3D ADVISORS

This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
Accounting: Quality of Earnings Issues
✓ **Governance:** Corporate Governance Issues

Insider Selling Puts Focus on Related-Party Issues Torchmark Corporation (NYSE: TMK)

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Torchmark Corporation is an insurance holding company. Its primary subsidiaries are American Income Life Insurance Company, Liberty National Life Insurance Company, Globe Life And Accident Insurance Company, United American Insurance Company and United Investors Life Insurance Company. Torchmark's insurance subsidiaries write a variety of non-participating ordinary life insurance products. These include traditional and interest sensitive whole-life insurance, term life insurance and other life insurance. Torchmark insurance subsidiaries are licensed to sell insurance in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, New Zealand and Canada. Distribution is through direct response, independent and exclusive agents.

Summary of 3DAdvisors Findings for TMK

- **Insider Trading:** CFO sales are break from prior behavior
- **Governance:** Related-party issues seriously compromise board independence

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Discussion of 3DAdvisors Findings

Insider Trading: CFO sales are break from prior behavior

A trade by Torchmark CFO **Gary Coleman** spoke loudly to us. On April 28th, he exercised options for 35,336 shares and sold them for $38.63 each. This transaction is quite unusual on two fronts. First, and most importantly, Coleman was clearing out of two separate options series, options that had been vested for a long time (most of them exercisable since May of 2000, the balance, December of 2001) and had a lot of time left on them (five years until expiration). Second, there was little profit in the trades. One set of options (for 12,500 shares) were exercised for $33.44 each, the other (for 22,836 shares) were exercised for $34.50 each. Without expiration being imminent, it is extremely uncommon to see someone exercise options so close to market price unless, that is, they feel that there is a reasonable risk of the options going underwater in the event of a decline in the share price. Another fact we note here is that this was Coleman's first sale since August of '01 and the first time he had ever sold the entire total of shares he had exercised for. In the past, he has usually retained some of the shares acquired through an option exercise. This is a break from his past behavior. There were other insider sales as well during the period, however it was this change in behavior from the CFO that caused us to look further into the situation.

Another insider seller here is Chief Actuary **Rosemary Montgomery** who sold 21,000 shares in mid May, right around the time of the release of the first quarter "Q" which revealed (for the first time) the note default by interests related to director Richey (Elgin Development Co.; see below). Like CFO Coleman, she had not sold a share sine back in August of '01.

<u>Governance: Related-party issues seriously compromise board independence</u>

Upon further inspection, we have found Torchmark to be a company that continues to adopt a good-old-boy director network fraught with enough Related Party Dealings to remind us of the pre-Enron days. Granted, there seems to be little attempt to hide anything; disclosure seems adequate. It is the high number of the relationships that stands out, which seems to have resulted in a high level of favorable treatment between the Company and its directors.

One relationship that jumps out involves an ongoing situation with a '99 transaction where an entity (Elgin Development Company) bought properties valued at $94 million from Torchmark. The deal was $85 million in cash with the balance in a collateralized note. Elgin is 30% owned by Torchmark director R.K. Richey, who also owns 25% of Elgin's parent. Torchmark originally booked a $10 million loss on the deal. But there's more. It was recently disclosed in Torchmark's Q1 "Q", filed May 14th, that Elgin has missed the scheduled payment on the note, due March 31, 2003 and the note (with $9.7 million remaining on it) was declared in default. Given Richey's director status, it seems unlikely that Torchmark didn't see this coming. Funny how this was never mentioned in the Q1 earnings release, issued April 21st. The Company instead, waited for the "Q" to disclose this. Good way to avoid "sensitive" questions that could arise in the post-release conference call.

The (Torchmark director) R.K. Richey involvement doesn't stop here however. Stonegate Realty (Elgin's parent) is 25% owned by him. He is also a 33% owner of Stonegate Management LLC, which is, in turn, a 50% owner of Commercial Real Estate Services (CRES). CRES manages "certain" of Torchmark's properties and collected fees and rentals totaling $1 million for such services (from Torchmark) in '02.

Another very interesting, and strange, relationship seems to exist between Torchmark and outside counsel, William J. Baxley. Baxley is a partner in the law firm of Baxley, Dillard & McNight. He is not a Torchmark employee or director, yet has, on occasion, received options for Torchmark shares as a consultant. In addition, Torchmark has loaned him $1,063,000 on an unsecured basis. Repayments are made in the form of legal services. Even more bizarre, a Torchmark subsidiary, Liberty National Life Insurance Co, has loaned Baxley's wife $883,000. Liberty has since sold this loan to Torchmark. These Baxley transactions really stand out when you consider the fact that Torchmark is not in the loan business. It is our opinion that the loans, though probably not illegal, raise a number of governance and ethics issues.

The Related Party transaction list does not stop here. Another Torchmark director, Lamar Smith, is the CEO of First Command Financial Services Inc. First Command sells certain Torchmark life insurance products and received $53.6 million in commissions from Torchmark in '02. In addition, Torchmark has a coinsurance agreement with First Command where Torchmark cedes back (to First Command) 5% of the new (Torchmark-related) life insurance business sold by First Command. Under this agreement, Torchmark provides First Command certain administrative, accounting and investment management services. Premiums ceded in '02 totaled $780,000. The deal does not stop there however. Torchmark has entered into two loan agreements with First Command: a construction loan totaling $19.4 million and a collateral loan totaling $22.9 million.

Another Torchmark director, George Records, is an officer, director and 38% owner of Midland Financial Co., the parent to MidFirst Bank who is the servicing agent for a portion of Torchmark's commercial mortgages portfolios who collected about $118,000 in fees in '02.