

ANNUAL REPORT - 1980

Table of Contents

To Our Shareholders	1
Consolidated Financial Statements	2
Notes to Consolidated Financial Statements	7
Accountants' Reports	20
Summary of Operations	21
Management's Discussion and Analysis of Financial Condition and Results of Operations	21
Statutory Financial Statements	23

EXECUTIVE OFFICES

National Western Life Insurance Company
850 East Anderson Lane
Austin, Texas 78776

ACCOUNTANTS

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American Bank Tower, Suite 1400
Austin, Texas 78701

GENERAL COUNSEL

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Austin, Texas

TRANSFER AGENTS/REGISTRARS

Manufacturers Hanover Trust Company
4 New York Plaza
10th Floor
New York, New York 10015

City National Bank
Post Office Box 2127
Austin, Texas 78768

SUBSIDIARIES

Commercial Adjusters, Inc.
Austin, Texas
Principal activity: Premium Financing
Inactive

Galvez Offshore, Inc.
Austin, Texas
Principal activity: General Business Corporation
Inactive

The Westcap Corporation
Houston, Texas
Principal activity:
U.S. Government and Municipal Securities Dealer

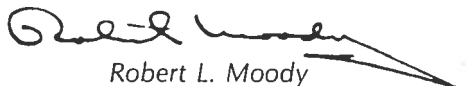
10-K Report Available

National Western Life Insurance Company's operations and financial position for the year ended December 31, 1980 have been presented in your Annual Report as well as in the Form 10-K report filed with the Securities and Exchange Commission. If you wish a copy of the 10-K report, one will be furnished upon request to the Treasurer, National Western Life Insurance Company, 850 East Anderson Lane, Austin, Texas 78776.

To Our Shareholders

The accompanying financial statements depict in detail consolidated operating results for the calendar year 1980. Earnings before net realized losses on investments and extraordinary credits amounted to \$3,033,569 or \$.89 per share compared to an operating earnings loss of \$(1,694,675) or \$(.50) per share in 1979. After the net realized losses from investments are included, the Company incurred losses of \$(11,149,111), or \$(3.27) a share, in 1980, as compared to \$(23,025,181), or \$(6.75) per share, in 1979. Most of the investment losses resulted from the liquidation of virtually all of the Company's holdings of Government National Mortgage Association and Federal Home Loan Mortgage Corporation guaranteed bonds. Most of the effects of the investment in those bonds are behind us. Interest on short-term bank borrowings made in connection with the purchase of the GNMA and FHLMC bonds will have a decreasing impact on overall investment income results during 1981. Management expects these loans to be paid off before year-end 1981 and that net earnings for 1981 will be positive.

Statutory net gain from operations, as reported to state regulatory authorities, amounted to \$28.3 million. However, when the statutory net gain is adjusted to take into consideration the effect of a Reinsurance Arrangement entered into during the year, it amounts to approximately \$3 million compared to \$5.3 million last year. Management views the Company's ability to recover from the effects of the GNMA and FHLMC investment program and realize a statutory gain as an indication of National Western Life's underlying strength.



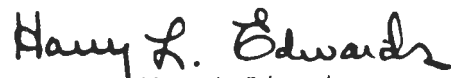
Robert L. Moody
Chairman of the Board

Despite the negative effects of the GNMA and FHLMC investment program on the Company's investment results, 1980 saw accomplishments in most every other aspect of operations. General expenses were sharply curtailed in the face of large increases in the cost of doing business. New business was up 33% over the previous year to a new high of \$656 million of volume. Premium income increased to \$46.9 million, an 11% increase. The Company continues to build an outstanding sales organization backed up by a strong and capable home office administrative staff.

This year marks the Twenty-Fifth Anniversary of the Company's incorporation. It was incorporated July 16, 1956.

Much is being said and written lately about the changing nature of the life insurance industry. National Western Life has always been a leader in innovative products and marketing methods, and management continuously seeks new markets and new concepts in staying abreast of competition and the developing trends in the habits of the insurance buying public.

We are looking confidently to the future, and with the continued splendid results of our marketing organization, the loyalty and dedication of our employees, officers and directors, and gratitude for your continuing support, National Western Life can and will move ahead.



Harry L. Edwards
President and
Chief Executive Officer

Consolidated Balance Sheets

ASSETS	December 31	
	1980	1979
Investments (notes 2, 3, 4, 5, 9, 10, 13, 14 and 16):		
Bonds, at amortized cost, partially pledged (note 5) (market value \$83,492,976 in 1980; \$99,872,065 in 1979)	\$115,882,188	120,764,601
GNMA and FHLMC certificates under repurchase agreements at market value in 1979 (amortized cost \$150,733,500 in 1979)	—	130,575,959
Preferred stocks, at market value (cost \$4,368,194 in 1980; \$6,823,267 in 1979)	2,313,529	5,025,727
Common stocks, at market value (cost \$405,145 in 1980; \$1,009,138 in 1979)	378,160	946,054
Investment in subsidiary, at equity (note 3)	2,666,695	2,413,832
Mortgage loans on real estate, net of unearned discount of \$931,022 in 1980 and \$929,113 in 1979, and allowance for uncollectible loans of \$200,000 in 1980 and 1979	57,154,487	53,990,656
Note receivable from affiliate	500,000	500,000
Real estate held for investment, at cost	2,053,401	2,539,501
Real estate acquired by foreclosure, sub- stantially at cost	100,084	126,193
Contracts of sale on real estate acquired by foreclosure, at cost	903,516	1,118,130
Policy loans	44,904,357	37,339,930
Collateral loans	880,000	1,514,696
Life interest in Libbie Shearn Moody Trust (note 4)	9,145,888	9,389,001
Other loans and investments, at cost	916,764	1,247,013
Invested cash	257,474	276,182
Total investments	238,056,543	367,767,475
Cash	2,218,171	1,740,616
Accounts receivable, net of allowance for doubtful accounts of \$237,000 in 1980 and \$270,000 in 1979	1,471,857	1,231,989
Accrued investment income	3,333,651	4,787,827
Deferred policy acquisition costs	48,815,856	44,376,775
Property and equipment at cost less accumulated depreciation of \$842,825 in 1980 and \$591,628 in 1979	3,114,528	3,267,873
Other assets	1,730,477	1,452,111
Excess of cost over net assets of sub- sidiaries acquired	750,142	845,405
	<u>\$299,491,225</u>	<u>425,470,071</u>

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheets

December 31

LIABILITIES AND STOCKHOLDERS' EQUITY	<u>1980</u>	<u>1979</u>
Future policy benefits:		
Life insurance	\$219,312,239	206,192,731
Accident and health insurance	2,362,091	2,157,001
Policy and contract claims	1,531,809	2,199,904
Other policyholders' funds:		
Supplementary contracts without life contingencies	407,962	441,310
Policyholders' dividends, coupons and endowment accumulations	16,322,846	16,715,126
Premium deposit funds	512,450	475,950
Other	117,413	125,387
Short-term borrowings from banks (note 5)	15,250,000	21,750,000
Funds purchased - with securities under repurchase agreements (note 2)	—	122,303,000
Deferred Federal income taxes payable (note 6)	19,617,000	18,347,000
Other liabilities	<u>5,395,973</u>	<u>4,897,770</u>
 Total liabilities	 <u>280,829,783</u>	 <u>395,605,179</u>
Stockholders' equity (notes 4, 6, 7, 12 and 14):		
Common stock:		
Class A of \$1 par value.		
Authorized 7,500,000 shares; issued 3,211,120 shares in 1980 and 3,211,218 shares in 1979	3,211,120	3,211,218
Class B of \$1 par value.		
Authorized and issued 200,000 shares	200,000	200,000
Additional paid-in capital	23,499,239	23,499,239
Net unrealized losses on investments in equity securities	(1,914,865)	(1,860,624)
Retained earnings:		
Appropriated - Mandatory Securities		
Valuation Reserve	—	3,224,792
Unappropriated, since January 1, 1972 at which date a deficit of \$3,891,663 was charged to additional paid-in capital in a quasi-reorganization	<u>(6,334,052)</u>	<u>1,590,267</u>
 Total stockholders' equity	 <u>18,661,442</u>	 <u>29,864,892</u>
	<u>\$299,491,225</u>	<u>425,470,071</u>
Commitments and contingencies (notes 11, 12, 14, 15 and 16)		

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations

Years Ended December 31

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Premiums and other revenue:			
Premiums (notes 11, 12 and 17):			
Life	\$ 38,876,134	34,082,911	30,748,499
Annuities	5,163,499	5,052,697	4,934,084
Accident and health	2,873,251	2,966,041	2,856,585
	<u>46,912,884</u>	<u>42,101,649</u>	<u>38,539,168</u>
Investment income (net of expenses of \$12,942,012 in 1980, \$14,682,481 in 1979, and \$3,459,944 in 1978) (note 9)	12,824,117	15,963,618	16,216,206
Other income	652,171	71,056	192,452
Total premiums and other revenue	<u>60,389,172</u>	<u>58,136,323</u>	<u>54,947,826</u>
Benefits and expenses:			
Life	19,938,318	17,168,142	14,710,247
Accident and health	1,682,664	1,555,114	1,359,176
Other	4,973,663	2,747,557	2,565,010
Increase in liabilities for future policy benefits:			
Life	13,119,508	14,596,997	14,304,217
Accident and health	205,090	204,594	95,959
Dividends to policyholders (note 12)	353,313	295,113	386,403
Amortization of deferred policy acqui- sition costs	7,159,250	6,414,934	4,726,253
Other operating expenses:			
Commissions	1,640,054	1,249,458	1,233,015
Salaries	2,804,819	2,885,869	2,716,927
Taxes, licenses and insurance fees	1,177,317	935,392	878,579
Other expenses	3,031,607	2,987,828	2,902,989
Total benefits and expenses	<u>56,085,603</u>	<u>51,040,998</u>	<u>45,878,775</u>
Loss on write-down of investment in subsidiary (note 3)	—	6,750,000	—
Earnings before provision for Federal income taxes, net realized gains (losses) on investments and extra- ordinary credit	4,303,569	345,325	9,069,051
Provision for deferred Federal income taxes (note 6)	<u>1,270,000</u>	<u>2,040,000</u>	<u>2,652,000</u>
Earnings (Loss) before net realized gains (losses) on investments and extraordinary credit	3,033,569	(1,694,675)	6,417,051
Net realized gains (losses) on invest- ments (note 2)	<u>(14,182,680)</u>	<u>(21,330,506)</u>	<u>1,079,652</u>
Earnings (Loss) before extraordinary credit	(11,149,111)	(23,025,181)	7,496,703
Extraordinary credit - tax benefit of capital loss carryforward	—	—	462,000
Net earnings (loss)	<u>\$(11,149,111)</u>	<u>(23,025,181)</u>	<u>7,958,703</u>
Earnings (Loss) per share of common stock (note 8):			
Earnings (Loss) before net realized gains (losses) on investments and extraordinary credit	\$.89	(.50)	1.88
Net realized gains (losses) on investments	<u>(4.16)</u>	<u>(6.25)</u>	<u>.32</u>
Earnings (Loss) before extraordinary credit	(3.27)	(6.75)	2.20
Extraordinary credit - tax benefit of capital loss carryforward	—	—	.13
Net earnings (loss)	<u>\$(3.27)</u>	<u>(6.75)</u>	<u>2.33</u>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

	Years Ended December 31		
	<u>1980</u>	<u>1979</u>	<u>1978</u>
Common stock (note 4):			
Balance at beginning of year	\$ 3,411,218	3,411,390	3,412,300
Par value of 98, 172 and 910 shares of Class A common stock cancelled in 1980, 1979 and 1978, respectively, relating to dissenters rights in former subsidiary's minority interest	(98)	(172)	(910)
Balance at end of year	<u>3,411,120</u>	<u>3,411,218</u>	<u>3,411,390</u>
Additional paid-in capital (note 7):			
Balance at beginning of year	23,499,239	23,499,239	23,511,184
Payments to minority interest dissenters in 1978	—	—	(11,945)
Balance at end of year	<u>23,499,239</u>	<u>23,499,239</u>	<u>23,499,239</u>
Net unrealized losses on investments in equity securities:			
Balance at beginning of year	(1,860,624)	(1,530,084)	(149,097)
Increase in unrealized losses on investments in equity securities during the year	(54,241)	(330,540)	(1,380,987)
Balance at end of year	<u>(1,914,865)</u>	<u>(1,860,624)</u>	<u>(1,530,084)</u>
Retained earnings (notes 4, 6, 7 and 12):			
Appropriated retained earnings:			
Balance at beginning of year	3,224,792	2,810,118	1,908,520
Allocation from (to) unappropriated retained earnings	(3,224,792)	414,674	901,598
Balance at end of year	<u>—</u>	<u>3,224,792</u>	<u>2,810,118</u>
Unappropriated retained earnings:			
Balance at beginning of year	1,590,267	25,030,122	17,973,017
Net earnings (loss)	(11,149,111)	(23,025,181)	7,958,703
Transfer (to) from appropriated retained earnings	3,224,792	(414,674)	(901,598)
Balance at end of year	<u>(6,334,052)</u>	<u>1,590,267</u>	<u>25,030,122</u>
Total stockholders' equity	<u>\$ 18,661,442</u>	<u>29,864,892</u>	<u>53,220,785</u>

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years Ended December 31

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Funds provided:			
From operations:			
Earnings (Loss) before extraordinary credit	\$(11,149,111)	(23,025,181)	7,496,703
Charges (credits) not affecting funds:			
Write-down of GNMA and FHLMC certificates	—	20,157,541	—
Loss on write-down of investment in subsidiary	—	6,750,000	—
Tax effect of capital loss carryforward	—	—	462,000
Provision for deferred Federal income taxes	1,270,000	2,040,000	2,652,000
Amortization of deferred policy acquisition costs	7,159,250	6,414,934	4,726,253
Increase in liability for future policy benefits	13,324,598	14,801,591	14,400,176
Increase (Decrease) in policy claim liabilities	(668,095)	(28,143)	331,276
Amortization of bond discount	(1,060,298)	(866,871)	(864,876)
Amortization of life interest in Libbie Shearn Moody Trust	243,113	240,798	238,505
Depreciation	258,134	342,666	348,327
Other	1,085,558	(1,041,648)	52,150
Funds provided from operations	<u>10,463,149</u>	<u>25,785,687</u>	<u>29,842,514</u>
Cost of investments sold and loans repaid:			
Bonds and notes	12,904,899	8,403,114	20,521,831
GNMA and FHLMC certificates	128,986,873	94,475,754	16,136,731
Stocks	3,411,910	5,257,026	2,099,754
Mortgage loans	3,197,960	3,932,182	3,850,617
Real estate held for investment	1,151,170	1,208,506	2,018,210
Collateral loans	634,696	—	—
Total	<u>150,287,508</u>	<u>113,276,582</u>	<u>44,627,143</u>
Book value of property and equipment sold	—	970,608	—
Decrease (Increase) in cash	(458,847)	978,379	1,068
Increase (Decrease) in short-term borrowings	(6,500,000)	19,750,000	420,000
Increase in funds purchased - under repurchase agreements	—	86,315,000	26,918,000
Other, net	97,384	—	—
Total funds provided	<u>\$153,889,194</u>	<u>247,076,256</u>	<u>101,808,725</u>
Funds used:			
Increase in policy loans	\$ 7,564,427	4,434,143	2,790,652
Cost of investments purchased or loans disbursed:			
Bonds and notes	5,506,668	2,551,368	31,149,115
GNMA and FHLMC certificates under repurchase agreements	—	205,816,827	45,768,476
Stocks	25,400	1,151,551	3,285,525
Mortgage loans	6,306,292	8,371,047	7,950,897
Real estate held for investment	403,952	2,516,755	452,453
Collateral loans and other	83,272	1,585,582	1,138,853
Total	<u>19,890,011</u>	<u>226,427,273</u>	<u>92,535,971</u>
Investment in subsidiary	—	8,963,832	—
Additions to deferred policy acquisition costs	11,598,331	10,450,799	7,695,940
Cost of property and equipment	97,852	418,534	812,588
Decrease in funds purchased - under repurchase agreements	122,303,000	—	—
Other, net	—	815,818	764,226
Total funds used	<u>\$153,889,194</u>	<u>247,076,256</u>	<u>101,808,725</u>

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying consolidated financial statements include the accounts of National Western Life Insurance Company and its wholly-owned subsidiaries Galvez Offshore, Inc. and Commercial Adjusters, Inc., both of which are immaterial. The Company has a controlling interest in the Westcap Corporation (formerly Hibbard, O'Connor, & Weeks, Inc.) and subsidiaries. The investment in this subsidiary is recorded on the equity basis in the accompanying consolidated financial statements (see note 3). All significant intercompany transactions and accounts have been eliminated in consolidation.

(A) Basis of Presentation — The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles which vary in certain respects from reporting practices prescribed or permitted by insurance regulatory authorities. The following are major differences between generally accepted accounting principles and accounting principles prescribed by insurance regulatory authorities:

1. Commissions and certain expenses related to policy issuance and underwriting, all of which generally vary with and are primarily related to the production of new business, have been deferred. In the case of purchased subsidiaries or blocks of business, the costs deferred as acquisition costs related to the business in force at date of purchase is based upon estimates as to what it would cost the Company to produce a similar block of business as of the purchase date, amortized to the date of acquisition based upon the age of the acquired business. These deferred acquisition costs are being amortized over the premium-paying period of the related policies in proportion to the ratio of the annual premium revenue earned to the total premium revenue anticipated, using the same assumptions as to interest, mortality and withdrawals as were used in calculating the liability for future policy benefits.

A summary of information relative to life insurance deferred acquisition costs and premiums follows:

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Costs deferred:			
Agents' commissions	\$ 9,811,003	8,574,466	6,320,077
Other	<u>1,787,328</u>	<u>1,876,333</u>	<u>1,375,863</u>
	<u>\$ 11,598,331</u>	<u>10,450,799</u>	<u>7,695,940</u>
Amounts amortized	<u>\$ 7,159,250</u>	<u>6,414,934</u>	<u>4,726,253</u>
First year and single premiums	<u>\$ 12,041,368</u>	<u>10,161,440</u>	<u>8,172,439</u>
Renewal premiums	<u>\$ 34,871,516</u>	<u>31,940,209</u>	<u>30,366,729</u>

2. The liability for future policy benefits has been calculated by the net level method using assumptions as to future mortality, interest and withdrawals which were used or which were being experienced at the time that policies were issued or, in the case of liabilities for future policy benefits of purchased subsidiaries or blocks of business, at the dates of purchase.

Deferred acquisition costs and future policy benefit factors have been calculated directly for a substantial number of major plans of insurance using assumptions as to future mortality, interest and withdrawals. A small number of plans, called minor plans of insurance, were associated with major plans having like benefit and gross premium characteristics and the factors for these major plans were used to calculate the deferred acquisition costs and liability for future policy benefits for the minor plans. The liability for future policy benefits of accident and health business has been calculated primarily on an unearned premium basis using the pro-rata method.

3. Deferred Federal income taxes are provided for income and deductions which are recognized in the financial statements in a different period than for Federal income tax purposes. Investment tax credits are being accounted for by the flow-through method (see note 6).
4. Investments in subsidiaries are recorded at admitted asset value for statutory purposes, whereas the financial statements of the wholly-owned subsidiaries have been consolidated with those of the Company under generally accepted accounting principles. The Company has an investment in a non-insurance subsidiary which

Notes to Consolidated Financial Statements . . . continued

is recorded on the equity basis in the accompanying consolidated financial statements (see note 3).

5. Certain assets which are non-admitted and charged to retained earnings for statutory purposes have been included as assets in the accompanying consolidated financial statements.
6. Investments in GNMA and FHLMC certificates under repurchase agreements have been written down to market value in 1979 under generally accepted accounting principles. These securities are carried at amortized cost under statutory accounting principles (see note 2).
7. Realized investment gains or losses from the sale or write-down of investments, less the related Federal income tax effect, if any, have been included in net earnings rather than being credited or charged directly to statutory retained earnings (see note 3).
8. The Mandatory Securities Valuation Reserve, a contingency reserve required by insurance regulatory authorities, has been reclassified as an appropriation of retained earnings rather than being recorded as a liability.
9. Allowances for doubtful receivables have been established by a charge to earnings where receivables have been deemed doubtful of collection, and the cost basis of investments which were deemed to have a permanent impairment in value have been reduced or written off by a charge to earnings as a realized loss. Under statutory accounting, the write-down of such receivables and investments generally would have been charged to unassigned surplus as non-admitted assets or unrealized losses.
10. The recorded value of the life interest in the Libbie Shearn Moody Trust (the Trust) is reported at its initial valuation, net of accumulated amortization. The initial valuation was based on the assumption that the Trust would provide certain income to the Company at an assumed interest rate and is being amortized over 53 years, the life expectancy of Mr. Robert L. Moody at the date he contributed the life interest to the Company. In the Company's annual statements to insurance departments, the life interest is reflected at an amount based on existing insurance in force on the life of Robert L. Moody net of the cash surrender value of the life insurance policies on Mr. Moody's life (see note 4). The statutory amount is not being amortized in the statutory financial statements.
11. Certain reinsurance transactions effected in 1980, which caused direct credits to surplus for statutory reporting purposes, have been treated differently under generally accepted accounting principles. The net effect of these transactions is reflected in the risk and expense charges to "other operating expenses (other expense)" in the accompanying consolidated statement of operations for the year ended December 31, 1980. (see note 11)

Reconciliations of net gain from operations and stockholders' equity (determined pursuant to statutory accounting requirements), as included in the annual statements filed with the Colorado Insurance Commission for the years ended December 31, 1980, 1979 and 1978 to the respective amounts as reported in the accompanying consolidated financial statements are as follows:

Description of Adjustments	Net Earnings (Loss)		
	1980	1979	1978
Per annual statement to Insurance Department	\$ 28,321,128	5,367,085	6,258,000
Statutory net earnings (loss) of subsidiaries	(451,163)	201,018	207,757
Consolidated statutory net gain			
from operations	27,869,965	5,568,103	6,465,757
Add (deduct):			
Write-down of GNMA and FHLMC			
certificates (note 2)	—	(20,157,541)	—
Loss on write-down of investment			
in subsidiary (note 3)	—	(6,750,000)	—
Deferral of policy acquisition costs	4,439,081	4,035,865	2,969,687
Adjustment of future policy benefits	(2,304,156)	(1,996,351)	(697,590)
Adjustment for portfolio reinsurance			
(note 11)	(26,477,850)	—	—
Amortization of investment in Trust	(243,113)	(240,798)	(238,505)
Deferred Federal income taxes	(1,270,000)	(2,040,000)	(2,652,000)

Other net realized gains (losses) on investments	(14,242,680)	(1,172,965)	1,079,652
Other, net	<u>1,079,642</u>	<u>(271,494)</u>	<u>1,031,702</u>
Amounts per accompanying consolidated financial statements	<u><u>\$(11,149,111)</u></u>	<u><u>(23,025,181)</u></u>	<u><u>7,958,703</u></u>

Description of Adjustments	Stockholders' Equity		
	1980	1979	1978
Per annual statement to Insurance Department	\$ 28,410,509	32,969,864	33,202,028
Adjustments to generally accepted accounting principles:			
Write-down of GNMA and FHLMC certificates (note 2)	—	(20,157,541)	—
Difference in initial valuation of investment in Libbie Shearn Moody Trust, net of amortization	(2,711,643)	(2,544,519)	(2,378,664)
Excess of cost over net assets of subsidiaries acquired	750,142	845,405	939,274
Deferral of policy acquisition costs, net of amortization	48,815,856	44,376,775	40,340,910
Adjustment of future policy benefits	(9,017,371)	(6,713,215)	(4,716,864)
Adjustment for portfolio reinsurance (note 11)	(26,477,850)	—	—
Deferred Federal income taxes	(19,617,000)	(18,347,000)	(16,307,000)
Adjustment to report preferred stocks at market value	(1,716,469)	(1,962,796)	(1,068,788)
Adjustments of investments in bonds to reflect permanent impairments in value ..	(288,713)	(155,147)	(230,856)
Transfer of Mandatory Securities Valuation Reserve to appropriated retained earnings	—	3,224,792	2,810,118
Allowance for uncollectible mortgage loans	(200,000)	(200,000)	(200,000)
Reinstatement of non-admitted assets	3,175,777	2,471,714	3,067,700
Other, net	<u>(2,461,796)</u>	<u>(3,943,440)</u>	<u>(2,237,073)</u>
Amounts per accompanying consolidated financial statements	<u><u>\$ 18,661,442</u></u>	<u><u>29,864,892</u></u>	<u><u>53,220,785</u></u>

(B) Investments — Investments in bonds are stated principally at amortized costs and investments in preferred and common stocks are stated at market values. Investments in securities held under repurchase agreements are stated at market value in 1979. Investments in specific securities having a permanent loss in value have been written down to their estimated realizable value and losses thereon have been included in realized investment losses. Net unrealized investment gains and losses on marketable equity securities are accounted for as direct increases or decreases in stockholders' equity. At December 31, 1980, gross unrealized investment gains and losses on marketable equity securities were \$414,254 and \$2,329,119, respectively.

The amortized cost of bonds is substantially in excess of market value. The Company has the intent and ability to hold these investments to maturity or until cost is recoverable. Therefore, the Company does not anticipate realizing any significant losses thereon and no provision has been made for possible losses on these investments.

Mortgage loans and other investments are stated at cost, less unamortized discounts and allowances for uncollectible loans. Discounts on mortgage loans are amortized using the "interest" method over the lives of the respective loans.

(C) Matching of Revenue and Expense — Premiums are recognized as revenues as they become due or, for

Notes to Consolidated Financial Statements . . . continued

short duration contracts, over the contract periods. Benefits and expenses are matched with premiums in arriving at profits by providing for policy benefits over the lives of the policies, and by amortizing acquisition costs over the premium-paying periods of the policies.

(D) Depreciation of Fixed Assets — Depreciation is based on the estimated useful lives of the assets, which range from 3 to 40 years and is calculated on the straight-line basis. Depreciation of fixed assets charged against earnings amounted to approximately \$258,000, \$343,000 and \$348,000 for the years ended December 31, 1980, 1979 and 1978, respectively.

(E) Amortization of Goodwill — The excess of cost over net assets of subsidiaries acquired is being amortized on a straight-line basis over the estimated remaining premium-paying periods of the life insurance in force at the dates of acquisition. Such periods range from 15 to 20 years. Amortization charged to operations in 1980, 1979 and 1978 amounted to approximately \$95,000.

(F) Maintenance, Repairs and Retirements of Fixed Assets — Maintenance, repairs and minor replacements which do not materially extend the useful life of the respective asset are charged to operations. Betterments are capitalized and depreciated over the estimated remaining useful life of the asset. At retirement or other disposition of fixed assets, the accounts are relieved of the cost and accumulated depreciation and gains or losses are reflected in operations.

(2) GOVERNMENT NATIONAL MORTGAGE ASSOCIATION (GNMA) AND FEDERAL HOME LOAN MORTGAGE CORPORATION (FHLMC) CERTIFICATES UNDER REPURCHASE AGREEMENTS

At December 31, 1979, the Company had investments in GNMA and FHLMC certificates under repurchase agreements aggregating \$130,575,959 with weighted average yield of 9.4%. At December 31, 1980, all of these investments had been sold.

These securities were financed under repurchase agreements through margin deposit agreements with brokerage firms and such securities were pledged as collateral for the short-term borrowings. Such borrowings are classified as funds purchased under repurchase agreements in the accompanying consolidated balance sheets. Borrowings under this arrangement aggregated zero and \$122,303,000 at December 31, 1980 and 1979, respectively.

The maximum amount outstanding under these agreements at any month-end during 1980 and 1979 was \$120,040,000 and \$122,303,000, respectively. The average amount outstanding during 1980 and 1979 was approximately \$40,148,000 and \$103,064,000, respectively, and the weighted average interest rate for 1980 and 1979 was approximately 18.2% and 10.5%, respectively.

During 1979, the Company increased its investment in this type of securities significantly. As a result of general economic and money market conditions, the Company had sustained significant declines in the market value of these securities while incurring significant margin deposits during 1979 and the first quarter of 1980. At that time, based on the general economic conditions and the uncertainty of future market conditions, the Company decided to dispose of all of its investments in these securities. Accordingly, the investment in these securities was written-down to market value as of December 31, 1979 and realized losses on investments of \$20,157,541 were recorded in the accompanying consolidated statement of operations for the year ended December 31, 1979. The remaining \$15,083,277 of realized loss incurred on sale of these investments is recognized in the accompanying consolidated statement of operations for the year ended December 31, 1980. No market value losses on these investments were recorded in 1978 as at that time the Company intended and had the ability to hold such investments to maturity or until cost was recoverable.

(3) INVESTMENT IN SUBSIDIARY, AT EQUITY

In 1979 the Company made advances to a brokerage firm (Hibbard, O'Connor and Weeks, Inc. and Subsidiaries) aggregating approximately \$8,964,000. These advances were made to the brokerage firm in an effort to protect the Company from substantial losses on their securities held under repurchase agreements as a result of the brokerage firm's inability to honor certain investment commitments from its own operations. The Company was the principal customer of the brokerage firm.

In September 1979, advances of \$8,080,000 were converted to an equity position and the Company became the controlling stockholder of the brokerage firm. The remaining \$883,832 in advances and accrued interest was

converted to subordinated debt. During 1980 this subordinated debt plus accrued interest was converted to 235,873 shares of preferred stock. The investment in this subsidiary is reflected at equity in the accompanying consolidated balance sheets. The accompanying consolidated statement of operations reflects a loss on write-down of investment in subsidiary of \$6,750,000 at December 31, 1979. The accompanying consolidated statement of operations for the year ended December 31, 1980 include \$393,203 of equity earnings of the subsidiary. As of December 31, 1980, the Company owned approximately 43% of the common stock and approximately 93% of the voting, convertible 8% noncumulative preferred stock of the subsidiary. The total equity ownership of the Company is approximately 92%. Effective December 1, 1980, the subsidiary changed its name to The Westcap Corporation.

Summary balance sheets, revenue and net income as of September 30, 1980 and 1979 and for the years then ended follow:

	<u>1980</u>	<u>1979</u>
Assets:		
Cash	\$ 1,444,886	1,334,061
Receivables	1,849,971	9,156,573
Trading inventory	3,406,944	3,208,796
Other assets	462,577	5,623,367
	<u>\$ 7,164,378</u>	<u>19,322,797</u>
Liabilities:		
Notes payable	\$ 319,992	7,330,520
Payables to customers and brokers	1,990,071	4,740,620
Other liabilities	1,825,255	4,924,007
	<u>4,135,318</u>	<u>16,995,147</u>
Liabilities subordinated to claims of general creditors	—	883,832
Stockholders' equity	3,029,060	1,443,818
	<u>\$ 7,164,378</u>	<u>19,322,797</u>
Revenues	<u>\$ 8,787,249</u>	<u>1,098,087</u>
Net gain (loss)	<u>\$ 641,750</u>	<u>(9,347,472)</u>

(4) TRANSACTIONS WITH CONTROLLING STOCKHOLDER AND AFFILIATES

(A) **Life Interest in Libbie Shearn Moody Trust** — The Company is the beneficial owner of a life interest (1/8 share), previously owned by Mr. Robert L. Moody, Chairman of the Board of Directors of the Company, in the trust estate of Libbie Shearn Moody. The life interest was assigned, in exchange for a debenture, by Mr. Moody to a company which was subsequently merged into National Western Life Insurance Company.

The recorded amount of the Company's life interest in the Trust is summarized below:

	Libbie Shearn Moody Trust	
	at December 31,	
	<u>1980</u>	<u>1979</u>
Original valuation of life interest, at February 26, 1960	\$ 13,793,149	13,793,149
Less accumulated amortization	4,647,261	4,404,148
Net asset value of life interest in Trust	<u>\$ 9,145,888</u>	<u>9,389,001</u>

Mr. Moody assigned his life interest in the Trust to the predecessor company in exchange for a debenture in the original amount of \$550,000, with principal payable \$150,000 each March 15, commencing in 1978 and interest payable at 3% each March 15, commencing in 1962. The entire balance of this debenture was prepaid during 1978.

The Company has been provided or has provided itself with the following protection against the loss of asset value and income in the event of Mr. Moody's untimely death and consequent termination of the life interest in the Trust:

Notes to Consolidated Financial Statements . . . continued

1. The Company is the beneficiary of life insurance on Mr. Moody's life in the amount of \$12,775,000, all of which was issued by the Company and is reinsured through agreements with unaffiliated insurance companies.
2. Approximately 196,267 shares of the Company's Class A common stock, owned by Mr. Moody, are held in trust by a bank pursuant to a trust agreement dated December 29, 1964. The trust agreement provides for the release of 7,009 shares to Mr. Moody as of December 31 of each year for so long as Mr. Moody lives. This trust agreement also provides that any shares remaining in trust at Mr. Moody's death are to be assigned to and become the property of the Company unless the shares are purchased for \$45 per share by Mr. Moody's estate within one year of his death with proceeds of such purchases to be paid to the Company. The Company's Class A common stock had an approximate market value of \$4.50 per share at December 31, 1980.

Income from the Trust and related expenses reflected in the accompanying consolidated statements of operations are summarized as follows:

	Years Ended December 31,		
	1980	1979	1978
Income distributions received	\$854,000	713,000	669,000
Add (deduct):			
Interest paid on debentures payable	—	—	(19,000)
Amortization of initial valuation	(243,000)	(241,000)	(238,000)
Reinsurance premiums charged			
to operations	(68,000)	(63,000)	(59,000)
Increase in cash surrender value of			
company-owned life insurance policies	76,000	75,000	77,000
Net income from life interest in the Trust	<u>\$619,000</u>	<u>484,000</u>	<u>430,000</u>

The accompanying statements also reflect an increase in the liability for future policy benefits related to Company-issued policies on Mr. Moody's life in the amount of \$57,000 in 1980, \$61,000 in 1979 and \$65,000 in 1978, and liabilities for future policy benefits related to these policies in the amounts of \$1,019,000, \$962,000 and \$901,000 at December 31, 1980, 1979 and 1978, respectively.

(B) Common Stock — Mr. Robert L. Moody, Chairman of the Board of Directors, owns 198,074 of the total outstanding shares of the Company's Class B common stock and 1,176,760 of the Class A common stock.

Holders of the Company's Class A common stock elect one-third of the Board of Directors of the Company, and holders of the Company's Class B common stock elect the remainder of the Company's Board of Directors. Any cash or in-kind dividends paid on each share of Class B common stock shall be only one-half of the cash or in-kind dividends paid on each share of Class A common stock. In addition, upon liquidation of the Company, the Class A stockholders shall first receive the par value of their shares; and the remaining net assets of the Company shall be divided ratably between the shareholders of both Class A and Class B common stock without preference to either.

(5) SHORT-TERM BORROWINGS FROM BANKS

Short-term borrowings from banks were \$15,250,000 and \$21,750,000 at December 31, 1980 and 1979, respectively. These borrowings bear interest at a defined prime rate (approximately 22% at December 31, 1980) and are secured by various securities with a book value of \$42,089,705 (market value of \$29,602,527) at December 31, 1980.

The maximum amount outstanding at any month end during 1980 and 1979 was \$32,250,000 and \$21,750,000, respectively. The average amount outstanding during 1980 and 1979 was approximately \$23,512,500 and \$12,366,000, respectively. The weighted average interest rate for 1980 and 1979 was approximately 15.9% and 12.2%, respectively.

(6) FEDERAL INCOME TAXES

Under the provisions of the Life Insurance Company Income Tax Act of 1959, life insurance companies are taxed on the lesser of taxable investment income or gain from operations (as defined by the Act), plus one-half of any excess of gains from operations over taxable investment income. One-half of the excess (if any) of the gain from operations over taxable investment income, which is not currently subject to taxation, plus special

deductions allowed in computing the gain from operations, is set aside in a special memorandum tax account designated "policyholders' surplus account". The accumulated amount of income subject to current taxation, less the tax thereon, is set aside in another special memorandum tax account designated "shareholders' surplus account".

At December 31, 1980, the Company had accumulated approximately \$1,010,000 in its tax "policyholders' surplus account". This account was not increased for the years ended December 31, 1980, 1979 and 1978. Federal income taxes will become payable on the "policyholders' surplus account" at the then current tax rate (a) when and to the extent that policyholders' surplus exceeds a specified maximum; (b) when and if distributions to stockholders, other than stock dividends and other limited exceptions, are made in excess of the "shareholders' surplus account"; or (c) when a company ceases to be a life insurance company as defined by the Internal Revenue Code and such termination is not due to another life insurance company acquiring its assets in a nontaxable transaction. Deferred Federal income taxes have not been provided on these untaxed earnings of the Company since the Company does not anticipate any other transactions that would cause any part of this amount to become taxable. However, should the remaining balances at December 31, 1980 become taxable, the Federal income tax computed at present rates would be approximately \$464,000.

The Company and its subsidiaries file separate income tax returns for Federal income tax purposes.

Deferred Federal income taxes result from timing differences in the recognition of certain items for tax and financial statement purposes. The sources of these differences and the approximate tax effect of each were as follows:

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Policy acquisition costs expensed for tax purposes and deferred for financial accounting purposes	\$ 1,464,000	724,000	1,298,000
Excess of the increase in the liability for future policy benefits for tax purposes over the increase for financial accounting purposes	(12,585,000)	1,791,000	2,109,000
Effect of special life insurance company deductions	(474,000)	(436,000)	(1,092,000)
Investment tax credit recapture	—	84,000	—
Effect of net level election	12,569,000	1,744,000	1,619,000
Other	296,000	(1,867,000)	(1,282,000)
	<u>\$ 1,270,000</u>	<u>2,040,000</u>	<u>2,652,000</u>

Total Federal income tax expense amounted to \$1,270,000, \$2,040,000 and \$2,652,000 for the years ended December 31, 1980, 1979 and 1978, respectively. These amounts vary from amounts computed by applying the statutory income tax rate to earnings before Federal income taxes and realized investment gains and losses. The reasons for the differences, and the tax effects thereof, are as follows:

<u>Description</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>
Computed expected income taxes at the statutory rate	\$1,939,000	159,000	4,353,000
Add (deduct):			
Capital losses not tax effected due to existence of capital loss carryforward	—	2,691,000	—
Special life insurance company deductions allowed for tax purposes	(395,000)	(416,000)	(1,026,000)
Dividends received deduction	(238,000)	(414,000)	(344,000)
Amortization of life interest in Libbie Shearn Moody Trust which is not tax deductible	112,000	111,000	114,000
Investment tax credit recapture	—	84,000	—
Other	(148,000)	(175,000)	(445,000)
Total provision for Federal income taxes	<u>\$1,270,000</u>	<u>2,040,000</u>	<u>2,652,000</u>

Notes to Consolidated Financial Statements . . . continued

At December 31, 1980, the Company had a tax operating loss deduction of approximately \$3,500,000 which the Company has elected to carry forward. The Company also has unused tax credits of approximately \$200,000. If not utilized to offset future taxable income, these tax loss carryforwards and tax credits will expire in 1983, 1984, 1985 and 1987. For financial statement purposes, the loss carryforward and tax credits have been recognized by reducing net deferred tax credits. To the extent the tax loss carryforward and tax credits are utilized to offset income for tax purposes, net deferred tax credits will be restored at the then current rates.

At December 31, 1980, the Company had additional loss carryforwards of approximately \$41,000,000 which the Company has treated on its Federal income tax return as expiring in 1986 and 1987.

(7) STOCKHOLDERS' EQUITY

Effective January 1, 1972, the Company's Board of Directors approved a quasi-reorganization. Accordingly, as of that date, the Company reclassified a deficit, determined in accordance with generally accepted accounting principles, of \$3,891,663 from retained earnings to additional paid-in capital. Thus, retained earnings is accumulated from January 1, 1972. Appropriated retained earnings relates to the Mandatory Securities Valuation Reserve, which is required to be appropriated by statutory authorities.

In January 1978, Great Plains Life Insurance Corporation, the remaining life insurance subsidiary of the Company, was merged into the Company.

Dividends to stockholders can be paid only from the Company's statutory unassigned surplus as determined by accounting principles prescribed by insurance regulatory authorities. Statutory unassigned surplus amounted to approximately \$12,815,000, \$17,373,000 and \$17,605,000 at December 31, 1980, 1979 and 1978, respectively, and stockholders' equity in that amount was available for dividends, subject to the tax effects of distributions from "policyholders' surplus account" described in note 6, to possible claims by participating policyholders as described in note 12, the contingencies described in note 14. The rights of the respective classes of common stock to share in dividends of the Company are described in note 4.

(8) EARNINGS (LOSS) PER SHARE

Earnings (loss) per share of common stock are based on the weighted average number of such shares outstanding during each year. The weighted average shares outstanding were 3,411,188, 3,411,338 and 3,411,615 for the years ended December 31, 1980, 1979 and 1978, respectively.

(9) NET INVESTMENT INCOME AND CONCENTRATION OF INVESTMENTS

The major components of net investment income are as follows:

	<u>1980</u>	<u>1979</u>	<u>1978</u>
Investment income:			
Interest on bonds	\$10,006,832	10,234,991	10,093,400
Interest on GNMA and FHLMC Certificates under repurchase agreements	5,880,826	10,082,291	1,755,659
Interest on mortgage loans	5,449,421	5,101,086	4,128,748
Interest on policy loans	2,182,479	1,805,298	1,612,444
Interest on notes receivable from affiliates	40,000	40,000	40,000
Income from life interest in Libbie Shearn Moody Trust (see note 4)	854,096	712,959	669,158
Other investment income	1,352,475	2,669,474	1,376,741
Total investment income	25,766,129	30,646,099	19,676,150
Interest expense on funds purchased with securities under repurchase agreements	7,311,791	10,854,289	1,741,727
Interest expense on other short-term borrowings	3,726,185	1,511,293	22,423
Other investment expenses	1,904,036	2,316,899	1,695,794
Net investment income	<u>\$12,824,117</u>	<u>15,963,618</u>	<u>16,216,206</u>

Investments of the following amounts were non-income producing for the six months prior to December 31, 1980 and 1979:

Type of Investment	1980	1979
Bonds	\$ 75,896	14,409
Mortgage loans	—	3,393
Common stock	—	1,342
Real estate	895,502	1,451,891

Listed below is a summary of investments other than real estate in any one person amounting to 2% or more of total invested assets at December 31, 1980 and 1979. In the case of real estate, no investments in excess of 2% were acquired within the previous five years.

	1980	1979
Life interest in Libbie Shearn Moody Trust	\$9,145,888	9,389,001

(10) ANALYSIS OF INVESTMENT GAINS AND LOSSES

The table below presents an analysis of realized investment gains and losses and the increase or decrease in unrealized losses on bonds, GNMA and FHLMC certificates under repurchase agreements and investments in marketable equity securities during the years ended December 31, 1980, 1979 and 1978, respectively:

	Net Realized Investment (Gains) Losses, Net of Tax	Increase (Decrease) in Unrealized Losses on Investments	Total
Year ended December 31, 1980			
Bonds	\$ 526,449	11,496,676	12,023,125
GNMA and FHLMC Certificates under repurchase agreements	13,149,333	—	13,149,333
Stocks	500,831	54,241	555,072
Other	6,067	—	6,067
Total	<u>14,182,680</u>	<u>11,550,917</u>	<u>25,733,597</u>
Year ended December 31, 1979			
Bonds	\$ (14,968)	9,956,798	9,941,830
GNMA and FHLMC Certificates under repurchase agreements	21,804,558	(2,370,451)	19,434,107
Stocks	(178,519)	330,540	152,021
Other	(280,565)	—	(280,565)
Total	<u>\$21,330,506</u>	<u>7,916,887</u>	<u>29,247,393</u>
Year ended December 31, 1978			
Bonds	\$ (344,410)	7,691,466	7,347,056
GNMA and FHLMC Certificates under repurchase agreements	(106,694)	2,370,451	2,263,757
Stocks	(513,330)	1,380,987	867,657
Other	(115,218)	—	(115,218)
Total	<u>\$ (1,079,652)</u>	<u>11,442,904</u>	<u>10,363,252</u>

(11) REINSURANCE

The Company is party to several reinsurance agreements. The Company's general policy is to reinsure that portion of any risk in excess of \$150,000 on the life of any one individual. Life insurance in force in the amounts of \$240,000,000 and \$220,000,000 is ceded on a yearly renewable term basis, \$3,900,000 and \$4,100,000 is ceded on a modified coinsurance basis and \$46,000,000 and \$59,000,000 is ceded on a coinsurance basis at December 31, 1980 and 1979, respectively. Accident and health is ceded on a coinsurance basis. In accordance with the reinsurance contracts, credits in the amounts of approximately \$2,500,000 and \$2,000,000 were taken against the liability for future policy benefits at December 31, 1980, and 1979, respectively. A contingent liability exists with respect to such reinsurance which could become a liability of the Company in the event such reinsurance companies are unable to meet their obligations under existing reinsurance agreements.

Notes to Consolidated Financial Statements . . . continued

On May 22, 1980, the Company entered into a portfolio reinsurance agreement for the purpose of preventing statutory insolvency. The agreement consisted of both coinsurance and modified coinsurance and was effective April 1, 1980. The coinsurance portion of the agreement increased statutory unassigned surplus by approximately \$27,941,000. Under the terms of the agreement, in the event of a default, the reinsurer would assume by bulk reinsurance all of the policies reinsured under the agreement. To secure the reinsurers in the event of default and the necessity to bulk reinsure such policies, the Company has transferred to and deposited with a bank, as custodian, approximately \$75,000,000 of its assets. To replace the ceded statutory premium and insurance in force the Company, later in 1980, entered into an assumption modified coinsurance agreement, also effective April 1, 1980. Under the provisions of these agreements, risk and expense charges of approximately \$1.13 million were paid during the year ended December 31, 1980. These amounts were charged to "other operating expenses (other expenses)". (see note 1)

(12) PARTICIPATING POLICIES

The Company, or its predecessors, has in the past issued participating policies which entitle the policyholders to participate in cash and, in certain instances, in stock dividends paid to stockholders. The participating preferences of these special policy plans are as follows:

- (A) Certain participating policies require payment of dividends to policyholders of not less than a specified percentage of dividends paid to stockholders. Holders of such policies at December 31, 1980 are entitled to dividends equal to an aggregate maximum of approximately 7% of dividends paid to holders of the Company's common stock.
- (B) Certain participating policies are entitled to receive policyholder dividends at least equivalent to stockholders' dividends paid on a designated number of shares of common stock of the Company. Holders of such policies at December 31, 1980 are entitled to receive dividends equivalent to less than 1% of dividends paid to holders of the Company's common stock.

All other policyholders' dividends are apportioned for payment by the Company's Board of Directors at the beginning of certain periods of time on participating policies having anniversary dates during such designated periods. These policyholders' dividends are at various rates based upon factors such as the policy plan, loading factor of the plan, issue date of policies, etc., and the provision for the policyholders' dividend liability is included in the future policy benefit liabilities.

Retained earnings are allocable to participating policies only when dividends thereon are specifically declared by the Company's Board of Directors except as noted above. At December 31, 1980, no retained earnings were so allocated.

Participating business constitutes approximately 20% and 24% of the Company's life insurance in force, 24% and 30% of the policies in force and 19% and 23% of the premium income for the years ended December 31, 1980 and 1979, respectively.

(13) DEPOSITS WITH REGULATORY AUTHORITIES

At December 31, 1980 and 1979, the following assets were on deposit with state and other regulatory authorities as required by law:

	<u>1980</u>	<u>1979</u>
Bonds, at amortized cost	\$46,818,874	46,253,046
Mortgage loans on real estate	5,548,797	5,973,281
Certificates of deposit	116,182	116,182
	<u>\$52,483,853</u>	<u>52,342,509</u>

(14) CONTINGENCIES

The Company is a defendant in a lawsuit involving a disability claim. The plaintiff seeks disability benefits under the policy, general damages of \$250,000 and punitive damages of \$2,500,000. In the opinion of management and legal counsel, the defenses asserted by the Company are meritorious and the Company should prevail. Accordingly, no provision has been made in the accompanying consolidated financial statements for any damages which may result from this suit.

The Company is a defendant in a class action suit alleging that the Company was in violation of certain securities laws for failure to disclose certain financial information related to the Company's investment in the subsidiary described in note 3. Plaintiffs are seeking money damages in an unspecified amount. No provision has been made in the accompanying consolidated financial statements for damages, if any, that may result from this suit.

The Company and certain of its past and present directors are involved in a lawsuit seeking certain claims including claims which may be covered under the above class action suit. The lawsuit is primarily in the nature of a derivative stockholder claim against the defendant directors and seeks alleged damages in excess of \$50,000,000. The complaint alleges that the directors were negligent and grossly negligent in discharging their duties to the Company. The directors will be indemnified under the Company's By-laws for costs and expenses in this lawsuit unless it is determined that they were liable for gross negligence or willful misconduct in performance of their duties. No provision has been made in the accompanying financial statements for damages, if any, that may result from the lawsuit.

The Company is a plaintiff in a civil action against four former officers and directors of Hibbard, O'Connor & Weeks, Inc., the parent corporation of Hibbard & O'Connor Government Securities, Inc., and their independent accounting firm. The complaint alleges violation of certain federal and state securities laws in connection with the Company's purchase of government guaranteed securities. The Company is seeking actual damages of \$35,000,000 and punitive damages of \$20,000,000. No provision has been made in the accompanying consolidated financial statements for recovery of damages, if any, that may result from this action.

The Company is a defendant in several other lawsuits, substantially all of which are in the normal course of the insurance business. In the opinion of management of the Company, the liability, if any, which may arise from these lawsuits would not be material.

As a result of an examination of the Federal income tax returns of the Company for the years 1971, 1972, 1973, 1974 and 1975, the Internal Revenue Service has assessed the Company for tax deficiencies aggregating approximately \$1,300,000, plus interest. The Company has filed a protest with the Internal Revenue Service contesting the material proposed deficiencies, and in the opinion of management of the Company, additional taxes, if any, which may arise from the assessment will not be material to the financial position and results of operations determined in accordance with generally accepted accounting principles. However, if the assessment for any material additional taxes is sustained, it will result primarily from timing differences which have already been provided for in the deferred Federal income tax liability included in the accompanying consolidated balance sheets. Also the tax effect of disallowed deductions which arose as a result of the quasi-reorganization will be charged to paid-in capital. For statutory accounting purposes any assessments for additional taxes and interest related thereto would be charged directly to statutory stockholders' equity. Such charges could materially affect the amount of statutory surplus available to pay dividends to stockholders.

The Company sold investment property during 1977 which was subject to a first mortgage lien. The mortgage loan payments were assumed by the purchaser under a "wrap around agreement". However, the Company remains contingently liable for the loan payments. The mortgage loan balance amounted to \$3,346,119 at December 31, 1980.

(15) PENSION AND PROFIT-SHARING AND INCENTIVE PLANS

Effective January 1, 1973, the Company adopted a noncontributory pension plan which covers substantially all permanent employees and a profit-sharing and incentive plan which covers full-time insurance agents who have career contracts with the Company. The Company's policy related to the pension plan is to fund pension costs accrued. The initial past service liability of the pension plan was approximately \$300,000 and is being amortized over a thirty-year period. As of December 31, 1980, the unfunded past service cost of the pension plan was \$213,000. The actuarially computed value of vested benefits of the pension plan did not exceed the net assets of the plan at December 31, 1980. Pension expense for the years ended December 31, 1980, 1979 and 1978 amounted to \$174,000, \$157,000 and \$112,000, respectively.

The Company's contribution with respect to agents is discretionary and may vary up to 10% of the participating agents' first year commissions earned, not to exceed 15% of total eligible compensation. The contribution accrued for 1979 and 1978 was \$68,000 and \$58,000, respectively. During 1980, the Company elected to

Notes to Consolidated Financial Statements . . . continued

make certain changes in its agents' contracts and replace certain previously furnished fringe benefits with an increased commission structure. Accordingly, the profit-sharing and incentive plan for agents is being terminated and in anticipation no contribution for 1980 was made.

(16) COMMITMENTS

At December 31, 1980, the Company was committed to disburse funds in connection with the normal investment activities for first lien mortgage loans in the aggregate amount of \$240,000 at an interest rate of 14%. The Company is also committed to purchase an airplane scheduled for delivery in late 1984. The cost will be \$3,695,000 plus an adjustment equal the percentage increase from January 1979 to January 1983 in the Wholesale Price Index for Industrial Commodities (1967 = 100) as published by the Bureau of Labor Statistics, U.S. Department of Labor.

(17) FOREIGN SALES

Total premium income related to life insurance written in foreign countries, primarily Latin America, was approximately \$15,000,000, \$12,000,000 and \$8,500,000 for the years ended December 31, 1980, 1979 and 1978, respectively.

(18) QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

In the fourth quarter of 1979, the Company recorded a significant write-down on its investment in GNMA and FHLMC certificates under repurchase agreements of \$20,157,541 based on its decision to dispose of all such certificates in 1980, as described in note 2. Had these investments been written-down to market during each quarter for 1979, the effect of the write-down described above on quarterly results of operations would have been an increase (decrease) of \$(4,800,000), \$900,000, \$(6,700,000) and \$(9,558,000), respectively. These certificates were written-down to market in 1980 and the effects are included in the appropriate quarterly results of operations. Quarterly results of operations for the years ended December 31, 1980, 1979 and 1978 are summarized as follows:

(000 omitted)	1980			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total premiums and other revenue	\$ 13,666	13,973	15,967	16,783
Total benefits and expenses	13,483	14,160	13,898	14,544
Earnings (Loss) before Federal income taxes and net realized gains on investments	183	(187)	2,069	2,239
Federal income taxes	40	(40)	430	840
Earnings (Loss) before net realized gains (losses) on investments	143	(147)	1,639	1,399
Net realized gains (losses) on investments	(16,711)	2,800	(49)	(223)
Net earnings (loss)	<u>\$ (16,568)</u>	<u>2,653</u>	<u>1,590</u>	<u>1,176</u>
Per Share Results:				
Earnings (Loss) before net realized gains (losses) on investments	\$.04	(.04)	.48	.41
Net realized gains (losses) on investments	(4.90)	.82	(.01)	(.07)
Net earnings (loss)	<u>\$ (4.86)</u>	<u>.78</u>	<u>.47</u>	<u>.34</u>
Weighted Average Shares Outstanding	<u>3,411,218</u>	<u>3,411,218</u>	<u>3,411,208</u>	<u>3,411,188</u>

	1979			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(000 omitted)				
Total premiums and other revenue	\$ 14,876	14,208	14,331	14,721
Total benefits and expenses	12,764	13,179	11,650	13,448
Loss on write-down of investment in subsidiary	—	—	6,640	110
Earnings (Loss) before Federal income taxes, net realized gains on investments and extraordinary tax credit	2,112	1,029	(3,959)	1,163
Federal income taxes	612	240	848	340
Earnings (Loss) before net realized gains (losses) on investments and extraordinary tax credit	1,500	789	(4,807)	823
Net realized gains (losses) on investments	3	(111)	194	(21,416)
Earnings (Loss) before extraordinary tax credit	1,503	678	(4,613)	(20,593)
Extraordinary tax credit	1	(1)	37	(37)
Net earnings (loss)	<u>\$ 1,504</u>	<u>677</u>	<u>(4,576)</u>	<u>(20,630)</u>
Per Share Results:				
Earnings (Loss) before net realized gains (losses) on investments and extraordinary tax credit	\$.44	.23	(1.41)	.24
Net realized gains (losses) on investments	—	(.03)	.06	(6.28)
Earnings (Loss) before extraordinary tax credit .....	.44	.20	(1.35)	(6.04)
Extraordinary tax credit	—	—	.01	(.01)
Net earnings (loss)	<u>\$.44</u>	<u>.20</u>	<u>(1.34)</u>	<u>(6.05)</u>
Weighted Average Shares Outstanding	<u>3,411,390</u>	<u>3,411,390</u>	<u>3,411,375</u>	<u>3,411,388</u>

(1) \$607,000 was reclassified from revenue to benefits to be consistent with year end reporting.

	1978			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
(000 omitted)				
Total premiums and other revenue	\$ 14,255	12,994	13,437	14,570
Total benefits and expenses	11,712	10,738	11,073	12,665
Earnings before Federal income taxes, net realized gains on investments and extraordinary tax credit	2,543	2,256	2,364	1,905
Federal income taxes	750	671	681	549
Earnings before net realized gains on investments and extraordinary tax credit	1,793	1,585	1,683	1,356
Net realized gains on investments, net of tax	355	147	154	423
Earnings before extraordinary tax credit	2,148	1,732	1,837	1,779
Extraordinary tax credit	152	48	80	182
Net earnings	<u>2,300</u>	<u>1,780</u>	<u>1,917</u>	<u>1,961</u>
Per Share Results:				
Earnings before net realized gains on investments and extraordinary tax credit	\$.53	.46	.49	.40
Net realized gains on investments, net of tax .....	.10	.04	.05	.13
Earnings before extraordinary tax credit .....	.63	.50	.54	.53
Extraordinary tax credit .....	.05	.01	.02	.05
Net earnings	<u>\$.68</u>	<u>.51</u>	<u>.56</u>	<u>.58</u>
Weighted Average Shares Outstanding	<u>3,411,991</u>	<u>3,411,795</u>	<u>3,411,703</u>	<u>3,411,615</u>

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
National Western Life Insurance Company
Austin, Texas

We have examined the consolidated balance sheet of National Western Life Insurance Company and subsidiaries as of December 31, 1980, and the related consolidated statements of operations, stockholders' equity and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of National Western Life Insurance Company and subsidiaries as of December 31, 1980, and the consolidated results of their operations and the changes in their financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

March 24, 1981
Austin, Texas

Touche Ross & Co.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
National Western Life Insurance Company

We have examined the consolidated balance sheet of National Western Life Insurance Company as of December 31, 1979, and the related consolidated statements of operations, stockholders' equity and changes in financial position for each of the years in the two-year period ended December 31, 1979. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the consolidated financial position of National Western Life Insurance Company and subsidiaries at December 31, 1979 and the results of their operations and the changes in their financial position for each of the years in the two-year period ended December 31, 1979, in conformity with generally accepted accounting principles applied on a consistent basis.

Austin, Texas
March 19, 1980 except as to
Notes 2 and 11, which are
as of July 1, 1980.

Peat, Marwick, Mitchell & Co

Summary of Operations

	Year Ended December 31				
	1980	1979	1978	1977	1976
Premium Income	\$46,912,884	42,101,649	38,539,168	35,721,430	32,094,276
Investment Income	12,824,117	15,963,618	16,216,206	13,723,926	12,377,547
Other Income	652,171	71,056	192,452	202,773	373,564
Total Income	60,389,172	58,136,323	54,947,826	49,648,129	44,845,387
Policyowner Benefits	40,272,556	36,567,517	33,421,012	31,189,919	27,938,980
Commissions and Other Expenses	15,813,047	14,473,481	12,457,763	12,005,475	11,403,486
Total Expenses	56,089,603	51,040,998	45,878,775	43,195,394	39,342,466
Loss on write-down of subsidiary	—	6,750,000	—	—	—
Earnings Before Taxes	4,303,569	345,325	9,069,051	6,452,735	5,502,921
Federal Income Taxes	1,270,000	2,040,000	2,652,000	1,773,000	1,525,000
Earnings (Loss) From Operations	3,033,569	(1,694,675)	6,417,051	4,679,735	3,977,921
Net Investment Gains (Losses)	(14,182,680)	(21,330,506)	1,079,652	(127,679)	28,576
Extraordinary Credit	—	—	462,000	—	—
Net Earnings (Loss)	\$(11,149,111)	(23,025,181)	7,958,703	4,552,056	4,006,497
Per Share:					
Earnings (Loss) From Operations	\$.89	(.50)	1.88	1.37	1.17
Investment Gains (Losses)	(4.16)	(6.25)	.32	(.04)	.01
Extraordinary Credit	—	—	.13	—	—
Net Earnings (Loss)	\$(3.27)	(6.75)	2.33	1.33	1.18

Management's Discussion and Analysis of Financial Condition and Results of Operations

Summary

The following table sets forth for the periods indicated (1) percentages which certain items reflected in the financial data bear to total revenues of the Company and (2) the percentage increase or decrease of such items as compared to the indicated prior period:

	Relationship to Total Revenues Year Ended December 31,			Period to Period Increase (Decrease) Years Ended	
	1978	1979	1980	1978-79	1979-80
Premiums	70.1%	72.4%	77.7%	9.2%	11.4%
Investment Income	29.5	27.5	21.2	(1.6)	(19.7)
Other Income	.4	.1	1.1	(63.1)	817.8
Total Revenues	100.0	100.0	100.0	5.8	3.9
Policyowner benefits	60.8	62.9	66.7	9.4	10.1
Commissions and other expenses	22.7	24.9	26.2	16.2	9.3
Loss on write-down of subsidiary	—	11.6	—	100.0	(100.0)
Earnings (loss) before taxes	16.5	.6	7.1	(96.2)	1146.2
Provision for income taxes	4.8	3.5	2.1	(23.1)	(37.8)
Earnings (loss) from operations	11.7	(2.9)	5.0	(126.4)	279.0
Net investment gains (losses)	2.0	(36.7)	(23.5)	(2075.7)	33.5
Extraordinary credit	.8	—	—	(100.0)	—
Net earnings (loss)	14.5	(39.6)	(18.5)	(389.3)	51.6

Management's Discussion and Analysis of Financial Condition and Results of Operations . . . continued

Results of Operations

Premium Income: Over the three years premium income has increased by 22%. The largest increases in premium came from the Company's Builders and Contractors and Mass Marketing Programs and from the new adjustable life product.

Investment Income: From 1978 through 1980 investment income decreased by 21%. This decrease resulted primarily from the negative interest spread experienced by the Company in its government securities investment program. In 1978 interest income was approximately \$100,000 in excess of interest expense; in 1979 there was an approximate \$1,900,000 excess interest expense over interest income; in 1980 when the Company disposed of these government securities, the excess interest expense over interest income was approximately \$5,350,000. The negative effect of this program will continue into 1981 until the related short term borrowings from banks are paid in full. These borrowings were paid down from a high of \$32,250,000 in April of 1980 to \$15,250,000 at December 31, 1980. It is expected that the remainder will be repaid from current cash flow during 1981.

Policyowner Benefits: The three year increase of 21% results primarily from increased surrender benefits. This increase can be directly related to increasing costs of borrowing and other inflationary economic conditions. It is anticipated that the trend will continue for the immediate future.

Commissions and Other Expenses: The increase of 16.2% from 1978 to 1979 was primarily attributable to increased commis-

sion expense which is directly related to increased first year premium income. Other causes for the increase centered around new business promotional costs including the agent sales convention in 1979. The increase of 9.3% from 1979 to 1980 was primarily attributable to the net expense relating to the portfolio reinsurance transaction effected in 1980. This reinsurance transaction provided the Company with approximately \$28,000,000 of statutory surplus relief which was needed in connection with losses taken in the government securities investment program. The net effect of the transaction is presented in the accompanying consolidated statements of operations under other operating expenses. This amount for 1980 was \$1,131,000.

Net Investment Gains (Losses): In 1979 and 1980 the Company incurred substantial losses in connection with its government securities investment program. The 1979 loss included a write-down on these investments of approximately \$20,150,000. When these investments were sold in 1980, the remaining loss of approximately \$15,050,000 was recognized.

Liquidity and Capital Commitments

Because of inflation and adverse economic conditions over the last three years, the Company has experienced increasing demand for policy loans. These loans are made to policyholders at contractual rates of interest varying from 3½% to 9%, with approximately 62% of these loans at a 5% interest rate. In 1979 policy loans increased by 13.5% over the previous year. The increase in 1980 over 1979 was 20.3%. It is apparent that the availability of loans at these attrac-

tive interest rates will cause continued increases in loan demand, especially if interest rates in other financial market places remain at current levels.

The Company is committed to repayment of short term loans from banks which at December 31, 1980 amounted to \$15,250,000. Additionally, under the portfolio reinsurance transaction effected in 1980, the Company is committed to quarterly payments to the reinsurers which in 1980 amounted to \$1,131,000. These payments for 1981 should approximate \$1,500,000 as the 1980 amount represented only nine months activity.

Management anticipates that the Company will be able to repay the short term loans, to make the reinsurance payments and to fund the increasing policy loans from 1981 cash flow without having to borrow additional funds.

The Company has no present material commitments for capital expenditures in 1981 and does not anticipate incurring any such commitments through the balance of 1981.

Common Stock Prices

Quarter	Ending	High Bid	Low Asked
3-31	1978	8-3/8	5-9/16
6-30	1978	9-1/8	8-3/16
9-30	1978	9-11/16	8
12-31	1978	8-7/8	6-5/8
3-31	1979	9	6-3/4
6-30	1979	9-5/8	8-1/2
9-30	1979	9-1/2	6-3/8
12-31	1979	6-1/8	4-1/8
3-31	1980	6	3-5/8
6-30	1980	4-1/4	3-3/4
9-30	1980	3-5/8	3-1/2
12-31	1980	5-1/2	3-3/4
3-31	1981	4-3/4	4-1/4

Statutory Balance Sheets

(Unaudited)
December 31

	<u>1980</u>	<u>1979</u>
ASSETS		
Bonds	\$117,723,915	276,003,939
Preferred stocks	6,730,792	5,909,184
Common stocks	2,222,528	3,299,209
Mortgage loans	60,851,183	54,396,732
Real estate	5,380,946	6,223,807
Policy loans	44,904,357	37,339,930
Collateral loans	880,000	1,220,076
Income interest in Libbie Shearn Moody Trust	11,857,531	11,933,520
Cash on hand and in banks	2,275,454	1,859,904
Premiums deferred and uncollected	11,152,924	9,659,407
Investment income due and accrued	3,233,119	4,729,925
Other assets	2,849,902	3,886,308
	<u>\$270,062,651</u>	<u>416,461,941</u>
 LIABILITIES, SURPLUS AND OTHER FUNDS		
Aggregate reserve for life policies	\$194,852,512	208,893,491
Aggregate reserve for accident and health policies	1,601,433	1,533,974
Supplementary contracts without life contingencies	407,962	441,310
Life claims	1,044,809	1,703,154
Accident and health claims	487,000	496,750
Policyholders' dividend, coupon and endowment accumulations ..	16,037,936	16,411,370
Policyholders' dividend liability	412,000	344,000
Other liabilities to policyholders	2,087,825	2,347,038
Commissions, expenses and taxes due or accrued	1,129,805	957,493
Borrowed money	20,070,090	144,053,000
Other liabilities	3,483,208	3,077,595
Reserve for contingencies	37,562	8,109
Mandatory Securities Valuation Reserve	—	3,224,793
Total liabilities	<u>241,652,142</u>	<u>383,492,077</u>
Capital paid up	3,411,120	3,411,218
Paid-in and contributed surplus	12,184,650	12,184,650
Unassigned surplus	12,814,739	17,373,996
Total capital and surplus	<u>28,410,509</u>	<u>32,969,864</u>
	<u>\$270,062,651</u>	<u>416,461,941</u>

Statutory Statements of Operations

	(Unaudited) Year Ended December 31	
	1980	1979
Life premiums	\$ 56,615,863	40,846,450
Accident and health premiums	2,873,251	2,966,041
Considerations for supplementary contracts, dividend, coupon and endowment accumulations	1,893,031	1,987,320
Reserve adjustment on reinsurance ceded	80,847,480	—
Commission & expense allowances on reinsurance ceded	30,520,452	—
Reserves received — Modco reinsurance	119,213,749	—
Net investment income	13,155,025	16,315,778
Other income	274,259	67,287
Total income	<u>305,393,110</u>	<u>62,182,876</u>
Death claims	7,517,237	6,876,312
Accident and health claims	1,770,925	1,625,785
Surrender benefits	8,582,124	7,677,768
Coupons and endowments to policyholders	2,074,348	2,254,896
Payments on supplementary contracts, dividend, coupon and endowment accumulations	2,966,706	2,726,351
Other policy benefits	2,499,861	2,064,918
Increase (decrease) in life reserves	(14,040,979)	14,139,789
Increase in accident and health reserves	67,459	144,193
Decrease in other reserves	(409,325)	(146,033)
Reserves transferred & adjustments on reinsurance	241,700,068	—
Commissions and expenses on reinsurance assumed	3,538,503	—
Commissions	11,451,057	9,823,924
General expenses and taxes	8,633,276	8,995,981
Increase in loading	299,409	275,771
Total benefits and expenses	<u>276,650,669</u>	<u>56,459,655</u>
Net gain before dividends and Federal income taxes	28,742,441	5,723,221
Dividends to policyholders	421,313	356,113
Net gain before Federal income taxes	28,321,128	5,367,108
Federal income taxes	—	23
Net gain from operations	<u>\$ 28,321,128</u>	<u>5,367,085</u>

Statutory Statements of Capital and Surplus

	(Unaudited) Year Ended December 31	
	1980	1979
Balance at beginning of year	\$ 32,969,864	33,202,028
Additions (deductions):		
Net gain from operations	28,321,128	5,367,085
Net capital gains (losses)	(36,461,762)	(5,664,760)
Net gain (loss) from non-admitted assets	134,773	481,625
Increase in Mandatory Securities Valuation Reserve	3,224,793	(414,674)
Other surplus changes	221,713	(1,440)
Balance at end of year	<u>\$ 28,410,509</u>	<u>32,969,864</u>

Directors

Robert L. Moody

Chairman of the Board, National Western Life Insurance Company Investments, Galveston, Texas
NWL Director—1964 to present

Harry L. Edwards

President and Chief Executive Officer, National Western Life Insurance Company
NWL Director—1969 to present

Arthur O. Dummer

Senior Vice President, Beneficial Life Insurance Company
Salt Lake City, Utah
NWL Director—1980 to present

Kenneth M. Dunn

President, Houston Industrial Services, Inc.
President, D & D Leasing Company, Inc.
Vice President, Dunn Equipment, Inc.
Vice President, Dunn Heat Exchangers, Inc.
President, Texas Matt & Rigging, Houston, Texas
NWL Director—1975 to present

Gerald A. Levy

Vice President, North American Reassurance Company
New York, New York
NWL Director—1980 to present

E. Douglas McLeod

Realtor-Builder, McLeod Properties
President, McLeod Builders, Inc.
Galveston, Texas
NWL Director—1979 to present

Louis Pauls, Jr.

Vice President, Louis Pauls & Company
Investments, Galveston, Texas
NWL Director—1971 to present

John Ben Shepperd

Consultant, El Paso Products Company and affiliated companies
NWL Director—1969 to present

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Robert R. Johnson, FLMI, CLU

Executive Vice President
Administration
Assistant Secretary

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Data Processing

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Agnes Connolly

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Robert L. Moody, Jr.

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Assistant Secretary

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