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Conseco Officials Have Company on Track to Recovery

By Bill W. Hornaday, The Indianapolis Star Knight Ridder/Tribune Business News

Apr. 3 - The timing seemed uncanny. On the same March day the Securities and Exchange Commission sued former Conseco executives Rollin Dick and James Adams for alleged accounting fraud, the company reported something it had not seen since early 2001.

A profit.

Ever since the Carmel-based insurer exited the third-largest bankruptcy in U.S. history last fall, ghosts from its past -- such as investor and customer lawsuits, continued federal probes into activities before the company's 2002 collapse, and hundreds of millions of dollars in loans owed by former officials -- have continued to steal the spotlight.

Yet the \$49.6 million Conseco netted in the past three months of 2003 tells a story not as well known.

Although its long-term prospects are far from certain, Conseco has met several key financial goals en route to a refinancing effort it believes will return the company to prominence.

One analyst whose ratings company is crucial to Conseco's insurance business says the company, its management team and CEO William J. Shea deserve praise for their work to regain its top-tier A credit rating.

"They're doing whatever it takes," said Michael A. Cohen, a vice president with A.M. Best Co., a New Jersey-based agency whose financial grades are viewed as the standard for the insurance industry. "Shea and his staff have worked their tails off, and I applaud them for that. When they do refinance, I am confident they are going to (regain an A rating)."

When Conseco emerged from Chapter 11 protection last September, it did so under tight bank covenants. Among other things, Conseco was required to regain at least an A-minus credit rating from A.M. Best in 2005 or default on the \$1.3 billion credit agreement that serves as the bedrock of its bankruptcy recovery plan.

The "ratings trigger" is gone -- eliminated by a January amendment -- but an A rating from A.M. Best is no less important to Conseco.



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Unless it sells insurance products with credit ratings as strong as those of its rivals, Conseco cannot compete as effectively. Sales decline. Policy lapses increase. Employee agents go to other companies, while independent agents sell more attractive products.

To keep agents in the fold, Conseco spent \$17 million on incentive programs in 2003. Yet even while it makes strides toward recovery, the company -- in its annual report filed with the SEC -- says that adverse publicity could harm efforts to restore confidence in the Conseco brand, impede its ability to sell products and attract new customers and make it harder to attract and retain agents and marketers.

Conseco spokesman Jim Rosensteele said that headlines about past problems "certainly are a distraction," but have little bearing on Conseco's current activities.

"Our focus is 100 percent on the financial strength of the company and fixing its business," Rosensteele said. "If we execute our plan, the old issues won't matter."

So far, Conseco has done so in three critical measures still covered by its credit agreement -- its revenue, debt-to-capital balance and ability to cover interest payments.

In its first post-bankruptcy quarter, Conseco earned \$290 million before interest, taxes and other considerations, according to its year-end report. That puts it on pace to surpass at least \$490 million -- the amount Conseco must generate by the end of its first two quarters to satisfy its banks -- and \$1.16 billion by the end of its fiscal year.

The lone drawback is one of prestige. That won't be enough to keep Conseco in the Fortune 500, an annual list compiled by Fortune magazine that ranks the nation's largest companies based on revenue. But it could remain in the Fortune 1,000. Conseco is No. 370 on this year's list based on 2003 earnings.

By year's end, Conseco's debt comprised 33.4 percent of its total capitalization. That fell within the banks' requirements of no higher than 35.6 percent requirement -- and was a far cry from the 82 percent it carried in August 2002 just after the company announced a "radical restructuring" of its debt.

The banks' requirement that Conseco have a 1-to-1 interest coverage ratio was met as well, as Conseco exceeded a 1.25-to-1 capability by year's end. But Conseco's debt-to-capital percentage remains high for the insurance industry, as many of its peers carry half that amount.

Reducing that margin is one reason that Conseco seeks to refinance its debt -- a process that begins once the SEC approves a proposed offering of common stock and mandatorily convertible preferred stock, Rosensteele said.

With proceeds from those sales, Conseco plans to redeem preferred stock issued to creditors just after it left bankruptcy, retire some existing debt and negotiate better terms with its banks. In turn, it is hoped the improved financial picture will persuade A.M. Best and other credit firms to improve Conseco's rating.

Outside of Conseco's credit agreement, other areas that reflect financial strength have improved as well.

Among them are reserves that Conseco's insurance companies are required by law to maintain to pay claims. At the end of 2003, the total pool for all of its insurance brands was \$1.5 billion, up from \$1.1 billion at the end of 2002.

A related measurement -- the company's risk-based capital rating -- reached 287 percent by year's end as well, up from 166 percent at the end of 2002.

Although many analysts have ignored the new Conseco thus far, one local researcher who follows the company is pleased with its performance.

"The company has tremendously improved its competitive positioning with the cleansing of its balance sheet and the disposition of ill-fated Conseco Finance," said Ryan S. Pfenninger of Indianapolis-based Pfenninger's Research in a Feb. 25 report.

While all of this -- plus Conseco's legacy issues -- plays out, the company projects a net income of \$175 million to \$200 million by the end of its first fiscal year. If Conseco remains on track, its stock -- which now trades around \$23 per share -- could reach near \$30 over the next year, Pfenninger says.

"Conseco's financial statements are beginning to tell a story that we believe will have a happy ending for investors," he said.

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