

INDEPENDENCE HOLDING CO
Form 10-Q
May 10, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended **March 31, 2006**

Transition Report under Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from: _____ to _____

Commission File Number: **0-10306**

INDEPENDENCE HOLDING COMPANY

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

58-1407235

(I.R.S. Employer Identification No.)

96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT

06902

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: **(203) 358-8000**

NOT APPLICABLE

Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Class
Common stock, \$ 1.00 par value

Outstanding at May 9, 2006
14,791,139 Shares

INDEPENDENCE HOLDING COMPANY

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Copies of the Company's SEC filings can be found on its website at www.independenceholding.com

PART I - FINANCIAL INFORMATION**Item 1.****Financial Statements**

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	March 31,	December
	2006	31,
	(unaudited)	2005
ASSETS:		
Investments:		
Short-term investments	\$ 638	\$ 8,810
Securities purchased under agreements to resell	6,052	44,399
Fixed maturities	679,902	683,008
Equity securities	70,613	62,300
Other investments	57,297	57,287
Total investments	814,502	855,804
Cash and cash equivalents	17,837	12,659
Due from securities brokers	16	1,951
Investment in American Independence Corp. ("AMIC")	38,975	39,167
Deferred acquisition costs	61,625	62,000
Due and unpaid premiums	11,234	12,230
Due from reinsurers	108,107	111,135
Notes and other receivables	13,502	12,102
Goodwill	45,958	16,110
Other assets	42,313	27,765
Total assets	\$ 1,154,069	\$ 1,150,923

LIABILITIES AND STOCKHOLDERS' EQUITY:**LIABILITIES:**

Insurance reserves-health	\$	156,201	\$	159,600
Insurance reserves-life and annuity		272,394		273,449
Funds on deposit		376,064		370,701
Unearned premiums		20,170		18,524
Policy claims-life		7,909		8,742
Policy claims-health		5,825		4,839
Other policyholders' funds		17,630		18,350
Due to securities brokers		-		4,856
Due to reinsurers		10,381		11,667
Accounts payable, accruals and other liabilities		28,682		30,798
Debt		12,500		12,500
Junior subordinated debt securities		38,146		38,146
Total liabilities		945,902		952,172

STOCKHOLDERS' EQUITY:

Preferred stock (none issued)		-		-
Common stock \$1.00 par value, 20,000,000 shares authorized; 14,852,979 and 14,235,066 shares issued, respectively;				
14,766,482 and 14,132,149 shares outstanding, respectively		14,853		14,235
Paid-in capital		91,575		78,554
Accumulated other comprehensive loss		(16,742)		(8,414)
Treasury stock, at cost; 86,497 and 102,917 shares, respectively		(1,532)		(1,829)
Retained earnings		120,013		116,205
Total stockholders' equity		208,167		198,751
Total liabilities and stockholders' equity	\$	1,154,069	\$	1,150,923

The accompanying notes are an integral part of these consolidated financial statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended	
	March 31,	
	2006	2005
REVENUES:		
Premiums earned:		
Health	\$ 55,373	\$ 39,708
Life and annuity	10,915	9,720
Net investment income	11,931	9,499
Fee income	7,411	2,117
Net realized and unrealized gains	417	248
Equity income from AMIC	176	477
Other income	617	3,904
	86,840	65,673
EXPENSES:		
Insurance benefits, claims and reserves:		
Health	37,296	25,757
Life and annuity	12,884	10,904
Selling, general and administrative expenses	27,149	16,508
Amortization of deferred acquisition costs	2,518	2,651
Interest expense on debt	903	845
	80,750	56,665
Income before income taxes	6,090	9,008
Income tax expense	2,061	3,256

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Net income	\$	4,029	\$	5,752
Basic income per common share	\$.28	\$.41
Weighted average shares outstanding		14,495		14,009
Diluted income per common share	\$.27	\$.40
Weighted average diluted shares outstanding		14,869		14,332

The accompanying notes are an integral part of these consolidated financial statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended	
	March 31,	
	2006	2005
CASH FLOWS PROVIDED BY (USED BY) OPERATING ACTIVITIES:		
Net income	\$ 4,029	\$ 5,752
Adjustments to reconcile net income to net change in cash from operating activities:		
Amortization of deferred acquisition costs	2,518	2,651
Net realized and unrealized gains	(417)	(248)
Equity income from AMIC and other equity method investments	(342)	(1,327)
Depreciation and amortization	577	378
Share-based compensation expenses	336	-
Deferred tax expense	71	2,261
Other	288	379
Changes in assets and liabilities:		
Net sales of trading securities	163	201
Change in insurance liabilities	(3,983)	3,692
Deductions from (additions to) deferred acquisition costs	801	(6,565)
Change in net amounts due from and to reinsurers	1,743	2,208
Change in income tax liability	178	(504)
Change in due and unpaid premiums	997	(685)
Other	(9,163)	(8,917)
Net change in cash from operating activities	(2,204)	(724)

**CASH FLOWS PROVIDED BY (USED BY) INVESTING
ACTIVITIES:**

Change in net amount due from and to securities brokers	(2,922)	(3,598)
Net proceeds of short-term investments	8,180	36
Net sales of securities under resale and repurchase agreements	38,347	37,107
Sales of equity securities	7,282	3,229
Purchases of equity securities	(14,930)	(14,400)
Sales of fixed maturities	97,441	143,918
Maturities of fixed maturities	-	3,915
Purchases of fixed maturities	(110,210)	(166,984)
Proceeds of sales of other investments	-	4,214
Additional investments in other investments, net of distributions	(220)	(976)
Cash paid in acquisitions of companies, net of cash acquired	(20,950)	(10,200)
Investment in AMIC	-	(69)
Cash paid for acquisition of policy blocks	(224)	-
Change in notes and other receivables	(1,639)	(1,927)
Other	(1,011)	586
Net change in cash from investing activities	(856)	(5,149)

**CASH FLOWS PROVIDED BY (USED BY) FINANCING
ACTIVITIES:**

Proceeds from issuance of common stock	2,500	-
Repurchases of common stock	-	(2,656)
Exercises of common stock options	77	92
Excess tax benefits from exercise of stock options	96	-
Proceeds of investment-type insurance contracts	5,918	8,645
Dividends paid	(353)	(353)
Net change in cash from financing activities	8,238	5,728
Net change in cash and cash equivalents	5,178	(145)
Cash and cash equivalents, beginning of year	12,659	13,196
Cash and cash equivalents, end of period	\$ 17,837	\$ 13,051

The accompanying notes are an integral part of these consolidated financial statements.

INDEPENDENCE HOLDING COMPANY AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

Note 1.

Significant Accounting Policies and Practices

(A)

Business and Organization

Independence Holding Company, a Delaware corporation (NYSE: IHC), is a holding company principally engaged in the life and health insurance business through: (i) its wholly-owned insurance companies, Standard Security Life Insurance Company of New York ("Standard Security Life") and Madison National Life Insurance Company, Inc. ("Madison National Life"); and (ii) its marketing and administrative companies, including Insurers Administrative Corporation (IAC), managing general underwriter (MGU) affiliates, Health Plan Administrators (HPA), GroupLink Inc. (GroupLink) and Community America Insurance Services Inc. (CAIS , formerly CA Insurance Services LLC).

These companies are sometimes collectively referred to as the "Insurance Group," and IHC and its subsidiaries (including the Insurance Group) are sometimes collectively referred to as the "Company." The Company also owns a 48% equity interest in American Independence Corp. (NASDAQ:AMIC), which owns Independence American Insurance Company (Independence American) and several MGU s.

Geneve Corporation, a diversified financial holding company, and its affiliated entities held approximately 55% of IHC's outstanding common stock at March 31, 2006.

(B)

Basis of Presentation

The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles and include the accounts of IHC and its consolidated subsidiaries. All significant intercompany transactions have been eliminated in consolidation. The preparation of financial statements in conformity with U.S. generally

accepted accounting principles requires management to make estimates and assumptions that affect: (i) the reported amounts of assets and liabilities; (ii) the disclosure of contingent assets and liabilities at the date of the financial statements; and (iii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. IHC's annual report on Form 10-K as filed with the Securities and Exchange Commission should be read in conjunction with the accompanying consolidated financial statements.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) that are necessary for a fair presentation of the consolidated financial position and results of operations for the interim periods have been included. The consolidated results of operations for the three months ended March 31, 2006 are not necessarily indicative of the results to be anticipated for the entire year.

(C)

Reclassifications

Certain amounts in prior years' Consolidated Financial Statements and notes thereto have been reclassified to conform to the 2006 presentation.

(D)

Share-Based Compensation

Effective January 1, 2006, under the modified prospective method, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment" ("SFAS 123R"), which revises SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS 123) and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees" and its related

interpretations (APB 25). SFAS 123R applies to all awards granted after its effective date and to modifications, repurchases or cancellations of existing awards after that date. Results for prior periods have not been restated. Additionally, under the modified prospective method of adoption, the Company recognizes compensation expense for the portion of outstanding awards on the adoption date for which the requisite service period has not yet been rendered based on the grant-date fair value of those awards calculated under SFAS 123 for purposes of pro forma disclosures.

In the first quarter of 2006, total share-based compensation expense was \$336,000, including \$288,000 of incremental share-based compensation expense resulting from the adoption of SFAS 123R. This incremental expense resulted in a decrease of \$173,000 to net income, after income tax benefits of \$115,000, for the quarter ended March 31, 2006. On a per share basis, the expensing of share-based compensation resulted in decreases of \$.01 per share in both basic and diluted earnings per share for the quarter ended March 31, 2006.

Prior to the adoption of SFAS 123R, the Company accounted for its share-based awards under APB 25. The following table details the effect on net income and earnings per share had compensation expense for employee share-based awards been recorded in the first quarter of 2005 based on the fair value method under SFAS 123 (in thousands, except per share data):

		Three Months Ended March 31, 2005
Net income, as reported	\$	5,752
Add stock-based employee compensation expense included in reported net income, net of related tax effects		-
Deduct total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects		(175)
Proforma net income	\$	5,577
Basic earnings per share:		
As reported	\$.41
Proforma	\$.40
Diluted earnings per share:		
As reported	\$.40
Proforma	\$.39

Under the terms of the Company's stock-based compensation plans, option exercise prices are equal to the quoted market price of the shares at the date of grant; option terms range from five to ten years; and vesting periods are three

years for employee options and six months for director options. The Company may also grant shares of restricted stock. These shares are valued at the quoted market price of the shares at the date of grant, and have a three year vesting period. There were 2,515 shares available for future option or restricted-stock grants under the shareholder-approved plans at March 31, 2006.

The total intrinsic value of options exercised during the three month periods ended March 31, 2006 and 2005 was \$304,000 and \$173,000, respectively. Cash proceeds received from options exercised for the three months ended March 31, 2006 and 2005 were \$77,000 and \$92,000, respectively.

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The Company's stock option activity for the three months ended March 31, 2006 is as follows:

	Shares Under Option	Weighted-Average Exercise Price
December 31, 2005	1,108,371	\$ 11.89
Granted	70,000	22.55
Exercised	(16,420)	4.68
Expired	(1,800)	20.89
March 31, 2006	1,160,151	\$ 12.62

The following table summarizes information regarding outstanding and exercisable options as of March 31, 2006:

	Outstanding	Exercisable
Number of options	1,160,151	816,281
Weighted average exercise price per share	\$ 12.62	\$ 10.03
Aggregate intrinsic value for all options	\$ 12,112,000	\$ 10,636,000
Weighted average contractual term remaining	2.0 years	1.5 years

The fair value of each option award is estimated on the date of grant using the Black Scholes option valuation model. The weighted average grant-date fair-value of options granted during the three months ended March 31, 2006 was \$7.14. The Company issued 37,075 restricted stock awards during the quarter ended March 31, 2006, with a weighted-average grant-date fair value of \$22.56 per share. No stock options or restricted stock awards were granted in the three month period ended March 31, 2005. The assumptions set forth in the table below were used to value the stock options granted during the three month period ended March 31, 2006.

Weighted-average risk-free interest rate	4.48%
Annual dividend rate per share	\$.05
Weighted-average volatility factor of the Company's common stock	32.4%
Weighted-average expected term of options	4.4 years

As of March 31, 2006, there was \$1,244,000 and \$823,000 of total unrecognized compensation expense related to non-vested options and non-vested restricted stock awards, respectively, which will be recognized over the remaining requisite weighted-average service periods of 1.1 years and 2.8 years, respectively.

Prior to the adoption of SFAS 123R, the Company presented the tax benefit resulting from the exercise of stock options and restricted stock awards as operating cash flows in the Consolidated Statements of Cash Flows. SFAS 123R requires such benefits to be reported as a financing cash flow, rather than as an operating cash flow. Excess tax benefits of \$96,000 were classified as a financing cash inflow in the first quarter of 2006 and \$44,000 were classified as an operating cash inflow in the first quarter of 2005.

Note 2.

American Independence Corp.

AMIC is an insurance holding company engaged in the insurance and reinsurance business as a result of its acquisition of First Standard Holdings Corp. ("FSHC") from the Company in November 2002. AMIC does business with the Insurance Group, including reinsurance treaties under which, in 2005, Standard Security Life and Madison National Life ceded to Independence American Insurance Company an average of 22% of their medical stop-loss business, 10% of their fully-insured health

business and 20% of their New York Statutory Disability business. IHC owns 48% of AMIC's outstanding common stock at March 31, 2006 and December 31, 2005 which was purchased in various transactions beginning in 2002. IHC accounts for its investment in AMIC under the equity method. At March 31, 2006 and December 31, 2005, IHC's investment in AMIC had a total carrying value of \$43,445,000 and \$43,637,000, respectively, including goodwill of \$4,470,000 at both dates. At March 31, 2006 and December 31, 2005, based on the closing market price of AMIC's common stock, the fair value of the AMIC shares owned by IHC was approximately \$48,740,000 and \$46,668,000, respectively.

For the quarters ended March 31, 2006 and 2005, IHC recorded \$176,000 and \$477,000, respectively, of equity income from its investment in AMIC, representing IHC's proportionate share of income based on its ownership interests during those periods. AMIC paid no dividends on its common stock in the three month periods ended March 31, 2006 and 2005.

IHC and its subsidiaries earned \$139,000 and \$168,000 for the quarters ended March 31, 2006 and 2005, respectively, from service agreements with AMIC and its subsidiaries. These are reimbursements to IHC and its subsidiaries, at agreed upon rates including an overhead factor, for management services provided by IHC and its subsidiaries, including accounting, legal, compliance, underwriting and claims. The Company also contracts for several types of insurance (e.g. directors and officers and professional liability) jointly with AMIC. The cost of this coverage is allocated between the Company and AMIC according to the type of risk, and IHC's portion is recorded in Selling, General and Administrative Expenses. The Company ceded premiums to AMIC of \$13,674,000 and \$13,059,000 for the quarters ended March 31, 2006 and 2005, respectively.