health insurance to union and credit union members and other associations. | 1,222 agents in the U.S., Canada, and New Zealand. |
| **United Investors Exclusive Agency** | **United Investors Life Insurance Company**<br>Birmingham, Alabama | Individual life insurance and annuities. | 2,370 Waddell & Reed representatives; independent agents; 184 offices nationwide. |
| **Military** | **Liberty National Life Insurance Company**<br>Birmingham, Alabama<br>**Globe Life And Accident Insurance Company**<br>Oklahoma City, Oklahoma | Individual life insurance | Independent Agency through career agents nationwide. |
| **United American Independent Agency and Exclusive Agency** | **United American Insurance Company**<br>McKinney, Texas | Senior life and supplemental health insurance including Medicare Supplement coverage and long-term care. | 43,000 independent agents in the U.S., Puerto Rico and Canada; 1,750 exclusive agents in 67 branch offices. |

Additional information concerning industry segments may be found in *Management's Discussion and Analysis* and in *Note 18—Business Segments in the Notes to Consolidated Financial Statements.*

### Insurance

#### Life Insurance

Torchmark's insurance subsidiaries write a variety of nonparticipating ordinary life insurance products. These include traditional and interest sensitive whole-life insurance, term life insurance, and other life insurance. The following table presents selected information about Torchmark's life products:

**(Amounts in thousands)**

| | Annualized Premium Issued | | | Annualized Premium in Force | | |
|---|---|---|---|---|---|---|
| | **1998** | **1997** | **1996** | **1998** | **1997** | **1996** |
| Whole life: | | | | | | |
| Traditional | $115,154 | $114,934 | $112,817 | $ 575,888 | $ 551,047 | $521,015 |
| Interest-sensitive | 17,131 | 14,981 | 16,638 | 162,046 | 163,058 | 167,912 |
| Term | 108,469 | 94,943 | 82,331 | 306,785 | 270,905 | 243,210 |
| Other | 3,713 | 5,521 | 2,955 | 17,928 | 22,369 | 14,388 |
| | $244,467 | $230,379 | $214,741 | $1,062,647 | $1,007,379 | $946,525 |

The distribution methods for life insurance products include sales efforts conducted by direct response, exclusive agents and independent agents. These methods are discussed in more depth under the heading ''Marketing.'' The following table presents life annualized premium issued by distribution method:

**(Amounts in thousands)**

| | Annualized Premium Issued | | | Annualized Premium in Force | | |
|---|---|---|---|---|---|---|
| | **1998** | **1997** | **1996** | **1998** | **1997** | **1996** |
| Direct response | $ 93,500 | $ 79,412 | $ 62,029 | $ 260,320 | $ 232,535 | $202,370 |
| Exclusive Agents: | | | | | | |
| Liberty National | 45,532 | 43,335 | 45,394 | 298,082 | 298,698 | 297,581 |
| American Income | 53,576 | 55,245 | 54,382 | 216,291 | 203,475 | 188,039 |
| United Investors | 15,386 | 10,261 | 10,715 | 99,775 | 88,842 | 84,495 |
| United American | 5,481 | 6,562 | 11,466 | 21,390 | 20,978 | 20,537 |
| Independent Agents: | | | | | | |
| Military | 16,891 | 15,781 | 8,165 | 98,902 | 86,209 | 74,150 |
| United American | 9,401 | 15,225 | 18,182 | 41,078 | 42,725 | 40,130 |
| Other | 4,700 | 4,558 | 4,408 | 26,809 | 33,917 | 39,223 |
| | $244,467 | $230,379 | $214,741 | $1,062,647 | $1,007,379 | $946,525 |

Permanent insurance products sold by Torchmark insurance subsidiaries build cash values which are available to policyholders. Policyholders may borrow such funds using the policies as collateral. The aggregate value of policy loans outstanding at December 31, 1998 was $234 million and the average interest rate earned on these loans was 6.7% in 1998. Interest income earned on policy loans was $15.3 million in 1998, $14.4 million in 1997, and $13.2 million in 1996. There were 198 thousand and 196 thousand policy loans outstanding at year-end 1998 and 1997, respectively.

The availability of cash values contributes to voluntary policy terminations by policyholders through surrenders. Life insurance products may be terminated or surrendered at the election of the insured at any time, generally for the full cash value specified in the policy. Specific surrender procedures vary with the type of policy. For certain policies this cash value is based upon a fund less a surrender charge which decreases with the length of time the policy has been in force. This surrender charge is either based upon a percentage of the fund or a charge per $1,000 of face amount of insurance. The schedule of charges may vary by plan of insurance and, for some plans, by age of the insured at issue. The ratio of aggregate face amount voluntary terminations to the mean amount of life insurance in force was 17.0% in 1998, 16.5% in 1997, and 17.1% in 1996.

The following table presents an analysis of changes to the Torchmark subsidiaries' life insurance business in force:

**(Amounts in thousands)**

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | **Number of policies** | **Amount of Insurance** | **Number of policies** | **Amount of Insurance** | **Number of policies** | **Amount of Insurance** |
| In force at January 1, | 9,630 | $ 91,869,995 | 9,392 | $ 86,948,151 | 9,196 | $ 80,391,376 |
| New issues | 1,452 | 21,448,243 | 1,441 | 20,267,520 | 1,320 | 18,718,479 |
| Business acquired | -0- | -0- | -0- | -0- | 38 | 2,573,996 |
| Other increases | 1 | 75,849 | 1 | 96,788 | 1 | 104,490 |
| Death benefits | (107) | (323,393) | (110) | (307,752) | (111) | (289,687) |
| Lapses | (1,006) | (14,589,649) | (895) | (13,358,973) | (880) | (13,008,065) |
| Surrenders | (151) | (1,438,085) | (149) | (1,383,373) | (140) | (1,296,744) |
| Other decreases | (197) | (703,901) | (50) | (392,366) | (32) | (245,694) |
| In force at December 31, | 9,622 | $ 96,339,059 | 9,630 | $ 91,869,995 | 9,392 | $ 86,948,151 |
| Average policy size (in dollar amounts): | | | | | | |
| Direct response—Juvenile | | $ 6,688 | | $ 6,725 | | $ 6,776 |
| Other | | 11,411 | | 10,689 | | 10,246 |

**Health insurance**

Torchmark insurance subsidiaries offer supplemental health insurance products. These are generally classified as (1) Medicare Supplement, (2) cancer and (3) other health policies.

Medicare Supplement policies are offered on both an individual and group basis through exclusive and independent agents, and direct response. These guaranteed renewable policies provide reimbursement for certain expenses not covered by the federal Medicare program. One popular feature is an automatic claim filing system for Medicare Part B benefits whereby policyholders do not have to file most claims because they are paid from claim records Medicare sends directly to the Torchmark insurers.

Cancer policies are offered on an individual basis through exclusive and independent agents as well as direct response. These guaranteed renewable policies are designed to fill gaps in existing medical coverage. Benefits are triggered by a diagnosis of cancer or health related events or medical expenses related to the treatment of cancer. Benefits may be in the form of a lump sum payment, stated amounts per diem, per medical procedure, or reimbursement for certain medical expenses.

Other health policies include accident, long term care and limited benefit hospital and surgical coverages. These policies are generally issued as guaranteed-renewable and are offered on an individual basis through exclusive and independent agents, and direct response. They are designed to supplement existing medical coverages. Benefits are triggered by certain health related events or incurred expenses. Benefit amounts are per diem, per health related event or defined expenses incurred up to a stated maximum.

The following table presents supplemental health annualized premium for the three years ended December 31, 1998 by marketing method:

**(Amounts in thousands)**

| | Annualized Premium Issued | | | Annualized Premium in Force | | |
|---|---|---|---|---|---|---|
| | **1998** | **1997** | **1996** | **1998** | **1997** | **1996** |
| Direct response | $ 3,884 | $ 3,001 | $ 4,990 | $ 9,617 | $ 7,248 | $ 5,141 |
| Exclusive agents: | | | | | | |
| Liberty National | 11,124 | 11,541 | 11,258 | 143,668 | 138,179 | 122,305 |
| American Income | 9,138 | 10,052 | 10,645 | 44,300 | 43,552 | 42,140 |
| United American | 64,245 | 39,616 | 31,565 | 172,927 | 141,780 | 131,250 |
| Independent agents: | | | | | | |
| United American | 50,508 | 42,643 | 42,523 | 426,351 | 431,293 | 447,317 |
| | $138,899 | $106,853 | $100,981 | $796,863 | $762,052 | $748,153 |

The following table presents supplemental health annualized premium information for the three years ended December 31, 1998 by product category:

**(Amounts in thousands)**

| | Annualized Premium Issued | | | Annualized Premium in Force | | |
|---|---|---|---|---|---|---|
| | **1998** | **1997** | **1996** | **1998** | **1997** | **1996** |
| Medicare Supplement | $102,421 | $ 65,161 | $ 65,767 | $553,737 | $522,054 | $523,902 |
| Cancer | 10,248 | 10,757 | 10,676 | 144,900 | 137,640 | 119,428 |
| Other health related policies | 26,230 | 30,935 | 24,538 | 98,226 | 102,358 | 104,823 |
| | $138,899 | $106,853 | $100,981 | $796,863 | $762,052 | $748,153 |

### Annuities

Annuity products offered by Torchmark insurance subsidiaries include single-premium deferred annuities, flexible-premium deferred annuities, and variable annuities. Single-premium and flexible-premium products are fixed annuities where a portion of the interest credited is guaranteed. Additional interest may be credited on certain contracts. Variable annuity policyholders may select from a variety of mutual funds managed by Waddell & Reed which offer different degrees of risk and return. The ultimate benefit on a variable annuity results from the account performance. The following table presents Torchmark subsidiaries' annuity collections and deposit balances by product type excluding Family Service:

| | (Amounts in thousands) Collections For the year ended December 31, | | | (Amounts in millions) Deposit Balance At December 31, | | |
|---|---|---|---|---|---|---|
| | 1998 | 1997 | 1996 | 1998 | 1997 | 1996 |
| Fixed annuities | $ 64,687 | $ 76,930 | $ 72,392 | $ 647.3 | $ 611.0 | $ 571.9 |
| Variable annuities | 299,005 | 247,446 | 247,461 | 2,343.5 | 1,821.2 | 1,375.5 |
| | $363,692 | $324,376 | $319,853 | $2,990.8 | $2,432.2 | $1,947.4 |

### Investments

The nature, quality, and percentage mix of insurance company investments are regulated by state laws that generally permit investments in qualified municipal, state, and federal government obligations, corporate bonds, preferred and common stock, real estate, and mortgages where the value of the underlying real estate exceeds the amount of the loan. The investments of Torchmark insurance subsidiaries consist predominantly of high-quality, investment-grade securities. Fixed maturities represented 91% of total investments at December 31, 1998. Approximately 13% of fixed maturity investments were securities guaranteed by the United States Government or its agencies or investments that were collateralized by U.S. government securities. More than 70% of these investments were in GNMA securities that are backed by the full faith and credit of the United States government. The remainder of these government investments were U.S. Treasuries, agency securities or collateralized mortgage obligations (''CMO's'') that are fully backed by GNMA's. (see *Note 3—Investment Operations* in the *Notes to Consolidated Financial Statements* and *Management's Discussion and Analysis.*)

The following table presents the market value of fixed maturity investments at December 31, 1998 on the basis of ratings as determined primarily by Standard & Poor's Corporation. Moody's Investors Services' bond ratings are used when Standard & Poor's ratings are not available. Ratings of BBB and higher (or their equivalent) are considered investment grade by the rating services.

| Rating | Amount (in thousands) | % |
|---|---|---|
| AAA | $1,410,967 | 24.5% |
| AA | 591,326 | 10.3 |
| A | 2,540,294 | 44.1 |
| BBB | 849,481 | 14.7 |
| BB | 267,086 | 4.6 |
| B | 293 | 0.0 |
| Less than B | 2,296 | 0.0 |
| Not rated | 106,704 | 1.8 |
| | $5,768,447 | 100.0% |

The following table presents the market value of fixed maturity investments of Torchmark's insurance subsidiaries at December 31, 1998 on the basis of ratings as determined by the National Association of Insurance Commissioners (''NAIC''). Categories one and two are considered investment grade by the NAIC.

| Rating | Amount (in thousands) | % |
|---|---|---|
| 1. Highest quality* | $4,592,764 | 80.9% |
| 2. High quality | 807,433 | 14.3 |
| 3. Medium quality | 249,731 | 4.4 |
| 4. Low quality | 25,500 | 0.4 |
| 5. Lower quality | 2,405 | 0.0 |
| 6. In or near default | 0 | 0.0 |
| | $5,677,833 | 100.0% |

* Includes $701 million of exempt securities or 12.4% of the portfolio. Exempt securities are exempt for valuation reserve purposes, and consist of U.S. Government guaranteed securities.

Securities are assigned ratings when acquired. All ratings are reviewed and updated at least annually. Specific security ratings are updated as information becomes available during the year.

### Pricing

Premium rates for life and health insurance products are established using assumptions as to future mortality, morbidity, persistency, and expenses, all of which are generally based on the experience of each insurance subsidiary, and on projected investment earnings. Revenues for individual life and health insurance products are primarily derived from premium income, and, to a lesser extent, through policy charges to the policyholder account values on certain individual life products. Profitability is affected to the extent actual experience deviates from that which has been assumed in premium pricing and to the extent investment income exceeds that which is required for policy reserves.

Collections for annuity products and certain life products are not recognized as revenues but are added to policyholder account values. Revenues from these products are derived from charges to the account balances for insurance risk and administrative costs. Profits are earned to the extent these revenues exceed actual costs. Profits are also earned from investment income on the deposits invested in excess of the amounts credited to policy accounts.

### Underwriting

The underwriting standards of each Torchmark insurance subsidiary are established by management. Each company uses information from the application and, in some cases, telephone interviews with applicants, inspection reports, doctors' statements and/or medical examinations to determine whether a policy should be issued in accordance with the application, with a different rating, with a rider, with reduced coverage or rejected.

For life insurance in excess of certain prescribed amounts, each insurance company requires medical information or examinations of applicants. These are graduated according to the age of the applicant and may vary with the kind of insurance. The maximum amount of insurance issued without additional medical information is $35,000 through age 40. Additional medical information is requested of all applicants, regardless of age or amount, if information obtained from the application or other sources indicates that such information is warranted.

In recent years, there has been considerable concern regarding the impact of the HIV virus associated with Acquired Immune Deficiency Syndrome (''AIDS''). The insurance companies have implemented certain underwriting tests to detect the presence of the HIV virus and continues to assess the utility of other appropriate underwriting tests to detect AIDS in light of medical developments in this field. To date, AIDS claims have not had a material impact on claims experience.

### Reinsurance

As is customary among insurance companies, Torchmark insurance subsidiaries cede insurance to other unaffiliated insurance companies on policies they issue in excess of retention limits. Reinsurance is an effective method for keeping insurance risk within acceptable limits. In the event insurance business is ceded, the Torchmark insurance subsidiaries remain contingently liable with respect to ceded insurance should any reinsurer be unable to meet the obligations it assumes (See *Note 17—Commitments and Contingencies* in the *Notes to Consolidated Financial Statements* and *Schedule IV—Reinsurance [Consolidated]).*

### Reserves

The life insurance policy reserves reflected in Torchmark's financial statements as future policy benefits are calculated based on generally accepted accounting principles. These reserves, with the addition of premiums to be received and the interest thereon compounded annually at assumed rates, must be sufficient to cover policy and contract obligations as they mature. Generally, the mortality and persistency assumptions used in the calculations of reserves are based on company experience. Similar reserves are held on most of the health policies written by Torchmark's insurance subsidiaries, since these policies generally are issued on a guaranteed-renewable basis. A list of the assumptions used in the calculation of Torchmark's reserves are reported in the financial statements (See *Note 9—Future Policy Benefit Reserves* in the *Notes to Consolidated Financial Statements)*. Reserves for annuity products consist of the policyholders' account values and are increased by policyholder deposits and interest credits and are decreased by policy charges and benefit payments.

### Marketing

Torchmark insurance subsidiaries are licensed to sell insurance in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, New Zealand and Canada. Distribution is through direct response, independent and exclusive agents.

*Direct Response.* Various Torchmark insurance companies offer life insurance products directly to consumers through direct mail, co-op mailings, television, national newspaper supplements and national magazines. Torchmark operates a full service letterpress which enables the direct response operation to maintain high quality standards while producing materials much more efficiently than they could be purchased from outside vendors.

*Exclusive Agents.* Liberty National's 1,829 agents sell life and health insurance, primarily in the seven state area of Alabama, Florida, Georgia, Tennessee, Mississippi, South Carolina, and North Carolina. These agents are employees of Liberty and are primarily compensated by commissions based on sales. During the past several years this operation has emphasized bank draft and direct bill collection of premium rather than agent collection, because of the resulting lower cost and improved persistency. Agent collected sales were discontinued in 1996.

Through the American Income Agency, individual life and fixed-benefit accident and health insurance are sold through approximately 1,222 exclusive agents who target moderate income wage earners through the cooperation of labor unions, credit unions, and other associations. These agents are authorized to use the ''union label'' because this sales force is represented by organized labor.

The Waddell & Reed sales force, consisting of 2,370 sales representatives, markets the life insurance products, fixed annuities, and variable annuities of United Investors Life. This Agency also distributes health insurance products of United American. This sales force continues to market Torchmark's insurance products subsequent to the spin-off of Waddell & Reed under a general agents' contract.

United American offers life and health insurance targeted to various special markets through approximately 1,750 United American exclusive agents in 67 branch offices throughout the United States.

*Independent Agents.* Torchmark insurance companies offer a variety of life and health insurance policies through approximately 43,000 independent agents, brokers, and licensed sales representatives.

Torchmark is not committed or obligated in any way to accept a fixed portion of the business submitted by any independent agent. All policy applications, both new and renewal, are subject to approval and acceptance by Torchmark. Torchmark is not dependent on any single agent or any small group of independent agents, the loss of which would have a materially adverse effect on insurance sales.

Various Torchmark insurance subsidiaries distribute life insurance through a nationwide independent agency whose sales force is comprised of former commissioned and non-commissioned military officers who sell exclusively to commissioned and non-commissioned military officers and their families.

### Ratings

The following list indicates the ratings currently held by Torchmark's five largest insurance companies as rated by A.M. Best Company:

| | A.M. Best Company |
|---|---|
| Liberty National Life Insurance Company | A+ (Superior) |
| Globe Life And Accident Insurance Company | A+ (Superior) |
| United Investors Life Insurance Company | A+ (Superior) |
| United American Insurance Company | A+ (Superior) |
| American Income Life Insurance Company | A (Excellent) |

A.M. Best states that it assigns A+ (Superior) ratings to those companies which, in its opinion, have demonstrated superior overall performance when compared to the norms of the life/health insurance industry. A+ (Superior) companies have a superior ability to meet their obligations to policyholders over a long period of time. A.M. Best states that it assigns A (Excellent) ratings to those companies which, in its opinion, have demonstrated excellent overall performance when compared to the norms of the life/health insurance industry. A (Excellent) companies have an excellent ability to meet their obligations to policyholders over a long period of time.

Liberty, Globe, United American, and UILIC have ratings of AA by Standard & Poor's Corporation. This AA rating is assigned by Standard & Poor's Corporation to those companies who offer excellent financial security on an absolute and relative basis and whose capacity to meet policyholders obligations is overwhelming under a variety of economic and underwriting conditions.

## Competition

The insurance industry is highly competitive. Torchmark competes with other insurance carriers through policyholder service, price, product design, and sales effort. In addition to competition with other insurance companies, Torchmark also faces increasing competition from other financial services organizations. While there are a number of larger insurance companies competing with Torchmark that have greater resources and have considerable marketing forces, there is no individual company dominating any of Torchmark's life or health markets.

Torchmark's health insurance products compete with, in addition to the products of other health insurance carriers, health maintenance organizations, preferred provider organizations, and other health care related institutions which provide medical benefits based on contractual agreements.

Generally, Torchmark companies operate at lower administrative expense levels than its peer companies, allowing Torchmark to have competitive rates while maintaining underwriting margins, or, in the case of Medicare Supplement business, to remain in the business while some companies have ceased new writings. Torchmark's years of experience in direct response business are a valuable asset in designing direct response products.

## Regulation

**Insurance.** Insurance companies are subject to regulation and supervision in the states in which they do business. The laws of the various states establish agencies with broad administrative and supervisory powers which include, among other things, granting and revoking licenses to transact business, regulating trade practices, licensing agents, approving policy forms, approving certain premium rates, setting minimum reserve and loss ratio requirements, determining the form and content of required financial statements, and prescribing the type and amount of investments permitted. Insurance companies can also be required under the solvency or guaranty laws of most states in which they do business to pay assessments up to prescribed limits to fund policyholder losses or liabilities of insolvent insurance companies. They are also required to file detailed annual reports with supervisory agencies, and records of their business are subject to examination at any time. Under the rules of the NAIC, insurance companies are examined periodically by one or more of the supervisory agencies. The most recent examinations of Torchmark's insurance subsidiaries were: American Income as of December 31, 1995; Globe, as of December 31, 1994; Liberty, as of December 31, 1996; United American, as of December 31, 1996; and UILIC, as of December 31, 1996.

*NAIC Ratios.* The NAIC developed the Insurance Regulatory Information System (''IRIS''), which is intended to assist state insurance regulators in monitoring the financial condition of insurance companies. IRIS identifies twelve insurance industry ratios from the statutory financial statements of insurance companies, which are based on regulatory accounting principles and are not based on generally accepted accounting principles (''GAAP''). IRIS specifies a standard or ''usual value'' range for each ratio, and a company's variation from this range may be either favorable or unfavorable. The following table presents the IRIS ratios as determined by the NAIC for Torchmark's five largest insurance subsidiaries, which varied unfavorably from the ''usual value'' range for the years 1997 and 1996.

| Company | Ratio Name | Usual Range | Reported Value |
|---|---|---|---|
| 1997: | | | |
| Liberty | Investment in Affiliate to Capital and Surplus | 0 to 100 | 199 |
| American Income | Non-admitted to Admitted Assets | 10 | 11 |
| 1996: | | | |
| United American | Change in Capital and Surplus | 50 to -10 | -15 |
| American Income | Non-admitted to Admitted Assets | 10 | 11 |
| Liberty | Investment in Affiliate to Capital and Surplus | 0 to 100 | 240 |
| Liberty | Change in Reserving Ratio | 20 to -20 | -20 |

Explanation of Ratios:

Change in Capital and Surplus—These ratios, calculated on both a gross and net basis, are a measure of improvement or deterioration in the company's financial position during the year. The NAIC considers ratios less than minus 10% and greater than 50% to be unusual. United American's ratios of minus 15% in 1996 was caused by the payment of dividends to Torchmark in excess of its statutory net income. This transaction did not affect the consolidated equity of Torchmark at December 31, 1996. Also, this transaction did not affect United American's ability to do business.

Non-admitted Assets to Admitted Assets—This ratio measures the degree to which a company has acquired assets which cannot be carried on its statutory balance sheet. American Income's ratio of 11% in 1997 and in 1996 was due to a large amount of agent balances that arose from commissions that are advanced to agents when a policy is submitted. Due to the growth of American Income's business, these advances have grown and caused a variance in this particular ratio. Agents balances due to American Income are fully recognized as assets in Torchmark's consolidated financial statements.

Investment in Affiliate to Capital and Surplus—This ratio is determined by measuring total investment in affiliates against the capital and surplus of the company. The NAIC considers a ratio of more than 100% to be high, and to possibly impact a company's liquidity, yield, and overall investment risk. The large ratio in Liberty in 1997 and 1996 is the result of its ownership of other Torchmark insurance companies and the ownership of 81% of the stock of Waddell & Reed. Liberty disposed of its investment in Waddell & Reed during 1998 in connection with Torchmark's spin-off of that company to its shareholders. All intercompany investment is eliminated in consolidation, and the internal organizational structure has no bearing on consolidated financial condition or results. Furthermore, this intercompany investment does not affect Liberty's ability to do business.

Change in Reserving Ratio—The change in reserving ratio represents the number of percentage points of difference between the reserving ratio for current and prior years. Liberty's ratio was slightly over the usual range in 1995, returning to the normal range in 1996, as a result of purchasing a block of business in late 1995. The assumption of this business caused an increase in 1995 year-end reserves. No allowance is made for special transactions such as this in the calculation of this ratio.

*Risk Based Capital.* The NAIC requires a risk based capital formula be applied to all life and health insurers. The risk based capital formula is a threshold formula rather than a target capital formula. It is designed only to identify companies that require regulatory attention and is not to be used to rate or rank companies that are adequately capitalized. All of the insurance subsidiaries of Torchmark are adequately capitalized under the risk based capital formula.

*Guaranty Assessments.* State solvency or guaranty laws provide for assessments from insurance companies into a fund which is used, in the event of failure or insolvency of an insurance company, to fulfill the obligations of that company to its policyholders. The amount which a company is assessed for these state funds is determined according to the extent of these unsatisfied obligations in each state. These assessments are recoverable to a great extent as offsets against state premium taxes.

**Holding Company.** States have enacted legislation requiring registration and periodic reporting by insurance companies domiciled within their respective jurisdictions that control or are controlled by other corporations so as to constitute a holding company system. Torchmark and its subsidiaries have registered as a holding company system pursuant to such legislation in Alabama, Delaware, Missouri, New York, Texas, and Indiana.

Insurance holding company system statutes and regulations impose various limitations on investments in subsidiaries, and may require prior regulatory approval for the payment of certain dividends and other distributions in excess of statutory net gain from operations on an annual noncumulative basis by the registered insurer to the holding company or its affiliates.

## Year 2000 Compliance

A full report of Torchmark's risks, project plan, state of readiness, contingency plans, and other matters concerning Year 2000 compliance is found in Management's Discussions and Analysis of Financial Condition and Results of Operations on page 34 of this report.

## Personnel

At the end of 1998, Torchmark had 1,820 employees and 2,261 licensed employees under sales contracts. Additionally, approximately 49,000 independent and exclusive agents and brokers, who were not employees of Torchmark, were associated with Torchmark's marketing efforts.

## Item 2. Real Estate

Torchmark, through its subsidiaries, owns or leases buildings that are used in the normal course of business. Liberty owns a 487,000 square foot building at 2001 Third Avenue South, Birmingham, Alabama which currently serves as Liberty's, UILIC's, and Torchmark's home office. Liberty leases approximately 160,000 square feet of this building to unrelated tenants. Liberty also operates from 59 company-owned district office buildings used for agency sales personnel.

United American owns and is the sole occupant of a 140,000 square foot facility, located in the Stonebridge Ranch development in McKinney, Texas (a North Dallas suburb).

Globe owns a 300,000 square foot office building at 204 North Robinson, Oklahoma City, of which Globe occupies 56,000 square feet as its home office and the remaining space is either leased or available for lease. Globe also owns an 80,000 square foot office building at 120 Robert S. Kerr Avenue, Oklahoma City, which is available for lease. Further, Globe owns a 112,000 foot facility located at 133 NW 122 Street in Oklahoma City which houses the Direct Response operation.

American Income owns and is the sole occupant of an office building located at 1200 Wooded Acres Drive, Waco, Texas. The building is a two story structure containing approximately 72,000 square feet of usable floor space.

Liberty and Globe also lease district office space for their agency sales personnel. All of the other Torchmark companies lease their office space in various cities in the U.S.

A Torchmark subsidiary, Torchmark Development Corporation (''TDC''), as a part of a joint venture with unaffiliated entities, is developing 3,400 acres as a planned community development known as Liberty Park, which is located along Interstate 459 in Birmingham, Alabama.

TMK Income Properties, L.P. (''TIP''), a partnership which is wholly-owned by Torchmark subsidiaries, owns seven office buildings. These properties include: 1.) a 330,000 square foot office building complex at 14000 Quail Springs Parkway Plaza Boulevard, Oklahoma City, which is 96% leased; 2.) six office buildings in Liberty Park in suburban Birmingham, Alabama containing approximately 675,000 square feet which are 95% leased.

### Information Technology Computing Equipment

Torchmark, and its primary subsidiaries, have significant information technology capabilities at their disposal. The corporation uses centralized mainframe computer systems, company-specific local-area networks, workstations, and personal computers to meet its ongoing information processing requirements. Torchmark and its primary subsidiaries also use data communications hardware and software to support their remote data communications networks, intranets, and internet-related telecommunications capabilities.

Torchmark's computer hardware, data communications equipment, and associated software programs are managed by information technology staff. All of the corporation's computer hardware and software support, information processing schedules, and computer-readable data-management requirements are met through company-specific policies and procedures. These company-specific policies and procedures also provide for the off-site storage and retention of backup computer software, financial, and business data files.

## Item 3. Legal Proceedings

Torchmark and its subsidiaries continue to be named as parties to pending or threatened legal proceedings. These lawsuits involve tax matters, alleged breaches of contract, torts, including bad faith and fraud claims based on alleged wrongful or fraudulent acts of agents of Torchmark's subsidiaries, employment discrimination, and miscellaneous other causes of action. Many of these lawsuits involve claims for punitive damages in state courts of Alabama, a jurisdiction particularly recognized for its large punitive damage verdicts. A number of such actions involving Liberty also name Torchmark as a defendant. As a practical matter, a jury's discretion regarding the amount of a punitive damage award is not limited by any clear, objective criteria under Alabama law. Accordingly, the likelihood or extent of a punitive damage award in any given case is virtually impossible to predict. As of December 31, 1998, Liberty was a party to approximately 125 active lawsuits (including 29 employment related cases and excluding interpleaders and stayed cases), more than 110 of which were Alabama proceedings in which punitive damages were sought. Liberty faces trial settings in these cases on an on-going basis.

Based upon information presently available, and in light of legal and other factual defenses available to Torchmark and its subsidiaries, contingent liabilities arising from threatened and pending litigation are not presently considered by management to be material. It should be noted, however, that large punitive damage awards bearing little or no relation to actual damages awarded by juries in jurisdictions in which Torchmark has substantial business, particularly in Alabama, continue to occur, creating the potential for unpredictable material adverse judgments in any given punitive damage suit.

As previously reported, Liberty has been subject to 76 individual cancer policy lawsuits pending in Alabama and Mississippi, which were stayed or otherwise held in abeyance pending final resolution of *Robertson v. Liberty National Life Insurance Company* (Case No. CV-92-021). Liberty filed motions to dismiss these lawsuits based upon the U.S. Supreme Court opinion issued in *Robertson* in March 1997. Only two of these individual cancer policy lawsuits remain, the other such suits having been dismissed.

As previously reported, Torchmark, its insurance subsidiaries Globe and United American, and certain Torchmark officers were named as defendants in purported class action litigation filed in the District Court of Oklahoma County, Oklahoma (*Moore v. Torchmark Corporation*, Case No. CJ-94-2784-65, subsequently amended and restyled *Tabor v. Torchmark Corporation*). This suit claims damages on behalf of individual health policyholders who are alleged to have been induced to terminate such policies and to purchase Medicare Supplement and/or other insurance coverages. On February 6, 1998, the defendants renewed their motion to dismiss the class claims for failure to prosecute. The District Court, in an order dated April 2, 1998, allowed bifurcation of *Tabor* into Medicare Supplement policy claims and non-Medicare Supplement policy claims. The non-Medicare Supplement claims were stayed pending disposition of a related case involving the same plaintiffs filed in Mississippi while discovery was allowed to proceed on plaintiffs' motion to certify a class of Medicare Supplement policyholders' claims.

On August 25, 1995, a purported class action was filed against Torchmark, Globe, United American and certain officers of these companies in the United States District Court for the Western District of Missouri on behalf of all former agents of Globe (*Smith v. Torchmark Corporation*, Case No. :95-3304-CV-S-4). This action alleges that the defendants breached independent agent contracts with the plaintiffs by treating them as captive agents and engaged in a pattern of racketeering activity wrongfully denying income and renewal commissions to the agents, restricting insurance sales, mandating the purchase of worthless leads, terminating agents without cause and inducing the execution of independent agent contracts based on misrepresentations of fact. Monetary damages in an unspecified amount are sought. A plaintiff class was certified by the District Court on February 26, 1996, although the certification does not go to the merit of the allegations in the complaint. On December 31, 1996, the plaintiffs filed an amended complaint in *Smith* to allege violations of various provisions of the Employment Retirement Income Security Act of 1974. Extensive discovery was then conducted. In October 1998, defendants filed a motion to decertify the presently defined class in *Smith*.

It has been previously reported that Torchmark, its subsidiaries United American and Globe and certain individual corporate officers are parties to purported class action litigation filed in April, 1996 in the U.S. District Court for the Northern District of Georgia (*Crichlow v. Torchmark Corporation*, Case No. 4:96-CV-0086-HLM) involving certain hospital and surgical insurance policies issued by Globe and United American. In September 1997, the U.S. District Court entered an order granting summary judgment against the plaintiffs on certain issues and denying national class certification, although indicating that plaintiffs could move for the certification of a state class of Georgia policyholders. Discovery then proceeded on the remaining claims for breach of contract and the duty of good faith arising from closure of the block of business and certain post-claim matters as well as fraud and conspiracy relating to pricing and delay in implementing rate increases. On June 17, 1998, the U.S. District Court entered an order which denied the plaintiffs' motion to certify a Georgia policyholders class, denied reconsideration of the previously entered motion for summary judgment on certain issues, denied reconsideration of the denial of national certification of a class of policyholders and severed and transferred claims of Mississippi policyholders to the U.S. District Court for the Northern District of Mississippi (*Greco v. Torchmark Corporation*, Case No. 1:98CV196-D-D). The U.S. District Court granted defendants' motion for summary judgment on all remaining issues in *Crichlow* on February 4, 1999. Plaintiffs in *Greco* have moved to certify a class of persons purchasing Globe hospital and surgical insurance policies in Mississippi. On February 1, 1999, defendants filed a motion for summary judgment in *Greco*.

It has been previously reported that Liberty was a party to 53 individual cases filed in Chambers County, Alabama involving allegations that an interest-sensitive life insurance policy would become paid-up or self-sustaining after a specified number of years. Only one of these cases remains pending with all others having been settled and dismissed by the Chambers County Circuit Court.

Torchmark has previously reported the case of *Lawson v. Liberty National Life Insurance Company* (Case No. CV-96-01119), filed in the Circuit Court of Jefferson County, Alabama, where the plaintiffs sought to represent a class of interest-sensitive life insurance policyholders, including those allegedly induced to exchange life insurance policies or where the existing policy's cash value was allegedly depleted, in litigation alleging fraud, negligence and breach of contract in the sale or exchange of interest-sensitive policies by Liberty. Torchmark was subsequently added as a defendant. In May 1996, the Circuit Court entered an order conditionally certifying a plaintiffs class, which was subsequently redefined in March 1997. The Circuit Court's order allowed the parties to challenge the conditional certification based upon subsequent discovery in the case. In March 1998, the defendants challenged the conditional certification and a hearing on final certification was held in October 1998. On February 9, 1999, the Circuit Court entered an order decertifying the conditional class and denying all petitions to certify a class in *Lawson*.

Purported class action litigation was filed on January 2, 1996 against Torchmark, Torch Energy Advisors Incorporated, and certain Torch Energy subsidiaries and affiliated limited partnerships in the Circuit Court of Pickens County, Alabama (*Pearson v. Torchmark Corporation*, Case No. CV-95-140). Plaintiff alleges improper payment of royalties and overriding royalties on coalbed methane gas produced and sold from wells in Robinson's Bend Coal Degasification Field, seeks certification of a class and claims unspecified compensatory and punitive damages on behalf of such class. On April 11, 1996, Torchmark's motion to change venue was granted and the case has been transferred to the Circuit Court of Tuscaloosa County, Alabama. Torchmark's motion to dismiss remains pending while discovery is proceeding. On February 10, 1999, the plaintiffs filed a request for a class certification hearing and to set a trial date for the *Pearson* case.

In 1978, the United States District Court for the Northern District of Alabama entered a final judgment in *Battle v. Liberty National Life Insurance Company, et al* (Case No. CV-70-H-752-S), class action litigation involving Liberty, a class composed of all owners of funeral homes in Alabama and a class composed of all insureds (Alabama residents only) under burial or vault policies issued, assumed or reinsured by Liberty. The final judgment fixed the rights and obligations of Liberty and the funeral directors authorized to handle Liberty burial and vault policies as well as reforming the benefits available to the policyholders under the policies. Although class actions are inherently subject to subsequent collateral attack by absent class members, the *Battle* decree remains in effect to date. A motion filed in February 1990 to challenge the final judgment under Federal Rule of Civil Procedure 60(b) was rejected by both the District Court in 1991 and the Eleventh Circuit Court of Appeals in 1992 and a Writ of Certiorari was denied by the U.S. Supreme Court in 1993.

In November 1993, an attorney (purporting to represent the funeral director class) filed a petition in the District Court seeking ''alternative relief'' under the final judgment. This petition was voluntarily withdrawn on November 8, 1995 by petitioners. On February 23, 1996, Liberty filed a petition with the District Court requesting that it order certain contract funeral directors to comply with their obligations under the Final Judgment in *Battle* and their funeral service contracts. A petition was filed on April 8, 1996 on behalf of a group of funeral directors seeking to modify the 1978 decree in *Battle* in light of changed economic circumstances. All parties made extensive submissions to the District Court and a hearing on the opposing petitions was held by the District Court on February 9, 1999.

It has been previously reported that in July 1998, a jury in U.S. District Court in the Middle District of Florida recommended an aggregate total verdict amounting to $21.6 million against Liberty in *Hipp v. Liberty National Life Insurance Company* (Case No. 95-1332-CIV-T-17A). This case, originally filed in 1995 in the Florida state court system, is a collective action under the Fair Labor Standards Act, alleging age discrimination by Liberty in violation of the Age Discrimination in Employment Act and the Florida Civil Rights Act. The plaintiffs, ten present or former Liberty district managers, sought damages for lost wages, loss of future earnings, lost health and retirement benefits and lost raises and expenses. Three of these plaintiffs, Florida residents, also sought compensatory and punitive damages allowable under Florida law. On November 20, 1998, the District Court remitted the $10 million punitive damage portion of the jury verdict to $0, thus reducing the total verdict to $11 million (including an advisory verdict of $3.2 million in front pay awards). Additional revised front pay submissions were made by the plaintiffs to the District Court in December 1998 and Liberty responded thereto in January 1999. Liberty is awaiting the entry of a final judgment in the *Hipp* case and thereafter will pursue all available post trial and appellate relief.

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

No matter was submitted to a vote of shareholders, through the solicitation of proxies or otherwise, during the fourth quarter of 1998.

## PART II

### Item 5. Market for the Registrant's Common Stock and Related Stockholder Matters

The principal market in which Torchmark's common stock is traded is the New York Stock Exchange. There were 6,738 shareholders of record on December 31, 1998, excluding shareholder accounts held in nominee form. On August 1, 1997, Torchmark paid a 100% stock dividend to its common shareholders of record on July 1, 1997. On November 6, 1998, Torchmark distributed its approximately 64% ownership of Waddell & Reed to its shareholders at a ratio of .3018 Waddell & Reed shares to one share of Torchmark. All market prices and dividends per share have been adjusted to reflect the 100% stock dividend and the Waddell & Reed distribution. Information concerning restrictions on the ability of Torchmark's subsidiaries to transfer funds to Torchmark in the form of cash dividends is set forth in *Note 15—Shareholders' Equity* in the *Notes to the Consolidated Financial Statements*. The market prices and cash dividends paid by calendar quarter for the past two years are as follows:

| | 1998 Market Price | | |
|---|---|---|---|
| Quarter | High | Low | Dividends Per Share |
| 1 | $41.2813 | $33.0156 | $ .1500 |
| 2 | 43.0000 | 34.5781 | .1500 |
| 3 | 40.7344 | 30.5313 | .1500 |
| 4 | 40.2500 | 27.4688 | .1300 |

Year-end closing price . . . . . . . . . . $35.3125

| | 1997 Market Price | | |
|---|---|---|---|
| Quarter | High | Low | Dividends Per Share |
| 1 | $26.7031 | $21.5781 | $ .1450 |
| 2 | 31.7031 | 22.6563 | .1450 |
| 3 | 35.9375 | 30.0469 | .1450 |
| 4 | 36.9531 | 30.3750 | .1500 |

Year-end closing price . . . . . . . . . . $36.4219

### Item 6. Selected Financial Data

The following information should be read in conjunction with Torchmark's Consolidated Financial Statements and related notes reported elsewhere in this Form 10-K:

**(Amounts in thousands except per share and percentage data)**

| Year ended December 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| Premium revenue: | | | | | |
| Life | $ 959,766 | $ 909,992 | $ 854,897 | $ 772,257 | $ 601,633 |
| Health | 759,910 | 739,485 | 732,618 | 750,588 | 773,375 |
| Other | 33,954 | 28,527 | 22,404 | 23,438 | 13,866 |
| Total | 1,753,630 | 1,678,004 | 1,609,919 | 1,546,283 | 1,388,874 |
| Net investment income | 459,558 | 429,116 | 399,551 | 377,338 | 344,015 |
| Realized investment gains (losses) | (57,637) | (36,979) | 5,830 | (14,323) | (2,551) |
| Total revenue | 2,157,876 | 2,071,103 | 2,016,416 | 1,910,454 | 1,732,350 |
| Net operating income(1) | 324,315 | 273,730 | 240,637 | 219,864 | 216,994 |
| Net income from continuing operations | 255,776 | 260,429 | 252,815 | 217,958 | 215,873 |
| Net income | 244,441 | 337,743 | 311,372 | 143,235 | 268,946 |
| Net income available to common shareholders | 244,441 | 337,743 | 311,372 | 143,235 | 268,142 |
| Annualized premium issued: | | | | | |
| Life | 244,467 | 230,379 | 214,741 | 217,988 | 149,833 |
| Health | 138,899 | 106,853 | 100,981 | 103,491 | 122,663 |
| Total | 383,366 | 337,232 | 315,722 | 321,479 | 272,496 |
| Per common share: | | | | | |
| Basic earnings: | | | | | |
| Net income | 1.75 | 2.43 | 2.19 | 1.00 | 1.86 |
| Net operating income(1) | 2.32 | 1.97 | 1.69 | 1.54 | 1.50 |
| Net income from continuing operations | 1.83 | 1.87 | 1.78 | 1.52 | 1.49 |
| Diluted earnings: | | | | | |
| Net income | 1.73 | 2.39 | 2.17 | 0.99 | 1.85 |
| Net operating income(1) | 2.29 | 1.94 | 1.67 | 1.52 | 1.49 |
| Net income from continuing operations | 1.81 | 1.84 | 1.76 | 1.51 | 1.48 |
| Cash dividends paid | 0.58 | 0.59 | 0.58 | 0.57 | 0.56 |
| Return on average common equity, excluding effect of SFAS 115, Vesta earnings, and discontinued operations | 15.1% | 18.2% | 18.4% | 18.3% | 19.5% |
| Basic average shares outstanding | 139,999 | 139,202 | 142,460 | 143,188 | 144,192 |
| Diluted average shares outstanding | 141,352 | 141,431 | 143,783 | 144,228 | 145,192 |

| As of December 31, | 1998 | 1997 | 1996 | 1995 | 1994 |
|---|---|---|---|---|---|
| Cash and invested assets | $ 6,417,511 | $ 6,473,096 | $5,863,163 | $5,724,180 | $4,913,925 |
| Total assets | 11,249,028 | 11,127,648 | 9,893,964 | 9,445,623 | 8,144,002 |
| Short-term debt | 355,392 | 347,152 | 40,910 | 189,372 | 250,116 |
| Long-term debt | 383,422 | 564,298 | 791,880 | 791,988 | 791,518 |
| Shareholders' equity | 2,259,528 | 1,932,736 | 1,629,343 | 1,588,952 | 1,242,603 |
| Per common share (2) | 16.51 | 13.80 | 11.69 | 11.09 | 8.69 |
| Per common share excluding effect of SFAS 115 | 15.43 | 12.90 | 11.42 | 10.16 | 9.65 |
| Annualized premium in force: | | | | | |
| Life | 1,062,647(3) | 1,007,379 | 946,525 | 869,366 | 796,955 |
| Health | 796,863 | 762,052 | 748,153 | 759,059 | 812,371 |
| Total | 1,859,510(3) | 1,769,431 | 1,694,678 | 1,628,425 | 1,609,326 |

(1) Excludes realized investment gains (losses), the related adjustment to deferred acquisition costs, equity in Vesta earnings, and discontinued operations.
(2) Computed after deduction of preferred shareholders' equity.
(3) Annualized life premium in force excludes $5.3 million representing the Family Service business sold in 1998.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

*Cautionary Statements.* Torchmark cautions readers regarding certain forward-looking statements contained in the following discussion and elsewhere in this document, and in any other statements made by, or on behalf of Torchmark whether or not in future filings with the Securities and Exchange Commission. Any statement that is not a historical fact, or that might otherwise be considered an opinion or projection concerning Torchmark or its business, whether express or implied, is meant as and should be considered a forward-looking statement. Such statements represent management's opinions concerning future operations, strategies, financial results or other developments.

Forward-looking statements are based upon estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond Torchmark's control. If these estimates or assumptions prove to be incorrect, the actual results of Torchmark may differ materially from the forward-looking statements made on the basis of such estimates or assumptions. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable events or developments, which may be national in scope, related to the insurance industry generally, or applicable to Torchmark specifically. Such events or developments could include, but are not necessarily limited to:

1) Deteriorating general economic conditions leading to increased lapses and/or decreased sales of Torchmark's policies;

2) Changes in governmental regulations (particularly those impacting taxes and changes to the Federal Medicare program that would affect Medicare Supplement insurance);

3) Financial markets trends that adversely affect sales of Torchmark's market-sensitive products;

4) Interest rate changes that adversely affect product sales and/or investment portfolio yield;

5) Increased pricing competition;

6) Adverse regulatory developments;

7) Adverse litigation results;

8) Adverse Year 2000 compliance results;

9) Developments involving Vesta Insurance Group, Inc., described more fully elsewhere in this document under the caption ''Transactions involving Vesta Insurance Group'' on page 34 of this report;

10) The inability of Torchmark to achieve the anticipated levels of administrative and operational efficiencies;

11) The customer response to new products and marketing initiatives;

12) Adverse levels of mortality, morbidity, and utilization of healthcare services relative to Torchmark's assumptions; and

13) The inability of Torchmark to obtain timely and appropriate premium rate increases.

Readers are also directed to consider other risks and uncertainties described in other documents filed by Torchmark with the Securities and Exchange Commission.

The following discussion should be read in conjunction with the Selected Financial Data and Torchmark's Consolidated Financial Statements and Notes thereto appearing elsewhere in this report.

## RESULTS OF OPERATIONS

In the analysis and comparison of Torchmark's operating results with prior periods, two divestitures that occurred in 1998 should be taken into account:

a) the divestiture of Waddell & Reed

b) the sale of Family Service

*Divestiture of Asset Management Operations.* Waddell & Reed, Torchmark's asset management subsidiary, completed an initial public offering in March, 1998 of approximately 24 million shares of its common stock. The offering represented approximately 36% of Waddell & Reed's shares. Net proceeds from the offering were approximately $516 million after underwriters' fees and expenses. Waddell & Reed used $481 million of the proceeds to repay existing notes owed to Torchmark and other Torchmark subsidiaries and retained the remaining $35 million. Torchmark's $481 million proceeds from the note repayments were invested or used to pay down debt. (See the discussion on Investments on page 27, Liquidity on page 31, and Capital Resources on page 31 of this report.) The initial public offering resulted in a $426 million gain which was added to Torchmark's additional paid-in capital. Torchmark retained the remaining 64% of the Waddell & Reed stock.

On November 6, 1998, Torchmark distributed its remaining 64% investment in Waddell & Reed through a tax-free spin-off to Torchmark shareholders. Each Torchmark shareholder of record on October 23, 1998 received a total of .3018 Waddell & Reed shares per Torchmark share. After the spin-off, Torchmark retained no further ownership interest in Waddell & Reed. As a result of the transaction, Torchmark incurred $54 million in expense related to the spin-off, the majority of which was $50 million of corporate Federal income tax resulting from the distribution of a portion of the policyholder surplus account of a Torchmark life subsidiary.

Torchmark has accounted for the spin-off of Waddell & Reed as a disposal of a segment. Accordingly, Torchmark's financial statements for 1998 and all prior periods have been modified to present the net assets and operating results of Waddell & Reed as discontinued operations of the disposed segment. The $54 million expense of the spin-off is included in discontinued operations under the caption ''Loss on Disposal.'' The distribution of the Waddell & Reed shares resulted in a reduction in Torchmark's shareholders' equity in the approximate amount of $174 million, consisting of the equity in Waddell & Reed, net of the 36% minority interest.

Torchmark's share of Waddell & Reed's earnings for 1998 was $48 million after reduction for the minority interest during the period subsequent to the initial public offering but before the spin-off. This compares with $77 million for 1997 and $66 million for 1996, when Torchmark owned 100% of Waddell & Reed for the entire periods.

*Sale of Family Service.* On June 1, 1998, Torchmark sold Family Service to an unaffiliated insurance carrier. Family Service, which was acquired in 1990, is a preneed funeral insurer but has not issued any new policies since 1995. Consideration for the sale was $140 million in cash. Torchmark recorded a pretax realized loss on the sale of approximately $14 million, but incurred a tax expense on the transaction of $9 million for a total after-tax loss of $23 million. In connection with the sale, Torchmark will continue to service the policies in force of Family Service for the next five years for a fee of $2 million per year plus certain variable processing costs. During 1997, Family Service accounted for $57 million in revenues and $7.7 million in pretax income. Through May, 1998, Family Service contributed $25 million in revenues and $5.8 million in pretax income. Invested assets were $778 million and total assets were $828 million at the date of the sale.

*Summary of Operating Results.* Torchmark's management computes a classification of income called ''net operating income.'' Net operating income is the measure of income Torchmark's management focuses on to evaluate the performance of the operations of the company. It differs from net income as reported in the financial statements in that it excludes unusual and nonrecurring income or loss items which distort operating trends.

The following items were excluded from net income as reported in Torchmark's financial statements in order to compute net operating income:

1) Realized investment gains and losses and the related adjustment to deferred acquisition costs, net of tax;

2) Torchmark's pro rata share of Vesta Insurance Group's (''Vesta's'') adjustment to its equity as a result of the accounting irregularities and earnings restatement reported by Vesta in the second quarter of 1998, amounting to a $13 million loss after tax;

3) The $54 million nonrecurring expenses of the Asset Management Operations (Waddell & Reed) spin-off;

4) The nonrecurring loss on the disposal of energy operations in 1996 in the after-tax amount of $7 million; and

5) The nonrecurring loss from the redemption by Torchmark of its debt in the second quarter of 1998, in the amount of $5 million net of tax.

Realized investment losses in 1998, which were $51 million net of tax, included a $23 million after-tax loss from the sale of Family Service, a $24 million after-tax loss on the writedown of Torchmark's Vesta holdings, and a $2 million after-tax loss from the sale of a portion of the Vesta holdings. Losses in 1997, in the after-tax amount of $24 million, were primarily a result of intentional sales of fixed-maturity investments at a loss to offset current and prior-year taxable gains. The Vesta adjustment and the disposal of energy operations is discussed on page 34 and the redemption of Torchmark debt is discussed under the caption ''Capital Resources'' on page 32 of this report.

Net operating income is then further divided into three categories: continuing insurance operations, discontinued operations, and Torchmark's equity in the earnings of Vesta. Continuing insurance operations consists of the operations of Torchmark's insurance subsidiaries and corporate activities. The operations of this group is reflective of Torchmark's operations after the Waddell & Reed spin-off. Discontinued operations include the discontinued asset management activities of Waddell & Reed.

A reconciliation of net operating income from continuing insurance operations to net income on a per diluted share basis is as follows:

**Reconciliation of Per Share Insurance Net Operating Income to Reported Net Income***

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Insurance net operating income | $2.29 | $1.94 | $1.67 |
| Discontinued Asset Management operations | .34 | .55 | .46 |
| Equity in Vesta earnings (losses) | (.03) | .07 | .06 |
| Net operating income—all operations | 2.60 | 2.56 | 2.19 |
| Realized investment gains (losses), net of tax | (.36) | (.17) | .03 |
| Vesta restatements, net of tax | (.09) | — | — |
| Cost of spin-off—Asset Management | (.38) | — | — |
| Loss on disposal of energy operations, net of tax | — | — | (.05) |
| Loss on redemption of debt, net of tax | (.04) | — | — |
| Net income | $1.73 | $2.39 | $2.17 |

* Diluted share basis

In accordance with accounting rules, Torchmark reports earnings per share data as basic and diluted. Basic earnings per share are based on average shares outstanding during the period. Diluted earnings per share assume the exercise of Torchmark's employee stock options for which the exercise price was lower than the market price during the year and their impact on shares outstanding. Diluted earnings per share differ from basic earnings per share in that they are influenced by changes in the market price of Torchmark stock and the number of options as well as the number of shares outstanding. Unless otherwise indicated, all references to per share data in this report are on the basis of diluted shares.

A comparison of Torchmark's basic and diluted earnings per share is as follows:

**Earnings and Earnings Per Share**
(Dollar amounts in thousands, except for per share data)

| | For the Year Ended December 31, | | |
|---|---|---|---|
| | **1998** | **1997** | **1996** |
| Insurance net operating income: | | | |
| Amount | $324,315 | $273,730 | $240,637 |
| Per Share: | | | |
| Basic | 2.32 | 1.97 | 1.69 |
| Diluted | 2.29 | 1.94 | 1.67 |
| Net operating income—all continuing and discontinued operations: | | | |
| Amount | 367,720 | 361,908 | 315,206 |
| Per Share: | | | |
| Basic | 2.63 | 2.60 | 2.21 |
| Diluted | 2.60 | 2.56 | 2.19 |
| Net income: | | | |
| Amount | 244,441 | 337,743 | 311,372 |
| Per Share: | | | |
| Basic | 1.75 | 2.43 | 2.19 |
| Diluted | 1.73 | 2.39 | 2.17 |

*Insurance Operations.* Revenues in 1998 were $2.16 billion, growing 4% over 1997 revenues of $2.07 billion. Revenues rose 3% in 1997 over 1996 revenues of $2.02 million. After adjustment for realized investment gains and losses in each year, revenues gained 5% in 1998 from $2.11 billion in 1997 to $2.22 billion in 1998. They rose 5% in 1997 over the prior year. Total premium increased $76 million or 5% in 1998, accounting for 70% of the $107 million increase in total revenues excluding realized gains and losses. Life insurance premium increased $50 million, or 5% and health premium grew $20 million or 3% in 1998. Net investment income increased 7% in 1998 to $460 million.

The $97 million or 5% growth in 1997 revenues excluding realized investment gains and losses resulted largely from the increase in life premium of $55 million or 6%. Investment income, which rose 7%, also contributed $29 million to 1997 revenue growth.

Other operating expenses have declined in both 1998 and 1997 from the respective prior year. They declined from $120 million in 1997 to $117 million in 1998. In 1997, expenses declined $6 million or 5%, primarily due to a reduction in litigation expense. As a percentage of revenues, excluding realized gains and losses, other operating expenses declined in each period and were 5.3% in 1998, 5.6% in 1997, and 6.2% in 1996. Other operating expenses consist of insurance administrative expenses and expenses of the parent company. The components of Torchmark's revenues and operations are described in more detail in the discussion of Insurance and Investment segments found on pages 20 through 30 of this report.

The effective tax rate for Torchmark was 34.5% in 1998, compared with 35.3% in 1997 and 35.8% in 1996. Excluding goodwill, the effective tax rates for insurance operations were 33.0%, 32.9%, and 33.5% in 1998, 1997 and 1996, respectively. The 1997 decline in the effective rate resulted from additional energy tax credits that were available as a part of the consideration from the 1996 disposition of the energy segment.

The following table is a summary of Torchmark's continuing insurance net operating income. Net underwriting income is defined by Torchmark management as premium income less net policy obligations, commissions, acquisition expenses, and insurance administrative expenses. Excess investment income is defined as tax equivalent net investment income reduced by the interest credited to net policy liabilities and financing costs. Financing costs include the interest on Torchmark's debt and the net cost of the Monthly Income Preferred Securities (''MIPS'').

**Summary of Insurance Net Operating Income**
(Dollar amounts in thousands)

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Insurance underwriting income before other income and administrative expenses: | | | | | | |
| Life | $ 252,556 | 60.8% | $ 241,038 | 60.0% | $ 222,004 | 57.5% |
| Health | 139,445 | 33.6 | 141,540 | 35.3 | 148,097 | 38.4 |
| Annuity | 23,423 | 5.6 | 19,025 | 4.7 | 15,960 | 4.1 |
| Other | 0 | | 7 | | 18 | |
| Total | 415,424 | 100.0% | 401,610 | 100.0% | 386,079 | 100.0% |
| Other income | 4,488 | | 3,141 | | 2,936 | |
| Administrative expenses | (102,559) | | (101,950) | | (108,020) | |
| Insurance underwriting income excluding Family Service | 317,353 | | 302,801 | | 280,995 | |
| Insurance underwriting income—Family Service | 1,393 | | 3,685 | | 4,200 | |
| Excess investment income | 206,119 | | 143,476 | | 118,872 | |
| Corporate expense | (12,061) | | (13,953) | | (13,798) | |
| Goodwill amortization | (12,075) | | (12,074) | | (12,074) | |
| Tax equivalency adjustment | (11,143) | | (9,951) | | (10,638) | |
| Pretax insurance net operating income | 489,586 | | 413,984 | | 367,557 | |
| Income tax | (165,271) | | (140,254) | | (126,920) | |
| Insurance net operating income | $ 324,315 | | $ 273,730 | | $ 240,637 | |
| Insurance net operating income per diluted share | $ 2.29 | | $ 1.94 | | $ 1.67 | |

Pretax insurance net operating income rose 18% in 1998 after a 13% increase in 1997 due to increases in both periods in insurance underwriting income and investment results and declines in financing costs. Torchmark's core operations are segmented into insurance underwriting operations and investment operations. Insurance underwriting activities are further segmented into life insurance, health insurance, and annuity product groups. A discussion of each of Torchmark's segments follows.

*Life insurance.* Life insurance is Torchmark's largest segment, with life premium representing 55% of total premium and life underwriting income before other income and administrative expense representing 61% of the total. Sales of this group of products continues to be emphasized because of its higher underwriting margins and larger asset base resulting from higher reserve levels. A larger asset base provides Torchmark the opportunity to increase investment income.

Life insurance premium increased 5% in 1998 to $960 million from $910 million in 1997. Life premium rose 6% in 1997. Sales of life insurance, in terms of annualized premium, were $244 million in 1998, increasing 6% over 1997 sales of $230 million. This compares with 7% growth in 1997 sales over 1996. Annualized life premium in force was $1.06 billion at December 31, 1998, compared with $1.01 billion at 1997 year end, an increase of 5%. Annualized premium grew 6% in 1997 from $947 million at year-end 1996. Annualized premium in force and issued data includes amounts collected on certain interest-sensitive life products which are not recorded as premium income but excludes single-premium income and policy account charges.

The sale of Family Service on June 1, 1998 caused some distortion in life insurance results for 1998. Excluding Family Service operations, life insurance premium income would have increased 6% to $957 million in 1998 and 7% to $901 million in 1997. Annualized life premium in force would have increased 6% in 1998 and 7% in 1997.

Life insurance products are marketed through a variety of distribution channels. The following table presents life insurance premium by distribution method excluding Family Service during each of the three years ended December 31, 1998.

**LIFE INSURANCE**
**Premium by Distribution Method**
(Dollar amounts in thousands)

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| United American Independent Agency | $ 36,925 | 3.9% | $ 36,810 | 4.1% | $ 33,404 | 4.0% |
| United American Exclusive Agency | 18,798 | 2.0 | 18,243 | 2.0 | 15,767 | 1.9 |
| Direct Response | 221,371 | 23.1 | 195,393 | 21.7 | 171,983 | 20.4 |
| Liberty National Exclusive Agency | 281,145 | 29.4 | 280,519 | 31.1 | 279,637 | 33.2 |
| American Income Exclusive Agency | 204,310 | 21.3 | 190,681 | 21.2 | 173,700 | 20.6 |
| Military Independent Agency | 92,204 | 9.6 | 79,631 | 8.8 | 71,223 | 8.4 |
| United Investors Exclusive Agency | 81,620 | 8.5 | 77,986 | 8.7 | 73,836 | 8.8 |
| Other | 20,901 | 2.2 | 21,924 | 2.4 | 22,636 | 2.7 |
| | $957,274 | 100.0% | $901,187 | 100.0% | $842,186 | 100.0% |

Direct Response marketing is conducted through direct mail, co-op mailings, television and consumer magazine advertising, and direct mail solicitations endorsed by groups, unions and associations. It markets a line of primarily life products to juveniles and adults with face amounts of less than $10 thousand on average. The Direct Response operation is a profitable distribution channel for Torchmark characterized by lower acquisition costs than Torchmark's agency-based marketing systems. Direct Response life operations have grown rapidly since the early 1990's when new direct distribution media and target markets were added. Prior to that time, the primary product was a direct mail juvenile life product. In both 1997 and 1998, this distribution center had Torchmark's highest growth in life insurance premium in dollar amount and accounted for over 23% of Torchmark's life insurance premium during 1998. Direct Response premium was $221 million in 1998, increasing 13% over 1997 premium of $195 million. Direct Response life premium in 1997 grew 14% over 1996 premium of $172 million.

Leading the other distribution channels, annualized premium sold by the Direct Response operation was $94 million in 1998, rising 18% over 1997 sales of $79 million. The 1997 sales increased 28% over 1996 sales of $62 million. Direct Response life annualized premium in force rose 12% to $260 million at December 31, 1998 from $233 million a year earlier. At December 31, 1998, Direct Response life annualized premium in force was second only to that of the Liberty National Exclusive Agency. Direct Response life insurance annualized premium in force grew 15% in 1997.

In addition to growth in life insurance sales and premium, the Direct Response operation has promoted growth in some of Torchmark's agent-based distribution channels through providing marketing support. Direct Response marketing support directly contributed to the increase in health sales by the United American Exclusive Agency and its resulting agent recruiting success. Methods to extend Direct Response marketing support to other Torchmark agent-based distribution channels are being explored.

The Liberty National Exclusive Agency distribution system represented Torchmark's largest portion of life insurance premium income in each of the three years presented, with 1998 premium of $281 million representing 29% of total life premium. The annualized life premium in force of the Liberty Agency was $298 million at year-end 1998, compared with $299 million and $298 million at year-ends 1997 and 1996, respectively. Life premium sales, in terms of annualized premium issued, grew 5% during 1998 to $46 million. This 1998 growth in life insurance sales compares to a decline in life sales during 1997 of 5% to $43 million. The turnaround in sales growth in the Liberty Agency was largely attributable to growth in the number of agents from 1,750 agents at year-end 1997 to 1,829 agents at year-end 1998, an increase of 5%. The number of first-year agents climbed 7% in 1998 to 804, after having increased 20% in 1997. New agent recruitment programs were implemented in late 1996 resulting in the new agent growth. Additionally, training programs have been employed to improve the retention of newly recruited agents. Management believes that the continued recruiting of new agents and the retention of productive agents are critical to the continued growth of sales in controlled agency distribution systems.

The Liberty National Agency has completed the transition from a debit-style renewal premium collection system to a direct bill or bank draft collection system. As a result, less than 1% of premium was debit collected in 1998.

Another of Torchmark's distribution channels for life insurance is a nationwide independent agency whose sales force is comprised of former commissioned and non-commissioned military officers who sell exclusively to commissioned and non-commissioned military officers and their families. This business is comprised of whole life products with term insurance riders. The quality of the business produced by this Military Agency is outstanding and is characterized by extremely low lapse rates. Life premium income from this distribution system grew 16% to $92 million in 1998, representing the largest percentage growth in life premium of any Torchmark distribution channel in 1998. Premium for this Agency rose 12% to $80 million in 1997. Annualized life premium in force for the Military distribution system grew 15% in 1998 to $99 million, after having increased 16% to $86 million in 1997. In both years this distribution system produced the greatest amount of growth in annualized life premium in force on a percentage basis. A major factor in this growth of in-force premium relates to the very high persistency associated with this business. Annualized premium sold during 1998 by this Agency was $17 million, an increase of 7% over sales of $16 million in 1997. Production almost doubled in 1997 from 1996 sales of $8 million.

The American Income Exclusive Agency is a distribution system that focuses on members of labor unions, credit unions, and other associations for its life insurance sales. It is a high margin business characterized by lower policy obligation ratios. At December 31, 1998, premium from this system accounted for 21% of Torchmark's total life premium. American Income's premium increased 7% to $204 million in 1998, after having risen 10% in 1997 to $191 million. Annualized life premium in force was $216 million at year-end 1998, an increase of 6% over 1997 premium in force of $203 million. Annualized life premium in force rose 8% in 1997. Sales, in terms of annualized premium issued, were $54 million in 1998, $55 million in 1997, and $54 million in 1996. This Agency experienced a 12% decline in agents during 1998, contributing to the decline in sales. Management is currently implementing changes to American Income's marketing organization to focus on the recruitment and retention of agents.

The United Investors Exclusive Agency is made up of Waddell & Reed sales representatives, who market the life insurance products of United Investors Life under a marketing agreement with Waddell & Reed. This Agency accounted for 9% of Torchmark's life premium in 1998. Premium income rose 5% in 1998 to $82 million, following a 6% increase in 1997 to $78 million. Sales growth in this Agency in terms of annualized premium issued was 50% in 1998, the highest life production of any Torchmark Agency in terms of percentage growth. Sales were $15 million in 1988, compared with $10 million in 1997. Annualized life premium in force increased 12% to $100 million at December 31, 1998, 9% of Torchmark's total life premium in force. In addition to the growth in life insurance sales, this agency has also increased production of variable life collections from $5 million in 1997 to $18 million in 1998, almost a fourfold increase. Although variable life collections are not included in premium in force data, they are indicative of growth in the variable life account balance. Indirectly, they add to premium revenue through the policy account charges for insurance coverage and administration as the account balance grows.

The United American Independent and Exclusive Agencies represented about 6% of total life premium in 1998. On a combined basis, life premium rose 1% to $56 million in 1998. Premium for these agencies increased 12% in 1997 to $55 million.

**LIFE INSURANCE**
**Summary of Results**
(Dollar amounts in thousands)

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Amount | % of Premium | Amount | % of Premium | Amount | % of Premium |
| Premium and policy charges | $ 957,274 | 100.0% | $ 901,187 | 100.0% | $ 842,186 | 100.0% |
| Policy obligations | 618,867 | 64.7 | 574,139 | 63.7 | 538,233 | 63.9 |
| Required reserve interest | (215,185) | (22.5) | (199,339) | (22.1) | (186,306) | (22.1) |
| Net policy obligations | 403,682 | 42.2 | 374,800 | 41.6 | 351,927 | 41.8 |
| Amortization of acquisition costs | 158,298 | 16.5 | 149,358 | 16.6 | 138,553 | 16.5 |
| Commissions and premium taxes | 57,364 | 6.0 | 55,019 | 6.1 | 53,747 | 6.4 |
| Required interest on deferred acquisition costs | 85,374 | 8.9 | 80,972 | 9.0 | 75,955 | 9.0 |
| Total expense | 704,718 | 73.6 | 660,149 | 73.3 | 620,182 | 73.7 |
| Insurance underwriting income before other income and administrative expense, excluding Family Service | 252,556 | 26.4% | 241,038 | 26.7% | 222,004 | 26.3% |
| Family Service insurance underwriting income before other income and administrative expense | 2,187 | | 5,650 | | 5,689 | |
| Insurance underwriting income before other income and administrative expense | $ 254,743 | | $ 246,688 | | $ 227,693 | |

Life insurance gross margins, as indicated by insurance underwriting income before other income and administrative expense as a percentage of premium, have remained at approximately 27% throughout the three-year period measured. The underwriting margin rose 3% in 1998 to $255 million, after having increased 8% to $247 million in 1997. Excluding Family Service, the underwriting margin increased 5% in 1998 to $253 million and 9% in 1997 to $241 million. Obligation ratios for life business rose slightly in 1998, caused by an increase in mortality. Fluctuations in mortality are normal in the life insurance industry and are not indicative of a trend.

*Health Insurance.* Torchmark markets its supplemental health insurance products through a number of distribution channels. The following table indicates health insurance premium income during each of the three years ended December 31, 1998 by distribution method.

**HEALTH INSURANCE**
**Premium by Distribution Method**
(Dollar amounts in thousands)

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| United American Independent Agency | $417,556 | 54.9% | $428,775 | 58.0% | $440,862 | 60.2% |
| United American Exclusive Agency | 150,602 | 19.8 | 132,426 | 17.9 | 124,037 | 16.9 |
| Liberty National Exclusive Agency | 135,861 | 17.9 | 125,701 | 17.0 | 120,028 | 16.4 |
| American Income Exclusive Agency | 47,074 | 6.2 | 46,116 | 6.2 | 44,172 | 6.0 |
| Direct Response | 8,817 | 1.2 | 6,467 | 0.9 | 3,519 | 0.5 |
| | $759,910 | 100.0% | $739,485 | 100.0% | $732,618 | 100.0% |

Health insurance premium increased 3% to $760 million in 1998 over 1997 premium of $739 million. In 1997, health premium rose 1% over 1996 premium. However, 1997 was the first year since 1993 that Torchmark recorded a year-over-year increase in premium for this segment. Annualized health premium in force grew 5% to $797 million at December 31, 1998 over the previous year-end balance of $762 million. Health premium in force rose 2% during 1997. Sales of health premium, in terms of annualized premium issued, were $139 million in 1998, increasing 30% over 1997 sales of $107 million. Sales in 1997 grew 6% over the prior year. Sales of health insurance have accelerated greatly in the past two years due to increases in sales of Medicare Supplement policies. Prior to 1997, Torchmark had not experienced year-over-year sales growth in health insurance for five years.

Health products sold by Torchmark insurance companies include Medicare Supplement, cancer, long-term care, and other under-age-65 limited-benefit supplemental medical and hospitalization products. As a percentage of annualized health premium in force at December 31, 1998, Medicare Supplement accounted for 69%, cancer 18%, and other health products 13%. Medicare Supplement and cancer annualized premium in force was $554 million and $145 million, respectively, at December 31, 1998.

Medicare Supplement insurance is sold primarily by the United American Exclusive Agency and the United American Independent Agency. While health sales in both Agencies have grown in the past three years, sales by the Exclusive Agency exceeded the health sales of the Independent Agency in 1998. This Agency sold $64 million in annualized health premium in 1998, a 62% gain over the prior year. Health sales of $40 million in 1997 rose 26% over 1996 sales. This Agency accounted for $18 million of the $20 million in health premium growth in 1998. It also was instrumental in health annualized premium growth in both 1998 and 1997, accounting for $31 million of the $35 million growth during 1998 in in-force premium and adding $11 million to annualized health premium in force in 1997. One factor in the growth in Medicare Supplement sales in the United American Exclusive Agency is the targeted marketing support provided by the Direct Response operation.

The United American Independent Agency continues to represent the largest amount of Torchmark's health premium in force. The Agency's $426 million of annualized health premium in force at December 31, 1998, of which $399 million was Medicare Supplement premium in force, was 54% of Torchmark's total health premium in force. Medicare Supplement sales by the United American Independent Agency were $38 million in 1998, a 47% increase over 1997. In spite of increased Medicare Supplement sales, Medicare Supplement annualized premium in force for the United American Independent Agency remained level at year-end 1998 compared with year-end 1997. This occurred because recent years' increases in sales resulting in additions to in force policies have been offset by normal lapses occurring in the large, aging block of in force Medicare Supplement policies.

Medicare Supplement policies are highly regulated at both the federal and state levels with limits on agent compensation and mandated minimum loss ratios. However, they remain a popular supplemental health policy with the country's large and growing group of Medicare beneficiaries. About 85% of all Medicare beneficiaries obtain Medicare supplements to cover at least some of the deductibles and coinsurance for which the federal Medicare program does not pay. During the last few years, Torchmark has focused on developing its United American Exclusive Agency to serve this market. Using the Direct Response operation, both targeted marketing support and increased agent recruiting have successfully led to increased sales. Because of loss ratio regulation, underwriting margins on Medicare supplements are less than on Torchmark's life business. However, due to United American's low cost, service-oriented customer service and claims administration, as well as its economies of scale, it is a profitable line of business.

Until recently the primary competition for Medicare Supplement sales had come from Medicare health maintenance organizations (HMO's), the managed care alternative to traditional fee-for-service Medicare which eliminated the need for a supplemental policy. However, in the last few years, growing public dissatisfaction with managed care, increased medical cost inflation and increased federal government regulatory pressures on Medicare HMO's have caused an increasing number of HMO's to withdraw from the market, reducing that competition. Other regulatory issues continue to affect the Medicare Supplement market. Medical cost inflation and changes to the Medicare program cause the need for annual rate increases, which generally require state insurance department approval. In addition, Congress and the Federal Administration have begun studying ways to finance the Medicare program in the future as it is anticipated that the program could be insolvent within the next decade. This would occur because of the growth in the number of ''baby boomers'' becoming eligible for Medicare during that period and increasing medical cost inflation generally due to increased utilization. Therefore, it is likely that changes will be made to the Medicare program at sometime in the future. However, regardless of proposed changes, it appears that there will continue to be an important role for private insurers in helping senior citizens cover their healthcare costs. As a result, Medicare Supplements should continue as a popular product for senior-age consumers.

Cancer insurance premium in force grew 5% in 1998 to $145 million, compared with 15% growth in 1997. Sales of this product declined 5% from 1997 sales of $11 million to $10 million. Sales in 1996 were also $11 million. Growth in cancer annualized premium in force has been attributable in large part to premium rate increases to offset increased health care costs. Cancer insurance products are sold primarily by the Liberty National Exclusive Agency. This Agency represented 85% of Torchmark's total cancer annualized premium in force at December 31, 1998.

Annualized premium in force for other health products declined 4% in 1998 to $98 million, after declining 2% in 1997. Other health sales declined 15% in 1998 to $26 million. Sales increased in 1997, however, with annualized premium issued rising 26% to $31 million. A large factor in the 1997 sales increase was the increased issue of a limited-benefit hospital-surgical product sold by the United American Independent Agency. With the resurgence of Medicare Supplement sales opportunities, the emphasis of the United American Independent Agency during 1998 returned to Medicare Supplement and less on other health products. As a result, sales and annualized premium in force by this agency of other health products declined as compared with 1997.

**HEALTH INSURANCE**
**Summary of Results**
(Dollar amounts in thousands)

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Amount | % of Premium | Amount | % of Premium | Amount | % of Premium |
| Premium | $759,910 | 100.0% | $739,485 | 100.0% | $732,618 | 100.0% |
| Policy obligations | 482,496 | 63.5 | 462,967 | 62.6 | 448,346 | 61.2 |
| Required reserve interest | (20,440) | (2.7) | (21,644) | (2.9) | (26,137) | (3.6) |
| Net policy obligations | 462,056 | 60.8 | 441,323 | 59.7 | 422,209 | 57.6 |
| Amortization of acquisition costs | 59,208 | 7.8 | 58,473 | 7.9 | 63,150 | 8.6 |
| Commissions and premium taxes | 87,828 | 11.5 | 87,069 | 11.8 | 87,687 | 12.0 |
| Required interest on deferred acquisition costs | 11,373 | 1.5 | 11,080 | 1.5 | 11,475 | 1.6 |
| Total expense | 620,465 | 81.6 | 597,945 | 80.9 | 584,521 | 79.8 |
| Insurance underwriting income before other income and administrative expense | $139,445 | 18.4% | $141,540 | 19.1% | $148,097 | 20.2% |

Health insurance underwriting income before other income and administrative expense declined 1% in 1998 to $139 million, after having declined 4% in 1997. As a percentage of premium, underwriting income before other income and administrative expense declined 1% in the years 1998 and 1997 from the prior year, respectively. Margins have lagged premium growth because of higher obligation costs. Medicare Supplement margins are restrained by the Federally mandated minimum loss ratio of 65% and by competition. Cancer obligation ratios have increased in each year because of healthcare inflationary pressures. To the extent management is able to obtain timely and adequate premium rate increases from regulatory authorities to offset these cost increases, margins may be stabilized on cancer business. Torchmark continues to seek such rate increases.

*Annuities.* Annuity products are marketed by Torchmark to service a variety of needs, including retirement income and long-term, tax-deferred growth opportunities. Torchmark's annuities are sold almost entirely by the United Investors' Exclusive Agency. This agency consists of the Waddell & Reed sales force which markets United Investors' annuities and other products under a marketing agreement. In 1998, this agency collected $309 million of Torchmark's total $368 million in annuity collections. The United Investors Agency accounted for 97% of total annuity policy charges in 1998.

Annuities are sold on both a fixed and variable basis. Fixed annuity deposits are held and invested by Torchmark and are obligations of the company. Variable annuity deposits are invested at the policyholder's direction into his choice among a variety of mutual funds managed by Waddell & Reed, which vary in degree of investment risk and return. A fixed annuity investment account is also available as a variable annuity investment option. Investments pertaining to variable annuity deposits are reported as ''Separate Account Assets'' and the corresponding deposit balances for variable annuities are reported as ''Separate Account Liabilities.''

Annuity premium is added to the annuity account balance as a deposit and is not reflected in income. Revenues on both fixed and variable annuities are derived from charges to the annuity account balances for insurance risk, administration, and surrender, depending on the structure of the contract. Variable accounts are also charged an investment fee and a sales charge. Torchmark benefits to the extent these policy charges exceed actual costs and to the extent actual investment income exceeds the investment income which is credited to fixed annuity policyholders.

The following table presents the annuity account balance at each year end and the annuity collections for each year for both fixed and variable annuities, excluding Family Service.

| | **Annuity Deposit Balances (Dollar amounts in millions)** | | | **Annuity Collections (Dollar amounts in thousands)** | | |
|---|---|---|---|---|---|---|
| | **1998** | **1997** | **1996** | **1998** | **1997** | **1996** |
| Fixed | $ 647.3 | $ 611.0 | $ 571.9 | $ 64,687 | $ 76,930 | $ 72,392 |
| Variable | 2,343.5 | 1,821.2 | 1,375.5 | 299,005 | 247,446 | 247,461 |
| Total | $2,990.8 | $2,432.2 | $1,947.4 | $363,692 | $324,376 | $319,853 |

Collections of fixed annuity premium were $65 million in 1998, compared with $77 million in 1997, a decline of 16%. Management believes that the low-interest environment in 1997 and 1998 has been a factor in the reduced sales of fixed annuities, as variable annuities and alternative investments have grown more attractive. Fixed annuity collections were $72 million in 1996. The fixed annuity deposit balance increased 6% in 1998 to $647 million at year end. It rose 7% in the prior period from $572 million at year-end 1996 to $611 million at the end of 1997.

During 1998, Torchmark sold Family Service, a wholly-owned provider of preneed annuities. While the sale of these preneed annuities had been discontinued in 1995, this block of annuities remained on deposit until Family was sold. At the date of sale, this deposit balance was approximately $396 million.

Variable annuity collections rose 21% to $299 million in 1998. Variable collections were flat in 1997, compared with the prior year at $247 million. The strength in financial markets has had a positive influence on sales of variable annuities in both 1998 and 1997.

The variable account balance has experienced rapid growth in recent years, rising 31% in 1996 to $1.4 billion at December 31, 1996, 32% in 1997 to $1.8 billion at year-end 1997, and 29% to $2.3 billion at the end of 1998. Strong financial markets in all of these periods contributed greatly to the growth. Variable accounts are valued based on the market values of the underlying securities. The additional collections in each year also added to the balances.

**ANNUITIES**
**Summary of Results**
(Dollar amounts in thousands)

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| | **Amount** | **Amount** | **Amount** |
| Policy charges | $ 33,594 | $ 27,426 | $ 21,029 |
| Policy obligations | 34,662 | 34,631 | 32,085 |
| Required reserve interest | (42,171) | (41,551) | (38,972) |
| Net policy obligations | (7,509) | (6,920) | (6,887) |
| Amortization of acquisition costs | 11,561 | 9,660 | 7,280 |
| Commissions and premium taxes | 510 | 710 | 423 |
| Required interest on deferred acquisition costs | 5,609 | 4,951 | 4,253 |
| Total expense | 10,171 | 8,401 | 5,069 |
| Insurance underwriting income before other income and administrative expense, excluding Family Service | 23,423 | 19,025 | 15,960 |
| Family Service insurance underwriting income before other income and administrative expense | 98 | 305 | 520 |
| Insurance underwriting income before other income and administrative expense | $ 23,521 | $ 19,330 | $ 16,480 |

Annuity underwriting income before other income and administrative expense has grown steadily throughout each of the years 1996 through 1998, increasing 22% to $24 million in 1998 and 17% to $19 million in 1997 over the respective prior year. Policy charges have also grown in each period, rising 22% in 1998 to $34 million and 30% in 1997 to $27 million. Growth in policy charges is primarily related to the growth in the size of the account balance, but is also attributable to the increase in the number of annuity contracts in force and the cumulative effect of the growth in sales over the past few years upon which the sales charge is based.

*Investments.* The following table summarizes Torchmark's investment income and excess investment income.

**Analysis of Excess Investment Income**
(Dollar amounts in thousands)

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Net investment income | $ 459,558 | $ 429,116 | $ 399,551 |
| Tax equivalency adjustment | 11,143 | 9,951 | 10,638 |
| Tax equivalent investment income | 470,701 | 439,067 | 410,189 |
| Required interest on net insurance policy liabilities: | | | |
| Interest on reserves | (296,696) | (308,632) | (298,408) |
| Interest on deferred acquisition costs | 103,481 | 100,096 | 95,556 |
| Net required | (193,215) | (208,536) | (202,852) |
| Financing costs | (71,367) | (87,055) | (88,465) |
| Excess investment income | $ 206,119 | $ 143,476 | $ 118,872 |
| Mean invested assets (at amortized cost) | $6,353,279 | $6,058,037 | $5,626,803 |
| Average net insurance policy liabilities | 3,261,982 | 3,468,702 | 3,312,575 |
| Average debt (including MIPS) | 1,000,063 | 1,062,543 | 1,076,673 |

Excess investment income represents the profit margin attributable to investment operations and cash flow management. It is defined as tax-equivalent investment income reduced by the interest cost credited to net policy liabilities and the interest cost associated with capital funding or ''financing costs.'' Excess investment income is increased in a number of ways: an increase in investment yields over the rates credited to policyholders' liabilities or over the rates applicable to Torchmark debt, growth in assets in relation to policy liabilities and debt, and the efficient use of capital resources and cash flow.

Net investment income rose 7% to $460 million in 1998, compared with an increase of 7% to $429 million in 1997. On a tax-equivalent basis, in which the yield on tax-exempt securities is adjusted to produce a yield equivalent to the pretax yield on taxable securities, investment income also rose 7% in both 1998 and 1997. These increases in investment income resulted primarily from the growth in the invested asset base during each period. Mean invested assets increased 5% in 1998 and 8% in 1997. Asset growth in 1998 was caused primarily by the receipt of $481 million in proceeds from the Waddell & Reed offering in early 1998, offset somewhat by the sale of investments to repay debt and to buy Torchmark stock. The Family Service sale also negatively impacted 1998 net investment income due to the loss of approximately $778 million in invested assets at the date of the sale. Growth in 1997 excess investment income was due to the accumulation of the investments backing life reserves and the reinvestment of cash flow.

The increases in excess investment income were greater than the growth in net investment income, however. In 1998, excess investment income increased 44% to $206 million. The $63 million increase in 1998 in excess investment income resulted primarily from the proceeds of the Waddell & Reed offering which provided Torchmark with $481 million in additional funds to invest or to apply to outstanding debt. There was also $7 million of interest income on an internal financing with Waddell & Reed included in 1998 income. Also in 1998, Torchmark essentially refinanced $380 million principal amount of its long-term debt with either short-term debt or lower-yielding investments sales, saving an average of 350 basis points in 1998 financing costs. The Family Services disposition had minimal impact on the change in excess investment income. The loss of Family's investment portfolio did result in a loss of net investment income, but this loss was offset by the reduction in required interest caused by the disposition of net policy obligations and the receipt of $140 million in proceeds from the sale which were added to investments.

In 1997, the 21% growth in excess investment income resulted primarily from the greater growth in average invested assets relative to the growth in net policy liabilities. Also, financing costs declined 2% during the period as a result of debt paydowns.

Torchmark's share repurchase program, which was renewed after the Waddell & Reed spin-off, had little impact on excess investment income in 1998 because purchases were made late in the year. However, in 1999, share purchases will negatively affect growth in excess investment income. While there is a cost of capital associated with share purchases, per share earnings could be improved.

U. S. Treasury rates continued a downward trend in 1998. The rates on corporate and municipal securities did not decline to the same extent as treasuries, resulting in a ''spread widening.'' For this reason, Torchmark was able to continue its fixed-maturity acquisition program relatively unchanged. Excluding Family Service, which was sold during 1998, acquisitions totaled $1.8 billion, compared with $1.7 billion for 1997. New fixed-maturity holdings were acquired at an average yield of 7.13% in 1998, compared with 7.29% for 1997 and 7.12% in 1996. The estimated average maturity of 1998 acquisitions was 20.7 years, compared with 13.3 years in 1997 and 7.8 years in 1996. Torchmark varies the maturities of its new investments based on a number of factors, including the level of rates and the slope of the prevailing yield curve in order to maximize investment value and return.

With lower yields on acquisitions, the fixed maturity portfolio yield declined to 7.42% at December 31, 1998, slightly below the year earlier level of 7.49% and 7.54% at year-end 1996. The average life of the portfolio increased to 8.8 years, compared with 8.0 years at year-end 1997 and 7.8 years at year-end 1996. At year-end 1998, duration was 5.7 years, compared with 5.1 years in 1997 and 5.0 years in 1996. Emphasis continues to be on marketable, high quality investments. Over 93% of the portfolio is considered by Standard and Poor's to be investment grade, while 95% is considered investment grade by the NAIC.

Torchmark considers its entire portfolio available for sale. It is therefore valued at market which fluctuates as interest rate changes occur. The portfolio's year-end 1998 unrealized gain of $249 million compares with an unrealized gain of $213 million at year-end 1997 and $63 million at year-end 1996. With the high quality and liquidity of its portfolio, Torchmark is able to minimize its holdings in short-term investments, which totaled $76 million at year-end 1998 and $66 million at year-end 1997. A substantial portion of the portfolio is expected to repay during the next several years.

| | 1998 | 1997 |
|---|---|---|
| Short terms and under 1 year | 7.8% | 5.4% |
| 2-5 years | 23.8 | 27.6 |
| 6-10 years | 31.8 | 43.8 |
| 11-15 years | 9.0 | 11.2 |
| 16-20 years | 3.8 | 3.7 |
| Over 20 years | 23.8 | 8.3 |
| | 100.0% | 100.0% |

Fixed maturity investments continued to represent 91% of investment assets at year-end 1998, which causes the percentage holdings of other type investments to vary from industry averages. The following table presents Torchmark's components of invested assets compared with the latest industry data:

| | Torchmark | | |
|---|---|---|---|
| | Amount (in thousands) | % | Industry % (1) |
| Bonds & short terms | $5,844,291 | 91.1% | 74.8% |
| Equities | 9,843 | .2 | 4.4 |
| Mortgage loans | 124,072 | 1.9 | 11.6 |
| Real estate | 164,644 | 2.6 | 1.8 |
| Policy loans | 233,765 | 3.6 | 5.8 |
| Other invested assets | 35,976 | .6 | 1.6 |
| | $6,412,591 | 100.0% | 100.0% |

(1) Latest data available from the American Council of Life Insurance.

*Market Risk Sensitivity.* Market risk is a risk that the value of a security will change because of a change in market conditions. Torchmark's primary exposure to market risk is interest rate risk which is the risk that a change in a securities' value could occur from a change in interest rates. This risk is significant to Torchmark's investment portfolio because its fixed-income holdings amount to 91% of total investments. The effects of these interest rate fluctuations on fixed investments are reflected on an after-tax basis in Torchmark's shareholders' equity from marking these investments to market.

The actual interest rate risk to Torchmark is reduced because the effect that changes in rates have on assets is offset by the effect they have on insurance liabilities and on debt. Interest assumptions are used to compute the majority of Torchmark's insurance liabilities. These liabilities, net of deferred acquisition costs, were $3.3 billion at December 31, 1998, compared with fixed income investments of $5.5 billion at amortized cost at the same date. Because of the long-term nature of insurance liabilities, temporary changes in value caused by rate fluctuations have little bearing on ultimate obligations. These liabilities are not marked to market.

Market risk is managed in a manner consistent with Torchmark's investment objectives. Torchmark seeks to maintain a portfolio of high-quality fixed-maturity assets that may be sold in response to changing market conditions. A significant change in the level of interest rates, changes in credit quality of individual securities, or changes in the relative values of a security or asset sector are the primary factors that influence such sales. Occasionally, the need to raise cash for various operating commitments may also necessitate the sale of a security. Volatility in the value of Torchmark's fixed-income holdings is reduced by maintaining a relatively short-term portfolio, of which 63% matures within ten years. Also, the portfolio and market conditions are constantly evaluated for appropriate action.

No derivative instruments are used to manage Torchmark's exposure to market risk in the investment portfolio. A swap instrument was entered into to allow Torchmark to participate in the downward trend in interest rates in connection with its MIPS as discussed in the Notes to the Consolidated Financial Statement on page 63 of this report and in Capital Resources on page 32 of this report. A cap instrument was also entered into to protect Torchmark from the market risk on an increase in rates associated with the swap on this security.

The liability for Torchmark's insurance policy obligations is computed using interest assumptions, some of which are contractually guaranteed. A reduction in market interest rates of a permanent nature could cause investment return to fall below amounts guaranteed. Torchmark's insurance companies participate in the cash flow testing procedures imposed by statutory insurance regulations, the purpose of which is to insure that such liabilities are adequate to meet the company's obligations under a variety of interest rate scenarios. It has been determined from those procedures that Torchmark's insurance policy liabilities, when considered in light of the assets held with respect to such liabilities and the investment income expected to be received on such assets, are adequate to meet the obligations and expenses of Torchmark's insurance activities in all but the most extreme circumstances.

The following table illustrates the market risk sensitivity of Torchmark's interest-rate sensitive fixed-maturity portfolio at December 31, 1998. This table measures the effect of a change in interest rates (as represented by the U.S. Treasury curve) on the fair value of Torchmark's fixed-maturity portfolio. The data is prepared through a model that measures the change in fair value arising from an immediate and sustained change in interest rates in increments of 100 basis points. It takes into account the effect that special option features such as call options, put options, and unscheduled repayments would have on the portfolio, given the changes in rates. The valuation of these option features is dependent upon assumptions about future interest rate volatility that are based on past performance.

| Change in Interest Rates (in basis points) | Market Value of Fixed-Maturity Portfolio ($ millions) |
|---|---|
| -200 | $6,476 |
| -100 | 6,108 |
| 0 | 5,768 |
| 100 | 5,450 |
| 200 | 5,147 |

## FINANCIAL CONDITION

*Liquidity.* Liquidity pertains to an institution's ability to meet on demand the cash commitments required by its business operations and financial obligations. Torchmark is highly liquid, as evidenced by its three sources of liquidity: its positive cash flow from operations, its portfolio of marketable securities, and its line of credit facility.

Torchmark's insurance operations generate positive cash flows in excess of its immediate needs. Cash flows provided from operations were $398 million in 1998, compared with $410 million in 1997 and $327 million in 1996. In addition to operating cash flows, Torchmark received $474 million in investment maturities and repayments during 1998, adding to available cash flows. Such repayments were $513 million in 1997 and $346 million in 1996. Cash flows in excess of immediate requirements are used to build an investment base to fund future requirements.

Torchmark's cash and short-term investments were $81 million at December 31, 1998, compared with $77 million at year-end 1997. In addition to Torchmark's liquid assets, Torchmark has a portfolio of marketable fixed and equity securities which are available for sale should the need arise. These securities had a value of $5.8 billion at December 31, 1998.

Torchmark has in place a line of credit facility with a group of lenders which allows unsecured borrowings up to a specified maximum amount. The maximum amount was increased during 1996 to $600 million and was at this level on December 31, 1998. Interest is charged at variable rates for borrowings. This line of credit is further designated as a backup credit line for a commercial paper program not to exceed $600 million, whereby Torchmark may borrow from either the credit line or issue commercial paper at any time but may not borrow in excess of a total of $600 million on the combined facilities. At December 31, 1998, $357 million in face amount of commercial paper was outstanding and there were no borrowings on the line of credit. A fee is charged on the entire $600 million facility. In accordance with the agreements, Torchmark is subject to certain covenants regarding capitalization and earnings. At December 31, 1998, Torchmark was in full compliance with these covenants.

Liquidity of the parent company is affected by the ability of the subsidiaries to pay dividends. Dividends are paid by subsidiaries to the parent in order to meet its dividend payments on common and preferred stock, interest and principal repayment requirements on parent-company debt, and operating expenses of the parent company. Dividends from insurance subsidiaries of Torchmark are limited to the greater of statutory net gain from operations, excluding capital gains and losses, on an annual noncumulative basis or 10% of surplus, in the absence of special approval, and distributions are not permitted in excess of statutory net worth. Subsidiaries are also subject to certain minimum capital requirements. Although these restrictions exist, dividend availability from subsidiaries has been and is expected to be more than adequate for parent-company operations. During 1999, a maximum amount of $258 million will be available to Torchmark from insurance subsidiaries without regulatory approval.

*Capital Resources.* Torchmark's capital structure consists of long and short-term debt, MIPS, and shareholders' equity. Torchmark's debt consists primarily of its funded debt and its commercial paper facility. An analysis of Torchmark's funded debt outstanding at year-ends 1998 and 1997 on the basis of par value is as follows:

| | | | 1998 | 1997 |
|---|---|---|---|---|
| **Instrument** | **Year Due** | **Rate** | **Principal Amount ($ thousands)** | **Principal Amount ($ thousands)** |
| Sinking Fund Debentures | 2017 | 8⅝% | $ –0– | $ 180,000 |
| Senior Notes | 1998 | 9⅝ | –0– | 200,000 |
| Senior Debentures | 2009 | 8¼ | 99,450 | 99,450 |
| Notes | 2023 | 7⅞ | 200,000 | 200,000 |
| Notes | 2013 | 7⅜ | 100,000 | 100,000 |
| Total funded debt | | | 399,450 | 779,450 |
| Current maturity of long-term debt | | | –0– | (208,000) |
| Debt held by subsidiaries | | | (10,828) | –0– |
| Long-term debt | | | $388,622 | $ 571,450 |

The carrying value of the funded debt was $383 million at December 31, 1998, compared with $772 million a year earlier.

During 1998, Torchmark received approximately $481 million in intercompany note repayments from Waddell & Reed as a result of their initial public offering. Torchmark utilized a portion of these funds to pay down funded debt. It has also taken advantage of the lower interest rate environment in 1998 to refinance existing funded debt at lower short-term rates. In early 1998, Torchmark repaid $20 million principal amount on its 8⅝% Sinking Fund Debentures due in 2017, of which $8 million was a mandatory redemption and $12 million was an optional repayment under the terms of the agreement. On April 1, 1998, Torchmark called the remaining $160 million principal balance of this debt at the prevailing call price of 103.76, or $166 million. A loss on the redemption of debt was recorded in the second quarter of 1998 in the after-tax amount of $5 million, representing the difference between the total call price and the carrying value of $158 million. In addition to the call, Torchmark's 9⅝% Senior Notes, principal amount $200 million, matured on May 1, 1998. Torchmark borrowed on its commercial paper facility to repay the Sinking Fund Debentures that were called and to repay its Senior Notes upon maturity with accrued interest, in the combined amount of $377 million. Additionally, in October, 1998, Torchmark, through a subsidiary, acquired $10.8 million principal amount of its 7 7/8% notes due 2023 in the open market at a cost of $10.6 million.

During 1997, Torchmark repaid $20 million principal amount on its Sinking Fund Debentures due In 2017, of which $8 million was a mandatory redemption and $12 million was an optional repayment under the terms of the agreement. It also repaid $550 thousand principal amount of its Senior Debentures in 1996 under the terms of a put provision.

The MIPS were issued in November, 1994 at a redemption amount of $200 million with an annual dividend rate of 9.18%. They are subject to a mandatory redemption in full at September 30, 2024, although Torchmark may elect to extend the MIPS for up to an additional 20 years if certain conditions are met. They are redeemable at Torchmark's option at any time after September 30, 1999. While Torchmark is obligated to pay dividends at a fixed rate of 9.18%, Torchmark has in place a ten-year interest-rate swap agreement with an unaffiliated party to reduce financing costs. The swap expires in 2004. The swap agreement calls for Torchmark to pay a variable rate on the $200 million face amount in exchange for payment of the fixed dividend by the other party. Torchmark is at risk on this instrument for higher financing costs to the extent interest rates rise during the remaining term. This risk is limited, however, by a five-year interest-rate cap which Torchmark acquired in conjunction with the swap agreement that insures the variable rate cannot exceed 10.39%. The cap expires on September 30, 1999. At December 31, 1998, the variable rate was 7.02%. During 1998, Torchmark's after-tax dividend cost for the MIPS was $9.8 million, compared with $11.9 million that would have been incurred without the swap and cap transactions. Torchmark's after-tax cost in 1997 was $9.9 million and in 1996 was $9.7 million, saving $2.0 million and $2.2 million in each of those years, respectively.

Torchmark reduced its shareholder cash dividend paid in the fourth quarter of 1998 to $.13 per share from $.15 paid in the previous four quarters. The fourth quarter 1998 dividend was paid prior to the spin-off of Waddell & Reed. Because the dividend Waddell & Reed pays on its shares represents approximately $.04 per Torchmark share, Torchmark's quarterly dividend is expected to be $.09 per share each quarter in 1999.

Torchmark resumed its share buyback program in November, 1998 after completion of the Waddell & Reed spin-off. Purchases of 3.4 million shares were made on the open market during November and December of 1998 at a cost of $126 million. Funds for these purchases were derived primarily from the sale of investments. During 1997, Torchmark acquired 5.2 million shares at a cost of $183 million. Share purchases of 4.6 million shares were made in 1996 for $107 million. Torchmark will continue to make share purchases under its share repurchase program on the open market when prices are attractive. Share purchases have a favorable impact on earnings per share and return on equity, but negatively affect book value per share.

Short-term debt consists primarily of Torchmark's commercial paper outstanding but also includes the current maturity of long-term debt. The commercial paper balance outstanding at December 31, 1998 was $355 million at carrying value, compared with a balance of $139 million a year earlier. As previously noted, Torchmark essentially refinanced $360 million face amount of funded debt with additional short-term borrowings. These borrowings were offset somewhat by the use of $82 million in Waddell & Reed offering proceeds for repayment. The commercial paper borrowing balance fluctuates based on Torchmark's current cash needs. There was no current maturity of long-term debt at year-end 1998, compared with $208 million a year earlier.

Shareholders' equity increased 17% to $2.26 billion at December 31, 1998, over December 31, 1997 shareholders' equity of $1.93 billion. Growth in shareholders' equity was greatly impacted by the Waddell & Reed offering and spin-off in 1998. Proceeds from the March, 1998 offering added $516 million to Torchmark's shareholders' equity, but equity was reduced by $90 million of minority interest at the time of the offering representing the 36% of Waddell & Reed that Torchmark no longer owned. Additionally, the November, 1998 spin-off caused a reduction in Torchmark's equity of $174 million, representing its carrying value of Waddell & Reed at the time of the spin. Book value per share was $16.51 at 1998 year end, compared with $13.80 at year-end 1997. After adjusting for the impact on shareholders' equity for security value fluctuations due to changes in interest rates in financial markets, book value per share was $15.43 at year-end 1998, an increase of 20% over $12.90 at year-end 1997. Return on common shareholders' equity was 15.1% in 1998, compared with 18.2% in 1997. The return on equity ratios exclude the mark up or down of shareholders' equity for changes in security values caused by fluctuations in market interest rates. They also exclude all discontinued operations, equity in earnings of Vesta, and realized investment gains and losses.

Total debt as a percentage of total capitalization continues to decline and was 24% at December 31, 1998. In the computation of this ratio, the MIPS are counted as equity and the effect of fluctuations in security values based on changes in interest rates in financial markets are excluded. This debt-to-capitalization ratio was 31% at year-end 1997 and 32% at year-end 1996. The 1998 decline in this ratio resulted primarily from the funded debt paydowns, net of the increase in short-term debt. The debt-to-capitalization ratio was also favorably impacted by the net increase in Torchmark's shareholders' equity resulting from the Waddell & Reed offering and spin-off. Torchmark's ratio of earnings before interest, taxes and discontinued operations to interest requirements also continues to improve and was 8.9 for 1998, compared with 6.5 in 1997 and 6.3 in 1996. Torchmark's interest expense declined 22% in 1998 from $72 million to $56 million. Interest expense was $74 million in 1996.

## OTHER ITEMS

*Transactions Regarding Vesta.* Since 1993, Torchmark has held a passive investment in 5.1 million shares of Vesta, a property insurance carrier, representing approximately 28% of the outstanding shares of Vesta. In June, 1998, Vesta announced that (a) an investigation of accounting irregularities that occurred during the fourth quarter of 1997 and the first quarter of 1998 would result in an aggregate $14 million net after-tax reduction in previously reported net income, and, in addition, that (b) it would restate its historical financial statements for the period of 1993 through the first quarter of 1998, reflecting reductions in reported net after-tax earnings of $49 million for the period of 1993 through 1997 and $10 million for the first quarter of 1998. To reflect its pro rata share of Vesta's cumulative reported financial corrections, Torchmark recorded a pre-tax charge of $20 million ($13 million after tax) or $.09 per diluted share in the second quarter of 1998. Additionally, Vesta is now subject to numerous class action lawsuits in state and Federal courts filed subsequent to such announcements.

During the fourth quarter of 1998, Torchmark announced it had entered into an agreement to sell approximately 1.8 million shares of Vesta common stock to an unaffiliated insurance carrier for $7.42 a share. In its fourth quarter Form 10Q, Torchmark reported its intent to sell its remaining Vesta shares and vacate the two Vesta board seats it occupied. In view of the pending transaction, Torchmark adjusted the carrying value of its holdings in Vesta to estimated net realizable value of $45 million, effective September 30, 1998. The adjustment produced an after-lax realized loss of $24 million or $.17 per Torchmark diluted share. Torchmark further reported that because of the agreement to sell the Vesta shares, the resulting writedown, and the vacating of the board seats, that Torchmark planned to discontinue equity-method accounting in accordance with accounting standards.

As of December 31, 1998, the terms of the agreement were not met by the unaffiliated insurance carrier and the contract to sell the Vesta shares was terminated. In the meantime, on December 29, 1998, Torchmark sold 680 thousand Vesta shares to another unrelated institution at a price of $4.75 per share. Torchmark realized a $2 million after-tax loss on the sale. The sale reduced Torchmark's ownership of Vesta to 4.45 million shares or approximately 24% of Vesta at December 31, 1998. Because Torchmark's interest in Vesta exceeded 20% and the sale contract with the insurance carrier expired, Torchmark continued equity-method accounting for its holdings in Vesta. Torchmark's carrying value for Vesta continues to reflect the previously-taken writedown.

Subsequent to Vesta's June, 1998 announcement involving the accounting irregularities and the financial restatements, Torchmark recorded its equity in Vesta's earnings in the quarter that Vesta reported those earnings. As a result, Torchmark's equity in Vesta's reported earnings during 1998, including the restatements, was a pretax loss of $27 million. Torchmark carried Vesta at a value of $32 million at December 31, 1998.

*Disposal of Energy Segment.* On September 30, 1996, Torchmark completed the sale of its energy business segment including its energy asset management subsidiary, Torch Energy Advisors Incorporated (''TEAI''), and its Black Warrior coalbed methane investment. These operations, which were classified as discontinued operations in Torchmark's financial statements during the period prior to the sale, were sold to a TEAI management group. After the sale, Torchmark had no controlling ownership interest in any energy asset management organization.

In addition to previously transferred securities, warrants, and Section 29 energy-related tax credits, which approximated $112 million at closing, Torchmark received subordinated debt and notes totaling $32.5 million along with $15.5 million in cash. After closing costs and retained liabilities, Torchmark recorded a pretax loss of $23 million and an after-tax loss of $7 million from the sale, or $.05 per share.

*Litigation.* Torchmark and its subsidiaries continue to be named as parties to pending or threatened litigation, most of which involve punitive damage claims based upon allegations of agent misconduct at Liberty in Alabama. Such punitive damage claims are tried in Alabama state courts where any punitive damage litigation has the potential for significant adverse results. It is impossible to predict the extent of punitive damages that may be awarded if liability is found in any given case, since the amount of punitive damages in Alabama is left largely to the discretion of the jury in each case. It is thus difficult to predict with certainty the liability of Torchmark or its subsidiaries in any given case because of the unpredictable nature of this type of litigation.

*Year 2000 Compliance.* The new millennium poses a significant concern to all businesses which use computer systems or electronic data in their operations. This concern arises because these organizations have been processing computer systems and programs that cannot always identify a proper date. For many years, programs were written using a two digit code to represent a year. At the beginning of the year 2000, more digits are needed to accurately determine the date in these programs. Without addressing this issue, many computer programs could fail or produce erroneous results. Additionally, companies which are electronically engaged with other businesses or which rely on other businesses for services are exposed to risk of failure by the electronic devices and computer systems of those other entities to the extent they are not Year 2000 compliant. The potential of failure of these systems creates considerable uncertainty and could potentially adversely affect the ongoing operations and stability of a business.

Torchmark is exposed to these risks should its computer systems fail due to date-related problems. Torchmark is also reliant on a number of third party businesses and governmental agencies with which it either interacts electronically or depends upon for services in the conduct of its business. These institutions include but are not limited to banks, financial institutions, telecommunication companies, utilities, mail delivery organizations, and a variety of governmental agencies. Should Torchmark's computer systems or the systems of its third-party business partners not be compliant, Torchmark may be exposed to considerable risks, including business interruption, loss of revenue, increased expense, loss of policyholders, and litigation.

To reduce its business risk to an acceptable level, Torchmark has established a project plan to insure that the company's business-critical computer systems will be Year 2000 compliant. This plan also addresses third-party compliance issues. Under the direction of executive management, objectives and timetables have been set forth to achieve compliance in each geographic location where Torchmark operates. Progress toward achieving those objectives is constantly monitored. Torchmark currently expects the entire project, including all Year 2000 testing activities, to be completed during 1999.

As of December 31, 1998, Torchmark remains on schedule to meet all of its Year 2000 compliance requirements. All known required software changes have been completed, and the related testing is in process with plans for completion in 1999. With regard to third party concerns, Torchmark has in process the following procedures:

1) Torchmark is confirming, with its software vendors, the Year 2000 readiness of its purchased software packages because Torchmark has purchased software packages on all of its computer platforms;

2) Torchmark is verifying the Year 2000 compliance status of its financial business partners' computer and data communications systems to insure readiness, including data interface testing with third parties; and

3) All of Torchmark's electronic operational systems (telephones, security, utility, environmental) are being evaluated for Year 2000 compliance.

As an example of Torchmark's interface testing with selected third parties, Torchmark is utilizing electronic data from selected third parties in processing Medicare Supplement benefit data using Year 2000 test data. Torchmark is also arranging similar testing with a selected number of banks. While Torchmark is making every effort to verify the compliance of third parties, no assurances as to the compliance of their computer systems can be given.

Torchmark has used primarily its own employees to complete its Year 2000 project. Other than completion of software testing, all significant Year 2000 project milestones for internal computer systems have been completed. Confirmation of third party compliance and electronic data interface testing with third parties is continuing with completion expected during 1999. Torchmark has spent $5 million on its Year 2000 project activities to date, including internal programming costs, outside contractors, and replacement costs. These costs have been expensed as incurred. Total project cost is expected to be approximately $6 million.

Year 2000 contingency plans are being developed for critical risk areas. Management throughout the organization has established and documented a contingency plan for Torchmark's most critical systems and interfaces with business partners within each individual's responsibility. Such contingency plans include possible manual operation efforts, staff adjustments, outside services, and alternative procedures. These contingency plans will be maintained well into 2000.

## NEW ACCOUNTING RULES

*Accounting for Derivative Instruments and Hedging Activities* (FASB Statement No. 133) is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999, with earlier application of all of the provisions of this statement encouraged. Early adoption of selective provisions is prohibited. Prior periods may not be restated for comparability.

This statement establishes standards for the accounting and reporting of derivative instruments. It requires that all derivatives be recognized as assets or liabilities on the balance sheet and be measured at fair value. Changes in the values of derivatives for the reporting period are reflected as adjustments to earnings through realized gains and losses. If certain conditions are met, a derivative may be designated as a hedge against exposure to market risks of other instruments or commitments, cash flow risks, or foreign currency risks. If a derivative is classified as a hedge, the adjustment to earnings is offset by a corresponding change in the value of the item hedged. Hedging relationships may be designated anew upon adoption of this statement.

Statement 133 will have minimal impact on Torchmark's financial statements. Torchmark has negligible investments in derivative instruments, which are currently valued at fair value in its financial statements. Torchmark's use of derivatives for hedging purposes is very limited.

## Item 8. Financial Statements and Supplementary Data

## INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
Torchmark Corporation
Birmingham, Alabama

We have audited the consolidated financial statements of Torchmark Corporation and subsidiaries as listed in Item 8. In connection with our audits of the consolidated financial statements, we have also audited the financial statement schedules as listed in Item 14(a). These consolidated financial statements and financial statement schedules are the responsibility of Torchmark's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedules based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial statement schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Torchmark Corporation and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 1998, in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

KPMG PEAT MARWICK LLP

Birmingham, Alabama
January 29, 1999 except
for Note 17 which is
as of February 10, 1999

**TORCHMARK CORPORATION**

CONSOLIDATED BALANCE SHEET

**(Dollar amounts in thousands except per share data)**

| | December 31, 1998 | December 31, 1997 |
|---|---|---|
| Assets: | | |
| Investments: | | |
| Fixed maturities—available for sale, at fair value (cost: 1998—$5,519,772; 1997—$5,628,924) | $ 5,768,447 | $ 5,841,690 |
| Equity securities, at fair value (cost: 1998—$2,256; 1997—$3,284) | 9,843 | 12,404 |
| Mortgage loans on real estate, at cost (estimated fair value: 1998—$124,191; 1997—$79,096) | 124,072 | 78,974 |
| Investment real estate, at cost (less allowance for depreciation: 1998—$40,828; 1997—$46,329) | 164,644 | 167,297 |
| Policy loans | 233,765 | 221,703 |
| Other long-term investments | 35,976 | 74,433 |
| Short-term investments | 75,844 | 65,510 |
| Total investments | 6,412,591 | 6,462,011 |
| Cash | 4,920 | 11,085 |
| Investment in unconsolidated subsidiaries | 31,510 | 102,305 |
| Accrued investment income | 99,279 | 100,392 |
| Other receivables | 130,279 | 116,506 |
| Deferred acquisition costs | 1,502,511 | 1,371,131 |
| Value of insurance purchased | 170,640 | 216,988 |
| Property and equipment | 39,080 | 37,100 |
| Goodwill | 414,658 | 426,732 |
| Discontinued operations assets | -0- | 387,910 |
| Other assets | 18,298 | 19,049 |
| Separate account assets | 2,425,262 | 1,876,439 |
| Total assets | $ 11,249,028 | $ 11,127,648 |
| Liabilities: | | |
| Future policy benefits | $ 4,595,567 | $ 5,023,763 |
| Unearned and advance premiums | 85,923 | 83,722 |
| Policy claims and other benefits payable | 194,965 | 228,754 |
| Other policyholders' funds | 81,568 | 82,224 |
| Total policy liabilities | 4,958,023 | 5,418,463 |
| Accrued income taxes | 511,311 | 416,665 |
| Other liabilities | 162,831 | 378,696 |
| Short-term debt | 355,392 | 347,152 |
| Long-term debt (estimated fair value: 1998—$430,431; 1997—$600,319) | 383,422 | 564,298 |
| Separate account liabilities | 2,425,262 | 1,876,439 |
| Total liabilities | 8,796,241 | 9,001,713 |
| Commitments and contingencies | | |
| Monthly income preferred securities (estimated fair value: 1998—$205,040; 1997—$210,500) | 193,259 | 193,199 |
| Shareholders' equity: | | |
| Preferred stock, par value $1 per share—Authorized 5,000,000 shares; outstanding: -0- in 1998 and in 1997 | -0- | -0- |
| Common stock, par value $1 per share—Authorized 320,000,000 shares; outstanding: 147,800,908 issued less 10,951,933 held in treasury in 1998 and 147,848,908 issued less 7,808,468 shares held in treasury in 1997 | 147,801 | 147,849 |
| Additional paid-in capital | 610,925 | 187,731 |
| Accumulated other comprehensive income | 144,501 | 136,926 |
| Retained earnings | 1,707,933 | 1,694,781 |
| Treasury stock | (351,632) | (234,551) |
| Total shareholders' equity | 2,259,528 | 1,932,736 |
| Total liabilities and shareholders' equity | $ 11,249,028 | $ 11,127,648 |

See accompanying Notes to Consolidated Financial Statements.

**TORCHMARK CORPORATION**
CONSOLIDATED STATEMENT OF OPERATIONS
**(Amounts in thousands except per share data)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Revenue: | | | |
| Life premium | $ 959,766 | $ 909,992 | $ 854,897 |
| Health premium | 759,910 | 739,485 | 732,618 |
| Other premium | 33,954 | 28,527 | 22,404 |
| Total premium | 1,753,630 | 1,678,004 | 1,609,919 |
| Net investment income | 459,558 | 429,116 | 399,551 |
| Realized investment gains (losses) | (57,637) | (36,979) | 5,830 |
| Other income | 2,325 | 962 | 1,116 |
| Total revenue | 2,157,876 | 2,071,103 | 2,016,416 |
| Benefits and expenses: | | | |
| Life policyholder benefits | 625,272 | 591,867 | 558,436 |
| Health policyholder benefits | 482,496 | 462,967 | 448,346 |
| Other policyholder benefits | 42,508 | 54,066 | 51,302 |
| Total policyholder benefits | 1,150,276 | 1,108,900 | 1,058,084 |
| Amortization of deferred acquisition costs | 231,024 | 224,738 | 218,826 |
| Commissions and premium taxes | 143,747 | 141,296 | 140,448 |
| Other operating expense | 117,438 | 120,233 | 125,881 |
| Amortization of goodwill | 12,075 | 12,074 | 12,074 |
| Interest expense | 56,325 | 71,863 | 73,611 |
| Total benefits and expenses | 1,710,885 | 1,679,104 | 1,628,924 |
| Income from continuing operations before income taxes, equity in earnings of unconsolidated subsidiaries, discontinued operations and extraordinary item | 446,991 | 391,999 | 387,492 |
| Income taxes | (154,338) | (138,409) | (138,676) |
| Equity in earnings (or losses) of Vesta | (6,866) | 16,714 | 13,654 |
| Adjustment to carrying value of Vesta | (20,234) | -0- | -0- |
| Monthly income preferred securities dividend (net of tax) | (9,777) | (9,875) | (9,655) |
| Net income from continuing operations | 255,776 | 260,429 | 252,815 |
| Discontinued operations of energy segment: | | | |
| Loss on disposal (less applicable income tax benefit of: 1996—$15,813) | -0- | -0- | (7,137) |
| Discontinued operations of Waddell & Reed: | | | |
| Income from operations (less applicable income tax expense of $42,932, $40,081, and $41,946 respectively) | 47,868 | 77,314 | 65,694 |
| Loss on disposal (including income tax of $49,840) | (54,241) | -0- | -0- |
| Net income before extraordinary item | 249,403 | 337,743 | 311,372 |
| Loss on redemption of debt, (less applicable income tax benefit of $2,672) | (4,962) | -0- | -0- |
| Net income | $ 244,441 | $ 337,743 | $ 311,372 |

**(Continued)**

See accompanying Notes to Consolidated Financial Statements.

**TORCHMARK CORPORATION**

CONSOLIDATED STATEMENT OF OPERATIONS—(Continued)

**(Amounts in thousands except per share data)**

| | Year Ended December 31, 1998 | 1997 | 1996 |
|---|---|---|---|
| Basic net income per share: | | | |
| Continuing operations | $1.83 | $1.87 | $1.78 |
| Discontinued operations of energy segment: | | | |
| Loss on disposal | –0– | –0– | (.05) |
| Discontinued operations of Waddell & Reed: | | | |
| Net income from operations | .34 | .56 | .46 |
| Loss on disposal | (.39) | –0– | –0– |
| Net income before extraordinary items | 1.78 | 2.43 | 2.19 |
| Loss on redemption of debt | (.03) | –0– | –0– |
| Net income per share | $1.75 | $2.43 | $2.19 |
| Diluted net income per share: | | | |
| Continuing operations | $1.81 | $1.84 | $1.76 |
| Discontinued operations of energy segment: | | | |
| Loss on disposal | –0– | –0– | (.05) |
| Discontinued operations of Waddell & Reed: | | | |
| Net income from operations | .34 | .55 | .46 |
| Loss on disposal | (.38) | –0– | –0– |
| Net income before extraordinary items | 1.77 | 2.39 | 2.17 |
| Loss on redemption of debt | (.04) | –0– | –0– |
| Net income per share | $1.73 | $2.39 | $2.17 |

See accompanying Notes to Consolidated Financial Statements.

**TORCHMARK CORPORATION**
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
**(Amounts in thousands)**

| | Year Ended December 31, 1998 | 1997 | 1996 |
|---|---|---|---|
| Net income | $244,441 | $337,743 | $311,372 |
| Other comprehensive income: | | | |
| Unrealized investment gains (losses): | | | |
| Unrealized gains (losses) on securities: | | | |
| Unrealized holding gains arising during period | 54,217 | 125,820 | (152,706) |
| Reclassification adjustment for (gains) losses on securities included in net income | 8,519 | 29,967 | (5,674) |
| Reclassification adjustment for amortization of (discount) and premium | (2,999) | (2,751) | (5,422) |
| Foreign exchange adjustment on securities marked to market | 1,958 | 1,373 | 141 |
| | 61,695 | 154,409 | (163,661) |
| Unrealized gains (losses) on other investments | (7,552) | (398) | 1,894 |
| Unrealized gains (losses) on deferred acquisition costs | (3,091) | (13,324) | 17,837 |
| Total unrealized investment gains (losses) | 51,052 | 140,687 | (143,930) |
| Applicable tax | (17,524) | (49,447) | 50,375 |
| Unrealized investment gains (losses), net of tax | 33,528 | 91,240 | (93,555) |
| Foreign exchange translation adjustments, other than securities | (2,081) | (1,585) | (24) |
| Applicable tax | -0- | -0- | -0- |
| Foreign exchange translation adjustments, net of tax | (2,081) | (1,585) | (24) |
| Unrealized gains (losses) on discontinued operations | (12,100) | 1,062 | (274) |
| Applicable tax | 4,235 | (372) | 96 |
| Unrealized gains (losses) on discontinued operations, net of tax | (7,865) | 690 | (178) |
| Other comprehensive income | 23,582 | 90,345 | (93,757) |
| Comprehensive income | $268,023 | $428,088 | $217,615 |

See accompanying Notes to Consolidated Financial Statements.

**TORCHMARK CORPORATION**
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
**(Amounts in thousands except per share data)**

| | Preferred Stock | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Retained Earnings | Treasury Stock | Total Shareholders' Equity |
|---|---|---|---|---|---|---|---|
| Year Ended December 31, 1996 | | | | | | | |
| Balance at January 1, 1996 | $-0- | $ 73,784 | $139,754 | $140,338 | $1,325,534 | $ (90,458) | $1,588,952 |
| Comprehensive income | | | | (93,757) | 311,372 | | 217,615 |
| Common dividends declared ($0.58 a share) | | | | | (82,320) | | (82,320) |
| Acquisition of treasury stock—common | | | | | | (106,996) | (106,996) |
| Exercise of stock options | | | 1,947 | | (5,195) | 15,340 | 12,092 |
| Balance at December 31, 1996 | -0- | 73,784 | 141,701 | 46,581 | 1,549,391 | (182,114) | 1,629,343 |
| Year Ended December 31, 1997 | | | | | | | |
| Comprehensive income | | | | 90,345 | 337,743 | | 428,088 |
| Common dividends declared ($0.585 a share) | | | | | (81,793) | | (81,793) |
| Two-for-one stock split in the form of a dividend | | 73,784 | | | (73,784) | | -0- |
| Acquisition of treasury stock—common | | | | | | (182,903) | (182,903) |
| Exercise of stock options | | 281 | 44,011 | | (36,776) | 130,466 | 137,982 |
| Grant of discounted options | | | 372 | | | | 372 |
| Grant of deferred options | | | 1,647 | | | | 1,647 |
| Balance at December 31, 1997 | -0- | 147,849 | 187,731 | 136,926 | 1,694,781 | (234,551) | 1,932,736 |
| Year Ended December 31, 1998 | | | | | | | |
| Comprehensive income | | | | 23,582 | 244,441 | | 268,023 |
| Common dividends declared ($0.58 a share) | | | | | (73,304) | | (73,304) |
| Proceeds from Waddell & Reed initial public offering | | | 516,138 | | | | 516,138 |
| Distribution of Waddell & Reed | | | | | (174,113) | | (174,113) |
| Minority interest—Waddell & Reed initial public offering | | | (90,484) | | | | (90,484) |
| Sale of Family Service | | | | (16,007) | 16,007 | | -0- |
| Acquisition of treasury stock—common | | | | | | (125,875) | (125,875) |
| Grant of deferred stock options | | | 319 | | | | 319 |
| Grant of restricted stock | | | (4,958) | | 1,428 | 3,530 | -0- |
| Conversion of restricted stock to Waddell & Reed shares | | (48) | 48 | | | | -0- |
| Expense of restricted stock grants and options | | | 865 | | | | 865 |
| Exercise of stock options | | | 1,266 | | (1,307) | 5,264 | 5,223 |
| Balance at December 31, 1998 | $-0- | $147,801 | $610,925 | $144,501 | $1,707,933 | $(351,632) | $2,259,528 |

See accompanying Notes to Consolidated Financial Statements.

**TORCHMARK CORPORATION**

CONSOLIDATED STATEMENT OF CASH FLOW

**(Amounts in thousands)**

| | Year ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Net income | $ 244,441 | $ 337,743 | $ 311,372 |
| Adjustments to reconcile net income to cash provided from operations: | | | |
| Increase in future policy benefits | 173,593 | 147,207 | 136,375 |
| Increase (decrease) in other policy benefits | (30,593) | 10,096 | 14,319 |
| Deferral of policy acquisition costs | (356,493) | (328,086) | (300,461) |
| Amortization of deferred policy acquisition costs | 231,024 | 224,738 | 218,826 |
| Change in accrued income taxes | 86,670 | 87,590 | 31,370 |
| Depreciation | 7,934 | 8,038 | 7,297 |
| Realized (gains) losses on sale of investments, subsidiaries, and properties | 57,637 | 36,979 | (5,830) |
| Change in accounts payable and other liabilities | 3,753 | (6,119) | (6,408) |
| Change in receivables | (20,331) | (14,368) | (18,372) |
| Change in payables and receivables of unconsolidated affiliates | 2,021 | 1,385 | (5,660) |
| Other accruals and adjustments | 25,631 | (17,825) | (12,595) |
| Adjustment to carrying value of Vesta | 20,234 | -0- | -0- |
| Minority interest in income of Waddell & Reed | 20,869 | -0- | -0- |
| Loss on energy disposal | -0- | -0- | 22,950 |
| Discontinued operations of Waddell & Reed | (68,737) | (77,314) | (65,694) |
| Cash provided from operations | $ 397,653 | $ 410,064 | $ 327,489 |

**(Continued)**

See accompanying Notes to Consolidated Financial Statements

**TORCHMARK CORPORATION**

CONSOLIDATED STATEMENT OF CASH FLOW—(Continued)

**(Amounts in thousands)**

| | Year ended December 31, 1998 | 1997 | 1996 |
|---|---|---|---|
| Cash provided from operations | $ 397,653 | $ 410,064 | $ 327,489 |
| Cash used for investment activities: | | | |
| Investments sold or matured: | | | |
| Fixed maturities available for sale—sold | 757,649 | 744,839 | 487,070 |
| Fixed maturities available for sale—matured, called, and repaid | 474,386 | 512,512 | 345,973 |
| Equity securities | -0- | 670 | 2,872 |
| Mortgage loans | 8,589 | 3,300 | 7,113 |
| Real estate | 12,220 | 7,341 | 5,780 |
| Other long-term investments | 51,903 | 28,082 | 12,347 |
| Total investments sold or matured | 1,304,747 | 1,296,744 | 861,155 |
| Acquisition of investments: | | | |
| Fixed maturities—available for sale | (1,872,040) | (1,668,301) | (1,080,791) |
| Mortgage loans | (52,921) | (17,826) | (18,360) |
| Real estate | (35,944) | (24,452) | (9,008) |
| Net increase in policy loans | (13,445) | (14,744) | (13,082) |
| Other long-term investments | (20,298) | (6,082) | (5,592) |
| Total investments acquired | (1,994,648) | (1,731,405) | (1,126,833) |
| Net (increase) decrease in short-term investments | (19,168) | (18,067) | 4,971 |
| Funds borrowed from affiliates | -0- | 42,210 | 167,070 |
| Repayment of loans to affiliates | (1,390) | -0- | -0- |
| Loans repaid by affiliates | -0- | -0- | 12,000 |
| Sale of Family Service | 140,388 | -0- | -0- |
| Sale of Vesta shares | 3,056 | -0- | -0- |
| Proceeds from sale of discontinued energy operations | -0- | -0- | 15,500 |
| Dispositions of properties | 1,033 | 1,407 | 1,769 |
| Additions to properties | (6,170) | (6,204) | (14,106) |
| Dividends from Waddell & Reed | 16,814 | 52,977 | 10,000 |
| Cash used for investment activities | (555,338) | (362,338) | (68,474) |
| Cash provided from (used for) financing activities: | | | |
| Issuance of common stock | 3,957 | 93,973 | 10,145 |
| Additions to debt | 216,429 | 98,185 | -0- |
| Cash dividends paid to shareholders | (90,780) | (107,097) | (111,394) |
| Repayments of debt | (390,917) | (20,132) | (149,144) |
| Acquisition of treasury stock | (125,875) | (182,903) | (106,996) |
| Proceeds from Waddell & Reed offering | 516,138 | -0- | -0- |
| Offering proceeds retained by Waddell & Reed | (35,251) | -0- | -0- |
| Net receipts from deposit product operations | 57,819 | 78,817 | 94,513 |
| Cash provided from (used for) financing activities | 151,520 | (39,157) | (262,876) |
| Increase (decrease) in cash | (6,165) | 8,569 | (3,861) |
| Cash at beginning of year | 11,085 | 2,516 | 6,377 |
| Cash at end of year | $ 4,920 | $ 11,085 | $ 2,516 |

See accompanying Notes to Consolidated Financial Statements.

**Note 1—Significant Accounting Policies**

*Basis of Presentation:* The accompanying financial statements have been prepared in conformity with generally accepted accounting principles (''GAAP''). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Principles of Consolidation:* The financial statements include the results of Torchmark Corporation (''Torchmark'') and its wholly-owned subsidiaries. Subsidiaries which are not majority-owned are reported on the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

*Investments.* Torchmark classifies all of its fixed maturity investments, which include bonds and redeemable preferred stocks, as available for sale. Investments classified as available for sale are carried at fair value with unrealized gains and losses, net of deferred taxes, reflected directly in shareholders' equity. Investments in equity securities, which include common and nonredeemable preferred stocks, are reported at fair value with unrealized gains and losses, net of deferred taxes, reflected directly in shareholders' equity. Policy loans are carried at unpaid principal balances. Mortgage loans are carried at amortized cost. Investments in real estate are reported at cost less allowances for depreciation, which are calculated on the straight line method. Short-term investments include investments in certificates of deposit and other interest-bearing time deposits with original maturities within three months. If an investment becomes permanently impaired, such impairment is treated as a realized loss and the investment is adjusted to net realizable value.

Gains and losses realized on the disposition of investments are recognized as revenues and are determined on a specific identification basis.

Realized investment gains and losses and investment income attributable to separate accounts are credited to the separate accounts and have no effect on Torchmark's net income. Investment income attributable to all other insurance policies and products is included in Torchmark's net investment income. Net investment income for the years ended December 31, 1998, 1997, and 1996 included $296.7 million, $308.6 million, and $298.4 million, respectively, which was allocable to policyholder reserves or accounts. Realized investment gains and losses are not allocable to insurance policyholders' liabilities.

*Determination of Fair Values of Financial Instruments:* Fair value for cash, short-term investments, short-term debt, receivables and payables approximates carrying value. Fair values for investment securities are based on quoted market prices, where available. Otherwise, fair values are based on quoted market prices of comparable instruments. Mortgages are valued using discounted cash flows. Substantially all of Torchmark's long-term debt, including the monthly income preferred securities, is valued based on quoted market prices.

*Cash:* Cash consists of balances on hand and on deposit in banks and financial institutions. Overdrafts arising from the overnight investment of funds offset cash balances on hand and on deposit.

*Recognition of Premium Revenue and Related Expenses:* Premiums for insurance contracts which are not defined as universal life-type according to Statement of Financial Accounting Standards (''SFAS'') No. 97 are recognized as revenue over the premium-paying period of the policy. Profits for limited-payment life insurance contracts as defined by SFAS 97 are recognized over the contract period. Premiums for universal life-type and annuity contracts are added to the policy account value, and revenues for such products are recognized as charges to the policy account value for mortality, administration, and surrenders (retrospective deposit method). Variable annuity products are also assessed an investment management fee and a sales charge. Life premium includes policy charges of $71.7 million, $72.3 million, and $72.8 million for the years ended December 31, 1998, 1997, and 1996,

**Note 1—Significant Accounting Policies (continued)**

respectively. Other premium includes annuity policy charges for the years ended December 31, 1998, 1997, and 1996 of $33.5 million, $28.2 million, and $22.4 million, respectively. Profits are also earned to the extent that investment income exceeds policy requirements. The related benefits and expenses are matched with revenues by means of the provision of future policy benefits and the amortization of deferred acquisition costs in a manner which recognizes profits as they are earned over the same period.

*Future Policy Benefits:* The liability for future policy benefits for universal life-type products according to SFAS 97 is represented by policy account value. The liability for future policy benefits for all other life and health products is provided on the net level premium method based on estimated investment yields, mortality, morbidity, persistency and other assumptions which were appropriate at the time the policies were issued. Assumptions used are based on Torchmark's experience as adjusted to provide for possible adverse deviation. These estimates are periodically reviewed and compared with actual experience. If it is determined future experience will probably differ significantly from that previously assumed, the estimates are revised.

*Deferred Acquisition Costs and Value of Insurance Purchased:* The costs of acquiring new insurance business are deferred. Such costs consist of sales commissions, underwriting expenses, and certain other selling expenses. The costs of acquiring new business through the purchase of other companies and blocks of insurance business are also deferred.

Deferred acquisition costs, including the value of life insurance purchased, for policies other than universal life-type policies, are amortized with interest over the estimated premium-paying period of the policies in a manner which charges each year's operations in proportion to the receipt of premium income. For limited-payment contracts, acquisition costs are amortized over the contract period. For universal life-type policies, acquisition costs are amortized with interest in proportion to estimated gross profits. The assumptions used as to interest, persistency, morbidity and mortality are consistent with those used in computing the liability for future policy benefits and expenses. If it is determined that future experience will probably differ significantly from that previously assumed, the estimates are revised. Deferred acquisition costs are adjusted to reflect the amounts associated with realized and unrealized investment gains and losses pertaining to universal life-type products.

*Income Taxes:* Income taxes are accounted for under the asset and liability method in accordance with SFAS 109. Under the asset and liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement book values and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

*Property and Equipment:* Property and equipment is reported at cost less allowances for depreciation. Depreciation is recorded primarily on the straight line method over the estimated useful lives of these assets which range from two to ten years for equipment and two to forty years for buildings and improvements. Ordinary maintenance and repairs are charged to income as incurred.

*Impairments:* Torchmark accounts for impairments in accordance with the provisions of SFAS 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* This standard requires that certain long-lived assets used in Torchmark's business as well as certain intangible assets be reviewed for impairment when circumstances indicate that these assets may not be recoverable, and further provides how such impairment shall be determined and measured. It also requires that long-lived assets and intangibles to be disposed of be reported at the lower of carrying amount or fair value less cost to sell. Except for Torchmark's writedown of its investment in Vesta Insurance Group (''Vesta''), as discussed in Note 19, there were no significant impairments in the three years ending 1998.

**Note 1—Significant Accounting Policies (continued)**

*Goodwill:* The excess cost of businesses acquired over the fair value of their net assets is reported as goodwill and is amortized on a straight-line basis over a period not exceeding 40 years. Torchmark's unamortized goodwill is periodically reviewed to ensure that conditions are present to indicate the recorded amount of goodwill is recoverable from the estimated future profitability of the related business. If events or changes in circumstances indicate that future profits will not be sufficient to support the carrying amount of goodwill, goodwill would be written down to the recoverable amount and amortized over the original remaining period or a reduced period if appropriate.

*Treasury Stock:* Torchmark accounts for purchases of treasury stock on the cost method. Issuance of treasury stock is accounted for using the weighted-average cost method.

*Reclassification:* Certain amounts in the financial statements presented have been reclassified from amounts previously reported in order to be comparable between years. These reclassifications have no effect on previously reported shareholders' equity or net income during the periods involved.

*Litigation:* Torchmark and its subsidiaries continue to be named as parties to legal proceedings. Because much of Torchmark's litigation is brought in Alabama, a jurisdiction known for excessive punitive damage verdicts bearing little or no relationship to actual damages, the ultimate outcome of any particular action cannot be predicted. It is reasonably possible that changes in the expected outcome of these matters could occur in the near term, but such changes should not be material to Torchmark's reported results or financial condition.

*Stock Split:* On August 1, 1997, Torchmark distributed one share for every one share owned by shareholders of record as of July 1, 1997 in the form of a stock dividend. The dividend was accounted for as a stock split. All prior-year share and per share data have been restated to give effect for this split.

*Earnings Per Share:* Torchmark adopted SFAS 128, ''Earnings per share,'' effective year end 1997. This standard requires the dual presentation of basic and diluted earnings per share (''EPS'') on the face of the income statement and a reconciliation of basic EPS to diluted EPS. As required by SFAS 128, all prior-period EPS data has been restated for comparability. Basic EPS is computed by dividing income available to common stockholders by the weighted average common shares outstanding for the period. Weighted average common shares outstanding for each period are as follows: 1998—139,998,671, 1997—139,202,354, 1996—142,459,783. Diluted EPS is calculated by adding to shares outstanding the additional net effect of potentially dilutive securities or contracts which could be exercised or converted into common shares. Weighted average diluted shares outstanding for each period are as follows: 1998—141,351,912, 1997—141,431,156, 1996—143,783,218.

*Comprehensive Income:* Torchmark adopted SFAS 130, *''Reporting Comprehensive Income,''* effective January 1, 1998. This standard defines comprehensive income as the change in equity of a business enterprise during a period from transactions from all nonowner sources. It requires the company to display comprehensive income for the period, consisting of net income and other comprehensive income. In compliance with SFAS 130, a Consolidated Statement of Comprehensive Income is included as an integral part of the financial statements.

**(Dollar amounts in thousands except per share data)**

**Note 2—Statutory Accounting**

Insurance subsidiaries of Torchmark are required to file statutory financial statements with state insurance regulatory authorities. Accounting principles used to prepare these statutory financial statements differ from GAAP. Consolidated net income and shareholders' equity on a statutory basis for the insurance subsidiaries were as follows:

| | Net Income Year Ended December 31, | | | Shareholders' Equity At December 31, | |
|---|---|---|---|---|---|
| | 1998 | 1997 | 1996 | 1998 | 1997 |
| Life insurance subsidiaries | $260,847 | $369,446 | $283,881 | $640,034 | $798,265 |

During 1998, Liberty National Life Insurance Company paid an extraordinary dividend to Torchmark in the amount of $213 million.

The excess, if any, of shareholders' equity of the insurance subsidiaries on a GAAP basis over that determined on a statutory basis is not available for distribution to Torchmark without regulatory approval.

A reconciliation of Torchmark's insurance subsidiaries' statutory net income to Torchmark's consolidated GAAP net income is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Statutory net income | $ 260,847 | $ 369,446 | $ 283,881 |
| Deferral of acquisition costs | 356,493 | 328,086 | 300,461 |
| Amortization of acquisition costs | (231,024) | (224,738) | (218,826) |
| Differences in insurance policy liabilities | 96,412 | 44,117 | 39,762 |
| Deferred income taxes | (107,384) | (47,541) | (20,496) |
| Income of noninsurance affiliates | (100,758) | (142,041) | (108,257) |
| Other | (30,145) | 10,414 | 34,847 |
| GAAP net income | $ 244,441 | $ 337,743 | $ 311,372 |

A reconciliation of Torchmark's insurance subsidiaries' statutory shareholders' equity to Torchmark's consolidated GAAP shareholders' equity is as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 1998 | 1997 |
| Statutory shareholders' equity | $ 640,034 | $ 798,265 |
| Differences in insurance policy liabilities | 585,680 | 543,365 |
| Deferred acquisition costs | 1,502,511 | 1,371,131 |
| Value of insurance purchased | 170,640 | 216,988 |
| Deferred income taxes | (467,023) | (405,375) |
| Debt of parent company | (749,290) | (911,159) |
| Monthly income preferred securities | (193,259) | (193,199) |
| Asset valuation reserves | 68,674 | 101,057 |
| Nonadmitted assets | 84,826 | 89,859 |
| Goodwill | 414,658 | 396,953 |
| Market value adjustment on fixed maturities | 200,087 | 196,369 |
| Other | 1,990 | (271,518) |
| GAAP shareholders' equity | $2,259,528 | $1,932,736 |

**(Dollar amounts in thousands except per share data)**

### Note 3—Investment Operations

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Investment income is summarized as follows: | | | |
| Fixed maturities | $410,528 | $396,489 | $ 371,805 |
| Equity securities | 301 | 367 | 373 |
| Mortgage loans on real estate | 9,247 | 7,127 | 6,525 |
| Investment real estate | 8,332 | 3,379 | 12,947 |
| Policy loans | 15,301 | 14,433 | 13,192 |
| Other long-term investments | 19,755 | 9,279 | 4,782 |
| Short-term investments | 6,089 | 5,762 | 4,669 |
| | 469,553 | 436,836 | 414,293 |
| Less investment expense | (9,995) | (7,720) | (14,742) |
| Net investment income | $459,558 | $429,116 | $ 399,551 |
| An analysis of gains (losses) from investments is as follows: | | | |
| Realized investment gains (losses): | | | |
| Fixed maturities | $ (8,519) | $ (30,122) | $ 3,761 |
| Equity securities | -0- | 155 | 1,913 |
| Other | (49,118) | (7,012) | 156 |
| | (57,637) | (36,979) | 5,830 |
| Adjustment to deferred acquisition costs | -0- | (198) | (749) |
| | (57,637) | (37,177) | 5,081 |
| Applicable tax | 20,173 | 13,012 | (1,778) |
| Gains (losses) from investments, net of tax | $ (37,464) | $ (24,165) | $ 3,303 |
| An analysis of the net change in unrealized investment gains (losses) is as follows: | | | |
| Equity securities | $ (1,080) | $ 4,061 | $ (734) |
| Fixed maturities available for sale | 66,526 | 150,494 | (163,224) |
| Other long-term investments and foreign exchange translation adjustments | (46,018) | (1,054) | 1,907 |
| Adjustment to deferred acquisition costs | (3,091) | (13,324) | 17,837 |
| | 16,337 | 140,177 | (144,214) |
| Applicable tax | (8,762) | (49,832) | 50,457 |
| Change in unrealized gains (losses), net of tax | $ 7,575 | $ 90,345 | $ (93,757) |

**(Dollar amounts in thousands except per share data)**

## Note 3—Investment Operations (continued)

A summary of fixed maturities available for sale and equity securities by amortized cost and estimated market value at December 31, 1998 and 1997 is as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Market Value | Amount per the Balance Sheet | % of Total Fixed Maturities |
|---|---|---|---|---|---|---|
| **1998:** | | | | | | |
| Fixed maturities available for sale: | | | | | | |
| Bonds: | | | | | | |
| U.S. Government direct obligations and agencies | $ 145,902 | $ 9,527 | $ (13) | $ 155,416 | $ 155,416 | 2.7% |
| GNMAs | 494,859 | 29,205 | (481) | 523,583 | 523,583 | 9.1 |
| Mortgage-backed securities, GNMA collateral | 60,724 | 566 | (15) | 61,275 | 61,275 | 1.1 |
| Other mortgage-backed securities | 355,419 | 14,968 | (837) | 369,550 | 369,550 | 6.4 |
| State, municipalities and political subdivisions | 615,125 | 36,730 | (233) | 651,622 | 651,622 | 11.3 |
| Foreign governments | 50,882 | 2,744 | (296) | 53,330 | 53,330 | .9 |
| Public utilities | 411,624 | 24,972 | (11) | 436,585 | 436,585 | 7.6 |
| Industrial and miscellaneous | 3,382,689 | 152,510 | (20,844) | 3,514,355 | 3,514,355 | 60.9 |
| Redeemable preferred stocks | 2,548 | 183 | -0- | 2,731 | 2,731 | -0- |
| Total fixed maturities | 5,519,772 | 271,405 | (22,730) | 5,768,447 | 5,768,447 | 100% |
| Equity securities: | | | | | | |
| Common stocks: | | | | | | |
| Banks and insurance companies | 2,013 | 7,756 | (8) | 9,761 | 9,761 | |
| Industrial and all others | 243 | -0- | (161) | 82 | 82 | |
| Total equity securities | 2,256 | 7,756 | (169) | 9,843 | 9,843 | |
| Total fixed maturities and equity securities | $5,522,028 | $279,161 | $(22,899) | $5,778,290 | $5,778,290 | |
| **1997:** | | | | | | |
| Fixed maturities available for sale: | | | | | | |
| Bonds: | | | | | | |
| U.S. Government direct obligations and agencies | $ 189,708 | $ 7,190 | $ (46) | $ 196,852 | $ 196,852 | 3.4% |
| GNMAs | 788,585 | 46,824 | (1,180) | 834,229 | 834,229 | 14.3 |
| Mortgage-backed securities, GNMA collateral | 97,740 | 2,695 | (13) | 100,422 | 100,422 | 1.7 |
| Other mortgage-backed securities | 436,457 | 19,663 | (2,054) | 454,066 | 454,066 | 7.8 |
| State, municipalities and political subdivisions | 634,304 | 28,610 | (1,163) | 661,751 | 661,751 | 11.3 |
| Foreign governments | 77,736 | 3,653 | (2) | 81,387 | 81,387 | 1.4 |
| Public utilities | 341,055 | 12,514 | (511) | 353,058 | 353,058 | 6.0 |
| Industrial and miscellaneous | 3,058,468 | 100,595 | (4,516) | 3,154,547 | 3,154,547 | 54.0 |
| Redeemable preferred stocks | 4,870 | 508 | -0- | 5,378 | 5,378 | .1 |
| Total fixed maturities | 5,628,923 | 222,252 | (9,485) | 5,841,690 | 5,841,690 | 100.0% |
| Equity securities: | | | | | | |
| Common stocks: | | | | | | |
| Banks and insurance companies | 2,014 | 8,703 | (10) | 10,707 | 10,706 | |
| Industrial and all others | 242 | 2 | (31) | 213 | 213 | |
| Non-redeemable preferred stocks | 1,028 | 456 | -0- | 1,484 | 1,485 | |
| Total equity securities | 3,284 | 9,161 | (41) | 12,404 | 12,404 | |
| Total fixed maturities and equity securities | $5,632,207 | $231,413 | $ (9,526) | $5,854,094 | $5,854,094 | |

**(Dollar amounts in thousands except per share data)**

### Note 3—Investment Operations (continued)

A schedule of fixed maturities by contractual maturity at December 31, 1998 is shown below on an amortized cost basis and on a market value basis. Actual maturities could differ from contractual maturities due to call or prepayment provisions.

| | Amortized Cost | Market Value |
|---|---|---|
| Fixed maturities available for sale: | | |
| Due in one year or less | $ 154,886 | $ 155,961 |
| Due from one to five years | 978,186 | 1,019,278 |
| Due from five to ten years | 1,443,002 | 1,523,155 |
| Due after ten years | 1,888,194 | 1,973,823 |
| | 4,464,268 | 4,672,217 |
| Redeemable preferred stocks | 2,548 | 2,731 |
| Mortgage-backed and asset-backed securities | 1,052,956 | 1,093,499 |
| | $5,519,772 | $5,768,447 |

Proceeds from sales of fixed maturities available for sale were $758 million in 1998, $745 million in 1997, and $487 million in 1996. Gross gains realized on those sales were $6.1 million in 1998, $1.3 million in 1997, and $8.7 million in 1996. Gross losses were $20.1 million in 1998, $32.2 million in 1997, and $5.3 million in 1996.

Torchmark had $24.7 million and $30.5 million in investment real estate at December 31, 1998 and 1997, respectively, which was nonincome producing during the previous twelve months. These properties included primarily construction in process and land. Torchmark had $124 thousand in non-income producing mortgages as of year end 1998. There were no fixed maturity investments, or other long-term investments which were nonincome producing at December 31, 1998.

Derivative investments were immaterial to Torchmark at December 31, 1998. These investments consist of interest-only and principal-only collateralized mortgage obligations. Torchmark's total carrying value of these investments was $9.6 million and $26.4 million at December 31, 1998 and 1997, respectively. Torchmark has no off-balance sheet exposure in connection with these investments.

### Note 4—Property and Equipment

A summary of property and equipment used in the business is as follows:

| | December 31, 1998 | | December 31, 1997 | |
|---|---|---|---|---|
| | Cost | Accumulated Depreciation | Cost | Accumulated Depreciation |
| Company occupied real estate | $ 59,417 | $28,697 | $ 55,780 | $25,313 |
| Data processing equipment | 19,915 | 18,743 | 19,201 | 18,342 |
| Transportation equipment | 11,157 | 7,551 | 11,034 | 7,367 |
| Furniture and office equipment | 35,777 | 32,195 | 33,812 | 31,705 |
| | $126,266 | $87,186 | $119,827 | $82,727 |

Depreciation expense on property used in the business was $4.2 million, $4.6 million, and $4.1 million, in each of the years 1998, 1997, and 1996, respectively.

**(Dollar amounts in thousands except per share data)**

## Note 5—Deferred Acquisition Costs and Value of Insurance Purchased

An analysis of deferred acquisition costs and the value of insurance purchased is as follows:

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Deferred Acquisition Costs | Value of Insurance Purchased | Deferred Acquisition Costs | Value of Insurance Purchased | Deferred Acquisition Costs | Value of Insurance Purchased |
| Balance at beginning of year | $1,371,131 | $216,988 | $1,253,727 | $244,368 | $1,121,325 | $277,297 |
| Additions: | | | | | | |
| Deferred during period: | | | | | | |
| Commissions | 207,864 | -0- | 199,177 | -0- | 185,197 | -0- |
| Other expenses | 148,629 | -0- | 128,909 | -0- | 115,264 | -0- |
| Total deferred | 356,493 | -0- | 328,086 | -0- | 300,461 | -0- |
| Deductions: | | | | | | |
| Amortized during period | (210,287) | (20,737) | (197,160) | (27,380) | (185,148) | (32,929) |
| Adjustment attributable to unrealized investment (gains)/losses(1) | (3,092) | -0- | (13,324) | -0- | 17,838 | -0- |
| Adjustment attributable to realized investment gains(1) | -0- | -0- | (198) | -0- | (749) | -0- |
| Business disposed | (11,734) | (25,611) | -0- | -0- | -0- | -0- |
| Total deductions | (225,113) | (46,348) | (210,682) | (27,380) | (168,059) | (32,929) |
| Balance at end of year | $1,502,511 | $170,640 | $1,371,131 | $216,988 | $1,253,727 | $244,368 |

(1) Represents amounts pertaining to investments relating to universal life-type products.

The amount of interest accrued on the unamortized balance of value of insurance purchased was $13.2 million, $16.6 million, and $18.9 million, for the years ended December 31, 1998, 1997, and 1996, respectively. The average interest rates used for the years ended December 31, 1998, 1997, and 1996 were 6.8%, 7.19%, and 7.26%, respectively. The estimated amount of the unamortized balance at December 31, 1998 to be amortized during each of the next five years is: 1999, $17.8 million; 2000, $15.8 million; 2001, $14.0 million; 2002, $12.5 million; and 2003, $11.2 million

In the event of lapses or early withdrawals in excess of those assumed, deferred acquisition costs and the value of insurance purchased may not be recoverable.

## Note 6—Initial Public Offering and Divestiture of Asset Management Segment

*Divestiture of Waddell & Reed.* Waddell & Reed, Torchmark's asset management subsidiary, completed an initial public offering in March, 1998 of approximately 24 million shares of its common stock. The offering represented approximately 36% of Waddell & Reed's shares. Net proceeds from the offering were approximately $516 million after underwriters' fees and expenses. Waddell & Reed used $481 million of the proceeds to repay existing notes owed to Torchmark and other Torchmark subsidiaries and retained the remaining $35 million. Torchmark's $481 million proceeds from the note repayments were invested or used to pay down debt. The initial public offering resulted in a $426 million gain which was added to Torchmark's additional paid-in capital in accordance with Staff Accounting Bulletin 51. Torchmark retained the remaining 64% of the Waddell & Reed stock.

**Note 6—Initial Public Offering and Divestiture of Asset Management Segment (continued)**

On November 6, 1998, Torchmark distributed the remaining 64% investment in Waddell & Reed through a tax-free spin-off to Torchmark shareholders. Each Torchmark shareholder of record on October 23, 1998 received a total of .3018 Waddell & Reed shares per Torchmark share. After the spin-off, Torchmark retained no further ownership interest in Waddell & Reed. As a result of the transaction, Torchmark incurred $54 million in expense related to the spin-off, the majority of which was $50 million of corporate Federal income tax resulting from the distribution of a portion of the policyholder surplus account of a Torchmark life subsidiary.

Torchmark has accounted for the spin-off of Waddell & Reed as a disposal of a segment. Accordingly, Torchmark's financial statements for 1998 and all prior periods have been modified to present the net assets and operating results of Waddell & Reed as discontinued operations of the disposed segment. The $54 million expense of the spin-off is included in discontinued operations under the caption ''Loss on Disposal.'' The distribution of the Waddell & Reed shares resulted in a reduction in Torchmark's shareholders' equity in the approximate amount of $174 million, consisting of the equity in Waddell & Reed net of the 36% minority Interest.

**Note 7—Disposal of Energy Segment**

On September 30, 1996, Torchmark completed the sale of its energy business segment including its energy asset management subsidiary, Torch Energy, and its Black Warrior coalbed methane investment. After the sale, Torchmark had no controlling ownership interest in any energy asset management organization. These operations were reclassified as discontinued operations in Torchmark's financial statements.

Prior to the Sale, Torch Energy transferred to Torchmark marketable securities, warrants, and Section 29 energy-related tax credits, which approximated $112 million at closing. Torchmark received at closing subordinated debt and notes totaling $32.5 million along with $15.5 million in cash. After closing costs and retained liabilities, Torchmark recorded a pretax loss of $23 million and an after-tax loss of $7 million from the sale, or $.05 per share.

In the first quarter of 1996, Torch Energy sold 1.5 million of its shares in Nuevo Energy common stock for proceeds of $35.6 million. These proceeds were transferred to Torchmark in the form of a dividend prior to the sale. Additionally, there were 1.3 million shares of Nuevo common stock included in the above mentioned transferred marketable securities which were sold in the fourth quarter of 1996 for proceeds of $57.6 million.

**Note 8—Sale of Family Service**

On June 1, 1998, Torchmark sold Family Service to an unaffiliated insurance carrier. Family Service, which was acquired in 1990, is a preneed funeral insurer but has not issued any new policies since 1995. Consideration for the sale was $140 million in cash. Torchmark recorded a pretax realized loss on the sale of approximately $14 million, but incurred a tax expense on the transaction of $9 million. In connection with the sale, Torchmark will continue to service the policies in force of Family Service for the next five years for a fee of $2 million per year plus certain variable processing costs. During 1997, Family Service accounted for $57 million in revenues and $7.7 million in pretax income. Through May, 1998, Family Service contributed $25 million in revenues and $5.8 million in pretax income. Invested assets were $778 million and total assets were $828 million at the date of the sale.

**(Dollar amounts in thousands except per share data)**

### Note 9—Future Policy Benefit Reserves

A summary of the assumptions used in determining the liability for future policy benefits at December 31, 1998 is as follows:

#### Individual Life Insurance

**Interest assumptions:**

| Years of Issue | Interest Rates | Percent of Liability |
|---|---|---|
| 1917-1998 | 3.00% | 3% |
| 1947-1954 | 3.25% | 1 |
| 1927-1998 | 3.50% | 1 |
| 1955-1961 | 3.75% | 1 |
| 1925-1998 | 4.00% | 12 |
| 1962-1969 | 4.50% graded to 4.00% | 2 |
| 1970-1980 | 5.50% graded to 4.00% | 4 |
| 1970-1998 | 5.50% | 1 |
| 1929-1998 | 6.00% | 14 |
| 1986-1994 | 7.00% graded to 6.00% | 12 |
| 1954-1998 | 8.00% graded to 6.00% | 12 |
| 1951-1985 | 8.50% graded to 6.00% | 10 |
| 1980-1987 | 8.50% graded to 7.00% | 1 |
| 1984-1998 | Interest Sensitive | 26 |
| | | 100% |

**Mortality assumptions:**

For individual life, the mortality tables used are various statutory mortality tables and modifications of:

1950-54 Select and Ultimate Table
1954-58 Industrial Experience Table
1955-60 Ordinary Experience Table
1965-70 Select and Ultimate Table
1955-60 Inter-Company Table
1970 United States Life Table
1975-80 Select and Ultimate Table
X-18 Ultimate Table

**Withdrawal assumptions:**

Withdrawal assumptions are based on Torchmark's experience.

#### Individual Health Insurance

**Interest assumptions:**

| Years of Issue | Interest Rates | Percent of Liability |
|---|---|---|
| 1962-1998 | 3.00% | 2% |
| 1982-1998 | 4.50% | 2 |
| 1993-1998 | 6.00% | 19 |
| 1986-1992 | 7.00% graded to 6.00% | 53 |
| 1955-1998 | 8.00% graded to 6.00% | 15 |
| 1951-1986 | 8.50% graded to 6.00% | 9 |
| | | 100% |

**(Dollar amounts in thousands except per share data)**

### Note 9—Future Policy Benefit Reserves (continued)

**Morbidity assumptions:**

For individual health, the morbidity assumptions are based on either Torchmark's experience or the assumptions used in calculating statutory reserves.

**Termination assumptions:**

Termination assumptions are based on Torchmark's experience.

**Overall Interest Assumptions**

The overall average interest assumption for determining the liability for future life and health insurance benefits in 1998 was 6.2%.

### Note 10—Liability for Unpaid Health Claims

Activity in the liability for unpaid health claims is summarized as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Balance at beginning of year: | $178,989 | $173,900 | $170,566 |
| Incurred related to: | | | |
| Current year | 518,993 | 503,948 | 495,642 |
| Prior year | (2,670) | 15,280 | 179 |
| Total incurred | 516,323 | 519,228 | 495,821 |
| Paid related to: | | | |
| Current year | 342,084 | 349,815 | 340,310 |
| Prior year | 207,426 | 164,324 | 152,177 |
| Total paid | 549,510 | 514,139 | 492,487 |
| Balance at end of year | $145,802 | $178,989 | $173,900 |

The liability for unpaid health claims is included with ''Policy claims and other benefits payable'' on the Balance Sheet.

**(Dollar amounts in thousands except per share data)**

### Note 11—Income Taxes

Torchmark and most of its subsidiaries file a life-nonlife consolidated federal income tax return. American Income files its own consolidated federal income tax return and will not be eligible to join Torchmark's consolidated return group until 2000.

Total income taxes were allocated as follows:

| | Year Ended December 31, 1998 | 1997 | 1996 |
|---|---|---|---|
| Income from continuing operations | $154,338 | $138,409 | $138,676 |
| Discontinued operations | 92,772 | 40,081 | 26,133 |
| Monthly income preferred securities dividend | (5,265) | (5,318) | (5,199) |
| Shareholders' equity: | | | |
| Unrealized gains (losses) | 8,540 | 49,832 | (50,457) |
| Tax basis compensation expense (from the exercise of stock options) in excess of amounts recognized for financial reporting purposes | (933) | (44,011) | (1,947) |
| Other | (1,964) | 1,514 | (898) |
| | $247,488 | $180,507 | $106,308 |

Income tax expense attributable to income from continuing operations consists of:

| | Year ended December 31, 1998 | 1997 | 1996 |
|---|---|---|---|
| Current income tax expense | $118,827 | $ 92,989 | $ 89,786 |
| Deferred income tax expense | 35,511 | 45,420 | 48,890 |
| | $154,338 | $138,409 | $138,676 |

In 1998, 1997, and 1996, deferred income tax expense was incurred because of certain differences between net operating income before income taxes as reported on the consolidated statement of operations and taxable income as reported on Torchmark's income tax returns. As explained in Note 1, these differences caused the financial statement book values of some assets and liabilities to be different from their respective tax bases.

The effective income tax rate differed from the expected 35% rate as shown below:

| | Year ended December 31, 1998 | % | 1997 | % | 1996 | % |
|---|---|---|---|---|---|---|
| Expected income taxes | $156,447 | 35% | $137,200 | 35% | $135,622 | 35% |
| Increase (reduction) in income taxes resulting from: | | | | | | |
| Tax-exempt investment income | (7,111) | (2) | (6,165) | (2) | (6,766) | (2) |
| Equity in earnings of Vesta | (9,485) | (2) | 5,850 | 1 | 4,779 | 1 |
| Sale of Family Service | 13,460 | 3 | -0- | | -0- | |
| Other | 1,027 | 1 | 1,524 | 1 | 5,041 | 2 |
| Income taxes | $154,338 | 35% | $138,409 | 35% | $138,676 | 36% |

**(Dollar amounts in thousands except per share data)**

**Note 11—Income Taxes (continued)**

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

| | December 31, 1998 | December 31, 1997 |
|---|---|---|
| Deferred tax assets: | | |
| Investments, principally due to the use of market value in recording the cost of fixed maturities for financial reporting purposes but not for tax purposes (in the acquisition of a subsidiary) | $ -0- | $ 2,376 |
| Unconsolidated affiliates, principally due to the use of equity method accounting for financial reporting purposes but not for tax purposes | 2,648 | -0- |
| Present value of future policy surrender charges | 20,153 | 13,925 |
| Other assets and other liabilities, principally due to the current nondeductibility of certain accrued expenses for tax purposes | 30,605 | 38,987 |
| Total gross deferred tax assets | 53,406 | 55,288 |
| Less valuation allowance | (2,111) | (2,111) |
| Net deferred tax assets | 51,295 | 53,177 |
| Deferred tax liabilities: | | |
| Investments, principally due to the accrual of discount for financial reporting purposes but not for tax purposes | 1,972 | -0- |
| Unconsolidated affiliates, principally due to the use of equity method accounting for financial reporting purposes but not for tax purposes | -0- | 19,208 |
| Deferred acquisition costs | 381,415 | 363,077 |
| Unrealized investment gains | 82,324 | 73,784 |
| Future policy benefits, unearned and advance premiums, and policy claims | 46,621 | 15,911 |
| Other | 15,625 | 9,877 |
| Total gross deferred tax liabilities | 527,957 | 481,857 |
| Net deferred tax liability | $476,662 | $428,680 |

The valuation allowance for deferred tax assets as of December 31, 1998 and 1997 was $2.1 million. Subsequently recognized tax benefits of $2.1 million relating to the December 31, 1998 valuation allowance will be allocated to goodwill.

Torchmark has not recognized a deferred tax liability for the undistributed earnings of its wholly-owned subsidiaries because such earnings are remitted to Torchmark on a tax-free basis. A deferred tax liability will be recognized in the future if the remittance of such earnings becomes taxable to Torchmark. In addition, Torchmark has not recognized a deferred tax liability of approximately $10 million that arose prior to 1984 on temporary differences related to the policyholders' surplus accounts in the life insurance subsidiaries. A current tax expense will be recognized in the future if and when these amounts are distributed.

As more fully discussed in Note 6, Torchmark completed the spin-off of its asset management segment, which resulted in a distribution of the policyholder surplus account of a Torchmark life insurance subsidiary. This caused a current tax expense of $50 million.

**(Dollar amounts in thousands except per share data)**

## Note 12—Postretirement Benefits

*Pension Plans:* Torchmark has retirement benefit plans and savings plans which cover substantially all employees. There is also a nonqualified excess benefit plan which covers certain employees. The total cost of these retirement plans charged to operations was as follows:

| Year Ended December 31, | Defined Contribution Plans | Defined Benefit Pension Plans | Excess Benefit Pension Plan |
|---|---|---|---|
| 1998 | $1,530 | $2,875 | $399 |
| 1997 | 2,123 | 3,244 | 526 |
| 1996 | 2,133 | 3,358 | 467 |

Torchmark accrues expense for the defined contribution plans based on a percentage of the employees' contributions. The plans are funded by the employee contributions and a Torchmark contribution equal to the amount of accrued expense.

Cost for the defined benefit pension plans has been calculated on the projected unit credit actuarial cost method. Contributions are made to the pension plans subject to minimums required by regulation and maximums allowed for tax purposes. Accrued pension expense in excess of amounts contributed has been recorded as a liability in the financial statements and was $7.2 million and $5.0 million at December 31, 1998 and 1997, respectively. The plans covering the majority of employees are organized as trust funds whose assets consist primarily of investments in marketable long-term fixed maturities and equity securities which are valued at market.

The excess benefit pension plan provides the benefits that an employee would have otherwise received from a defined benefit pension plan in the absence of the Internal Revenue Code's limitation on benefits payable under a qualified plan. Although this plan is unfunded, pension cost is determined in a similar manner as for the funded plans. Liability for the excess benefit plan was $4.7 million and $5.4 million as of December 31, 1998 and 1997, respectively.

Net periodic pension cost for the defined benefit plans by expense component was as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Service cost—benefits earned during the period | $ 4,555 | $ 4,732 | $ 5,277 |
| Interest cost on projected benefit obligation | 7,595 | 7,389 | 7,145 |
| Actual return on assets | (21,572) | (17,014) | (14,309) |
| Net amortization and deferral | 12,696 | 8,663 | 5,712 |
| Net periodic pension cost | $ 3,274 | $ 3,770 | $ 3,825 |

**(Dollar amounts in thousands except per share data)**

**Note 12—Postretirement Benefits (continued)**

Torchmark adopted FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits,* effective for year-end 1998 with comparative periods restated. In accordance with this Standard, the following table presents a reconciliation from the beginning to the end of the year of the benefit obligation and plan assets. This table also presents a reconciliation of the plans' funded status with the amounts recognized on Torchmark's balance sheet.

| | Pension Benefits For the year ended December 31, | |
|---|---|---|
| | **1998** | **1997** |
| *Changes in benefit obligation:* | | |
| Obligation at beginning of year | $ 98,078 | $ 94,665 |
| Service cost | 4,555 | 4,732 |
| Interest cost | 7,595 | 7,389 |
| Actuarial loss (gain) | 7,823 | 71 |
| Benefits paid | (8,331) | (8,779) |
| Obligation at end of year | 109,720 | 98,078 |
| *Changes in plan assets:* | | |
| Fair value at beginning of year | 108,942 | 99,803 |
| Return on assets | 21,572 | 17,014 |
| Contributions | 1,106 | 905 |
| Benefits paid | (8,331) | (8,779) |
| Fair value at end of year | 123,289 | 108,943 |
| Funded status at year end | 13,569 | 10,865 |
| *Unrecognized amounts at year end:* | | |
| Unrecognized actuarial loss (gain) | (25,016) | (19,965) |
| Unrecognized prior service cost | 851 | 907 |
| Unrecognized transition obligation | (356) | (596) |
| Net amount recognized at year end | $(10,952) | $ (8,789) |
| *Amounts recognized consist of:* | | |
| Prepaid benefit cost | $ 212 | $ 171 |
| Accrued benefit liability | (12,083) | (10,570) |
| Intangible asset | 919 | 1,610 |
| Net amount recognized at year end | $(10,952) | $ (8,789) |

The weighted average assumed discount rates used in determining the actuarial benefit obligations was 7.0% in 1998 and 7.5% in 1997. The rate of assumed compensation increase was 4.0% in 1998 and 4.5% in 1997 while the expected long-term rate of return on plan assets was 9.22% in 1998 and 9.25% in 1997.

*Postretirement Benefit Plans Other Than Pensions:* Torchmark provides postretirement life insurance benefits for most retired employees, and also provides additional postretirement life insurance benefits for certain key employees. The majority of the life insurance benefits are accrued over the working lives of active employees.

For retired employees over age sixty-five, Torchmark does not provide postretirement benefits other than pensions. Torchmark does provide a portion of the cost for health insurance benefits for employees who retired before February 1, 1993 and before age sixty-five, covering them until they reach age sixty-five. Eligibility for this benefit was generally achieved at age fifty-five with at least fifteen years of service. This subsidy is minimal to retired employees who did not retire before February 1, 1993. This plan is unfunded.

**(Dollar amounts in thousands except per share data)**

**Note 12—Postretirement Benefits (continued)**

The components of net periodic postretirement benefit cost other than pensions is as follows:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Service cost | $ 249 | $ 248 | $ 249 |
| Interest cost on accumulated postretirement benefit obligation | 493 | 490 | 546 |
| Actual return on plan assets | -0- | -0- | -0- |
| Net amortization and deferral | (281) | (377) | (233) |
| Net periodic postretirement benefit cost | $ 461 | $ 361 | $ 562 |

The following table presents a reconciliation of the benefit obligation and plan assets from the beginning to the end of the year, also reconciling the funded status to the accrued benefit liability.

| | Benefits Other Than Pensions | |
|---|---|---|
| | For the year ended December 31, 1998 | 1997 |
| *Changes in benefit obligation:* | | |
| Obligation at beginning of year | $ 6,431 | $ 6,787 |
| Service cost | 249 | 249 |
| Interest cost | 493 | 490 |
| Amendments | (149) | -0- |
| Actuarial loss (gain) | 435 | (384) |
| Benefits paid | (610) | (711) |
| Obligation at end of year | 6,849 | 6,431 |
| *Changes in plan assets:* | | |
| Fair value at beginning of year | -0- | -0- |
| Return on assets | -0- | -0- |
| Contributions | 610 | 711 |
| Benefits paid | (610) | (711) |
| Fair value at end of year | -0- | -0- |
| Funded status at year end | (6,849) | (6,431) |
| *Unrecognized amounts at year end:* | | |
| Unrecognized actuarial loss (gain) | (1,259) | (1,769) |
| Unrecognized prior service cost | (506) | (563) |
| Net amount recognized at year end as accrued benefit liability | $(8,614) | $(8,763) |

For measurement purposes, a 7.0% to 8.0% annual rate of increase in per capita cost of covered healthcare benefits was assumed for 1998. These rates grade to ranges of 4.5% to 5.5% by the year 2007. The health care cost trend rate assumption has a significant effect on the amounts reported, as illustrated in the following table which presents the effect of a one-percentage-point increase and decrease on the service and interest cost components and the benefit obligation:

| | Change in Trend Rate | |
|---|---|---|
| **Effect on:** | 1% Increase | 1% Decrease |
| Service and interest cost components | $ 79 | $ (67) |
| Benefit obligation | 517 | (453) |

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 7.38% in 1998 and 7.37% in 1997.

**(Dollar amounts in thousands except per share data)**

**Note 12—Postretirement Benefits (continued)**

For measurement purposes, a 7.0% to 8.0% annual rate of increase in per capita cost of covered healthcare benefits was assumed for 1998. These rates grade to ranges of 4.5% to 5.5% by the year 2007. The health care cost trend rate assumption has a significant effect on the amounts reported, as illustrated in the following table which presents the effect of a one-percentage-point increase and decrease on the service and interest cost components and the benefit obligation:

| | Change in Trend Rate | |
|---|---|---|
| Effect on: | 1% Increase | 1% Decrease |
| Service and interest cost components | $ 79 | $ (67) |
| Benefit obligation | 517 | (453) |

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 7.38% in 1998 and 7.37% in 1997.

**Note 13—Debt**

An analysis of debt at carrying value is as follows:

| | December 31, | | | |
|---|---|---|---|---|
| | 1998 | | 1997 | |
| | Short-term Debt | Long-term Debt | Short-term Debt | Long-term Debt |
| Sinking Fund Debentures | | | $ 8,000 | $170,354 |
| Senior Notes, due 1998 | | | 199,898 | |
| Senior Debentures, due 2009 | | $ 99,450 | | 99,450 |
| Notes, due 2023 | | 185,394 | | 195,969 |
| Notes, due 2013 | | 98,578 | | 98,525 |
| Commercial paper | $355,242 | | 138,963 | |
| Other notes and mortgages payable at various interest rates; collateralized by buildings | 150 | | 291 | |
| | $355,392 | $383,422 | $347,152 | $564,298 |

The amount of debt that becomes due during each of the next five years is: 1999, $355,392, and 2000-2003, $0.

In the first quarter of 1998, Torchmark repaid $20 million principal amount of its 8⅝% Sinking Fund Debentures due March 1, 2017, through a sinking fund payment of which $8 million was mandatory and $12 million was elective under the terms of the issue. An identical payment was made in the third quarter of 1997. The remaining $160 million principal amount was called on April 1, 1998, at a prevailing call price of 103.76, or $166 million. An after-tax loss on the redemption of debt of $5 million was recorded in the second quarter of 1998. These payments were made from additional commercial paper borrowings.

The 9⅝% Senior Notes matured on May 1, 1998. The principal amount of $200 million with accrued interest was repaid from additional commercial paper borrowings.

The Senior Debentures, remaining principal amount of $99 million, are due August 15, 2009. They bear interest at a rate of 8¼%, with interest payable on February 15 and August 15 of each year. The Senior Debentures, which are not redeemable at the option of Torchmark prior to maturity, provided the holder with an option to require Torchmark to repurchase the debentures on August 15, 1996 at principal amount plus accrued interest. Pursuant to this option, $550 thousand debentures were repurchased in 1996. The Senior Debentures have equal priority with other Torchmark unsecured indebtedness.

**Note 13—Debt (continued)**

The Notes, due May 15, 2023, were issued in May, 1993 in the principal amount of $200 million. Proceeds of the issue, net of issue costs, were $196 million. Interest is payable on May 15 and November 15 of each year at a rate of 7⅞%. In October, 1998, $10.8 million principal amount were purchased in the open market at a cost of $10.6 million. These notes are not redeemable prior to maturity and have equal priority with other Torchmark unsecured indebtedness.

The Notes, due August 1, 2013, were issued in July, 1993 in the principal amount of $100 million for net proceeds of $98 million. Interest is payable on February 1 and August 1 of each year at a rate of 7⅜%. These notes are not redeemable prior to maturity and have equal priority with other Torchmark unsecured indebtedness.

Torchmark has entered into a revolving credit agreement with a group of lenders under which it may borrow on an unsecured basis up to $600 million. The commitment matures October 22, 2002. Borrowings are at interest rates selected by Torchmark based on either the corporate base rate or the Eurodollar rate at the time of borrowings. At December 31, 1998 and December 31, 1997 there were no borrowings under the revolving credit agreement. The revolving credit agreement is also designed to back up a commercial paper program. The short-term borrowings under the revolving credit agreements and in the commercial paper market averaged $287 million during 1998, and were made at an average yield of 5.58%. At December 31, 1998, commercial paper was outstanding in the face amount of $357 million. Torchmark is subject to certain covenants for the revolving credit agreements regarding capitalization and earnings, for which it was in compliance at December 31, 1998, and pays a facility fee based on size of the line.

Interest in the amount of $2.4 million, $1.7 million, and $1.4 million was capitalized during 1998, 1997, and 1996, respectively.

**Note 14—Monthly Income Preferred Securities**

In October, 1994, Torchmark, through its wholly-owned finance subsidiary, Torchmark Capital L.L.C., completed a public offering of eight million shares of 9.18% MIPS at a face amount of $200 million. The securities are subject to a mandatory redemption in full at September 30, 2024, although Torchmark may elect to extend the MIPS for up to an additional 20 years if certain conditions are met. They are redeemable at Torchmark's option after September 30, 1999. Torchmark subsequently entered into a ten-year swap agreement with an unaffiliated party whereby Torchmark agreed to pay a variable rate on the $200 million face amount in exchange for payment of the fixed dividend. In a related transaction, Torchmark purchased a five-year cap on the swap agreement that insures that the variable rate cannot exceed 10.39% through September 30, 1999. The interest rate was 7.02% at December 31, 1998 and 7.36% at December 31, 1997. Torchmark paid the final yearly fee of $860 thousand for the cap agreement on September 30, 1998. The market value of the swap agreement was a benefit of $24.7 million December 31, 1998 and $18.7 million at December 31, 1997. The market value of the cap agreement, net of the present value of future annual payments, was $0 at December 31, 1998 and $.8 million at December 31, 1997. Except as otherwise described in *Note 3—Investments*, Torchmark is a party to no other derivative instruments as defined by SFAS 119.

**(Dollar amounts in thousands except per share data)**

## Note 15—Shareholders' Equity

*Share Data:* A summary of preferred and common share activity which has been restated to give effect for the two-for-one stock split in the form of a dividend is as follows:

| | Preferred Stock | | Common Stock | |
|---|---|---|---|---|
| | Issued | Treasury Stock | Issued | Treasury Stock |
| 1996: | | | | |
| Balance at December 31, 1995 | -0- | -0- | 147,568,456 | (4,234,182) |
| Issuance of common stock due to exercise of stock options | | | | 676,376 |
| Other treasury stock acquired | | | | (4,618,700) |
| Balance at December 31, 1996 | -0- | -0- | 147,568,456 | (8,176,506) |
| 1997: | | | | |
| Issuance of common stock due to exercise of stock options | | | 280,452 | 5,539,596 |
| Other treasury stock acquired | | | | (5,171,558) |
| | -0- | -0- | 147,848,908 | (7,808,468) |
| 1998: | | | | |
| Issuance of common stock due to exercise of stock options | | | | 175,240 |
| Issuance of common stock due to restricted stock grant | | | | 117,500 |
| Other treasury stock acquired | | | | (3,436,205) |
| Restricted shares converted to Waddell & Reed shares | | | (48,000) | |
| | -0- | -0- | 147,800,908 | (10,951,933) |

| | At December 31, 1998 | | At December 31, 1997 | |
|---|---|---|---|---|
| | Preferred Stock | Common Stock | Preferred Stock | Common Stock |
| Par value per share | $1.00 | $1.00 | $1.00 | $1.00 |
| Authorized shares | 5,000,000 | 320,000,000 | 5,000,000 | 320,000,000 |

*Acquisition of Common Shares:* Torchmark shares are acquired from time to time through open market purchases under the Torchmark stock repurchase program when it is believed to be the best use of Torchmark's funds and for future employee stock option exercises. Share repurchases under this program were 3.4 million shares at a cost of $126 million in 1998 and 5.2 million shares at a cost of $183 million in 1997, and 4.6 million shares at a cost of $107 million in 1996.

*Grant of Restricted Stock:* On January 1, 1998, 117,500 shares were granted to four executive officers of Torchmark or its subsidiaries. These shares vest over eight years in accordance with the following schedule: 16% on the first anniversary, with the vesting percentage declining one percent each year thereafter until the eighth anniversary. The market value of Torchmark stock was $42.1875 per share on the grant date.

*Restrictions:* Restrictions exist on the flow of funds to Torchmark from its insurance subsidiaries. Statutory regulations require life insurance subsidiaries to maintain certain minimum amounts of capital and surplus. These restrictions generally limit the payment of dividends by insurance subsidiaries to statutory net gain on an annual noncumulative basis in the absence of special approval. Additionally, insurance companies are not permitted to distribute the excess of shareholders' equity as determined on a GAAP basis over that determined on a statutory basis. In 1999, $258 million will be available to Torchmark for dividends from insurance subsidiaries in compliance with statutory regulations without prior regulatory approval.

**(Dollar amounts in thousands except per share data)**

### Note 15—Shareholders' Equity (continued)

*Earnings Per Share:* A reconciliation of basic and diluted weighted-average shares outstanding, in accordance with SFAS 128, is as follows:

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Basic weighted average shares outstanding | 139,998,671 | 139,202,354 | 142,459,783 |
| Weighted average dilutive options outstanding | 1,353,241 | 2,228,802 | 1,323,435 |
| Diluted weighted average shares outstanding | 141,351,912 | 141,431,156 | 143,783,218 |

Weighted average options outstanding considered to be anti-dilutive under SFAS 128 totaled 0, 742,472, and 598,342 as of December 31, 1998, 1997 and 1996, respectively, and are excluded from the calculation of diluted earnings per share. Income available to common shareholders for basic earnings per share is equivalent to income available to common shareholders for diluted earnings per share.

### Note 16—Employee Stock Options

Certain employees and directors have been granted options to buy shares of Torchmark stock generally at the market value of the stock on the date of grant under the provisions of the Torchmark Corporation 1987 Stock Incentive Plan (''1987 Option Plan''). The options are exercisable during the period commencing from the date they vest until expiring ten years or ten years and two days after grant. Employee stock options granted under the 1987 Option Plan generally vest one-half in two years and one-half in three years. Director grants generally vest in six months. A grant in September, 1997 vested immediately. Deferred executive and director grants vest over ten years. Torchmark generally issues shares for the exercise of stock options out of treasury stock.

An analysis of shares available for grant in terms of shares adjusted for the stock dividend is as follows:

| | Available for Grant | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Balance at January 1 | 2,434,004 | 1,345,080 | 2,499,778 |
| Amendment of 1987 Plan | | 4,800,000 | |
| 1998 Stock Incentive Plan | 14,000,000 | | |
| Deferred and Director Grants | (216,481) | (633,672) | |
| Grant of restricted stock(1) | (117,500) | | |
| Expired | 13,700 | 32,896 | 293,502 |
| Closure of option plans(2) | (2,113,723) | | |
| Granted(3) | (807,494) | (3,110,300) | (1,448,200) |
| Balance on December 31 | 13,192,506 | 2,434,004 | 1,345,080 |

(1) This stock grant was made from the 1987 Stock Incentive Plan.
(2) The 1987 Stock Incentive Plan, the 1998 Directors' Stock Option Plan, and the 1998 Executive Deferred Compensation Stock Option Plan were closed in 1998.
(3) Granted from the 1998 Stock Incentive Plan.

Torchmark accounts for its employee stock options in accordance with SFAS 123 ''Accounting for Stock-Based Compensation'', which defines a ''fair value method'' of measuring and accounting for employee stock options. It also allows accounting for such options under the ''intrinsic value method'' in accordance with Accounting Principles Board Opinion No. 25, ''Accounting for Stock Issued to Employees'' (''APB 25'') and related interpretations. If a company elects to use the intrinsic value method, then pro forma disclosures of earnings and earnings per share are required as if the fair value method of accounting was applied. The effects of applying SFAS 123 in the pro forma disclosures are not necessarily indicative of future amounts.

**Note 16—Employee Stock Options (continued)**

Torchmark has elected to account for its stock options under the intrinsic value method as outlined in APB 25. The fair value method requires the use of an option valuation model, such as the Black-Scholes option valuation model, to value employee stock options, upon which a compensation expense is based. The Black-Scholes option valuation model was not developed for use in valuing employee stock options. Instead, this model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because Torchmark's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, it is management's opinion that the existing models do not provide a reliable measure of the fair value of its employee stock options. Under the intrinsic value method, compensation expense is only recognized if the exercise price of the employee stock option is less than the market price of the underlying stock on the date of grant.

The fair value for Torchmark's employee stock options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 1998, 1997 and 1996:

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Risk-free interest rate | 4.8% | 6.1% | 6.4% |
| Dividend yield | 1.1% | 1.7% | 3.7% |
| Volatility factor | 22.8 | 23.7 | 22.8 |
| Weighted average expected life (in years) | 4.71 | 3.93 | 4.17 |

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. Torchmark's pro forma information follows (in thousands except for earnings per share information):

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Pro forma net income | $245,383 | $318,671 | $309,657 |
| Pro forma basic net income per share | 1.75 | 2.29 | 2.17 |
| Pro forma diluted net income per share | 1.74 | 2.25 | 2.15 |

On September 25, 1997, Torchmark executed a stock option exercise and ''reload'' program through which over 100 Torchmark directors and employees exercised vested stock options and received replacement options at current market price. This program resulted in the issuance of 4.8 million shares, of which over 3 million shares were immediately sold by the directors and employees through the open market to cover the cost of the purchased shares and related taxes. As a result of the ''reload'' program, management's ownership interest increased, and Torchmark received a significant current tax benefit from the exercise of the options.

On November 6, 1998, in connection with its spin-off of Waddell & Reed, Torchmark adjusted the number and exercise price of its employee stock options so that the options' value after the spin would be equivalent to its value before the spin. Additionally, every eligible optionee was given the opportunity to elect to convert a portion of their Torchmark options into equivalent Waddell & Reed options in accordance with the same spin ratio that was applicable to all Torchmark shareholders. Also, employees of Waddell & Reed and directors were allowed to convert all of their Torchmark options into equivalent Waddell & Reed options. In every case, the employee or director maintained the same value after the spin-off as was held prior to the transaction.

As a result of the adjustment and conversion of these options, 7.2 million outstanding Torchmark options with an aggregate exercise price of $219 million on November 6, 1998 were replaced with 6.4 million adjusted Torchmark options with an aggregate exercise price of $167 million. Also 3.7 million Waddell & Reed options were granted with an aggregate exercise price of $51.6 million.

**(Dollar amounts in thousands except per share data)**

**Note 16—Employee Stock Options (continued)**

A summary of Torchmark's stock option activity adjusted for the stock dividend, and related information for the years ended December 31, 1998, 1997, and 1996 follows:

| | 1998 | | 1997 | | 1996 | |
|---|---|---|---|---|---|---|
| | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price | Options | Weighted Average Exercise Price |
| Outstanding-beginning of year | 7,241,050 | $29.76 | 9,350,022 | $18.52 | 8,871,700 | $17.31 |
| Granted | 1,023,975 | 34.97 | 3,743,972 | 36.70 | 1,448,200 | 24.55 |
| Exercised | (175,240) | 22.58 | (5,820,048) | 16.17 | (676,376) | 15.00 |
| Expired | (13,700) | 29.19 | (32,896) | 29.81 | (293,502) | 19.63 |
| Reduction due to Waddell & Reed spinoff | (7,249,129) | 30.20 | | | | |
| Addition due to Waddell & Reed spinoff | 6,401,444 | 26.16 | | | | |
| Outstanding-end of year | 7,228,400 | 27.04 | 7,241,050 | 29.76 | 9,350,022 | 18.52 |
| Exercisable at end of year | 5,038,081 | 26.24 | 4,189,238 | 32.82 | 6,188,622 | 16.47 |

The weighted average fair value of options granted during the years ended December 31, 1998, 1997 and 1996 were $8.88, $8.43, and $5.08, respectively.

**(Dollar amounts in thousands except per share data)**

## Note 16—Employee Stock Options (continued)

The following table summarizes information about stock options outstanding at December 31, 1998:

| Exercise Price | Grant Date | Number Outstanding | Number Exercisable | Contract Termination Date |
|---|---|---|---|---|
| 4.86419 | October 1, 1993 | 6,416 | 6,416 | October 3, 2003 |
| 5.63977 | October 1, 1993 | 5,016 | 5,016 | October 3, 2003 |
| 13.32138 | January 15, 1991 | 14,699 | 14,699 | January 17, 2001 |
| 13.91029 | January 2, 1991 | 21,029 | 21,029 | January 4, 2001 |
| 14.17778 | January 25, 1990 | 21,029 | 21,029 | January 27, 2000 |
| 14.55172-14.70181 | December 16, 1994 | 179,899 | 179,899 | December 18, 2004 |
| 14.55222-14.57135 | December 7, 1992 | 9,390 | 9,390 | December 9, 2002 |
| 14.55659-14.57236 | December 14, 1993 | 20,337 | 20,337 | December 16, 2003 |
| 14.57232-14.57573 | October 1, 1993 | 6,552 | 6,552 | October 3, 2003 |
| 14.7127-14.73215 | December 12, 1991 | 31,364 | 31,364 | December 14, 2001 |
| 14.92781 | January 3, 1995 | 7,010 | 7,010 | January 5, 2005 |
| 15.94885* | December 18, 1996 | 60,000 | 12,000 | December 18, 2007 |
| 16.42468 | January 2, 1992 | 21,029 | 21,029 | January 4, 2002 |
| 18.56413-18.5922 | December 20, 1995 | 1,151,575 | 1,151,575 | December 22, 2005 |
| 18.61765-18.63421 | December 14, 1993 | 62,219 | 62,219 | December 16, 2003 |
| 19.26091 | January 2, 1996 | 7,010 | 7,010 | January 4, 2006 |
| 19.26091-19.276 | January 3, 1994 | 13,010 | 13,010 | January 5, 2004 |
| 19.94133 | October 1, 1993 | 2,536 | 2,536 | October 3, 2003 |
| 21.29257-21.30859 | December 16, 1996 | 1,040,887 | 520,444 | December 18, 2006 |
| 21.50657-21.52056 | January 2, 1997 | 142,003 | 8,827 | January 4, 2007 |
| 22.14864-22.16202 | January 31, 1997 | 466,015 | 329,347 | January 31, 2008 |
| 22.25559-22.26895 | December 7, 1992 | 96,411 | 96,411 | December 9, 2002 |
| 24.7174-24.72794 | January 4, 1993 | 19,010 | 19,010 | January 6, 2003 |
| 33.27631-33.28237 | December 24, 1997 | 340,361 | 0 | December 26, 2007 |
| 33.4375 | December 16, 1998 | 687,600 | 0 | December 18, 2008 |
| 33.4375 | December 16, 1998 | 119,894 | 0 | December 16, 2009 |
| 33.4903-33.497 | September 25, 1997 | 2,435,922 | 2,435,922 | September 27, 2007 |
| 33.54382 | January 9, 1998 | 12,984 | 0 | January 9, 2009 |
| 34.75 | December 30, 1998 | 39,659 | 0 | December 30, 2009 |
| 35.63037 | February 16, 1998 | 12,056 | 0 | February 16, 2009 |
| 36.11175-36.11284 | January 2, 1998 | 152,709 | 36,000 | January 4, 2008 |
| 36.37928 | February 10, 1998 | 11,357 | 0 | February 10, 2009 |
| 36.43278 | February 4, 1998 | 11,412 | 0 | February 4, 2009 |
| | | 7,228,400 | 5,038,081 | |

* Issued when the market price was $24.8125. Option price at that time (prior to the Waddell & Reed spin-off adjustment) was $18.61.

## Note 17—Commitments and Contingencies

*Reinsurance:* Insurance affiliates of Torchmark reinsure that portion of insurance risk which is in excess of their retention limits. Retention limits for ordinary life insurance range up to $2.5 million per life. Life insurance ceded represents less than 1.0% of total life insurance in force at December 31, 1998. Insurance ceded on life and accident and health products represents .8% of premium income for 1998. Torchmark would be liable for the reinsured risks ceded to other companies to the extent that such reinsuring companies are unable to meet their obligations.

Insurance affiliates also assume insurance risks of other companies. Life reinsurance assumed represents 2.5% of life insurance in force at December 31, 1998 and reinsurance assumed on life and accident and health products represents 1.8% of premium income for 1998.

**Note 17—Commitments and Contingencies (continued)**

*Leases:* Torchmark leases office space and office equipment under a variety of operating lease arrangements. These leases contain various renewal options, purchase options, and escalation clauses. Rental expense for operating leases was $3.2 million in each of the years 1998, 1997, and 1996. Future minimum rental commitments required under operating leases having remaining noncancelable lease terms in excess of one year at December 31, 1998 are as follows: 1999, $2.0 million; 2000, $1.3 million; 2001, $639 thousand; 2002, $397 thousand; 2003, $197 thousand; and in the aggregate, $4.5 million.

*Concentrations of Credit Risk:* Torchmark maintains a highly-diversified investment portfolio with limited concentration in any given region, industry, or economic characteristic. At December 31, 1998, the investment portfolio consisted of securities of the U.S. government or U.S. government-backed securities (12%); non government-guaranteed mortgage-backed securities (6%); short-term investments, which generally mature within one month (1%); securities of state and municipal governments (10%); securities of foreign governments (1%) and investment-grade corporate bonds (57%). The remainder of the portfolio was in real estate (3%), which is not considered a financial instrument according to GAAP; policy loans (4%), which are secured by the underlying insurance policy values; and equity securities, noninvestment grade securities, and other long-term investments (6%). Investments in municipal governments and corporations are made throughout the U.S. with no concentration in any given state. Most of the investments in foreign government securities are in Canadian government obligations. Corporate debt and equity investments are made in a wide range of industries. At December 31, 1998, 1% or more of the portfolio was invested in the following industries: Financial services (19%); regulated utilities (7%); consumer goods (5%); chemicals and allied products (4%); manufacturing (4%); transportation (4%); services (4%); retailing (3%); machinery and equipment (3%); media/communications (3%); petroleum (3%); asset-backed securities (2%); and forestry, paper, and allied products (1%). Otherwise, no individual industry represented 1% or more of Torchmark's investments. At year-end 1998, 5% of the carrying value of fixed maturities was rated below investment grade (BB or lower as rated by Standard & Poor's or the equivalent NAIC designation). Par value of these investments was $294.7 million, amortized cost was $294.5 million, and market value was $295.3 million. While these investments could be subject to additional credit risk, such risk should generally be reflected in market value.

*Collateral Requirements:* Torchmark requires collateral for investments in instruments where collateral is available and is typically required because of the nature of the investment. Since the majority of Torchmark's investments is in government, government-secured, or corporate securities, the requirement for collateral is rare. Torchmark's mortgages are secured by collateral.

*Litigation:* Torchmark and its subsidiaries continue to be named as parties to pending or threatened legal proceedings. These lawsuits involve tax matters, alleged breaches of contract, torts, including bad faith and fraud claims based on alleged wrongful or fraudulent acts of agents of Torchmark's subsidiaries, employment discrimination, and miscellaneous other causes of action. Many of these lawsuits involve claims for punitive damages in state courts of Alabama, a jurisdiction particularly recognized for its large punitive damage verdicts. A number of such actions involving Liberty also name Torchmark as a defendant. As a practical matter, a jury's discretion regarding the amount of a punitive damage award is not limited by any clear, objective criteria under Alabama law. Accordingly, the likelihood or extent of a punitive damage award in any given case is virtually impossible to predict. As of December 31, 1998, Liberty was a party to approximately 125 active lawsuits (including 29 employment related cases and excluding interpleaders and stayed cases), more than 110 of which were Alabama proceedings in which punitive damages were sought. Liberty faces trial settings in these cases on an on-going basis.

Based upon information presently available, and in light of legal and other factual defenses available to Torchmark and its subsidiaries, contingent liabilities arising from threatened and pending litigation are not presently considered by management to be material. It should be noted, however, that large punitive damage awards bearing little or no relation to actual damages awarded by juries in jurisdictions in which Torchmark has substantial business, particularly in Alabama, continue to occur, creating the potential for unpredictable material adverse judgments in any given punitive damage suit.

**Note 17—Commitments and Contingencies (continued)**

As previously reported, Liberty has been subject to 76 individual cancer policy lawsuits pending in Alabama and Mississippi, which were stayed or otherwise held in abeyance pending final resolution of *Robertson v. Liberty National Life Insurance Company* (Case No. CV-92-021). Liberty filed motions to dismiss these lawsuits based upon the U.S. Supreme Court opinion issued in *Robertson* in March 1997. Only two of these individual cancer policy lawsuits remain, the other such suits having been dismissed.

It has been previously reported that Liberty was a party to 53 individual cases filed in Chambers County, Alabama involving allegations that an interest-sensitive life insurance policy would become paid-up or self-sustaining after a specified number of years. Only one of these cases remains pending with all others having been settled and dismissed by the Chambers County Circuit Court.

As previously reported, Torchmark, its insurance subsidiaries Globe and United American, and certain Torchmark officers were named as defendants in purported class action litigation filed in the District Court of Oklahoma County, Oklahoma (*Moore v. Torchmark Corporation*, Case No. CJ-94-2784-65, subsequently amended and restyled *Tabor v. Torchmark Corporation*). This suit claims damages on behalf of individual health policyholders who are alleged to have been induced to terminate such policies and to purchase Medicare Supplement and/or other insurance coverages. On February 6, 1998, the defendants renewed their motion to dismiss the class claims for failure to prosecute. The District Court, in an order dated April 2, 1998, allowed bifurcation of *Tabor* into Medicare Supplement policy claims and non-Medicare Supplement policy claims. The non-Medicare Supplement claims were stayed pending disposition of a related case involving the same plaintiffs filed in Mississippi while discovery was allowed to proceed on plaintiffs' motion to certify a class of Medicare Supplement policyholders' claims.

On August 25, 1995, a purported class action was filed against Torchmark, Globe, United American and certain officers of these companies in the United States District Court for the Western District of Missouri on behalf of all former agents of Globe (*Smith v. Torchmark Corporation*, Case No. :95-3304-CV-S-4). This action alleges that the defendants breached independent agent contracts with the plaintiffs by treating them as captive agents and engaged in a pattern of racketeering activity wrongfully denying income and renewal commissions to the agents, restricting insurance sales, mandating the purchase of worthless leads, terminating agents without cause and inducing the execution of independent agent contracts based on misrepresentations of fact. Monetary damages in an unspecified amount are sought. A plaintiff class was certified by the District Court on February 26, 1996, although the certification does not go to the merit of the allegations in the complaint. On December 31, 1996, the plaintiffs filed an amended complaint in *Smith* to allege violations of various provisions of the Employment Retirement Income Security Act of 1974. Extensive discovery was then conducted. In October 1998, defendants filed a motion to decertify the presently defined class in *Smith*.

It has been previously reported that Torchmark, its subsidiaries United American and Globe and certain individual corporate officers are parties to purported class action litigation filed in April, 1996 in the U.S. District Court for the Northern District of Georgia (*Crichlow v. Torchmark Corporation*, Case No. 4:96-CV-0086-HLM) involving certain hospital and surgical insurance policies issued by Globe and United American. In September 1997, the U.S. District Court entered an order granting summary judgment against the plaintiffs on certain issues and denying national class certification, although indicating that plaintiffs could move for the certification of a state class of Georgia policyholders. Discovery then proceeded on the remaining claims for breach of contract and the duty of good faith arising from closure of the block of business and certain post-claim matters as well as fraud and conspiracy relating to pricing and delay in implementing rate increases. On June 17, 1998, the U.S. District Court entered an order which denied the plaintiffs' motion to certify a Georgia policyholders class, denied reconsideration of the previously entered motion for summary judgment on certain issues, denied reconsideration of the denial of national certification of a class of policyholders and severed and transferred claims of Mississippi policyholders to the U.S. District Court for the Northern District of Mississippi (*Greco v. Torchmark Corporation*, Case No. 1:98CV196-D-D). The U.S. District Court granted defendants' motion for summary judgment on all remaining issues in *Crichlow* on February 4, 1999. Plaintiffs in *Greco* have moved to certify a class of persons purchasing Globe hospital and surgical insurance policies in Mississippi. On February 1, 1999, defendants filed a motion for summary judgment in *Greco*.

**Note 17—Commitments and Contingencies (continued)**

Torchmark has previously reported the case of *Lawson v. Liberty National Life Insurance Company* (Case No. CV-96-01119), filed in the Circuit Court of Jefferson County, Alabama, where the plaintiffs sought to represent a class of interest-sensitive life insurance policyholders, including those allegedly induced to exchange life insurance policies or where the existing policy's cash value was allegedly depleted, in litigation alleging fraud, negligence and breach of contract in the sale or exchange of interest-sensitive policies by Liberty. Torchmark was subsequently added as a defendant. In May 1996, the Circuit Court entered an order conditionally certifying a plaintiffs class, which was subsequently redefined in March 1997. The Circuit Court's order allowed the parties to challenge the conditional certification based upon subsequent discovery in the case. In March 1998, the defendants challenged the conditional certification and a hearing on final certification was held in October 1998. On February 9, 1999, the Circuit Court entered an order decertifying the conditional class and denying all petitions to certify a class in *Lawson*.

Purported class action litigation was filed on January 2, 1996 against Torchmark, Torch Energy Advisors Incorporated, and certain Torch Energy subsidiaries and affiliated limited partnerships in the Circuit Court of Pickens County, Alabama (*Pearson v. Torchmark Corporation*, Case No. CV-95-140). Plaintiff alleges improper payment of royalties and overriding royalties on coalbed methane gas produced and sold from wells in Robinson's Bend Coal Degasification Field, seeks certification of a class and claims unspecified compensatory and punitive damages on behalf of such class. On April 11, 1996, Torchmark's motion to change venue was granted and the case has been transferred to the Circuit Court of Tuscaloosa County, Alabama. Torchmark's motion to dismiss remains pending while discovery is proceeding. On February 10, 1999, the plaintiffs filed a request for a class certification hearing and to set a trial date for the *Pearson* case.

In 1978, the United States District Court for the Northern District of Alabama entered a final judgment in *Battle v. Liberty National Life Insurance Company, et al* (Case No. CV-70-H-752-S), class action litigation involving Liberty, a class composed of all owners of funeral homes in Alabama and a class composed of all insureds (Alabama residents only) under burial or vault policies issued, assumed or reinsured by Liberty. The final judgment fixed the rights and obligations of Liberty and the funeral directors authorized to handle Liberty burial and vault policies as well as reforming the benefits available to the policyholders under the policies. Although class actions are inherently subject to subsequent collateral attack by absent class members, the *Battle* decree remains in effect to date. A motion filed in February 1990 to challenge the final judgment under Federal Rule of Civil Procedure 60(b) was rejected by both the District Court in 1991 and the Eleventh Circuit Court of Appeals in 1992 and a Writ of Certiorari was denied by the U.S. Supreme Court in 1993.

In November 1993, an attorney (purporting to represent the funeral director class) filed a petition in the District Court seeking ''alternative relief'' under the final judgment. This petition was voluntarily withdrawn on November 8, 1995 by petitioners. On February 23, 1996, Liberty filed a petition with the District Court requesting that it order certain contract funeral directors to comply with their obligations under the Final Judgment in *Battle* and their funeral service contracts. A petition was filed on April 8, 1996 on behalf of a group of funeral directors seeking to modify the 1978 decree in *Battle* in light of changed economic circumstances. All parties made extensive submissions to the District Court and a hearing on the opposing petitions was held by the District Court on February 9, 1999.

It has been previously reported that in July 1998, a jury in U.S. District Court in the Middle District of Florida recommended an aggregate total verdict amounting to $21.6 million against Liberty in *Hipp v. Liberty National Life Insurance Company* (Case No. 95-1332-CIV-T-17A). This case, originally filed in 1995 in the Florida state court system, is a collective action under the Fair Labor Standards Act, alleging age discrimination by Liberty in violation of the Age Discrimination in Employment Act and the Florida Civil Rights Act. The plaintiffs, ten present or former Liberty district managers, sought damages for lost wages, loss of future earnings, lost health and retirement benefits and lost raises and expenses. Three of these plaintiffs, Florida residents, also sought compensatory and punitive damages allowable under Florida law. On November 20, 1998, the District Court remitted the $10 million punitive damage portion of the jury

**(Dollar amounts in thousands except per share data)**

## Note 17—Commitments and Contingencies (continued)

verdict to $0, thus reducing the total verdict to $11 million (including an advisory verdict of $3.2 million in front pay awards). Additional revised front pay submissions were made by the plaintiffs to the District Court in December 1998 and Liberty responded thereto in January 1999. Liberty is awaiting the entry of a final judgment in the *Hipp* case and thereafter will pursue all available post trial and appellate relief.

## Note 18—Business Segments

Torchmark's segments are based on the insurance product lines it markets and administers, life insurance, health insurance, and annuities. These major product lines are set out as segments because of the common characteristics of products within these categories, comparability of margins, and the similarity in regulatory environment and management techniques. There is also an investment segment which manages the investment portfolio, debt, and cash flow for the insurance segments and the corporate function.

Life insurance products include traditional and interest-sensitive whole life insurance as well as term life insurance. Health products are generally guaranteed-renewable and include Medicare Supplement, cancer, accident, long-term care, and limited hospital and surgical coverages. Annuities include both fixed-benefit and variable contracts. Variable contracts allow policyholders to choose from a variety of mutual funds in which to direct their deposits.

Torchmark markets its insurance products through a number of distribution channels, each of which sells the products of one or more of Torchmark's insurance segments. The tables below present segment premium revenue by each of Torchmark's marketing groups.

| | For the Year 1998 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Life | | Health | | Annuity | | Total | |
| Distribution Channel | Amount | % of Total | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Direct Response | $221,371 | 23.1% | $ 8,817 | 1.2% | | | $ 230,188 | 13.1% |
| Liberty National Exclusive | 281,145 | 29.3 | 135,861 | 17.9 | $ 84 | 0.2% | 417,090 | 23.8 |
| American Income Exclusive | 204,310 | 21.3 | 47,074 | 6.2 | | | 251,384 | 14.3 |
| United American Independent | 36,925 | 3.8 | 417,556 | 54.9 | 445 | 1.3 | 454,926 | 25.9 |
| United American Exclusive | 18,798 | 2.0 | 150,602 | 19.8 | | | 169,400 | 9.7 |
| Military Independent | 92,204 | 9.6 | | | | | 92,204 | 5.3 |
| United Investors Exclusive | 81,620 | 8.5 | | | 33,065 | 97.4 | 114,685 | 6.5 |
| Other | 23,393 | 2.4 | | | 360 | 1.1 | 23,753 | 1.4 |
| | $959,766 | 100.0% | $759,910 | 100.0% | $33,954 | 100.0% | $1,753,630 | 100.0% |

| | For the Year 1997 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Life | | Health | | Annuity | | Total | |
| Distribution Channel | Amount | % of Total | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Direct Response | $195,393 | 21.5% | $ 6,467 | 0.9% | | | $ 201,860 | 12.0% |
| Liberty National Exclusive | 280,519 | 30.8 | 125,701 | 17.0 | $ 84 | 0.3% | 406,304 | 24.2 |
| American Income Exclusive | 190,681 | 20.9 | 46,116 | 6.2 | | | 236,797 | 14.1 |
| United American Independent | 36,810 | 4.0 | 428,775 | 58.0 | 333 | 1.2 | 465,918 | 27.8 |
| United American Exclusive | 18,243 | 2.0 | 132,426 | 17.9 | | | 150,669 | 9.0 |
| Military Independent | 79,631 | 8.8 | | | | | 79,631 | 4.7 |
| United Investors Exclusive | 77,986 | 8.6 | | | 27,009 | 94.7 | 104,995 | 6.3 |
| Other | 30,729 | 3.4 | | | 1,101 | 3.8 | 31,830 | 1.9 |
| | $909,992 | 100.0% | $739,485 | 100.0% | $28,527 | 100.0% | $1,678,004 | 100.0% |

**(Dollar amounts in thousands except per share data)**

## Note 18—Business Segments (continued)

| | For the Year 1996 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Life | | Health | | Annuity | | Total | |
| Distribution Channel | Amount | % of Total | Amount | % of Total | Amount | % of Total | Amount | % of Total |
| Direct Response | $171,983 | 20.1% | $ 3,519 | 0.5% | | | $ 175,502 | 10.9% |
| Liberty National Exclusive | 279,637 | 32.7 | 120,028 | 16.4 | $ 99 | 0.4% | 399,764 | 24.8 |
| American Income Exclusive | 173,700 | 20.3 | 44,172 | 6.0 | | | 217,872 | 13.5 |
| United American Independent | 33,404 | 3.9 | 440,862 | 60.2 | 249 | 1.1 | 474,515 | 29.5 |
| United American Exclusive | 15,767 | 1.8 | 124,037 | 16.9 | | | 139,804 | 8.7 |
| Military Independent | 71,223 | 8.3 | | | | | 71,223 | 4.4 |
| United Investors Exclusive | 73,836 | 8.6 | | | 20,681 | 92.3 | 94,517 | 5.9 |
| Other | 35,347 | 4.3 | | | 1,375 | 6.2 | 36,722 | 2.3 |
| | $854,897 | 100.0% | $732,618 | 100.0% | $22,404 | 100.0% | $1,609,919 | 100.0% |

Because of the nature of the insurance industry, Torchmark has no individual or group which would be considered a major customer. Substantially all of Torchmark's business is conducted in the United States, primarily in the Southeastern and Southwestern regions.

The measure of profitability for insurance segments is underwriting income before other income and administrative expenses, in accordance with the manner the segments are managed. It essentially represents gross profit margin on insurance products before insurance administrative expenses and consists of premium, less net policy obligations, acquisition expenses, and commissions. It differs from GAAP pretax operating income before other income and administrative expense for two primary reasons. First, there is a reduction to policy obligations for interest credited by contract to policyholders because this interest is earned and credited by the investment segment. Second, interest is also added to acquisition expense which represents the implied interest cost of deferred acquisition costs, which is funded by and is attributed to the investment segment.

The measure of profitability for the investment segment is excess investment income, which represents the income earned on the investment portfolio in excess of net policy requirements and financing costs associated with debt and Torchmark's MIPS. The investment segment is measured on a tax-equivalent basis, equating the return on tax-exempt investments to the pretax return on taxable investments. Other than the above-mentioned interest allocations, there are no other intersegment revenues or expenses. Expenses directly attributable to corporate operations are included in the ''Corporate'' category. All other unallocated revenues and expenses on a pretax basis, including insurance administrative expense, are included in the ''Other'' segment category. The table below sets forth a reconciliation of Torchmark's revenues and operations by segment to its major income statement line items.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

**(Dollar amounts in thousands except per share data)**

## Note 18—Business Segments (continued)

| | For the year 1998 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Life | Health | Annuity | Investment | Other | Corporate | Family Service Underwriting Income | Adjustments | Consolidated |
| Revenue: | | | | | | | | | |
| Premium | $ 957,274 | $759,910 | $ 33,594 | | | | $ 2,852 | | $1,753,630 |
| Net investment income | | | | $ 470,701 | | | | $(11,143) | 459,558 |
| Other income | | | | | $ 4,488 | | | (2,163) | 2,325 |
| Total revenue | 957,274 | 759,910 | 33,594 | 470,701 | 4,488 | | 2,852 | (13,306) | 2,215,513 |
| Expenses: | | | | | | | | | |
| Policy benefits | 618,867 | 482,496 | 34,662 | | | | 14,251 | | 1,150,276 |
| Required reserve interest | (215,185) | (20,440) | (42,171) | 296,696 | | | (18,900) | | -0- |
| Amortization of acquisition costs | 158,298 | 59,208 | 11,561 | | | | 3,883 | (1,926) | 231,024 |
| Commissions and premium tax | 57,364 | 87,828 | 510 | | | | 208 | (2,163) | 143,747 |
| Required interest on acquisition costs | 85,374 | 11,373 | 5,609 | (103,481) | | | 1,125 | | -0- |
| Financing costs* | | | | 71,367 | | | | (15,042) | 56,325 |
| Total expenses | 704,718 | 620,465 | 10,171 | 264,582 | | | 567 | (19,131) | 1,581,372 |
| Underwriting income before other income and administrative expense** | 252,556 | 139,445 | 23,423 | | | | 2,285 | | 417,709 |
| Reclass of Family Service | 2,187 | | 98 | | | | (2,285) | | -0- |
| Underwriting income before other income and administrative expense | 254,743 | 139,445 | 23,521 | | | | | | 417,709 |
| Excess investment income | | | | 206,119 | | | | | 206,119 |
| Subtotal adjustments | | | | | 4,488 | | | 5,825 | 10,313 |
| Subtotal | 254,743 | 139,445 | 23,521 | 206,119 | 4,488 | | | 5,825 | 634,141 |
| Administrative expense | | | | | (103,451) | | | | (103,451) |
| Parent expense | | | | | | $(10,406) | | (3,581) | (13,987) |
| Goodwill amortization | | | | | | (12,075) | | | (12,075) |
| Pretax operating income | $254,743 | $139,445 | $23,521 | $ 206,119 | $ (98,963) | $(22,481) | $ -0- | $ 2,244 | 504,628 |
| Deduct realized investment losses and deferred acquisition cost adjustment | | | | | | | | | (57,637) |
| Pretax income | | | | | | | | | $446,991 |

* Investment segment includes MIPS dividend on a pretax basis.

** Insurance segments exclude Family Service.

**(Dollar amounts in thousands except per share data)**

## Note 18—Business Segments (continued)

| | For the year 1997 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Life | Health | Annuity | Investment | Other | Corporate | Family Service Underwriting Income | Adjustments | Consolidated |
| Revenue: | | | | | | | | | |
| Premium | $ 901,187 | $739,485 | $ 27,426 | | | | $ 9,906 | | $1,678,004 |
| Net investment income | | | | $ 439,067 | | | | $(9,951) | 429,116 |
| Other income | | | | | $ 3,141 | | | (2,179) | 962 |
| Total revenue | 901,187 | 739,485 | 27,426 | 439,067 | 3,141 | | 9,906 | (12,130) | 2,108,082 |
| Expenses: | | | | | | | | | |
| Policy benefits | 574,139 | 462,967 | 34,631 | | (7) | | 37,170 | | 1,108,900 |
| Required reserve interest | (199,339) | (21,644) | (41,551) | 308,632 | | | (46,098) | | -0- |
| Amortization of acquisition costs | 149,358 | 58,473 | 9,660 | | | | 9,105 | (1,858) | 224,738 |
| Commissions and premium tax | 55,019 | 87,069 | 710 | | | | 681 | (2,183) | 141,296 |
| Required interest on acquisition costs | 80,972 | 11,080 | 4,951 | (100,096) | | | 3,093 | | -0- |
| Financing costs* | | | | 87,055 | | | | (15,192) | 71,863 |
| Total expenses | 660,149 | 597,945 | 8,401 | 295,591 | (7) | | 3,951 | (19,233) | 1,546,797 |
| Underwriting income before other income and administrative expense** | 241,038 | 141,540 | 19,025 | | 7 | | 5,955 | | 407,565 |
| Reclass of Family Service | 5,650 | | 305 | | | | (5,955) | | -0- |
| Underwriting income before other income and administrative expense | 246,688 | 141,540 | 19,330 | | 7 | | | | 407,565 |
| Excess investment income | | | | 143,476 | | | | | 143,476 |
| Subtotal adjustments | | | | | 3,141 | | | 7,103 | 10,244 |
| Subtotal | 246,688 | 141,540 | 19,330 | 143,476 | 3,148 | | | 7,103 | 561,285 |
| Administrative expense | | | | | (104,220) | | | | (104,220) |
| Parent expense | | | | | | $(13,879) | | (2,134) | (16,013) |
| Goodwill amortization | | | | | | (12,074) | | | (12,074) |
| Deferred acquisition cost adjustment for realized gains | | | | | | | | 198 | 198 |
| Pretax operating income | $ 246,688 | $141,540 | $ 19,330 | $ 143,476 | $(101,072) | $(25,953) | $ 0 | $ 5,167 | 429,176 |
| Deduct realized investment losses and deferred acquisition cost adjustment | | | | | | | | | (37,177) |
| Pretax income | | | | | | | | | $ 391,999 |

* Investment segment includes MIPS dividend on a pretax basis.
** Insurance segments exclude Family Service.

**(Dollar amounts in thousands except per share data)**

### Note 18—Business Segments (continued)

| | For the year 1996 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Life** | **Health** | **Annuity** | **Investment** | **Other** | **Corporate** | **Family Service Underwriting Income** | **Adjustments** | **Consolidated** |
| Revenue: | | | | | | | | | |
| Premium | $ 842,186 | $732,618 | $ 21,029 | | | | $14,086 | | $1,609,919 |
| Net Investment income | | | | $410,189 | | | | $(10,638) | 399,551 |
| Other income | | | | | $ 2,936 | | | (1,820) | 1,116 |
| Total revenue | 842,186 | 732,618 | 21,029 | 410,189 | 2,936 | | 14,086 | (12,458) | 2,010,586 |
| Expenses: | | | | | | | | | |
| Policy benefits | 538,233 | 448,346 | 32,085 | | (18) | | 39,438 | | 1,058,084 |
| Required reserve interest | (186,306) | (26,137) | (38,972) | 298,408 | | | (46,993) | | -0- |
| Amortization of acquisition costs | 138,553 | 63,150 | 7,280 | | | | 10,937 | (1,094) | 218,826 |
| Commissions and premium tax | 53,747 | 87,687 | 423 | | | | 622 | (2,031) | 140,448 |
| Required interest on acquisition costs | 75,955 | 11,475 | 4,253 | (95,556) | | | 3,873 | | -0- |
| Financing costs* | | | | 88,465 | | | | (14,854) | 73,611 |
| Total expenses | 620,182 | 584,521 | 5,069 | 291,317 | (18) | | 7,877 | (17,979) | 1,490,969 |
| Underwriting income before other income and administrative expense | 222,004 | 148,097 | 15,960 | | 18 | | 6,209 | | 392,288 |
| Reclass of Family Service | 5,689 | | 520 | | | | (6,209) | | -0- |
| Underwriting income before other income and administrative expense** | 227,693 | 148,097 | 16,480 | | 18 | | | | 392,288 |
| Excess investment income | | | | 118,872 | | | | | 118,872 |
| Subtotal adjustments | | | | | 2,936 | | | 5,521 | 8,457 |
| Subtotal | 227,693 | 148,097 | 16,480 | 118,872 | 2,954 | | | 5,521 | 519,617 |
| Administrative expense | | | | | (110,029) | | | | (110,029) |
| Parent expense | | | | | | $(13,959) | | (1,893) | (15,852) |
| Goodwill amortization | | | | | | (12,074) | | | (12,074) |
| Deferred acquisition cost adjustment for realized gains | | | | | | | | 749 | 749 |
| Pretax operating income | $ 227,693 | $148,097 | $ 16,480 | $118,872 | $(107,075) | $(26,033) | $ -0- | $ 4,377 | 382,411 |
| Add realized investment gains and deferred acquisition cost adjustment | | | | | | | | | 5,081 |
| Pretax income | | | | | | | | | $ 387,492 |

* Investment segment includes MIPS dividend on a pretax basis.
** Insurance segments exclude Family Service.

**(Dollar amounts in thousands except per share data)**

### Note 18—Business Segments (continued)

Assets for each segment are reported based on a specific identification basis. The insurance segments' assets contain deferred acquisition costs, value of insurance purchased, and separate account assets. The investment segment includes the investment portfolio, cash, and accrued investment income. Goodwill is assigned to corporate operations. All other assets, representing less than 2% of total assets, are included in the other category. The table below reconciles segment assets to total assets as reported in the financial statements.

| | At December 31, 1998 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Life | Health | Annuity | Investment | Other | Corporate | Adjustments | Consolidated |
| Cash and invested assets | | | | $6,449,021 | | | | $ 6,449,021 |
| Accrued investment income | | | | 99,279 | | | | 99,279 |
| Deferred acquisition costs | $1,390,030 | $190,285 | $ 92,836 | | | | | 1,673,151 |
| Goodwill | | | | | | $414,658 | | 414,658 |
| Separate account assets | | | 2,425,262 | | | | | 2,425,262 |
| Other assets | | | | | $187,657 | | | 187,657 |
| Total assets | $1,390,030 | $190,285 | $2,518,098 | $6,548,300 | $187,657 | $414,658 | | $11,249,028 |

| | At December 31, 1997 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Life | Health | Annuity | Investment | Other | Corporate | Adjustments | Consolidated |
| Cash and invested assets | | | | $6,575,401 | | | | $ 6,575,401 |
| Accrued investment income | | | | 100,392 | | | | 100,392 |
| Deferred acquisition costs | $1,296,501 | $178,903 | $ 112,715 | | | | | 1,588,119 |
| Goodwill | | | | | | $426,732 | | 426,732 |
| Separate account assets | | | 1,876,439 | | | | | 1,876,439 |
| Other assets | | | | | $172,655 | | | 172,655 |
| Discontinued assets | | | | | | | $387,910 | 387,910 |
| Total assets | $1,296,501 | $178,903 | $1,989,154 | $6,675,793 | $172,655 | $426,732 | $387,910 | $11,127,648 |

| | At December 31, 1996 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Life | Health | Annuity | Investment | Other | Corporate | Adjustments | Consolidated |
| Cash and invested assets | | | | $5,951,214 | | | | $ 5,951,214 |
| Accrued investment income | | | | 91,837 | | | | 91,837 |
| Deferred acquisition costs | $1,215,863 | $175,498 | $ 106,734 | | | | | 1,498,095 |
| Goodwill | | | | | | $438,806 | | 438,806 |
| Separate account assets | | | 1,420,025 | | | | | 1,420,025 |
| Other assets | | | | | $159,966 | | | 159,966 |
| Discontinued assets | | | | | | | $334,021 | 334,021 |
| Total assets | $1,215,863 | $175,498 | $1,526,759 | $6,043,051 | $159,966 | $438,806 | $334,021 | $ 9,893,964 |

**(Dollar amounts in thousands except per share data)**

## Note 19—Related Party Transactions

*Transactions Regarding Vesta.* Since 1993, Torchmark has held a passive investment in 5.1 million shares of Vesta, a property insurance carrier, representing approximately 28% of the outstanding shares of Vesta. In June, 1998, Vesta announced that (a) an investigation of accounting irregularities that occurred during the fourth quarter of 1997 and the first quarter of 1998 would result in an aggregate $14 million net after-tax reduction in previously reported net income, and, in addition, that (b) it would restate its historical financial statements for the period of 1993 through the first quarter of 1998, reflecting reductions in reported net after-tax earnings of $49 million for the period of 1993 through 1997 and $10 million for the first quarter of 1998. To reflect its pro rata share of Vesta's cumulative reported financial corrections, Torchmark recorded a pre-tax charge of $20 million ($13 million after tax) or $.09 per diluted share in the second quarter of 1998. Additionally, Vesta is now subject to numerous class action lawsuits in state and Federal courts filed subsequent to such announcements.

During the fourth quarter of 1998, Torchmark announced it had entered into an agreement to sell approximately 1.8 million shares of Vesta common stock to an unaffiliated insurance carrier for $7.42 a share. In its fourth quarter Form 10Q, Torchmark reported its intent to sell its remaining Vesta shares and vacate the two Vesta board seats it occupied. In view of the pending transaction, Torchmark adjusted the carrying value of its holdings in Vesta to estimated net realizable value of $45 million, effective September 30, 1998. The adjustment produced an after-lax realized loss of $24 million or $.17 per Torchmark diluted share.

As of December 31, 1998, the terms of the agreement were not met by the unaffiliated insurance carrier and the contract to sell the Vesta shares expired. In the meantime, on December 29, 1998, Torchmark sold 680 thousand Vesta shares to another unrelated institution at a price of $4.75 per share. Torchmark realized a $2 million after-tax loss on the sale. The sale reduced Torchmark's ownership of Vesta to 4.45 million shares or approximately 24% of Vesta at December 31, 1998.

Subsequent to Vesta's June, 1998 announcement involving the accounting irregularities and the financial restatements, Torchmark recorded its equity in Vesta's earnings in the quarter that Vesta reported those earnings. As a result, Torchmark's equity in Vesta's reported earnings during 1998, including the restatements, was a pretax loss of $27 million. Torchmark carried Vesta at a value of $32 million at December 31, 1998, reflecting the previously taken writedown.

Torchmark leases office space to Vesta. Total rental income received from Vesta was $857 thousand, $585 thousand, and $508 thousand, for the years ended December 31, 1998, 1997 and 1996, respectively.

## Note 20—Supplemental Disclosures for Cash Flow Statement

The following table summarizes Torchmark's noncash transactions, which are not reflected on the Statement of Cash Flow:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Paid-in capital from tax benefit for stock option exercises | $ 933 | $39,873 | $ 1,598 |
| Discounted/deferred option grants | 582 | 2,020 | -0- |
| Non-cash assets received from sale of energy operations | -0- | -0- | 79,289 |
| Non-cash liabilities assumed from sale of energy operations | -0- | -0- | 48,942 |
| Distribution of Waddell & Reed stock | 174,113 | -0- | -0- |

The following table summarizes certain amounts paid during the period:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Interest paid | $ 60,573 | $73,537 | $74,433 |
| Income taxes paid | $102,753 | $31,422 | $66,987 |

**(Dollar amounts in thousands except per share data)**

### Note 21—Selected Quarterly Data (Unaudited)

The following is a summary of quarterly results for the two years ended December 31, 1998. The information is unaudited but includes all adjustments (consisting of normal accruals) which management considers necessary for a fair presentation of the results of operations for these periods.

| | Three Months Ended | | | |
|---|---|---|---|---|
| | March 31, | June 30, | September 30, | December 31, |
| **1998:** | | | | |
| Premium and policy charges | $433,017 | $439,364 | $437,964 | $443,285 |
| Net investment income | 119,800 | 117,881 | 112,165 | 109,712 |
| Realized investment losses | (3,173) | (1,854) | (39,750) | (12,860) |
| Total revenues | 550,032 | 556,048 | 511,271 | 540,525 |
| Policy benefits | 287,024 | 291,826 | 285,217 | 286,209 |
| Amortization of acquisition expenses | 57,334 | 57,755 | 57,248 | 58,687 |
| Pretax income from continuing operations | 117,799 | 123,856 | 87,054 | 118,282 |
| (Loss) from discontinued operations | 14,766 | 15,222 | (38,607) | 2,246 |
| Net income | 92,918 | 63,142 | 14,546 | 73,835 |
| Basic net income per common share from continuing operations | .56 | .34 | .38 | .51 |
| Basic net income per common share | .66 | .45 | .10 | .53 |
| Basic net income per common share from continuing operations excluding realized losses, related DPAC adjustment, and equity in earnings of Vesta | .55 | .58 | .58 | .61 |
| Diluted net income per common share from continuing operations | .55 | .34 | .38 | .51 |
| Diluted net income per common share | .66 | .45 | .10 | .53 |
| Diluted net income per common share from continuing operations excluding realized losses, related DPAC adjustment, and equity in earnings of Vesta | .55 | .57 | .58 | .60 |
| **1997:** | | | | |
| Premium and policy charges | $415,690 | $419,887 | $420,227 | $422,200 |
| Net investment income | 102,537 | 105,728 | 109,504 | 111,347 |
| Realized investment losses | (10,831) | (22,948) | (390) | (2,810) |
| Total revenues | 507,597 | 503,116 | 529,442 | 530,948 |
| Policy benefits | 273,081 | 279,797 | 279,311 | 276,711 |
| Amortization of acquisition expenses | 56,523 | 55,128 | 56,736 | 56,351 |
| Pretax income from continuing operations | 89,940 | 82,368 | 110,551 | 109,140 |
| Income from discontinued operations | 18,215 | 19,559 | 19,281 | 20,259 |
| Net income | 77,328 | 74,590 | 92,974 | 92,851 |
| Basic net income per common share from continuing operations | .42 | .40 | .53 | .52 |
| Basic net income per common share | .55 | .54 | .67 | .66 |
| Basic net income per common share from continuing operations excluding realized losses, related DPAC adjustment, and equity in earnings of Vesta | .46 | .48 | .51 | .51 |
| Diluted net income per common share from continuing operations | .42 | .39 | .52 | .51 |
| Diluted net income per common share | .55 | .53 | .66 | .66 |
| Diluted net income per common share from continuing operations excluding realized losses, related DPAC adjustment, and equity in earnings of Vesta | .45 | .48 | .50 | .51 |

## Item 9. Disagreements on Accounting and Financial Disclosure

On October 21, 1998, with the approval of the Audit Committee of the Board of Directors of Torchmark, Torchmark engaged Deloitte & Touche LLP as its principal accountants as of January 1, 1999, effective upon the issuance of KPMG Peat Marwick LLP's (''KPMG'') reports on the consolidated financial statements of Torchmark and subsidiaries and the separately issued financial statements of Torchmark's subsidiaries, unit investment trust accounts and benefit plans as of and for the year ending December 31, 1998. The reports of KPMG on the financial statements of Torchmark for either of the two most recent fiscal years did not contain any adverse opinion or disclaimer of opinion. Such reports were not qualified or modified as to uncertainty, audit scope or accounting principles. During such years and during the period between December 31, 1997 and the date of the independent accountants report for the consolidated financial statements of Torchmark for the three years ended December 31, 1998, there was no disagreement between KPMG and Torchmark on any matter of accounting principals or practices, financial statement disclosure, or auditing scope or procedure, which disagreements, if not resolved to the satisfaction of KPMG, would have caused that firm to make reference to the subject matter of such disagreement in connection with its report on Torchmark's financial statements.

Torchmark's appointment of Deloitte & Touche will be submitted to shareholders for ratification at Torchmark's April, 1999 annual shareholders meeting.

# PART III

## Item 10. Directors and Executive Officers of Registrant

Information required by this item is incorporated by reference from the sections entitled ''Election of Directors,'' ''Profiles of Directors and Nominees,'' ''Executive Officers'' and Section 16(a) ''Beneficial Ownership Reporting Compliance'' of the Securities Exchange Act in the Proxy Statement for the Annual Meeting of Stockholders to be held April 29, 1999 (the ''Proxy Statement''), which is to be filed with the Securities and Exchange Commission.

## Item 11. Executive Compensation

Information required by this item is incorporated by reference from the section entitled ''Compensation and Other Transactions with Executive Officers and Directors'' in the Proxy Statement.

## Item 12. Security Ownership of Certain Beneficial Owners of Management

(a) Security ownership of certain beneficial owners:

Information required by this item is incorporated by reference from the section entitled ''Principal Stockholders'' in the Proxy Statement.

(b) Security ownership of management:

Information required by this item is incorporated by reference from the section entitled ''Stock Ownership'' in the Proxy Statement.

(c) Changes in control:

Torchmark knows of no arrangements, including any pledges by any person of its securities, the operation of which may at a subsequent date result in a change of control.

## Item 13. Certain Relationships and Related Transactions

Information required by this item is incorporated by reference from the section entitled ''Compensation and Other Transactions with Executive Officers and Directors'' in the Proxy Statement.

## PART IV

### Item 14. Exhibits, Financial Statements Schedules, and Reports on Form 8-K

(a) Index of documents filed as a part of this report:



Schedules not referred to have been omitted as inapplicable or not required by Regulation S-X.

(b) Reports on Form 8-K.

The following Forms 8-K were filed by the registrant during the fourth quarter of 1998:

(1) Form 8-K dated October 19, 1998, announcing that on November 6, 1998, the registrant would spin-off its remaining stock interest in Waddell & Reed to Torchmark common shareholders;

(2) Form 8-K dated October 28, 1998, reporting changes in the registrant's certifying accountant; and

(3) Form 8-K/A dated November 20, 1998, reporting completion of the spin-off disposition of Waddell & Reed.

No financial statements were required in either of the Forms 8-K. Torchmark Corporation Pro Forma Condensed Consolidated Financial Statements (Unaudited) were filed in Form 8-K/A dated November 20, 1998.

(c) Exhibits

## EXHIBITS

| | | Page of this Report |
|---|---|---|
| (3)(i) | Restated Certificate of Incorporation of Torchmark Corporation, as amended (incorporated by reference from Exhibit 3(i) to Form 10-K for the fiscal year ended December 31, 1998) | |
| (ii) | By-Laws of Torchmark Corporation, as amended (incorporated by reference from Exhibit 3(b) to Form 10-K for the fiscal year ended December 31, 1989) | |
| (4)(a) | Specimen Common Stock Certificate (incorporated by reference from Exhibit 4(a) to Form 10-K for the fiscal year ended December 31, 1989) | |
| (b) | Trust Indenture dated as of February 1, 1987 between Torchmark Corporation and Morgan Guaranty Trust Company of New York, as Trustee (incorporated by reference from Exhibit 4(b) to Form S-3 for $300,000,000 of Torchmark Corporation Debt Securities and Warrants (Registration No. 33-11816)) | |
| (10)(a) | Torchmark Corporation and Affiliates Retired Lives Reserve Agreement, as amended, and Trust (incorporated by reference from Exhibit 10(b) to Form 10-K for the fiscal year ended December 31, 1991) | |
| (b) | Capital Accumulation and Bonus Plan of Torchmark Corporation, as amended, (incorporated by reference from Exhibit 10(c) to Form 10-K for the fiscal year ended December 31, 1988) | |
| (c) | Torchmark Corporation Supplementary Retirement Plan (incorporated by reference from Exhibit 10(c) to Form 10-K for the fiscal year ended December 31, 1992) | |
| (d) | Certified Copies of Resolutions Establishing Retirement Policy for Officers and Directors of Torchmark Corporation and Providing Retirement Benefits for Directors (incorporated by reference from Exhibit 10(d) to Form 10-K for the fiscal year ended December 31, 1998) | |
| (e) | Torchmark Corporation Restated Deferred Compensation Plan for Directors, Advisory Directors, Directors Emeritus and Officers, as amended (incorporated by reference from Exhibit 10(e) to Form 10-K for the fiscal year ended December 31, 1992) | |
| (f) | The Torchmark Corporation 1987 Stock Incentive Plan (incorporated by reference from Exhibit 10(f) to Form 10-K for the fiscal year ended December 31, 1998) | |
| (g) | General Agency Contract between Liberty National Life Insurance Company and Independent Research Agency For Life Insurance, Inc. (incorporated by reference from Exhibit 10(i) to Form 10-K for the fiscal year ended December 31, 1990) | |
| (h) | Form of Marketing and Administrative Services Agreement between Liberty National Fire Insurance Company, Liberty National Insurance Corporation and Liberty National Life Insurance Company (incorporated by reference from Exhibit 10.2 to Form S-1 Registration Statement No. 33-68114) | |
| (i) | Form of Deferred Compensation Agreement Between Torchmark Corporation or Subsidiary and Officer at the Level of Vice President or Above Eligible to Participate in the Torchmark Corporation and Affiliates Retired Lives Reserve Agreement and to Retire Prior to December 31, 1986 (incorporated by reference from Exhibit 10(k) to Form 10-K for the fiscal year ended December 31, 1991) | |

| | | Page of this Report |
|---|---|---|
| (j) | Form of Deferred Compensation Agreement between Torchmark Corporation or Subsidiary and Officer at the Level of Vice President or Above Eligible to Participate in the Torchmark Corporation and Affiliates Retired Lives Reserve Agreement and Not Eligible to Retire Prior to December 31, 1986 (incorporated by reference from Exhibit 10(l) to Form 10-K for the fiscal year ended December 31, 1991) | |
| (k) | Torchmark Corporation Supplemental Savings and Investment Plan (incorporated by reference from Exhibit 10(m) to Form 10-K for the fiscal year ended December 31, 1992) | |
| (l) | Service Agreement, dated as of January 1, 1991, between Torchmark Corporation and Liberty National Life Insurance Company (prototype for agreements between Torchmark Corporation and other principal operating subsidiaries) (incorporated by reference from Exhibit 10(n) to Form 10-K for the fiscal year ended December 31, 1992) | |
| (m) | The Torchmark Corporation Pension Plan (incorporated by reference from Exhibit 10(o) to Form 10-K for the fiscal year ended December 31, 1992) | |
| (n) | The Torchmark Corporation 1998 Stock Incentive Plan | |
| (o) | The Torchmark Corporation Savings and Investment Plan (incorporated by reference from Exhibit 10(s) to Form 10-K for the fiscal year ended December 31, 1992) | |
| (p) | Credit Agreements dated as of October 24, 1996 among Torchmark Corporation, the Lenders and The First National Bank of Chicago, as Agent (364 Day and Five Year) (incorporated by reference from Exhibit 10(t) to Form 10-K for the fiscal year ended December 31, 1996) | |
| (q) | Coinsurance and Servicing Agreement between Security Benefit Life Insurance Company and Liberty National Life Insurance Company, effective as of December 31, 1995 (incorporated by reference from Exhibit 10(u) to Form 10-K for the fiscal year ended December 31, 1995) | |
| (r) | Form of Deferred Compensation Agreement Between Torchmark Corporation or Subsidiary and Officer at the Level of Vice President or Above Not Eligible to Participate in Torchmark Corporation and Affiliates Retired Lives Reserve Agreement (incorporated by reference from Exhibit 10(j) to Form 10-K for the fiscal year ended December 31, 1991) | |
| (s) | Torchmark Corporation 1996 Non-Employee Director Stock Option Plan (incorporated by reference from Exhibit 10(w) to Form 10-K for the fiscal year ended December 31, 1996) | |
| (t) | Torchmark Corporation 1996 Executive Deferred Compensation Stock Option Plan (incorporated by reference from Exhibit 10(x) to Form 10-K for the fiscal year ended December 31, 1996) | |
| (11) | Statement re computation of per share earnings | 85 |
| (20) | Proxy Statement for Annual Meeting of Stockholders to be held April 29, 1999 | |
| (21) | Subsidiaries of the registrant | 85 |
| (23)(a) | Consent of KPMG Peat Marwick LLP to incorporation by reference of their audit report dated January 29, 1999, except for Note 17, which is as of February 10, 1999, into Form S-8 of The Torchmark Corporation Savings and Investment Plan (Registration No. 2-76378) | |

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this
Report

(b) Consent of KPMG Peat Marwick LLP to incorporation by reference of their audit report dated January 29, 1999, except for Note 17, which is as of February 10, 1999 into Form S-8 and the accompanying Form S-3 Prospectus of the Torchmark Corporation 1996 Non-Employee Stock Option Plan (Registration No. 2-93760)

(c) Consent of KPMG Peat Marwick LLP to incorporation by reference of their audit report dated January 29, 1999, except for Note 17, which is as of February 10, 1999 into Form S-8 and the accompanying Form S-3 Prospectus of the Torchmark Corporation 1987 Stock Incentive Plan (Registration No. 33-23580)

(d) Consent of KPMG Peat Marwick LLP to incorporation by reference of their audit report dated January 29, 1999, except for Note 17, which is as of February 10, 1999 into Form S-8 and the accompanying Form S-3 Prospectus of The Capital Accumulation and Bonus Plan of Torchmark Corporation (Registration No. 33-1032)

(e) Consent of KPMG Peat Marwick LLP to incorporation by reference of their audit report dated January 29, 1999, except for Note 17, which is as of February 10, 1999 into Form S-8 of the Liberty National Life Insurance Company 401(k) Plan (Registration No. 33- 65507)

(f) Consent of KPMG Peat Marwick LLP to incorporation by reference of their audit report dated January 29, 1999, except for Note 17, which is as of February 10, 1999 into Form S-8 and accompanying Form S-3 Prospectus of the Torchmark Corporation 1996 Executive Deferred Compensation Stock Option Plan (Registration No. 333-27111)

(24) Powers of attorney

(27) Financial Data Schedule

*Exhibit 11. Statement re computation of per share earnings*

## TORCHMARK CORPORATION
## COMPUTATION OF EARNINGS PER SHARE

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Net income from continuing operations | $255,776,000 | $260,429,000 | $252,815,000 |
| Discontinued operations of energy segment: | | | |
| Loss on disposal | -0- | -0- | (7,137,000) |
| Discontinued operations of Waddell & Reed: | | | |
| Net income from operations | 47,868,000 | 77,314,000 | 65,694,000 |
| Loss on disposal | (54,241,000) | -0- | -0- |
| Net income before extraordinary items | 249,403,000 | 337,743,000 | 311,372,000 |
| Loss on redemption of debt | (4,962,000) | -0- | -0- |
| Net income | $244,441,000 | $337,743,000 | $311,372,000 |
| Basic weighted average shares outstanding | 139,998,671 | 139,202,354 | 142,459,783 |
| Diluted weighted average shares outstanding | 141,351,912 | 141,431,156 | 143,783,218 |
| Basic earnings per share: | | | |
| Net income from continuing operations | $ 1.83 | $ 1.87 | $ 1.78 |
| Discontinued operations of energy segment: | | | |
| Loss on disposal | -0- | -0- | (0.05) |
| Discontinued operations of Waddell & Reed: | | | |
| Net income from operations | 0.34 | 0.56 | .46 |
| Loss on disposal | (0.39) | -0- | -0- |
| Net income before extraordinary items | 1.78 | 2.43 | 2.19 |
| Loss on redemption of debt | (0.03) | -0- | -0- |
| Net income | $ 1.75 | $ 2.43 | $ 2.19 |
| Diluted earnings per share: | | | |
| Net income from continuing operations | $ 1.81 | $ 1.84 | $ 1.76 |
| Discontinued operations of energy segment: | | | |
| Loss on disposal | -0- | -0- | (0.05) |
| Discontinued operations of Waddell & Reed: | | | |
| Net income from operations | 0.34 | 0.55 | 0.46 |
| Loss on disposal | (0.38) | -0- | -0- |
| Net income before extraordinary items | 1.77 | 2.39 | 2.17 |
| Loss on redemption of debt | (0.04) | -0- | -0- |
| Net income | $ 1.73 | $ 2.39 | $ 2.17 |

*Exhibit 21. Subsidiaries of the Registrant*

The following table lists subsidiaries of the registrant which meet the definition of ''significant subsidiary'' according to Regulation S-X:

| Company | State of Incorporation | Name Under Which Company Does Business |
|---|---|---|
| American Income Life Insurance Company | Indiana | American Income Life Insurance Company |
| Globe Life And Accident Insurance Company | Delaware | Globe Life And Accident Insurance Company |
| Liberty National Life Insurance Company | Alabama | Liberty National Life Insurance Company |
| United American Insurance Company | Delaware | United American Insurance Company |
| United Investors Life Insurance Company | Missouri | United Investors Life Insurance Company |

All other exhibits required by Regulation S-K are listed as to location in the ''Index of documents filed as a part of this report'' on pages 81 through 84 of this report. Exhibits not referred to have been omitted as inapplicable or not required.

**TORCHMARK CORPORATION**
**(PARENT COMPANY)**
SCHEDULE II. CONDENSED FINANCIAL INFORMATION OF REGISTRANT
CONDENSED BALANCE SHEET
**(Amounts in thousands)**

| | December 31, 1998 | December 31, 1997 |
|---|---|---|
| Assets: | | |
| Investments: | | |
| Long-term investments | $ 105,703 | $ 23,917 |
| Short-term investments | 1,714 | 336 |
| Total investments | 107,417 | 24,253 |
| Cash | 7,724 | 7,272 |
| Investment in affiliates | 3,156,322 | 3,277,785 |
| Due from affiliates | 53,207 | 114,440 |
| Accrued investment income | 1,731 | 132 |
| Discontinued operations assets | -0- | 90,335 |
| Other assets | 35,377 | 18,961 |
| Total assets | $3,361,778 | $3,533,178 |
| Liabilities and shareholders' equity: | | |
| Liabilities: | | |
| Short-term debt | $ 355,242 | $ 346,861 |
| Long-term debt | 394,048 | 564,298 |
| Taxes payable | 8,683 | 11,905 |
| Due to affiliates | 61,542 | 373,792 |
| Other liabilities | 89,476 | 110,387 |
| Total liabilities | 908,991 | 1,407,243 |
| Monthly income preferred securities | 193,259 | 193,199 |
| Shareholders' equity: | | |
| Preferred stock | 299 | -0- |
| Common stock | 147,801 | 147,849 |
| Additional paid-in capital | 910,119 | 262,731 |
| Accumulated other comprehensive income | 144,501 | 136,926 |
| Retained earnings | 1,707,933 | 1,694,781 |
| Treasury stock | (651,125) | (309,551) |
| Total shareholders' equity | 2,259,528 | 1,932,736 |
| Total liabilities and shareholders' equity | $3,361,778 | $3,533,178 |

See accompanying Independent Auditors' Report.

**TORCHMARK CORPORATION**
**(PARENT COMPANY)**
SCHEDULE II. CONDENSED FINANCIAL INFORMATION OF REGISTRANT (continued)
CONDENSED STATEMENT OF OPERATIONS
**(Amounts in thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **1998** | **1997** | **1996** |
| Net investment income | $ 20,024 | $ 5,275 | $ 931 |
| Realized investment losses | (54,855) | (19,706) | (5,738) |
| Other income | -0- | -0- | 1 |
| Total revenue | (34,831) | (14,431) | (4,806) |
| General operating expenses | 10,406 | 13,880 | 13,958 |
| Reimbursements from affiliates | (13,653) | (13,956) | (13,332) |
| Interest expense | 65,871 | 96,402 | 88,916 |
| Total expenses | 62,624 | 96,326 | 89,542 |
| Operating loss before income taxes and equity in earnings of affiliates | (97,455) | (110,757) | (94,348) |
| Income taxes | 44,132 | 38,189 | 23,102 |
| Net operating loss before equity in earnings of affiliates | (53,323) | (72,568) | (71,246) |
| Equity in earnings of affiliates | 327,984 | 420,186 | 420,900 |
| Adjustment to carrying value of Vesta | (20,234) | -0- | -0- |
| Monthly income preferred securities dividend (net of tax) | (9,777) | (9,875) | (9,655) |
| Net income from continuing operations | 244,650 | 337,743 | 339,999 |
| Discontinued operations of energy segment: | | | |
| Loss on disposal (net of tax) | -0- | -0- | (28,627) |
| Discontinued operations of Waddell & Reed: | | | |
| Income from operations | 9,154 | -0- | -0- |
| Loss on disposal | (4,401) | -0- | -0- |
| Net income before extraordinary item | 249,403 | 337,743 | 311,372 |
| Loss on redemption of debt (net of tax) | (4,962) | -0- | -0- |
| Net income | $244,441 | $337,743 | $311,372 |

See accompanying Independent Auditors' Report.

**TORCHMARK CORPORATION**
**(PARENT COMPANY)**
SCHEDULE II. CONDENSED FINANCIAL INFORMATION OF REGISTRANT—(continued)
CONDENSED STATEMENT OF CASH FLOW
**(Amounts in thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 1998 | 1997 | 1996 |
| Cash provided from operations before dividends from subsidiaries | $ (46,825) | $ (35,284) | $ (77,291) |
| Cash dividends from subsidiaries | 462,267 | 370,032 | 265,688 |
| Cash provided from operations | 415,442 | 334,748 | 188,397 |
| Cash provided from (used for) investing activities: | | | |
| Disposition of investments | 217,323 | -0- | -0- |
| Acquisition of investments | (311,784) | (2,150) | (1,667) |
| Investment in subsidiaries | (710) | (174,799) | -0- |
| Loans to subsidiaries | (48,723) | (117,392) | (12,508) |
| Repayments on loans to subsidiaries | 120,079 | 28,242 | -0- |
| Net decrease (increase) in temporary investments | (1,378) | 5,604 | (4,946) |
| Additions to properties | (48) | (454) | (49) |
| Other | -0- | (7,460) | -0- |
| Cash used for investing activities | (25,241) | (268,409) | (19,170) |
| Cash provided from (used for) financing activities: | | | |
| Issuance of debt | 216,279 | 98,185 | -0- |
| Sale of Vesta shares | 3,056 | -0- | -0- |
| Repayments of debt | (380,000) | (20,000) | (149,020) |
| Issuance of stock | 3,957 | 93,973 | 10,145 |
| Redemption of preferred stock | -0- | (2,767) | -0- |
| Acquisitions of treasury stock | (125,875) | (182,904) | (106,996) |
| Borrowed from subsidiaries | -0- | 133,880 | 153,959 |
| Repayment on borrowings from subsidiaries | -0- | (93,060) | 8,500 |
| Payment of dividends | (107,166) | (86,530) | (85,659) |
| Cash provided from (used for) financing activities | (389,749) | (59,223) | (169,071) |
| Net increase in cash | 452 | 7,116 | 156 |
| Cash balance at beginning of period | 7,272 | 156 | -0- |
| Cash balance at end of period | $ 7,724 | $ 7,272 | $ 156 |

**TORCHMARK CORPORATION**
**(PARENT COMPANY)**
NOTES TO CONDENSED FINANCIAL STATEMENTS
**(Amounts in thousands)**

### Note A—Dividends from Subsidiaries

Cash dividends paid to Torchmark from the consolidated subsidiaries were as follows:

| | 1998 | 1997 | 1996 |
|---|---|---|---|
| Consolidated subsidiaries | $462,267 | $370,032 | $265,688 |

See accompanying Independent Auditors' Report.

**TORCHMARK CORPORATION**

SCHEDULE IV. REINSURANCE (CONSOLIDATED)

**(Amounts in thousands)**

| | Gross Amount | Ceded to Other Companies | Assumed from Other Companies | Net Amount | Percentage of Amount Assumed to Net |
|---|---|---|---|---|---|
| **For the Year Ended December 31, 1998:** | | | | | |
| Life insurance in force | $93,904,622 | $718,777 | $2,434,438 | $95,620,283 | 2.5 % |
| Premiums:* | | | | | |
| Life insurance | $ 862,101 | $ 5,090 | $ 31,503 | $ 888,514 | 3.5 % |
| Health insurance | 768,874 | 7,873 | (1,092) | 759,909 | (.1)% |
| Total premiums | $ 1,630,975 | $ 12,963 | $ 30,411 | $ 1,648,423 | 1.8 % |
| **For the Year Ended December 31, 1997:** | | | | | |
| Life insurance in force | $89,372,206 | $728,843 | $2,497,790 | $91,141,153 | 2.7 % |
| Premiums:* | | | | | |
| Life insurance | $ 813,918 | $ 4,232 | $ 28,363 | $ 838,049 | 3.4 % |
| Health insurance | 748,375 | 8,889 | -0- | 739,486 | 0 % |
| Total premiums | $ 1,562,293 | $ 13,121 | $ 28,363 | $ 1,577,535 | 1.8 % |
| **For the Year Ended December 31, 1996:** | | | | | |
| Life insurance in force | $84,360,821 | $655,574 | $2,587,330 | $86,292,577 | 3.0 % |
| Premiums:* | | | | | |
| Life insurance | $ 759,321 | $ 3,472 | $ 26,511 | $ 782,360 | 3.4 % |
| Health insurance | 742,319 | 9,835 | 135 | 732,619 | 0 % |
| Total premiums | $ 1,501,640 | $ 13,307 | $ 26,646 | $ 1,514,979 | 1.8 % |

* Excludes policy charges

See accompanying Independent Auditors' Report.

## SIGNATURES

Pursuant to the requirements of Section 12 or 15(d) of the Securities Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TORCHMARK CORPORATION

By: /s/ C.B. HUDSON

**C.B. Hudson, Chairman, President, Chief Executive Officer and Director (Principal Financial Officer)**

By: /s/ GARY L. COLEMAN

**Gary L. Coleman, Vice President and Chief Accounting Officer**

Date: March 10, 1999

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ DAVID L. BOREN *

**David L. Boren**
**Director**

By: /s/ MARK S. MCANDREW *

**Mark S. McAndrew**
**Director**

By: /s/ JOSEPH M. FARLEY *

**Joseph M. Farley**
**Director**

By: /s/ HAROLD T. MCCORMICK *

**Harold T. McCormick**
**Director**

By: /s/ LOUIS T. HAGOPIAN *

**Louis T. Hagopian**
**Director**

By: /s/ GEORGE J. RECORDS *

**George J. Records**
**Director**

By: /s/ JOSEPH L. LANIER, JR. *

**Joseph L. Lanier, Jr.**
**Director**

By: /s/ R.K. RICHEY *

**R.K. Richey**
**Director**

Date: March 10, 1999

*By: /s/ GARY L. COLEMAN

**Gary L. Coleman**
**Attorney-in-fact**