

NATIONAL WESTERN LIFE INSURANCE CO
Form 10-Q
May 12, 2008

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, 2008

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

For the transition period from _____ to _____

Commission File Number: 2-17039

NATIONAL WESTERN LIFE INSURANCE COMPANY
(Exact name of Registrant as specified in its charter)

COLORADO
(State of Incorporation)

84-0467208
(I.R.S. Employer Identification Number)

850 EAST ANDERSON LANE
AUSTIN, TEXAS 78752-1602
(Address of Principal Executive Offices)

(512) 836-1010
(Telephone Number)

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 file" 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

As of May 6, 2008, the number of shares of Registrant's common stock outstanding was: Class A
– 3,425,454 and Class B - 200,000.

TABLE OF CONTENTS

	Page
<u>Part I. Financial Information:</u>	3
<u>Item 1. Financial Statements</u>	3
<u>Condensed Consolidated Balance Sheets</u> March 31, 2008 (Unaudited) and December 31, 2007	3
<u>Condensed Consolidated Statements of Earnings</u> For the Three Months Ended March 31, 2008 and 2007 (Unaudited)	5
<u>Condensed Consolidated Statements of Comprehensive Income</u> For the Three Months Ended March 31, 2008 and 2007 (Unaudited)	6
<u>Condensed Consolidated Statements of Stockholders' Equity</u> For the Three Months Ended March 31, 2008 and 2007 (Unaudited)	7
<u>Condensed Consolidated Statements of Cash Flows</u> For the Three Months Ended March 31, 2008 and 2007 (Unaudited)	8
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	10
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	46
<u>Item 4. Controls and Procedures</u>	46
<u>Part II. Other Information:</u>	46
<u>Item 1. Legal Proceedings</u>	46
<u>Item 1A. Risk Factors</u>	46
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	47
<u>Item 6. Exhibits</u>	47
<u>Signatures</u>	48

Table of Content

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

ASSETS	(Unaudited) March 31, 2008	December 31, 2007
Investments:		
Securities held to maturity, at amortized cost	\$ 3,766,162	3,778,603
Securities available for sale, at fair value	1,911,583	1,900,714
Mortgage loans, net of allowance for possible losses (\$3,568 and \$3,567)	98,530	99,033
Policy loans	82,032	83,772
Derivatives	8,069	25,907
Other long-term investments	16,214	16,562
Total Investments	5,882,590	5,904,591
Cash and short-term investments	93,997	45,206
Deferred policy acquisition costs	663,117	664,805
Deferred sales inducements	104,937	104,029
Accrued investment income	64,222	65,034
Federal income tax receivable	6,099	10,010
Other assets	46,112	41,651
	\$ 6,861,074	6,835,326

See accompanying notes to condensed consolidated financial statements.

Table of Content

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

LIABILITIES AND STOCKHOLDERS' EQUITY	(Unaudited) March 31, 2008	December 31, 2007
LIABILITIES:		
Future policy benefits:		
Traditional life and annuity contracts	\$ 138,723	138,672
Universal life and annuity contracts	5,423,348	5,441,871
Other policyholder liabilities	130,685	120,400
Federal income tax liability:		
Current	-	-
Deferred	65,599	61,720
Other liabilities	75,742	60,978
Total liabilities	5,834,097	5,823,641
COMMITMENTS AND CONTINGENCIES (Notes 5 and 8)		
STOCKHOLDERS' EQUITY:		
Common stock:		
Class A - \$1 par value; 7,500,000 shares authorized; 3,425,454 and 3,422,324 issued and outstanding in 2008 and 2007	3,425	3,422
Class B - \$1 par value; 200,000 shares authorized, issued, and outstanding in 2008 and 2007	200	200
Additional paid-in capital	36,563	36,236
Accumulated other comprehensive loss	(6,549)	(7,065)
Retained earnings	993,338	978,892
Total stockholders' equity	1,026,977	1,011,685
	\$ 6,861,074	6,835,326

Note: The condensed consolidated balance sheet at December 31, 2007, has been derived from the audited consolidated financial statements as of that date.

See accompanying notes to condensed consolidated financial statements.

Table of Content

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

For the Three Months Ended March 31, 2008 and 2007

(Unaudited)

(In thousands, except per share amounts)

	2008	2007
Premiums and other revenue:		
Life and annuity premiums	\$ 3,894	4,733
Universal life and annuity contract revenues	32,218	28,796
Net investment income	59,430	77,026
Other income	3,139	3,316
Realized gains (losses) on investments	(44)	241
Total premiums and other revenue	98,637	114,112
Benefits and expenses:		
Life and other policy benefits	10,455	10,974
Amortization of deferred policy acquisition costs	26,249	23,785
Universal life and annuity contract interest	26,617	37,433
Other operating expenses	13,430	14,116
Total benefits and expenses	76,751	86,308
Earnings before Federal income taxes	21,886	27,804
Provision for Federal income taxes:		
Current	3,890	4,314
Deferred	3,550	4,818
Total Federal income taxes	7,440	9,132
Net earnings	\$ 14,446	18,672
Basic Earnings Per Share:		
Class A	\$ 4.10	5.30
Class B	\$ 2.05	2.65
Diluted Earnings Per Share:		
Class A	\$ 4.07	5.23
Class B	\$ 2.05	2.65

See accompanying notes to condensed consolidated financial statements.

Table of Content

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Three Months Ended March 31, 2008 and 2007
(Unaudited)
(In thousands)

	2008	2007
Net earnings	\$ 14,446	18,672
Other comprehensive income, net of effects of deferred costs and taxes:		
Unrealized gains on securities:		
Net unrealized holding gains arising during period	408	4,723
Reclassification adjustment for net gains included in net earnings	(36)	(167)
Amortization of net unrealized gains related to transferred securities	16	20
Net unrealized gains on securities	388	4,576
Foreign currency translation adjustments	(181)	(87)
Benefit plans:		
Amortization of net prior service cost and net gain	309	-
Other comprehensive gain	516	4,489
Comprehensive income	\$ 14,962	23,161

See accompanying notes to condensed consolidated financial statements.

Table of Content

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the Three Months Ended March 31, 2008 and 2007
(Unaudited)
(In thousands)

	2008	2007
Common stock:		
Balance at beginning of year	\$ 3,622	3,621
Shares exercised under stock option plan	3	1
Balance at end of period	3,625	3,622
Additional paid-in capital:		
Balance at beginning of year	36,236	36,110
Shares exercised under the stock option plan	327	126
Balance at end of period	36,563	36,236
Accumulated other comprehensive income:		
Unrealized gains on securities:		
Balance at beginning of year	1,184	3,148
Change in unrealized gains during period	388	4,576
Balance at end of period	1,572	7,724
Foreign currency translation adjustments:		
Balance at beginning of year	3,078	3,122
Change in translation adjustments during period	(181)	(87)
Balance at end of period	2,897	3,035
Benefit plan liability adjustment:		
Balance at beginning of year	(11,327)	(10,001)
Amortization of net prior service cost and net gain	309	-
Balance at end of period	(11,018)	(10,001)
Accumulated other comprehensive income (loss) at end of period	(6,549)	758
Retained earnings:		
Balance at beginning of year	978,892	896,984
Cumulative effect of change in accounting principle, net of tax	-	(2,195)
Net earnings	14,446	18,672
Balance at end of period	993,338	913,461

Total stockholders' equity	\$	1,026,977	954,077
----------------------------	----	-----------	---------

See accompanying notes to condensed consolidated financial statements.

7

Table of Content

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended March 31, 2008 and 2007

(Unaudited)

(In thousands)

	2008	2007
Cash flows from operating activities:		
Net earnings	\$ 14,446	18,672
Adjustments to reconcile net earnings to net cash from operating activities:		
Universal life and annuity contract interest	26,617	37,433
Surrender charges and other policy revenues	(9,568)	(8,600)
Realized (gains) losses on investments	44	(241)
Accrual and amortization of investment income	(1,300)	(996)
Depreciation and amortization	272	356
Decrease in value of derivatives	20,480	8,590
Increase in deferred policy acquisition and sales inducement costs	(1,535)	(1,290)
Decrease in accrued investment income	812	610
(Increase) decrease in other assets	(2,773)	5,580
Increase in liabilities for future policy benefits	52	784
Increase in other policyholder liabilities	10,285	6,173
Increase in Federal income tax liability	8,100	7,788
Decrease in other liabilities	(814)	(10,547)
Other	1,810	(1,742)
Net cash provided by operating activities	66,928	62,570
Cash flows from investing activities:		
Proceeds from sales of:		
Securities held to maturity	-	5,175
Securities available for sale	124	234
Other investments	197	171
Proceeds from maturities and redemptions of:		
Securities held to maturity	248,009	28,571
Securities available for sale	78,696	78,592
Derivatives	8,964	8,570
Purchases of:		
Securities held to maturity	(234,856)	(71,837)
Securities available for sale	(67,636)	(87,912)
Other investments	(11,810)	(9,576)
Principal payments on mortgage loans	1,308	13,912
Cost of mortgage loans acquired	(777)	(16,066)
Decrease in policy loans	(1,546)	(613)
Other	(1,893)	(938)

Net cash provided by (used in) investing activities	18,780	(51,717)
---	--------	----------

(Continued on next page)

Table of Content

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS, CONTINUED

For the Three Months Ended March 31, 2008 and 2007

(Unaudited)
(In thousands)

	2008	2007
Cash flows from financing activities:		
Deposits to account balances for universal life and annuity contracts	\$ 115,410	111,937
Return of account balances on universal life and annuity contracts	(152,553)	(137,622)
Issuance of common stock under stock option plan	330	127
Net cash used in financing activities	(36,813)	(25,558)
Effect of foreign exchange	(104)	(156)
Net increase (decrease) in cash and short-term investments	48,791	(14,861)
Cash and short-term investments at beginning of year	45,206	49,901
Cash and short-term investments at end of period	\$ 93,997	35,040

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the three month period for:

Interest	\$ 10	10
Income taxes	-	1,254

See accompanying notes to condensed consolidated financial statements.

Table of Content

NATIONAL WESTERN LIFE INSURANCE COMPANY AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

(1) CONSOLIDATION AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for annual financial statements. In the opinion of management, the accompanying condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of the Company as of March 31, 2008, and the results of its operations and its cash flows for the three months ended March 31, 2008 and 2007. The results of operations for the three months ended March 31, 2008 and 2007 are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 accessible free of charge through the Company's internet site at www.nationalwesternlife.com or the Securities and Exchange Commission internet site at www.sec.gov.

The accompanying condensed consolidated financial statements include the accounts of National Western Life Insurance Company and its wholly-owned subsidiaries ("Company"), The Westcap Corporation, NWL Investments, Inc., NWL Services, Inc., NWL Financial, Inc., and Regent Care San Marcos Holdings, LLC. All significant intercorporate transactions and accounts have been eliminated in consolidation.

(2) CHANGES IN ACCOUNTING PRINCIPLES

In September 2005, the AICPA issued Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts ("SOP 05-1") which was effective for internal replacements occurring in fiscal years beginning after December 15, 2006. SOP 05-1 provides guidance on accounting by insurance enterprises for deferred acquisition costs on internal replacements of insurance and investment contracts other than those specifically described in FASB No. 97. SOP 05-1 defines an internal replacement as a modification in product benefits, features, rights, or coverages that occurs by the exchange of a contract for a new contract, or by amendment, endorsement, or rider to a contract, or by the election of a feature or coverage within a contract. The Company had an impact related to the adoption of SOP 05-1 for contracts which annuitized and for reinstatements of contracts. The unamortized deferred acquisition costs and deferred sales inducement assets have to be written-off at the time of annuitization and can not be continued related to reinstatements. SOP 05-1 resulted in changes in assumptions relative to estimated gross profits which affected unamortized deferred acquisition costs, unearned revenue liabilities, and deferred sales inducement balances as of the beginning of 2007. The effect of this SOP on beginning retained earnings as of January 1, 2007 was a decrease of \$2.2 million, net of tax, as detailed below.

	Amounts (In thousands)
Write-off of deferred acquisition cost	\$ 3,321
Adjustment to deferred annuity revenue	56
	3,377
Federal income tax	(1,182)

Cumulative effect of change in accounting for internal replacements and investment contracts	\$	2,195
--	----	-------

10

Table of Content

In September of 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. The Company adopted SFAS 157 effective January 1, 2008, and the adoption did not have an impact on the Company’s consolidated financial statements. See Note 9 for additional disclosures concerning fair value measurement.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which permits entities to choose to measure at fair value many financial instruments and certain other items that are not currently required to be measured at fair value. The Company adopted SFAS 159 effective January 1, 2008, which did not have an impact on the consolidated financial statements as no items were elected for measurement at fair value upon initial adoption.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements. SFAS 160 establishes accounting and reporting standards for entities that have equity investments that are not attributable directly to the parent, called noncontrolling interests or minority interests. Specifically, SFAS 160 states where and how to report noncontrolling interests in the consolidated statements of financial position and operations, how to account for changes in noncontrolling interests and provides disclosure requirements. The provisions of SFAS 160 are effective beginning January 1, 2009. The Company is currently evaluating the impact that the adoption of this statement will have on the consolidated financial position, results of operations and disclosures.

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations. SFAS 141(R) establishes how an entity accounts for the identifiable assets acquired, liabilities assumed, and any noncontrolling interests acquired, how to account for goodwill acquired and determines what disclosures are required as part of a business combination. SFAS 141(R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, early adoption is prohibited. The adoption of SFAS 141(R) is not expected to have a material impact on the Company’s consolidated financial statements.

In February 2008, the FASB issued FSP FAS 157-2, Effective Date of FASB Statement No. 157. This FSP delays the effective date of SFAS 157 for nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years and interim periods beginning after November 15, 2008.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133. This statement requires enhanced disclosures regarding an entity’s derivative and hedging activity to enable investors to better understand their effects on an entity’s financial position, financial performance, and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. The adoption of SFAS 161 is not expected to have a material impact on the Company’s consolidated financial statements.

(3) STOCKHOLDERS' EQUITY

The Company is restricted by state insurance laws as to dividend amounts which may be paid to stockholders without prior approval from the Colorado Division of Insurance. The Company paid no cash dividends on common stock during the three months ended March 31, 2008 and 2007.

Table of Content

(4) EARNINGS PER SHARE

Basic earnings per share of common stock are computed by dividing net income by the weighted-average basic common shares outstanding during the period. Diluted earnings per share assumes the issuance of common shares applicable to stock options in the denominator.

	Three Months Ended March 31,			
	Class A	Class B	Class A	Class B
	2008			
	2007			
	(In thousands except per share amounts)			
Numerator for Basic and Diluted Earnings Per Share:				
Net income	\$ 14,446		18,672	
Dividends – Class A shares	-		-	
Dividends – Class B shares	-		-	
Undistributed income	\$ 14,446		18,672	
Allocation of net income:				
Dividends	\$ -	-	-	-
Allocation of undistributed income	14,036	410	18,142	530
Net income	\$ 14,036	410	18,142	530
Denominator:				
Basic earnings per share - weighted-average shares	3,423	200	3,421	200
Effect of dilutive stock options	24	-	48	-
Diluted earnings per share - adjusted weighted-average shares for assumed conversions	3,447	200	3,469	200
Basic Earnings Per Share	\$ 4.10	2.05	5.30	2.65
Diluted Earnings Per Share	\$ 4.07	2.05	5.23	2.65

Table of Content

(5) PENSION AND OTHER POSTRETIREMENT PLANS

(A) Defined Benefit Pension Plans

The Company sponsors a qualified defined benefit pension plan covering substantially all employees. The plan provides benefits based on the participants' years of service and compensation. The Company makes annual contributions to the plan that comply with the minimum funding provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"). On October 19, 2007, the Company's Board of Directors approved an amendment to freeze the Pension Plan as of December 31, 2007. The freeze ceased future benefit accruals to all participants and closed the Plan to any new participants. In addition, all participants became immediately 100% vested in their accrued benefits as of that date. Using estimated assumptions, the cumulative estimated minimum required contribution for the next five years is \$2.1 million at which time the Plan is expected to be fully funded. Future pension expense is projected to be minimal. The following summarizes the components of net periodic benefit cost.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Service cost	\$ 180	173
Interest cost	272	255
Expected return on plan assets	(275)	(237)
Amortization of prior service cost	1	1
Amortization of net loss	80	88
Net periodic benefit cost	\$ 258	280

The Company expects to contribute \$1.1 million to the plan in 2008. As of March 31, 2008, the Company has not yet contributed to the plan.

The Company also sponsors a non-qualified defined benefit plan primarily for senior officers. The plan provides benefits based on the participants' years of service and compensation. The pension obligations and administrative responsibilities of the plan are maintained by a pension administration firm, which is a subsidiary of American National Insurance Company ("ANICO"). ANICO has guaranteed the payment of pension obligations under the plan. However, the Company has a contingent liability with respect to the pension plan should these entities be unable to meet their obligations under the existing agreements. Also, the Company has a contingent liability with respect to the plan in the event that a plan participant continues employment with the Company beyond age seventy, the aggregate average annual participant salary increases exceed 10% per year, or any additional employees become eligible to participate in the plan. If any of these conditions are met, the Company would be responsible for any additional pension obligations resulting from these items. Amendments were made to the plan to allow an additional employee to participate and to change the benefit formula for the Chairman of the Company. As previously mentioned, these additional obligations are a liability to the Company. Effective December 31, 2004, this plan was frozen with respect to the continued accrual of benefits of the Chairman and the President of the Company in order to comply with law changes under the American Jobs Creation Act of 2004 ("Act").

Effective July 1, 2005, the Company established a second non-qualified defined benefit plan for the benefit of the Chairman of the Company. This plan is intended to provide for post-2004 benefit accruals that mirror and supplement the pre-2005 benefit accruals under the previously discussed non-qualified plan, while complying with the requirements of the Act.

Effective November 1, 2005, the Company established a third non-qualified defined benefit plan for the benefit of the President of the Company. This plan is intended to provide for post-2004 benefit accruals that supplement the pre-2005 benefit accruals under the first non-qualified plan as previously discussed, while complying with the requirements of the Act.

Table of Content

The following summarizes the components of net periodic benefit costs for these non-qualified plans.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Service cost	\$ 193	407
Interest cost	241	177
Amortization of prior service cost	260	260
Amortization of net loss	101	46
Net periodic benefit cost	\$ 795	890

The Company expects to contribute \$1.7 million to these plans in 2008. As of March 31, 2008, the Company has not yet contributed to the plan.

(B) Defined Benefit Postretirement Plans

The Company sponsors two healthcare plans to provide postretirement benefits to certain fully-vested individuals. The following summarizes the components of net periodic benefit costs.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Interest cost	\$ 35	29
Amortization of net loss	7	-
Amortization of prior service cost	26	26
Net periodic benefit cost	\$ 68	55

As previously disclosed in its financial statements for the year ended December 31, 2007, the Company expects to contribute minimal amounts to the plan in 2008.

Table of Content

(6) SEGMENT AND OTHER OPERATING INFORMATION

Under Statement of Financial Accounting Standards ("SFAS") No. 131, Disclosures about Segments of an Enterprise and Related Information, the Company defines its reportable operating segments as domestic life insurance, international life insurance, and annuities. These segments are organized based on product types and geographic marketing areas. A summary of segment information for the quarters ended March 31, 2008 and 2007 is provided below.

Selected Segment Information:

	Domestic Life Insurance	International Life Insurance	Annuities (In thousands)	All Others	Total
March 31, 2008:					
Selected Balance Sheet Items:					
Deferred policy acquisition costs and sales inducements	\$ 61,709	206,193	500,152	-	768,054
Total segment assets	403,186	812,575	5,489,342	123,456	6,828,559
Future policy benefits	320,225	565,910	4,675,936	-	5,562,071
Other policyholder liabilities	11,502	18,608	100,575	-	130,685
Three Months Ended					
March 31, 2008:					
C o n d e n s e d I n c o m e					
Statements:					
Premiums and contract revenues	\$ 6,619	23,485	6,008	-	36,112
Net investment income	5,161	3,039	50,297	933	59,430
Other income	6	12	38	3,083	3,139
Total revenues	11,786	26,536	56,343	4,016	98,681
Policy benefits	4,205	5,313	937	-	10,455
Amortization of deferred acquisition costs	2,287	8,791	15,171	-	26,249
Universal life and investment annuity contract interest	2,355	2,694	21,568	-	26,617
Other operating expenses	2,974	3,872	3,806	2,778	13,430
Federal income taxes	(12)	1,994	5,052	421	7,455
Total expenses	11,809	22,664	46,534	3,199	84,206
Segment earnings (losses)	\$ (23)	3,872	9,809	817	14,475

Table of ContentSelected Segment
Information:

	Domestic Life Insurance	International Life Insurance	Annuities (In thousands)	All Others	Total
March 31, 2007:					
Selected Balance Sheet Items:					
Deferred policy acquisition					
costs and sales inducements	\$ 52,491	180,409	499,369	-	732,269
Total segment assets	388,103	723,250	5,487,541	103,794	6,702,688
Future policy benefits	316,880	509,015	4,713,294	-	5,539,189
Other policyholder liabilities	10,812	18,605	89,205	-	118,622

Three Months Ended

March 31, 2007:

C o n d e n s e d I n c o m e
Statements:

Premiums and contract

revenues	\$ 6,333	21,671	5,525	-	33,529
Net investment income	4,678	5,762	65,753	833	77,026
Other income	14	45	228	3,029	3,316
Total revenues	11,025	27,478	71,506	3,862	113,871
Policy benefits	6,141	3,677	1,156	-	10,974
Amortization of deferred acquisition costs	1,864	8,163	13,758	-	23,785
Universal life and investment annuity contract interest	2,320	5,252	29,861	-	37,433
Other operating expenses	2,712	4,310	4,481	2,613	14,116
Federal income taxes	(660)	1,995	7,303	410	9,048
Total expenses	12,377	23,397	56,559	3,023	95,356
Segment earnings (losses)	\$ (1,352)	4,081	14,947	839	18,515

Reconciliations of segment information to the Company's condensed consolidated financial statements are provided below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Premiums and Other Revenue:		
Premiums and contract revenues	\$ 36,112	33,529
Net investment income	59,430	77,026
Other income	3,139	3,316

Realized gains (losses) on investments	(44)	241
Total consolidated premiums and other revenue	\$ 98,637	114,112

Table of Content

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Federal Income Taxes:		
Total segment Federal income taxes	\$ 7,455	9,048
Taxes on realized gains (losses) on investments	(15)	84
Total consolidated Federal income taxes	\$ 7,440	9,132

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Net Earnings:		
Total segment earnings	\$ 14,475	18,515
Realized gains (losses) on investments, net of taxes	(29)	157
Total consolidated net earnings	\$ 14,446	18,672

	March 31,	
	2008	2007
	(In thousands)	
Assets:		
Total segment assets	\$ 6,828,559	6,702,688
Other unallocated assets	32,515	24,790
Total consolidated assets	\$ 6,861,074	6,727,478

(7) SHARE-BASED PAYMENTS

The Company has a stock and incentive plan ("Plan") which provides for the grant of any or all of the following types of awards to eligible employees: (1) stock options, including incentive stock options and nonqualified stock options; (2) stock appreciation rights, in tandem with stock options or freestanding; (3) restricted stock; (4) incentive awards; and (5) performance awards. The Plan began on April 21, 1995, and was to terminate on April 20, 2005, unless terminated earlier by the Board of Directors. The Plan was amended on June 25, 2004 to extend the termination date to April 20, 2010. The number of shares of Class A, \$1.00 par value, common stock which may be issued under the Plan, or as to which stock appreciation rights or other awards may be granted, may not exceed 300,000. These shares may be authorized and unissued shares. The Company has only issued nonqualified stock options.

All of the employees of the Company and its subsidiaries are eligible to participate in the Plan. In addition, directors of the Company, other than Compensation and Stock Option Committee members, are eligible for restricted stock awards, incentive awards, and performance awards. Company directors, including members of the Compensation and Stock Option Committee, are eligible for nondiscretionary stock options. The directors' stock options vest 20% annually following one full year of service to the Company from the date of grant. The officers' stock options vest 20% annually following three full years of service to the Company from the date of grant. Options issued expire after

ten years. No awards were issued in the first quarter of 2008 or during the year 2007.

17

Table of Content

The Company adopted and implemented a limited stock buy-back program which provides option holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. Option holders may elect to sell such acquired shares back to the Company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election. The buy-back program did not alter the terms and conditions of the Plan, however the program necessitated a change in accounting from the equity classification to the liability classification. Accordingly, the Company is using the current fair value method to measure compensation cost. A summary of shares available for grant and stock option activity is detailed below.

	Shares Available For Grant	Options Outstanding Shares	Weighted-Average Exercise Price
Balance at January 1, 2008	27,668	94,984	\$ 128.47
Stock Options:			
Exercised	-	(15,580)	99.43
Forfeited	-	-	-
Expired	-	-	-
Balance at March 31, 2008	27,668	79,404	\$ 134.16

The total intrinsic value of options exercised was \$1.6 million and \$2.4 million for the three months ended March 31, 2008 and 2007, respectively. The total share-based liabilities paid were \$1.3 million for the three months ended March 31, 2008. There were no shares vested during the first quarter of 2008.

The following table summarizes information about stock options outstanding at March 31, 2008.

Exercise prices:	Options Outstanding Number Outstanding	Options Outstanding Weighted-Average Remaining Contractual Life	Options Exercisable
\$ 112.38	3,800	0.2 years	3,800
92.13	12,604	3.1 years	5,736
95.00	7,000	3.2 years	7,000
150.00	56,000	6.0 years	12,600
Totals	79,404		29,136
Aggregate intrinsic value (in thousands)	\$ 6,561		\$ 2,806

The aggregate intrinsic value in the table above is based on the closing stock price of \$216.79 per share on March 31, 2008.

Table of Content

In estimating the fair value of the options outstanding at March 31, 2008 and 2007, the Company employed the Black-Scholes option pricing model with assumptions as detailed below.

	2008	2007
Expected term of options	1 to 5 years	2 to 6 years
Expected volatility:		
Range	21.59% to 30.17%	15.63% to 23.72%
Weighted-average	24.07%	19.36%
Expected dividends	\$0.36	-
Risk-free rate:		
Range	1.61% to 3.06%	4.57% to 4.95%
Weighted-average	2.31%	4.67%

The Company reviewed the contractual term relative to the options as well as perceived future behavior patterns of exercise. Volatility is based on historical volatility over the expected term.

The pre-tax compensation cost recognized in the financial statements related to the Plan was \$(58,000) and \$1.3 million for the three months ended March 31, 2008 and 2007, respectively. The related tax (benefit) expense recognized was \$(20,000) and \$0.4 million for the three months ended March 31, 2008 and 2007, respectively.

As of March 31, 2008, the total compensation cost related to nonvested options not yet recognized was \$0.9 million. This amount is expected to be recognized over a weighted-average period of 1.4 years. The Company recognizes compensation cost over the graded vesting periods.

For the three months ended March 31, 2008 and 2007, the total cash received from the exercise of options under the Plan was \$0.3 million and \$0.1 million, respectively.

(8) LEGAL PROCEEDINGS

The Company is a defendant in three class action lawsuits. The Court has certified a class consisting of certain California policyholders age 65 and older alleging violations under California Business and Professions Code section 17200. The Court has additionally certified a subclass of 36 policyholders alleging fraud against their agent, and vicariously, against National Western Life. Management believes that the Company has good and meritorious defenses and intends to continue to vigorously defend itself against these claims. A second class action lawsuit is in discovery with no class certification motion pending. The third class action lawsuit was certified as a class by the trial court, but ultimately reversed by the Texas Supreme Court. Thereupon the plaintiff filed a new motion for class certification which was denied by the trial court. The Plaintiff filed a notice of appeal, which has not been perfected.

The Company is involved or may become involved in various other legal actions, in the normal course of business, in which claims for alleged economic and punitive damages have been or may be asserted, some for substantial amounts. Although there can be no assurances, at the present time, the Company does not anticipate that the ultimate liability arising from potential, pending, or threatened legal actions, will have a material adverse effect on the financial condition or operating results of the Company.

Table of Content

(9) FAIR VALUE MEASUREMENTS

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price methodology). SFAS 157 establishes a framework for measuring fair value that includes a hierarchy used to classify inputs used in measuring fair value. The hierarchy prioritizes inputs to valuation techniques used to measure fair value into three levels which are either observable or unobservable. Observable inputs reflect market data obtained from independent sources while unobservable inputs reflect an entity's view of market assumptions in the absence of observable market information. The level in the fair value hierarchy within which the fair value measurement falls is determined based on the lowest level input that is significant to the fair value measurement. The three levels of the fair value hierarchy defined by SFAS 157 are as follows:

Level 1: Fair value is based on unadjusted quoted prices in active markets that are accessible to the Company for identical assets or liabilities. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. These generally provide the most reliable evidence and are used to measure fair value whenever available. The Company's Level 1 assets include equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets.

Level 2: Fair value is based upon significant inputs other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable for substantially the full term of the asset or liability through corroboration with observable market data as of the reporting date. Level 2 inputs include quoted market prices in active markets for similar assets and liabilities, quoted market prices in markets that are not active for identical or similar assets or liabilities, model-derived valuations whose inputs are observable or whose significant value drivers are observable and other observable inputs. The Company's Level 2 assets include fixed maturity debt securities (corporate and private bonds, government or agency securities, asset-backed and mortgage-backed securities), preferred stock, certain equity securities, and over-the-counter derivative contracts. The Company's Level 2 liabilities consist of certain product-related embedded derivatives. Valuations are generally obtained from third party pricing services for identical or comparable assets or determined through use of valuation methodologies using observable market inputs.

Level 3: Fair value is based on significant unobservable inputs which reflect the entity's or third party pricing service assumptions about the assumptions market participants would use in pricing an asset or liability. The Company's Level 3 assets include certain equity securities and certain less liquid or private fixed maturity debt securities where significant valuation inputs cannot be corroborated with market observable data. The Company's Level 3 liabilities consist of share-based compensation obligations. Valuations are estimated based on non-binding broker prices or internally developed valuation models or methodologies, discounted cash flow models and other similar techniques.

The following table sets forth the Company's assets and liabilities that are measured at fair value on a recurring basis as of the date indicated:

Description	Total	March 31, 2008		
		Level 1	Level 2	Level 3
(In thousands)				
Debt securities, available for sale	\$ 1,892,223	-	1,890,607	1,616
Equity securities, available for sale	19,360	267	11,903	7,190
Derivatives	8,069	-	8,069	-

Edgar Filing: NATIONAL WESTERN LIFE INSURANCE CO - Form 10-Q

Total assets	\$	1,919,652	267	1,910,579	8,806
Policyholder account balances (a)	\$	18,867	-	18,867	-
Other liabilities (b)		6,387	-	-	6,387
Total liabilities	\$	25,254	-	18,867	6,387

(a) Represents the fair value of certain product-related embedded derivatives that were recorded at fair value.

(b) Represents the liability for share-based compensation.

Table of Content

The following table provides additional information about fair value measurements for which significant unobservable (Level 3) inputs were utilized to determine fair value.

	Debt Securities, Available For Sale	Equity Securities, Available For Sale	Total Assets	Other Liabilities
	(In thousands)			
Beginning balance, January 1, 2008	\$ 1,618	7,147	8,765	7,712
Total realized and unrealized gains (losses):				
Included in net income	-	-	-	(58)
Included in other comprehensive income (loss)	-	43	43	-
Purchases, sales, issuances and settlements, net	(2)	-	(2)	(1,267)
Transfers into (out of) Level 3	-	-	-	-
Ending balance, March 31, 2008	\$ 1,616	7,190	8,806	6,387
Amount of total gains (losses) for the period included in net income attributable to the change in unrealized gains (losses) relating to assets still held as of March 31, 2008	\$ -	-	-	(58)

Realized gains (losses) on Level 3 assets and liabilities are reported in the consolidated statements of earnings as net investment gains (losses) while unrealized gain (losses) are reported as other comprehensive income (loss) within stockholders' equity.

The fair value hierarchy classifications are reviewed each reporting period. Reclassification of certain financial assets and liabilities may result based on changes in the observability of valuation attributes. Reclassifications are reported as transfers into and out of Level 3 at the beginning fair value for the reporting period in which the changes occur.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Certain information contained herein or in other written or oral statements made by or on behalf of National Western Life Insurance Company or its subsidiaries are or may be viewed as forward-looking. Although the Company has taken appropriate care in developing any such information, forward-looking information involves risks and uncertainties that could significantly impact actual results. These risks and uncertainties include, but are not limited to, matters described in the Company's SEC filings such as exposure to market risks, anticipated cash flows or operating performance, future capital needs, and statutory or regulatory related issues. However, National Western, as a matter of policy, does not make any specific projections as to future earnings, nor does it endorse any projections regarding future performance that may be made by others. Whether or not actual results differ materially from forward-looking

statements may depend on numerous foreseeable and unforeseeable events or developments. Also, the Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments, or otherwise.

Table of Content

OVERVIEW

Insurance Operations - Domestic

The Company is currently licensed to do business in all states except for New York. Products marketed are annuities, universal life insurance, fixed indexed annuities and fixed indexed universal life, and traditional life insurance, which include both term and whole life products. The Company's domestic sales have historically been more heavily weighted toward annuity products, which include single and flexible premium deferred annuities, single premium immediate annuities, and fixed indexed annuities. Most of these annuities can be sold as tax qualified or nonqualified products. At March 31, 2008, the Company maintained approximately 119,100 annuity policies in force.

National Western markets and distributes its domestic products primarily through independent national marketing organizations ("NMOs"). These NMOs assist the Company in recruiting, contracting, and managing independent agents. The Company currently has approximately 5,450 independent agents contracted. Roughly 27% of these contracted agents have submitted policy applications to the Company in the past twelve months.

Insurance Operations - International

The Company's international operations focus on foreign nationals in upper socioeconomic classes. Insurance products are issued primarily to residents of countries in Central and South America, the Caribbean, Eastern Europe, Asia and the Pacific Rim. Issuing policies to residents of countries in these different regions provides diversification that helps to minimize large fluctuations that could arise due to various economic, political, and competitive pressures that may occur from one country to another. Products issued to international residents are almost entirely universal life and traditional life insurance products. However, certain annuity and investment contracts are also available. At March 31, 2008, the Company had approximately 73,400 international life insurance policies in force representing approximately \$15.0 billion in face amount of coverage.

International applications are submitted by independent contractor consultants and broker-agents. The Company has approximately 5,460 independent international consultants and brokers currently contracted, 42% of which have submitted policy applications to the Company in the past twelve months.

There are some inherent risks of accepting international applications which are not present within the domestic market that are reduced substantially by the Company in several ways. As previously described, the Company accepts applications from foreign nationals in upper socioeconomic classes who have substantial financial resources. This targeted customer base coupled with the Company's conservative underwriting practices have historically resulted in claims experience, due to natural causes, similar to that in the United States. The Company minimizes exposure to foreign currency risks by requiring payment of premiums, claims and other benefits almost entirely in United States dollars. The Company's over forty years of experience with the international products and its longstanding independent consultant and broker-agents relationships further serve to minimize risks.

Table of Content

SALES

Life Insurance

The following table sets forth information regarding the Company's life insurance sales activity as measured by annualized first year premiums. While the figures shown below are in accordance with industry practice and represent the amount of new business sold during the periods indicated, they are considered a non-GAAP financial measure. The Company believes sales are a measure of distribution productivity and are a leading indicator of future revenue trends. However, revenues are driven by sales in prior periods as well as in the current period and therefore, a reconciliation of sales to revenues is not meaningful or determinable.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
International:		
Universal life	\$ 3,230	1,644
Traditional life	1,354	1,727
Fixed-indexed life	4,107	4,727
	8,691	8,098
Domestic:		
Universal life	899	373
Traditional life	38	75
Fixed-indexed life	2,332	1,422
	3,269	1,870
Totals	\$ 11,960	9,968

Life insurance sales as measured by annualized first year premiums increased 20% in the first quarter of 2008 as compared to the first quarter of 2007. Both of the Company's life insurance lines of business, international and domestic, posted increases over the comparable results in the first quarter of 2007 with domestic sales up 75% and international sales 7% greater.

Over the past three or four years management has placed considerable emphasis on building domestic life insurance sales as a strategic focus for future growth. This focus was also in response to comments from outside rating agencies who expressed a preference for a greater proportion of overall Company earnings to derive from the life insurance line of business. Domestic operations have generally focused more heavily on annuity sales than on life insurance sales. The Company spent the greater part of 2003 and 2004 revamping its domestic life operations by changing the way it contracts distribution for life business, eliminating products and distribution that have not contributed significantly to earnings, and creating new and competitive products. A single premium universal life ("SPUL") product was launched at the end of 2003 beginning a diversification of the Company's product portfolio away from smaller dollar face amount policies. The Company released its first fixed equity-indexed universal life ("EIUL") product for its domestic markets at the end of the third quarter of 2005. This product accounted for 71% of domestic life insurance sales in the first three months of 2008. With the introduction of the EIUL and SPUL products and the discontinued marketing of smaller premium and volume life insurance policies, the Company has attracted new independent distributors with access to customers purchasing larger face amounts of insurance per policy. As a result, the Company has witnessed an increase in the average amount of per policy coverage purchased in its domestic markets as shown in the following table:

	Average New Policy Face Amount	
	Domestic	International
Year ended December 31, 2003	\$ 76,100	219,600
Year ended December 31, 2004	101,700	234,500
Year ended December 31, 2005	137,900	245,900
Year ended December 31, 2006	315,800	254,700
Year ended December 31, 2007	416,800	251,000
Three months ended March 31, 2008	505,400	250,600

Table of Content

The Company's international life business consists of applications submitted from residents in various regions outside of the United States, the volume of which typically varies based upon changes in the socioeconomic climates of these regions. Historically, the Company has experienced a simultaneous combination of rising and declining sales in various countries; however, the appeal of the Company's dollar-denominated life insurance products overcomes many of the local and national difficulties. Applications submitted from residents of Latin America and the Pacific Rim perennially have comprised the majority of the Company's international life insurance sales. Over the past few years, effort has been directed toward the sale of a traditional endowment form of life insurance product for residents of Eastern European and the Commonwealth of Independent States (former Soviet Union). More recently, the Company's universal life product offerings have been made available to residents of these countries.

	Three Months Ended March 31,	
	2008	2007
Percentage of International Sales:		
Latin America	60.1%	60.6%
Pacific Rim	25.3	18.6
Eastern Europe	14.6	20.8
Totals	100.0%	100.0%

Year-to-date, the Company has recorded sales to residents outside of the United States in over thirty different countries with Brazil (26%), Taiwan (25%), and Kazakhstan (8%) making up the largest markets.

The table below sets forth information regarding the Company's life insurance in force for each date presented.

	Insurance In Force as of March	
	31,	
	2008	2007
	(\$ in thousands)	
Universal life:		
Number of policies	73,140	75,550
Face amounts	\$ 8,157,590	8,007,830
Traditional life:		
Number of policies	51,230	52,880
Face amounts	\$ 1,856,520	1,756,000
Fixed-indexed life:		
Number of policies	25,520	20,630
Face amounts	\$ 5,828,780	4,519,930
Rider face amounts	\$ 2,088,800	1,817,290
Total life insurance:		
Number of policies	149,890	149,060
Face amounts	\$ 17,931,690	16,101,050

Table of Content

Annuities

The following table sets forth information regarding the Company's annuity sales activity as measured by single and annualized first year premiums. Similar to life insurance sales, these figures are considered a non-GAAP financial measure but are shown in accordance with industry practice and depict the Company's sales productivity.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Fixed-indexed annuities	\$ 73,008	68,684
Other deferred annuities	25,822	27,657
Immediate annuities	1,728	1,722
Total	\$ 100,558	98,063

Annuity sales for the first quarter of 2008 were 3% higher than the comparable period in 2007 reversing a declining trend of the past several years. Since 2003 when the Company achieved nearly \$1.2 billion in sales, annuity sales have trended lower due to a combination of declining interest rates, investors returning to alternative investment vehicles and the Company managing its targeted levels of risk and statutory capital and surplus. During the past several years the interest rate yield curve has either been inverted (shorter term rates higher than longer term rates) or relatively flat. In such an interest rate environment, consumers tend toward short term investment vehicles such as bank certificates of deposits rather than longer term choices which include fixed rate annuities.

The Company's mix of annuity sales has shifted the past few years. With a stronger performance in the equity market, sales of fixed indexed annuity products have been more prevalent since 2004. Over the past several years, sales of fixed indexed products have consistently accounted for more than one-half of all annuity sales and were 73% during the first three months of 2008. For all fixed indexed products, the Company purchases over the counter options to hedge the equity return feature. The options are purchased relative to the issuance of the annuity contracts in such a manner to minimize timing risk. Generally, the index return during the indexing period (if the underlying index increases), becomes a component in a formula (set forth in the annuity), the result of which is credited as interest to contract holders electing the index formula crediting method at the beginning of the indexing period. The formula result can never be less than zero with these products. The Company does not deliberately mismatch or under hedge for the equity feature of the products.

The level of annuity sales volume the past several years has required a greater level of asset/liability analysis. The Company monitors its asset/liability matching within the self-constraints of desired capital levels and risk tolerance. Despite the amounts of new business, the company's capital level remains substantially above industry averages and regulator targets.

Table of Content

The following table sets forth information regarding annuities in force for each date presented.

	Annuities In Force as of March 31,	
	2008	2007
	(\$ in thousands)	
Fixed-indexed annuities		
Number of policies	32,380	31,000
GAAP annuity reserves	\$ 1,959,740	1,834,094
Other deferred annuities		
Number of policies	73,230	79,020
GAAP annuity reserves	\$ 2,451,216	2,627,803
Immediate annuities		
Number of policies	13,510	12,990
GAAP annuity reserves	\$ 262,237	248,420
Total annuities		
Number of policies	119,120	123,010
GAAP annuity reserves	\$ 4,673,193	4,710,317

Critical Accounting Estimates

Accounting policies discussed below are those considered critical to an understanding of the Company's financial statements.

Impairment of Investment Securities. The Company's accounting policy requires that a decline in the value of a security below its amortized cost basis be evaluated to determine if the decline is other-than-temporary. The primary factors considered in evaluating whether a decline in value for fixed income and equity securities is other-than-temporary include: (a) the length of time and the extent to which the fair value has been less than cost, (b) the financial conditions and near-term prospects of the issuer, (c) whether the debtor is current on contractually obligated principal and interest payments, and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for any anticipated recovery. In addition, certain securitized financial assets with contractual cash flows are evaluated periodically by the Company to update the estimated cash flows over the life of the security. If the Company determines that the fair value of the securitized financial asset is less than its carrying amount and there has been a decrease in the present value of the estimated cash flows since the previous estimate, then an other-than-temporary impairment charge is recognized. When a security is deemed to be impaired a charge is recorded as net realized losses equal to the difference between the fair value and amortized cost basis of the security. Once an impairment charge has been recorded, the fair value of the impaired investment becomes its new cost basis and the Company continues to review the other-than-temporarily impaired security for appropriate valuation on an ongoing basis. Under U.S. generally accepted accounting principles, the Company is not permitted to increase the basis of impaired securities for subsequent recoveries in value.

Deferred Acquisition Costs ("DAC"). The Company is required to defer certain policy acquisition costs and amortize them over future periods. These costs include commissions and certain other expenses that vary with and are primarily associated with acquiring new business. The deferred costs are recorded as an asset commonly referred to as deferred policy acquisition costs. The DAC asset balance is subsequently charged to income over the lives of the

underlying contracts in relation to the anticipated emergence of revenue or profits. Actual revenue or profits can vary from Company estimates resulting in increases or decreases in the rate of amortization. The Company regularly evaluates to determine if actual experience or other evidence suggests that earlier estimates should be revised. Assumptions considered significant include surrender and lapse rates, mortality, expense levels, investment performance, and estimated interest spread. Should actual experience dictate that the Company change its assumptions regarding the emergence of future revenues or profits (commonly referred to as “unlocking”), the Company would record a charge or credit to bring its DAC balance to the level it would have been if using the new assumptions from the inception date of each policy.

Table of Content

DAC is also subject to periodic recoverability and loss recognition testing. These tests ensure that the present value of future contract-related cash flows will support the capitalized DAC balance to be amortized in the future. The present value of these cash flows, less the benefit reserve, is compared with the unamortized DAC balance and if the DAC balance is greater, the deficiency is charged to expense as a component of amortization and the asset balance is reduced to the recoverable amount.

Deferred Sales Inducements. Costs related to sales inducements offered on sales to new customers, principally on investment type contracts and primarily in the form of additional credits to the customer's account value or enhancements to interest credited for a specified period, which are beyond amounts currently being credited to existing contracts, are deferred and recorded as other assets. All other sales inducements are expensed as incurred and included in interest credited to contract holders' funds. Deferred sales inducements are amortized to income using the same methodology and assumptions as DAC, and are included in interest credited to contract holders' funds. Deferred sales inducements are periodically reviewed for recoverability. See the discussion of the adoption of Statement of Position ("SOP") 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts on page 10 of this report.

Future Policy Benefits. Because of the long-term nature of insurance contracts, the Company is liable for policy benefit payments many years into the future. The liability for future policy benefits represents estimates of the present value of the Company's expected benefit payments, net of the related present value of future net premium collections. For traditional life insurance contracts, this is determined by standard actuarial procedures, using assumptions as to mortality (life expectancy), morbidity (health expectancy), persistency, and interest rates, which are based on the Company's experience with similar products. The assumptions used are those considered to be appropriate at the time the policies are issued. An additional provision is made on most products to allow for possible adverse deviation from the assumptions assumed. For universal life and annuity products, the Company's liability is the amount of the contract's account balance. Account balances are also subject to minimum liability calculations as a result of minimum guaranteed interest rates in the policies. While management and Company actuaries have used their best judgment in determining the assumptions and in calculating the liability for future policy benefits, there is no assurance that the estimate of the liabilities reflected in the financial statements represents the Company's ultimate obligation. In addition, significantly different assumptions could result in materially different reported amounts.

Revenue Recognition. Premium income for the Company's traditional life insurance contracts is generally recognized as the premium becomes due from policyholders. For annuity and universal life contracts, the amounts collected from policyholders are considered deposits and are not included in revenue. For these contracts, fee income consists of policy charges for policy administration, cost of insurance charges and surrender charges assessed against policyholders' account balances which are recognized in the period the services are provided.

Investment activities of the Company are integral to its insurance operations. Since life insurance benefits may not be paid until many years into the future, the accumulation of cash flows from premium receipts are invested with income reported as revenue when earned. Anticipated yields on investments are reflected in premium rates, contract liabilities, and other product contract features. These anticipated yields are implied in the interest required on the Company's net insurance liabilities (future policy benefits less deferred acquisition costs) and contractual interest obligations in its insurance and annuity products. The Company benefits to the extent actual net investment income exceeds the required interest on net insurance liabilities and manages the rates it credits on its products to maintain the targeted excess or "spread" of investment earnings over interest credited. The Company will continue to be required to provide for future contractual obligations in the event of a decline in investment yield. For more information concerning revenue recognition, investment accounting, and interest sensitivity, please refer to Note 1, Summary of Significant Accounting Policies, and Note 3, Investments, in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007, and the discussions under Investments in Item 2 of this report.

Pension Plans and Other Postretirement Benefits. The Company sponsors a qualified defined benefit pension plan, which was frozen effective December 31, 2007, covering substantially all employees and three nonqualified defined benefit plans covering certain senior officers. In addition, the Company also has postretirement health care benefits for certain senior officers. In accordance with prescribed accounting standards, the Company annually reviews plan assumptions.

Table of Content

The Company annually reviews its pension benefit plan assumptions which include the discount rate, the expected long-term rate of return on plan assets, and the compensation increase rate. The assumed discount rate is set based on the rates of return on high quality long-term fixed income investments currently available and expected to be available during the period to maturity of the pension benefits. The assumed long-term rate of return on plan assets is generally set at the rate expected to be earned based on long-term investment policy of the plans and the various classes of the invested funds, based on the input of the plan's investment advisors and consulting actuary and the plan's historic rate of return. The compensation rate increase assumption is generally set at a rate consistent with current and expected long-term compensation and salary policy, including inflation. The freeze ceased future benefit accruals to all participants and closed the Plan to any new participants. In addition, all participants immediately 100% vested in their accrued benefits as of that date.

Other postretirement benefit assumptions include future events affecting retirement age, mortality, dependency status, per capita claims costs by age, health care trend rates, and discount rates. Per capita claims cost by age is the current cost of providing postretirement health care benefits for one year at each age from the youngest age to the oldest age at which plan participants are expected to receive benefits under the plan. Health care trend rates involve assumptions about the annual rate(s) of change in the cost of health care benefits currently provided by the plan, due to factors other than changes in the composition of the plan population by age and dependency status. These rates implicitly consider estimates of health care inflation, changes in utilization, technological advances and changes in health status of the participants. These assumptions involve uncertainties and judgment, and therefore actual performance may not be reflective of the assumptions.

Share-Based Payments. Liability awards under a share-based payment arrangement have been measured based on the award's fair value at the reporting date. The Black-Scholes valuation method has been used to estimate the fair value of the options. This fair value calculation of the options include assumptions relative to the following:

- exercise price
- expected term based on contractual term and perceived future behavior relative to exercise
- current price
- expected volatility
- risk-free interest rates
- expected dividends

These assumptions are continually reviewed by the Company and adjustments may be made based upon current facts and circumstances.

Other significant accounting policies, although not involving the same level of measurement uncertainties as those discussed above but nonetheless important to an understanding of the financial statements, are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

RESULTS OF OPERATIONS

The Company's consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). In addition, the Company regularly evaluates operating performance using non-GAAP financial measures which exclude or segregate derivatives and realized investment gains and losses from operating revenues and earnings. Similar measures are commonly used in the insurance industry in order to assess profitability and results from ongoing operations. The Company believes that the presentation of these non-GAAP financial measures enhances the understanding of the Company's results of operations by highlighting the results from ongoing operations and the underlying profitability factors of the Company's business. The Company excludes or segregates derivatives and realized investment gains and losses because such items are often the result of events which may or may not be at

the Company's discretion and the fluctuating effects of these items could distort trends in the underlying profitability of the Company's business. Therefore, in the following sections discussing consolidated operations and segment operations, appropriate reconciliations have been included to report information management considers useful in enhancing an understanding of the Company's operations to reportable GAAP balances reflected in the consolidated financial statements.

Table of Content

Consolidated Operations

Revenues. The following details Company revenues.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Traditional life and annuity premiums	\$ 3,894	4,733
Universal life and annuity contract revenues	32,218	28,796
Net investment income (excluding derivatives)	83,987	81,621
Other income	3,139	3,316
Operating revenues	123,238	118,466
Derivative loss	(24,557)	(4,595)
Realized gains (losses) on investments	(44)	241
Total revenues	\$ 98,637	114,112

Traditional life and annuity premiums - Traditional life and annuity premiums decreased 17.7% in the first three months of 2008 compared to the same period in 2007. Traditional life insurance premiums for products such as whole life and term life are recognized as revenues over the premium-paying period. These are products that the Company has de-emphasized in favor of universal life products, particularly equity-indexed universal life products.

Universal life and annuity contract revenues - Revenues for universal life and annuity contract revenues increased 11.9% for the three months in 2008 compared to 2007 and consist of policy charges for the cost of insurance, administration charges, and surrender charges assessed against policyholder account balances. Revenues in the form of cost of insurance charges were \$20.0 million in the first quarter of 2008 compared to \$17.9 million for the quarter ended March 31, 2007, reflecting the growing block of life insurance in force. Surrender charges assessed against policyholder account balances upon withdrawal increased to \$9.0 million in the first quarter of 2008 versus \$7.6 million in 2007 indicative of a slightly higher incidence of policy withdrawals and terminations.

Net investment income - A detail of net investment income is provided below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Gross investment income:		
Debt securities	\$ 78,693	76,316
Mortgage loans	1,959	2,208
Policy loans	1,520	1,645
Short-term investments	1,163	1,886
Other invested assets	1,308	235
Total investment income	84,643	82,290
Investment expenses	656	669
Net investment income		

Edgar Filing: NATIONAL WESTERN LIFE INSURANCE CO - Form 10-Q

(excluding derivatives)	83,987	81,621
Derivative loss	(24,557)	(4,595)
Net investment income	\$ 59,430	77,026

29

Table of Content

Short term investment income declined \$0.7 million in the first quarter of 2008 from the prior year first quarter as the Company reduced its short-term holdings in response to a reshaping of the yield curve. During the early part of 2007, the shape of the yield curve was inverted or flat offering value at the short end of the maturity range. With the decline in short-term rates as a result of Federal Reserve Board reductions, the yield curve steepened eliminating some of the value of the shorter maturities. Income from other invested assets for the three months ended March 31, 2008 includes a settlement payment of \$0.9 million from a previously impaired and sold security. Derivative income and losses are recorded as a component of investment income but may fluctuate substantially from period to period based on the performance of the S&P 500® Composite Stock Price Index ("S&P 500 Index®"). See the discussion that follows this section relating to index options and derivatives.

To ensure the Company will be able to pay future commitments to policyholders and provide a financial return, the funds received as premium payments and deposits are invested in high quality investments, primarily fixed maturity debt securities. The income from these investments is closely monitored by the Company due to its significant impact on the business.

Net investment income performance is summarized as follows:

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Excluding derivatives:		
Net investment income	\$ 83,987	81,621
Average invested assets, at amortized cost	\$ 5,820,135	5,673,090
Annual yield on average invested assets	5.77%	5.75%
Including derivatives:		
Net investment income	\$ 59,430	77,026
Average invested assets, at amortized cost	\$ 5,886,236	5,750,193
Annual yield on average invested assets	4.04%	5.36%

The yield on average invested assets increased from 5.75% in 2007 to 5.77% in 2008, excluding derivatives. The higher yield in 2008 compared to 2007 is due to the additional income recognized from the other invested assets as well as a modest shift in the portfolio from short-term investment holdings to long-term debt securities. Although long-term interest rate levels were lower in the first quarter of 2008 compared to the first quarter of 2007, the increase in corporate spreads over treasury rates substantially offset the lower interest rate level such that long-term investment yields remained largely the same. Net investment income performance is analyzed excluding the derivative income which is a common practice in the insurance industry in order to assess underlying profitability and results from ongoing operations.

Other income - Other income primarily pertains to the Company's operations involving a nursing home in Reno, Nevada. Revenues associated with this operation were \$3.1 million and \$3.0 million for the three months ended March 31, 2008 and 2007, respectively.

Derivative income (loss) - Index options are derivative financial instruments used to hedge the equity return component of the Company's fixed-indexed products. Index options are intended to act as hedges to match closely the returns on the S&P 500 Index®. With an increase or decline in this index, the index option values likewise increase or decline. Any income or loss from the sale or expiration of the options, as well as period-to-period changes in fair values, are reflected as a component of net investment income. However, increases or decreases in income from these

options are substantially offset by corresponding increases or decreases in amounts credited to fixed-indexed annuity and life policyholders.

Table of Content

Derivative components included in net investment income and the corresponding contract interest amounts are detailed below for each date presented.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Derivatives:		
Unrealized loss	\$ (20,480)	(8,590)
Realized income (loss)	(4,077)	3,995
Total loss included in net investment income	\$ (24,557)	(4,595)
Total contract interest	\$ 26,617	37,433

Benefits and Expenses. The following details benefits and expenses.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Life and other policy benefits	\$ 10,455	10,974
Amortization of deferred acquisition costs	26,249	23,785
Universal life and annuity contract interest	26,617	37,433
Other operating expenses	13,430	14,116
Totals	\$ 76,751	86,308

Life and other policy benefits - Death claim benefits increased from \$7.7 million during the first quarter of 2007 to \$8.0 million for the quarter ended March 31, 2008. While death claim amounts are subject to variation from period to period, the Company's mortality experience has generally been consistent with or better than its product pricing assumptions.

Amortization of deferred acquisition costs - Life insurance companies are required to defer certain expenses associated with acquiring new business. The majority of these acquisition expenses consist of commissions paid to agents, underwriting costs, and certain marketing expenses and sales inducements. The Company defers sales inducements in the form of first year interest bonuses on annuity and universal life products that are directly related to the production of new business. These charges are deferred and amortized using the same methodology and assumptions used to amortize other capitalized acquisition costs and the amortization is included in contract interest. Recognition of these deferred policy acquisition costs in the financial statements occurs over future periods in relation to the emergence of profits priced into the products sold. This emergence of profits is based upon assumptions regarding premium payment patterns, mortality, persistency, investment performance, and expense patterns. Companies are required to review these assumptions periodically to ascertain whether actual experience has deviated significantly from that assumed. If it is determined that a significant deviation has occurred, the emergence of profits pattern is to be "unlocked" and reset based upon the actual experience. While the Company is required to evaluate its emergence of profits continually, management believes that the current amortization patterns of deferred policy acquisition costs are reflective of actual experience.

Amortization of deferred policy acquisition costs increased \$2.5 million in the first quarter of 2008 compared to 2007. The increase was largely due to additional amortization in the current quarter due to compression on the Company's investment spreads given a sustained lower interest rate environment relative to the Company's minimum interest rate guarantees in its products. In addition, the introduction of SOP 05-1 in 2007 requires that unamortized deferred acquisition costs, unearned revenue liabilities and deferred sales inducement assets related to annuitizations and certain internal replacements of contracts be written off. This activity was higher in the first quarter of 2008 relative to the first quarter of 2007.

Table of Content

Universal life and annuity contract interest - The Company closely monitors its credited interest rates on interest sensitive policies, taking into consideration such factors as profitability goals, policyholder benefits, product marketability, and economic market conditions. As long term interest rates change, the Company's credited interest rates are often adjusted accordingly, taking into consideration the factors as described above. The difference between yields earned over policy credited rates is often referred to as the "interest spread". As noted above, the Company is experiencing a compression on its investment spreads currently.

The Company's approximated average credited rates are as follows:

	March 31,		March 31,	
	2008	2007	2008	2007
	(Excluding derivative products)		(Including derivative products)	
Annuity	2.79%	3.30%	1.84%	2.53%
Interest sensitive life	3.41%	3.42%	2.71%	4.43%

Contract interest also includes the performance of the equity-indexed component of the Company's derivative products as noted which resulted in losses of \$24.6 million and \$4.6 million in the first three months of 2008 and 2007, respectively. As previously noted, the market performance of these equity-index features is largely included in contract interest expense while also impacting the Company's investment income given the hedge nature of the options purchased for these products.

Other operating expenses - Other operating expenses consist of general administrative expenses, licenses and fees, and commissions not subject to deferral. Like revenues from other income, nursing home operation expenses are included in other operating expenses and were \$2.8 million and \$2.6 million for the first quarter of 2008 and 2007, respectively. Other operating expenses include compensation costs under SFAS 123(R) for the Company's stock option plan pertaining to the current charge related to outstanding vested and unvested options. Compensation costs recorded in the first quarter of 2008 and 2007 were (\$0.1) and \$1.3 million, respectively.

Federal Income Taxes. Federal income taxes on earnings from continuing operations reflect effective tax rates of 34.0% and 32.8% for the first quarter of 2008 and 2007, respectively, which are lower than the expected Federal rate of 35%. The effective tax rate is lower than the Federal rate of 35% primarily due to tax-exempt investment income related to municipal securities and dividends-received deductions on income from stocks.

Segment Operations

Summary of Segment Earnings

A summary of segment earnings (losses) for the quarters ended March 31, 2008 and 2007 is provided below. The segment earnings exclude realized gains and losses on investments, net of taxes.

	Domestic Life Insurance	International Life Insurance	Annuities (In thousands)	All Others	Totals
Segment earnings (losses):					
March 31, 2008	\$ (23)	3,872	9,809	817	14,475

March 31, 2007	\$	(1,352)	4,081	14,947	839	18,515
----------------	----	---------	-------	--------	-----	--------

Table of Content

Domestic Life Insurance Operations

A comparative analysis of results of operations for the Company's domestic life insurance segment is detailed below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Premiums and other revenue:		
Premiums and contract revenues	\$ 6,619	6,333
Net investment income	5,161	4,678
Other income	6	14
Total premiums and other revenue	11,786	11,025
Benefits and expenses:		
Life and other policy benefits	4,205	6,141
Amortization of deferred policy acquisition costs	2,287	1,864
Universal life insurance contract interest	2,355	2,320
Other operating expenses	2,974	2,712
Total benefits and expenses	11,821	13,037
Segment losses before Federal income taxes	(35)	(2,012)
Benefit for Federal income taxes	(12)	(660)
Segment losses	\$ (23)	(1,352)

Revenues from domestic life insurance operations include life insurance premiums on traditional type products and revenues from universal life insurance. Revenues from traditional products are simply premiums collected, while revenues from universal life insurance consist of policy charges for the cost of insurance, policy administration fees, and surrender charges assessed during the period. A comparative detail of premiums and contract revenues is provided below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Universal life insurance revenues	\$ 6,045	5,190
Traditional life insurance premiums	1,622	1,712
Reinsurance premiums	(1,048)	(569)
Totals	\$ 6,619	6,333

The Company's U.S. operations have typically emphasized annuity product sales over life product sales but efforts over the past several years have been made to attract new independent agents and to promote life products to improve domestic sales. Consequently, the increased sales levels noted earlier in this report have translated to the increase in insurance revenues.

Table of Content

Premiums collected on universal life products are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual universal life premiums collected are detailed below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Universal life insurance:		
First year and single premiums	\$ 4,330	2,841
Renewal premiums	4,728	4,177
Totals	\$ 9,058	7,018

Along with the increased revenues from higher sales levels, earnings for the domestic life insurance segment improved due to more favorable mortality experience in the first quarter of 2008 compared to the first quarter of 2007. This favorable experience caused benefits and expenses to decrease by \$1.2 million.

International Life Insurance Operations

A comparative analysis of results of operations for the Company's international life insurance segment is detailed below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Premiums and other revenue:		
Premiums and contract revenues	\$ 23,485	21,671
Net investment income	3,039	5,762
Other income	12	45
Total premiums and other revenue	26,536	27,478
Benefits and expenses:		
Life and other policy benefits	5,313	3,677
Amortization of deferred policy acquisition costs	8,791	8,163
Universal life insurance contract interest	2,694	5,252
Other operating expenses	3,872	4,310
Total benefits and expenses	20,670	21,402
Segment earnings before Federal income taxes	5,866	6,076
Provision for Federal income taxes	1,994	1,995
Segment earnings	\$ 3,872	4,081

Table of Content

As with domestic operations, revenues from the international life insurance segment include both premiums on traditional type products and revenues from universal life insurance. A comparative detail of premiums and contract revenues is provided below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Universal life insurance revenues	\$ 23,952	20,687
Traditional life insurance premiums	3,041	3,577
Reinsurance premiums	(3,508)	(2,593)
Totals	\$ 23,485	21,671

Premiums collected on universal life products are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual universal life premiums collected are detailed below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Universal life insurance:		
First year and single premiums	\$ 9,386	8,929
Renewal premiums	22,556	20,503
Totals	\$ 31,942	29,432

The Company reported increased premiums for fixed-indexed universal life products with approximately \$18.3 million and \$16.0 million for the first quarter of 2008 and 2007, respectively. Contract revenues have similarly increased as the amount of international life insurance in force has grown from \$13.4 billion at March 31, 2007, to \$15.0 billion at March 31, 2008.

As previously noted, net investment income and contract interest include period-to-period changes in fair values pertaining to options purchased that are tied to the performance of the S&P 500 Index®. The largest selling product in the international life insurance segment for the past five years has been an equity-indexed universal life policy with the equity component linked in part to the S&P 500 Index®. With the growth in this block of business, the period-to-period changes in fair values of the underlying options have had an increasingly greater impact on net investment and contract interest. A detail of net investment income for international life insurance operations is provided below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Net investment income (excluding derivatives)	\$ 7,067	6,286
Derivative loss	(4,028)	(524)
Net investment income	\$ 3,039	5,762

Amortization of deferred policy acquisition costs increased approximately 8% comparing the first three months of 2008 to the same period in 2007. A portion of this increase is due to the application of SOP 05-1 as previously discussed. In addition, amortization expense further increased due to the compression of interest spreads noted earlier.

Table of Content

Annuity Operations

The Company's annuity operations are almost exclusively in the United States. Although some of the Company's investment contracts are available to international residents, current sales are small relative to total annuity sales. A comparative analysis of results of operations for the Company's annuity segment is detailed below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Premiums and other revenue:		
Premiums and contract revenues	\$ 6,008	5,525
Net investment income	50,297	65,753
Other income	38	228
Total premiums and other revenue	56,343	71,506
Benefits and expenses:		
Life and other policy benefits	937	1,156
Amortization of deferred policy acquisition costs	15,171	13,758
Annuity contract interest	21,568	29,861
Other operating expenses	3,806	4,481
Total benefits and expenses	41,482	49,256
Segment earnings before Federal income taxes	14,861	22,250
Provision for Federal income taxes	5,052	7,303
Segment earnings	\$ 9,809	14,947

Revenues from annuity operations primarily include surrender charges and recognition of deferred revenues relating to immediate or payout annuities. A comparative detail of the components of premiums and annuity contract revenues is provided below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Surrender charges	\$ 4,795	4,392
Payout annuity and other revenues	1,207	1,126
Traditional annuity premiums	6	7
Totals	\$ 6,008	5,525

The Company's earnings are dependent upon annuity contracts persisting or remaining in force. While premium and contract revenues decline with a reduction in surrender charges, the Company's investment earnings benefit as more policies remain in force.

Table of Content

Deposits collected on annuity contracts are not reflected as revenues in the Company's statements of earnings in accordance with GAAP. Actual annuity deposits collected for the three months ended March 31, 2008 and 2007 are detailed below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Fixed-indexed annuities	\$ 69,024	63,453
Other deferred annuities	29,728	32,686
Immediate annuities	1,649	1,774
Totals	\$ 100,401	97,913

Fixed-indexed product sales typically follow the stock market in that sales are higher when confidence is high in the stock market and low if the stock market is showing poor performance. However, in a low interest environment the Company's experience has shown a higher proportion of fixed-indexed annuity sales relative to other deferred annuity products which have a fixed interest rate of interest credited to the policy.

Other deferred annuity product sales have been trending lower over the past few years due to low interest rates and investor preferences. As a selling inducement, many of the deferred products, as well as the fixed-indexed annuity products, include a first year interest bonus in addition to a base interest rate. These bonus rates are deferred in conjunction with other capitalized policy acquisition costs. The amount deferred and amortized over future periods amounted to approximately \$4.5 million and \$4.2 million during the first quarter of 2008 and 2007, respectively.

A detail of net investment income for annuity operations is provided below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Net investment income (excluding derivatives)	\$ 70,826	69,824
Derivative loss	(20,529)	(4,071)
Net investment income	\$ 50,297	65,753

As noted previously, derivative income and loss fluctuate from period to period based on the S&P 500 Index® performance.

Annuity contract interest includes the equity component return associated with the Company's fixed-indexed annuities. The detail of fixed-indexed annuity contract interest compared to contract interest for all other annuities is as follows:

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Fixed-indexed annuities	\$ 4,917	7,841

Edgar Filing: NATIONAL WESTERN LIFE INSURANCE CO - Form 10-Q

All other annuities	18,350	23,857
Gross contract interest	23,267	31,698
Bonus interest deferred and capitalized	(4,484)	(4,165)
Bonus interest amortization	2,785	2,328
Total contract interest	\$ 21,568	29,861

37

Table of Content

Contract interest reflects a decrease due to the S&P 500 Index® performance relative to fixed-indexed products.

Similar to the international life insurance segment, amortization of deferred policy acquisition costs increased approximately 10% comparing the first three months of 2008 to the same period in 2007. A portion of this increase is due to the application of SOP 05-1 as well as additional amortization expense due to the compression of interest spreads noted earlier.

Other Operations

National Western's primary business encompasses its domestic and international life insurance operations and its annuity operations. However, National Western also has small real estate, nursing home, and other investment operations through its wholly-owned subsidiaries. Nursing home operations generated \$0.3 million and \$0.4 million of operating earnings in the first quarters of 2008 and 2007, respectively.

INVESTMENTS

General

The Company's investment philosophy emphasizes the prudent handling of policyowners' and stockholders' funds to achieve security of principal, to obtain the maximum possible yield while maintaining security of principal, and to maintain liquidity in a measure consistent with current and long-term requirements of the Company.

The Company's overall conservative investment philosophy is reflected in the allocation of its investments, which is detailed below as of March 31, 2008 and December 31, 2007. The Company emphasizes investment grade debt securities, with smaller holdings in mortgage loans and policy loans.

	Composition of Investments			
	March 31, 2008		December 31, 2007	
	Amount (In thousands)	%	Amount (In thousands)	%
Debt securities	\$ 5,658,385	96.2	\$ 5,659,604	95.9
Mortgage loans	98,530	1.7	99,033	1.7
Policy loans	82,032	1.4	83,772	1.4
Derivatives	8,069	0.1	25,907	0.4
Equity securities	19,360	0.3	19,713	0.3
Real estate	11,925	0.2	11,994	0.2
Other	4,289	0.1	4,568	0.1
Totals	\$ 5,882,590	100.0	\$ 5,904,591	100.0

Table of Content

Debt and Equity Securities

The Company maintains a diversified portfolio which consists primarily of corporate, mortgage-backed, and public utilities fixed income securities. Investments in mortgage-backed securities primarily include U.S. government agency pass-through securities and collateralized mortgage obligations ("CMO"). As of March 31, 2008 and December 31, 2007, the Company's debt securities portfolio consisted of the following:

	Composition of Debt Securities			
	March 31, 2008		December 31, 2007	
	Amount (In thousands)	%	Amount (In thousands)	%
Corporate	\$ 2,462,296	43.5	\$ 2,429,753	43.0
Mortgage-backed securities	1,995,612	35.3	1,909,405	33.7
Public utilities	711,337	12.6	689,447	12.2
U.S. government/agencies	285,692	5.0	431,303	7.6
Asset-backed securities	101,956	1.8	107,019	1.9
States & political subdivisions	80,489	1.4	61,794	1.1
Foreign governments	21,003	0.4	30,883	0.5
Totals	\$ 5,658,385	100.0	\$ 5,659,604	100.0

Because the Company's holdings of mortgage-backed securities are subject to prepayment and extension risk, the Company has substantially reduced these risks by investing primarily in collateralized mortgage obligations, which have more predictable cash flow patterns than pass-through securities. These securities, known as planned amortization class I ("PAC I") and sequential tranches are designed to amortize in a more predictable manner than other CMO classes or pass-throughs. Using this strategy, the Company can more effectively manage and reduce prepayment and extension risks, thereby helping to maintain the appropriate matching of the Company's assets and liabilities.

Due to recent negative news relative to the mortgage industry and in particular subprime mortgages the Company has included detailed information below related to the exposure at March 31, 2008 and December 31, 2007 in the debt securities portfolio. The Company holds approximately \$102.0 million in asset-backed securities at March 31, 2008. This portfolio includes \$50.2 million of manufactured housing bonds and \$51.8 million of home equity loans (also referred to as subprime securities). The Company does not have any holdings in collateralized bond obligations (CBOs), collateralized debt obligations (CDOs), or collateralized loan obligations (CLOs). Principal risks in holding asset-backed securities are structural, credit, and capital market risks. Structural risks include the securities' priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from collateral and the potential for prepayments. Credit risks include corporate credit risks or consumer credit risks for financing such as subprime mortgages. Capital market risks include the general level of interest rates and the liquidity for these securities in the marketplace.

Table of Content

The mortgage-backed portfolio includes one Alt-A security with a carrying value of \$4.2 million. The Alt-A sector is a sub-sector of the jumbo prime MBS sector. The average FICO for an Alt-A borrower is approximately 715 compared to a score of 730 for a jumbo prime borrower. The Company's exposure to the Alt-A and subprime sectors is limited to investments in the senior tranches of structured securities collateralized by Alt-A or subprime residential mortgage loans. The asset-backed portfolio includes thirteen subprime securities, totaling \$51.8 million. The subprime sector is generally categorized under the asset-backed sector. This sector lends to borrowers who do not qualify for prime interest rates due to poor or insufficient credit history. Subprime borrowers generally have FICO scores of 660 or below. The slowing housing market, rising interest rates, and relaxed underwriting standards for loans originated after 2005 resulted in higher delinquency rates and losses in 2007. These events caused illiquidity in the market and volatility in the market prices of subprime securities. All of the loans classified as Alt-A or subprime in the Company's portfolio as of March 31, 2008 were underwritten prior to 2005 as noted in the table below.

Investment Origination Year	March 31, 2008		December 31, 2007	
	Carrying Value	Market Value	Carrying Value	Market Value
(In thousands)				
Subprime:				
1998	\$ 13,485	11,786	14,026	14,045
2002	1,251	1,211	1,312	1,290
2003	7,483	6,307	7,761	7,232
2004	29,628	24,792	31,186	30,278
Subtotal subprime	\$ 51,847	44,096	54,285	52,845
Alt A:				
2004	\$ 4,224	4,224	4,665	4,665

As of March 31, 2008, all of the subprime securities had investment grade ratings with only one rated below AAA. Seven of the thirteen subprime securities owned by the Company were wrapped by bond insurers in order to provide additional credit enhancement. These insurers were AMBAC Assurance Corporation, MBIA Insurance Corporation, and Financial Guaranty Insurance Company ("FGIC").

In addition to diversification, an important aspect of the Company's investment approach is managing the credit quality of its investments in debt securities. As of March 31, 2008, 98.3% of the Company's debt securities were investment grade quality using ratings by Standard and Poor's ("S&P®"). Thorough credit analysis is performed on potential corporate investments including examination of a company's credit and industry outlook, financial ratios and trends, and event risks. This emphasis is reflected in the high average credit rating of the Company's portfolio. In the table below, investments in debt securities are classified according to credit ratings S&P®, or other nationally recognized statistical rating organizations if securities were not rated by S&P®.

	March 31, 2008		December 31, 2007	
	Amount (In thousands)	%	Amount (In thousands)	%
AAA and U.S. government	\$ 2,487,550	44.0	\$ 2,564,975	45.3
AA	249,287	4.4	301,469	5.3
A	1,433,052	25.3	1,399,581	24.7
BBB	1,392,327	24.6	1,293,358	22.9

Edgar Filing: NATIONAL WESTERN LIFE INSURANCE CO - Form 10-Q

BB and other below investment grade	96,169	1.7	100,221	1.8
Totals	\$ 5,658,385	100.0	\$ 5,659,604	100.0

40

Table of Content

The Company is required to classify its investments in debt and equity securities into one of three categories: (a) trading securities, (b) securities available for sale, or (c) securities held to maturity. The Company purchases securities with the intent to hold to maturity and accordingly does not maintain a portfolio of trading securities. Of the remaining two categories, available for sale and held to maturity, the Company makes a determination based on various factors including the type and quality of the particular security and how it will be incorporated into the Company's overall asset/liability management strategy. As shown in the table below, at March 31, 2008, approximately 33% of the Company's total debt and equity securities, based on fair values, were classified as securities available for sale.

	Fair Value	Amortized Cost (In thousands)	Unrealized Gains (Losses)
Securities held to maturity:			
Debt securities	\$ 3,804,626	3,766,162	38,464
Securities available for sale:			
Debt securities	1,892,223	1,898,523	(6,300)
Equity securities	19,360	12,302	7,058
Totals	\$ 5,716,209	5,676,987	39,222

In accordance with SFAS No. 115, Accounting for Certain Debt and Equity Securities, during the first quarter of 2007 one security was sold from the held to maturity portfolio due to significant credit deterioration with an amortized cost of \$5.2 million resulting in a minimal realized gain. No securities were transferred from the held to maturity portfolio to the available for sale portfolio during the first quarter of 2008 or 2007.

Proceeds from sales of securities available for sale totaled \$0.1 million and \$0.2 million during the first quarter of 2008 and 2007, respectively, which resulted in realized gains of \$0.1 million for both periods.

Market Risk

Market risk is the risk of change in market values of financial instruments due to changes in interest rates, currency exchange rates, commodity prices, or equity prices. The most significant market risk exposure for National Western is interest rate risk. The fair values of fixed income debt securities correlate to external market interest rate conditions. Because interest rates are fixed on almost all of the Company's debt securities, market values typically increase when market interest rates decline, and decrease when market interest rates rise. However, market values may fluctuate for other reasons, such as changing economic conditions or increasing event-risk concerns.

Table of Content

The correlation between fair values and interest rates for debt securities is reflected in the tables below.

	March 31, 2008	December 31, 2007
	(In thousands except percentages)	
Debt securities - fair value	\$ 5,696,849	5,655,194
Debt securities - amortized cost	\$ 5,664,685	5,670,827
Fair value as a percentage of amortized cost	100.57 %	99.72 %
Unrealized gain (loss) balance	\$ 32,164	(15,633)
Ten-year U.S. Treasury bond - decrease in yield for the quarter	(0.61) %	(0.68) %

	Unrealized Gain (Loss) Balance		
	At March 31, 2008	At December 31, 2007	Change in Unrealized Balance
	(In thousands)		
Debt securities held to maturity	\$ 38,464	(4,410)	42,874
Debt securities available for sale	(6,300)	(11,223)	4,923
Totals	\$ 32,164	(15,633)	47,797

Changes in interest rates typically have a sizable affect on the fair values of the Company's debt securities. Market interest rates of the ten-year U.S. Treasury bond decreased approximately sixty basis points from year-end 2007 causing a unrealized gain of \$47.8 million during the quarter on a portfolio of approximately \$5.7 billion. The Company would expect similar results in the future from any significant upward or downward movement in market rates. However, since the majority of the Company's debt securities are classified as held to maturity, which are recorded at amortized cost, changes in fair values have relatively small effects on the Company's consolidated balance sheet.

The Company manages interest rate risk through on-going cash flow testing required for insurance regulatory purposes. Computer models are used to perform cash flow testing under various commonly used stress test interest rate scenarios to determine if existing assets would be sufficient to meet projected liability outflows. Sensitivity analysis allows the Company to measure the potential gain or loss in fair value of its interest-sensitive instruments and to protect its economic value and achieve a predictable spread between what is earned on invested assets and what is paid on liabilities. The Company seeks to minimize the impact of interest risk through surrender charges that are imposed to discourage policy surrenders. Interest rate changes can be anticipated in the computer models and the corresponding risk addressed by management actions affecting asset and liability instruments. However, potential changes in the values of financial instruments indicated by hypothetical interest rate changes will likely be different from actual changes experienced, and the differences could be significant.

The Company performed detailed sensitivity analysis as of December 31, 2007, for its interest rate-sensitive assets and liabilities. The changes in market values of the Company's debt securities in the first quarter of 2008 were reasonable given the expected range of results of this analysis.

Table of Content

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Liquidity requirements are met primarily by funds provided from operations. Premium deposits and revenues, investment income, and investment maturities are the primary sources of funds while investment purchases, policy benefits, and operating expenses are the primary uses of funds. The Company historically has not been put in the position of liquidating invested assets to provide cash flow. However, investments consist primarily of marketable debt securities that could be readily converted to cash for liquidity needs. The Company may also borrow up to \$40 million on its bank line of credit for short-term cash needs.

A primary liquidity concern for life insurers is the risk of an extraordinary level of early policyholder withdrawals. The Company includes provisions within its annuity and universal life insurance policies, such as surrender charges, that help limit and discourage early withdrawals.

The actual amounts paid by product line in connection with surrenders and withdrawals for the quarters ended March 31 are noted in the table below.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Product Line:		
Traditional Life	\$ 1,072	990
Universal Life	9,450	8,047
Annuities	99,847	91,979
Total	\$ 110,369	101,016

The above contractual withdrawals, as well as the level of surrenders experienced, were generally consistent with the Company's assumptions in asset/liability management, and the associated cash outflows did not have an adverse impact on overall liquidity. Individual life insurance policies are less susceptible to withdrawal than annuity reserves and deposit liabilities because policyholders may incur surrender charges and undergo a new underwriting process in order to obtain a new insurance policy. Cash flow projections and tests under various market interest rate scenarios are also performed to assist in evaluating liquidity needs and adequacy. The Company currently expects available liquidity sources and future cash flows to be more than adequate to meet the demand for funds.

In the past, cash flows from the Company's insurance operations have been sufficient to meet current needs. Cash flows from operating activities were \$66.9 million and \$62.6 million for the three months ended March 31, 2008 and 2007, respectively. The Company also has significant cash flows from both scheduled and unscheduled investment security maturities, redemptions, and prepayments. These cash flows totaled \$335.7 million and \$115.7 million for the three months ended March 31, 2008 and 2007, respectively. These cash flow items could be reduced if interest rates rise. Net cash outflows from the Company's universal life and investment annuity deposit product operations totaled \$37.1 million and \$25.7 million during the three months ended March 31, 2008 and 2007, respectively.

Capital Resources

The Company relies on stockholders' equity for its capital resources as there is no long-term debt outstanding and the Company does not anticipate the need for any long-term debt in the near future. As of March 31, 2008, the Company had commitments of approximately \$6.2 million which were approved by the Company's Board of Directors for the

construction of a nursing home facility in Central Texas. The construction of the new facility began in 2007 and is expected to be completed in the third or fourth quarter of 2008.

Table of Content

OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

It is not Company practice to enter into off-balance sheet arrangements nor is it Company policy to issue guarantees to third parties, other than in the normal course of issuing insurance contracts. Commitments related to insurance products sold are reflected as liabilities for future policy benefits. Insurance contracts guarantee certain performances by the Company.

Insurance reserves are the means by which life insurance companies determine the liabilities that must be established to assure that future policy benefits are provided for and can be paid. These reserves are required by law and based upon standard actuarial methodologies to ensure fulfillment of commitments guaranteed to policyholders and their beneficiaries, even though the obligations may not be due for many years. Refer to Note (1) in the Notes to Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 for a discussion of reserving methods.

The table below summarizes future estimated cash payments under existing contractual obligations.

	Total	Payment Due by Period			
		Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
(In thousands)					
Operating lease obligations (1)	\$ 2,023	846	1,177	-	-
Construction commitments	6,232	6,232	-	-	-
Life claims payable (2)	57,804	57,804	-	-	-
Other long-term reserve liabilities reflected on the balance sheet under GAAP (3)	6,910,276	649,040	1,105,566	1,342,661	3,813,009
Total	\$ 6,976,335	713,922	1,106,743	1,342,661	3,813,009

(1) Refer to Note 9 in the Notes to Consolidated Financial Statements relating to leases in the Company's Annual Report on Form 10-K.

(2) Life claims payable include benefit and claim liabilities for which the Company believes the amount and timing of the payment is essentially fixed and determinable. Such amounts generally relate to incurred and reported death and critical illness claims including an estimate of claims incurred but not reported.

(3) Other long-term liabilities include estimated life and annuity obligations related to death claims, policy surrenders, policy withdrawals, maturities and annuity payments based on mortality, lapse, annuitization, and withdrawal assumptions consistent with the Company's historical experience. These estimated life and annuity obligations are undiscounted projected cash outflows that assume interest crediting and market growth consistent with assumptions used in amortizing deferred acquisition costs. They do not include any offsets for future premiums or deposits. Other long-term liabilities also include determinable payout patterns related to immediate annuities. In contrast to this table, the majority of the Company's liabilities for future obligations recorded on the consolidated balance sheet do not incorporate future credited interest and market growth. Therefore, the estimated life and annuity obligations presented in this table significantly exceed the life and annuity liabilities recorded in the reserves for future life and annuity obligations. Due to the significance of the assumptions used, the actual cash outflows will differ both in amount and timing, possibly materially, from these estimates.

CHANGES IN ACCOUNTING PRINCIPLES AND CRITICAL ACCOUNTING POLICIES

Changes in Accounting Principles

Refer to Note 2 and Note 9 of the Notes to Condensed Consolidated Financial Statements.

45

Table of Content

REGULATORY AND OTHER ISSUES

Statutory Accounting Practices

Regulations that affect the Company and the insurance industry are often the result of efforts by the National Association of Insurance Commissioners ("NAIC"). The NAIC routinely publishes new regulations as model acts or laws which states subsequently adopt as part of their insurance regulations. Currently, the Company is not aware of any NAIC regulatory matter material to its operations or reporting of financial results.

Risk-Based Capital Requirements

The NAIC established risk-based capital ("RBC") requirements to help state regulators monitor the financial strength and stability of life insurers by identifying those companies that may be inadequately capitalized. Under the NAIC's requirements, each insurer must maintain its total capital above a calculated threshold or take corrective measures to achieve the threshold. The threshold of adequate capital is based on a formula that takes into account the amount of risk each company faces on its products and investments. The RBC formula takes into consideration four major areas of risk which are: (i) asset risk which primarily focuses on the quality of investments; (ii) insurance risk which encompasses mortality and morbidity risk; (iii) interest rate risk which involves asset/liability matching issues; and (iv) other business risks. Statutory laws prohibit public dissemination of certain RBC information. However, the Company's current statutory capital and surplus is significantly in excess of the threshold RBC requirements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES
ABOUT MARKET RISK

This information is included in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, in the Investments in Debt and Equity Securities section.

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective in recording, processing, summarizing, and reporting, on a timely basis, information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act.

There have been no changes in the Company's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Refer to Note 8 "Legal Proceedings" of the accompanying financial statements included in this Form 10-Q.

ITEM 1A. RISK FACTORS

There have been no changes relative to the risk factors disclosed in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

46

Table of Content

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Effective March 10, 2006, the Company adopted and implemented a limited stock buy-back program associated with the Company's 1995 Stock Option and Incentive Plan ("Plan") which provides Option Holders the additional alternative of selling shares acquired through the exercise of options directly back to the Company. Option Holders may elect to sell such acquired shares back to the Company at any time within ninety (90) days after the exercise of options at the prevailing market price as of the date of notice of election.

During the month ended March, 2008, the Company purchased 12,450 shares from option holders at an average price of \$199.72. These purchased shares are reported in the Company's condensed consolidated financial statements as authorized and unissued.

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit 31(a) -Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 31(b) -Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32(a) -Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Content

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NATIONAL WESTERN LIFE INSURANCE COMPANY
(Registrant)

Date: May 9, 2008

/S/ Ross R. Moody
Ross R. Moody
President, Chief Operating
Officer,
and Director
(Authorized Officer)

Date: May 9, 2008

/S/ Brian M. Pribyl
Brian M. Pribyl
Senior Vice President,
Chief Financial &
Administrative
Officer and Treasurer
(Principal Financial Officer)
(Principal Accounting
Officer)
