AFLAC INC
Form 10-Q
May 08, 2006

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2006

OR

[ ] 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: 001-07434

Aflac Incorporated

(Exact name of registrant as specified in its charter)

GEORGIA	58-1167100
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1932 Wynnton Road, Columbus, Georgia	31999
(Address of principal executive offices)	(ZIP Code)

Registrant's telephone number, including area code: 706.323.3431

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

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

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

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	April 28, 2006
Common Stock, $.10 Par Value	498,627,326 shares

Aflac Incorporated and Subsidiaries
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Items other than those listed above are omitted because they are not required or are not applicable.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Aflac Incorporated and Subsidiaries
Consolidated Statements of Earnings

(In millions, except for share and per-share amounts - Unaudited)	Three Months Ended March 31, 2006	2005
Revenues:		
Premiums, principally supplemental health insurance	$ 3,005	$ 3,041
Net investment income	524	514
Realized investment gains (losses)	14	3
Other income	16	1
Total revenues	3,559	3,559
Benefits and expenses:		
Benefits and claims	2,181	2,266
Acquisition and operating expenses:		
Amortization of deferred policy acquisition costs	144	137
Insurance commissions	321	333
Insurance expenses	307	287
Interest expense	5	6
Other operating expenses	26	24
Total acquisition and operating expenses	803	787
Total benefits and expenses	2,984	3,053
Earnings before income taxes	575	506
Income taxes	200	178
Net earnings	$ 375	$ 328
Net earnings per share:		
Basic	$ .75	$ .65
Diluted	.74	.64

Common shares used in computing earnings per share (In thousands):		
Basic	498,037	502,706
Diluted	504,574	509,449
Cash dividends per share	$ .13	$ .11

See the accompanying Notes to the Consolidated Financial Statements.

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Aflac Incorporated and Subsidiaries
Consolidated Balance Sheets

(In millions - Unaudited)	March 31, 2006	December 31, 2005
Assets		
:		
Investments and cash:		
Securities available for sale, at fair value:		
Fixed maturities (amortized cost $26,221 in 2006 and $25,860 in 2005)	$ 27,710	$ 28,142
Perpetual debentures (amortized cost $4,272 in 2006 and $4,255 in 2005)	4,255	4,370
Equity securities (cost $17 in 2006 and $30 in 2005)	58	84
Securities held to maturity, at amortized cost:		
Fixed maturities (fair value $11,096 in 2006 and $10,839 in 2005)	11,440	10,867
Perpetual debentures (fair value $4,161 in 2006 and $4,252 in 2005)	4,186	4,172
Other investments	61	57
Cash and cash equivalents	1,155	1,297
Total investments and cash	48,865	48,989
Receivables, primarily premiums	402	479
Receivables for security transactions	-	105

Accrued investment income	460	484
Deferred policy acquisition costs	5,706	5,590
Property and equipment, at cost less accumulated depreciation	447	448
Other	256	266
Total assets	$ 56,136	$ 56,361

See the accompanying Notes to the Consolidated Financial Statements.

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Aflac Incorporated and Subsidiaries

Consolidated Balance Sheets (continued)

(In millions, except for share and per-share amounts - Unaudited)	March 31, 2006	December 31, 2005
Liabilities and shareholders' equity		
:		
Liabilities:		
Policy liabilities:		
Future policy benefits	$ 38,742	$ 37,853
Unpaid policy claims	2,555	2,504
Unearned premiums	614	594
Other policyholders' funds	1,447	1,378
Total policy liabilities	43,358	42,329
Notes payable	1,400	1,395
Income taxes	2,132	2,577
Payables for return of cash collateral on loaned securities	467	622
Other	1,203	1,511
Commitments and contingent liabilities (Notes 8 and 9)		
Total liabilities	48,560	48,434
Shareholders' equity:		
Common stock of $.10 par value. In thousands: authorized 1,000,000 shares; issued 655,088 shares in 2006 and 654,522 shares in 2005	66	65
Additional paid-in capital	819	791
Retained earnings	8,358	8,048
Accumulated other comprehensive income:		

Unrealized foreign currency translation gains	84	77
Unrealized gains on investment securities	1,299	1,917
Minimum pension liability adjustment	(37)	(37)
Treasury stock, at average cost	(3,013)	(2,934)
Total shareholders' equity	7,576	7,927
Total liabilities and shareholders' equity	$ 56,136	$ 56,361
Shareholders' equity per share	$ 15.20	$ 15.89

See the accompanying Notes to the Consolidated Financial Statements.

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Aflac Incorporated and Subsidiaries

Consolidated Statements of Shareholders' Equity

	Three Months Ended March 31,	
(In millions, except for per-share amounts - Unaudited)	2006	2005
Common stock:		
Balance, beginning of period	$ 65	$ 65
Exercise of stock options	1	-
Balance, end of period	66	65
Additional paid-in capital:		
Balance, beginning of period	791	676
Exercise of stock options, including income tax benefits	13	8
Share-based compensation	7	7
Gain on treasury stock reissued	8	7
Balance, end of period	819	698
Retained earnings:		
Balance, beginning of period	8,048	6,785
Net earnings	375	328
Dividends to shareholders ($.13 per share in 2006 and $.11 per share in 2005)	(65)	(55)
Balance, end of period	8,358	7,058
Accumulated other comprehensive income:		
Balance, beginning of period	1,957	2,611
Change in unrealized foreign currency translation gains (losses)		

during period, net of income taxes	7	(28)
Change in unrealized gains (losses) on investment		
securities during period, net of income taxes	(618)	32
Balance, end of period	1,346	2,615
Treasury stock:		
Balance, beginning of period	(2,934)	(2,561)
Purchases of treasury stock	(98)	(113)
Cost of shares issued	19	14
Balance, end of period	(3,013)	(2,660)
Total shareholders' equity	$ 7,576	$ 7,776

See the accompanying Notes to the Consolidated Financial Statements.

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Aflac Incorporated and Subsidiaries

Consolidated Statements of Cash Flows

	Three Months Ended March 31,	
(In millions - Unaudited)	2006	2005
Cash flows from operating activities:		
Net earnings	$ 375	$ 328
Adjustments to reconcile net earnings to net		
cash provided by operating activities:		
Change in receivables and advance premiums	97	(6)
Increase in deferred policy acquisition costs	(98)	(103)
Increase in policy liabilities	779	856
Change in income tax liabilities	(111)	17
Realized investment (gains) losses	(14)	(3)
Other, net	(5)	85
Net cash provided by operating activities	1,023	1,174
Cash flows from investing activities:		
Proceeds from investments sold or matured:		
Securities available for sale:		
Fixed maturities sold	270	174
Fixed maturities matured	81	276

Perpetual debentures sold	1	7
Equity securities and other	30	-
Costs of investments acquired:		
Securities available for sale:		
Fixed maturities	(781)	(686)
Perpetual debentures	-	(286)
Securities held to maturity:		
Fixed maturities	(526)	(984)
Cash received as collateral on loaned securities, net	(158)	(2,372)
Other, net	(5)	(3)
Net cash used by investing activities	$ (1,088)	$ (3,874)

See the accompanying Notes to the Consolidated Financial Statements.

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Aflac Incorporated and Subsidiaries

Consolidated Statements of Cash Flows (continued)

	Three Months Ended March 31,	
(In millions - Unaudited)	2006	2005
Cash flows from financing activities:		
Purchases of treasury stock	$ (98)	$ (113)
Change in investment-type contracts, net	55	54
Dividends paid to shareholders	(62)	(53)
Treasury stock reissued	15	10
Principal payments under debt obligations	(2)	(2)
Other, net	12	8
Net cash used by financing activities	(80)	(96)
Effect of exchange rate changes on cash and cash equivalents	3	(25)
Net change in cash and cash equivalents	(142)	(2,821)
Cash and cash equivalents, beginning of period	1,297	3,813
Cash and cash equivalents, end of period	$ 1,155	$ 992
Supplemental disclosures of cash flow information:		
Income taxes paid	$ 329	$ 162

Interest paid	1	1
Noncash financing activities:		
Capitalized lease obligations	2	1
Treasury shares issued for:		
Associate stock bonus	7	8
Shareholder dividend reinvestment	3	2
Stock compensation grants	2	1

See the accompanying Notes to the Consolidated Financial Statements.

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Aflac Incorporated and Subsidiaries

Consolidated Statements of Comprehensive Income

(In millions - Unaudited)	Three Months Ended March 31, 2006	2005
Net earnings	$ 375	$ 328
Other comprehensive income (loss) before income taxes:		
Foreign currency translation adjustments:		
Change in unrealized foreign currency translation gains (losses) during period	-	17
Unrealized gains (losses) on investment securities:		
Unrealized holding gains (losses) arising during the period	(935)	44
Reclassification adjustment for realized (gains) losses included in net earnings	(14)	(3)
Total other comprehensive income (loss) before income taxes	(949)	58
Income tax expense (benefit) related to items of other comprehensive income	(338)	53
Other comprehensive income (loss) net of income taxes	(611)	5
Total comprehensive income (loss)	$ (236)	$ 333

See the accompanying Notes to the Consolidated Financial Statements.

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Aflac Incorporated and Subsidiaries

Notes to the Consolidated Financial Statements

1. BASIS OF PRESENTATION

We prepare our financial statements in accordance with U.S. generally accepted accounting principles (GAAP). These principles are established primarily by the Financial Accounting Standards Board (FASB). The preparation of financial statements in conformity with GAAP requires us to make estimates when recording transactions resulting from business operations based on currently available information. The most significant items on our balance sheet that involve a greater degree of accounting estimates and actuarial determinations subject to changes in the future are the valuation of investments, deferred policy acquisition costs, and liabilities for future policy benefits and unpaid policy claims. These accounting estimates and actuarial determinations are sensitive to market conditions, investment yields, mortality, morbidity, commission and other acquisition expenses, and terminations by policyholders. As additional information becomes available, or actual amounts are determinable, the recorded estimates will be revised and reflected in operating results. Although some variability is inherent in these estimates, we believe the amounts provided are adequate.

The consolidated financial statements include the accounts of the Parent Company, its majority-owned subsidiaries and those entities required to be consolidated under applicable accounting standards. All material intercompany accounts and transactions have been eliminated.

In the opinion of management, the accompanying unaudited consolidated financial statements of Aflac Incorporated and subsidiaries (the "Company") contain all adjustments, consisting of normal recurring accruals, which are necessary to fairly present the consolidated balance sheets as of March 31, 2006, and December 31, 2005, and the consolidated statements of earnings, shareholders' equity, cash flows and comprehensive income for the three-month periods ended March 31, 2006, and 2005. Results of operations for interim periods are not necessarily indicative of results for the entire year. As a result, these financial statements should be read in conjunction with the financial statements and notes thereto included in our annual report to shareholders for the year ended December 31, 2005.

New Accounting Pronouncements:

In February 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 155, Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140 (SFAS 155). The provisions of SFAS 155 are effective for all financial instruments acquired or issued after the beginning of the first fiscal year after September 15, 2006. Earlier adoption is permitted. SFAS 155 amends the accounting for hybrid financial instruments and eliminates the exclusion of beneficial interests in securitized financial assets from the guidance under SFAS 133 and eliminates the prohibition on the type of derivative instruments that qualified special purpose entities may hold under SFAS 140. SFAS 155 also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. In accordance with the standard's early adoption provisions, we adopted the provisions of SFAS 155 on January 1, 2006. The adoption of this standard did not have any impact on our financial position or results of operations.

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In December 2004, the FASB issued SFAS No. 123 (revised), Share-Based Payment (SFAS 123R). This standard amends SFAS No. 123, Accounting for Stock-Based Compensation, and supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS 123R establishes the accounting for grants of share-based awards in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or transactions that may be settled by the issuance of those equity instruments. SFAS 123R requires that companies use a fair value method to value share-based awards and recognize the related compensation expense in net earnings. The provisions of SFAS 123R, as amended by the Securities and Exchange Commission, are effective as of the beginning of the first fiscal year after June 15, 2005, although earlier application is encouraged. In accordance with the standard's early adoption provisions, we began accounting for share-based awards using the modified-retrospective application method effective January 1, 2005.

For additional information on new accounting pronouncements and their impact, if any, on our financial position or results of operations, see Note 1 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2005.

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2. BUSINESS SEGMENT INFORMATION

The Company consists of two reportable insurance business segments: Aflac Japan and Aflac U.S., both of which sell individual supplemental health and life insurance.

Operating business segments that are not individually reportable are included in the "Other business segments" category. We do not allocate corporate overhead expenses to business segments. We evaluate and manage our business segments using a financial performance measure called pretax operating earnings. Our definition of operating earnings excludes the following items from net earnings on an after-tax basis: realized investment gains/losses, the impact from SFAS 133, and nonrecurring items. We then exclude income taxes related to operations to arrive at pretax operating earnings. Information regarding operations by segment for the three months ended March 31 follows:

(In millions)	2006	2005
Revenues:		
Aflac Japan:		
Earned premiums	$ 2,139	$ 2,254
Net investment income	408	411

Other income	6	7
Total Aflac Japan	2,553	2,672
Aflac U.S.:		
Earned premiums	866	787
Net investment income	110	102
Other income	4	2
Total Aflac U.S.	980	891
Other business segments	10	9
Total business segment revenues	3,543	3,572
Realized investment gains (losses)	14	3
Corporate*	26	4
Intercompany eliminations	(24)	(20)
Total revenues	$ 3,559	$ 3,559

*Includes investment income of $5 in 2006 and $2 in 2005. Also, includes a gain of $3 in 2006 and a loss of $13 in 2005 related to the impact from SFAS 133.

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(In millions)	2006	2005
Pretax earnings:		
Aflac Japan	$ 425	$ 399
Aflac U.S.	147	133
Other business segments	-	1
Total business segments	572	533
Interest expense, noninsurance operations	(4)	(5)
Corporate and eliminations	(10)	(12)
Pretax operating earnings	558	516
Realized investment gains (losses)	14	3
Impact from SFAS 133	3	(13)
Total earnings before income taxes	$ 575	$ 506
Income taxes applicable to pretax operating earnings	$ 194	$ 181
Effect of foreign currency translation on operating earnings	(22)	5

Assets were as follows:

(In millions)	March 31, 2006	December 31, 2005
Assets		
:		
Aflac Japan	$ 46,101	$ 46,200
Aflac U.S.	9,491	9,547
Other business segments	92	90
Total business segments	55,684	55,837
Corporate	9,200	9,559
Intercompany eliminations	(8,748)	(9,035)
Total assets	$ 56,136	$ 56,361

3. INVESTMENTS

Realized Investment Gains and Losses

During the quarter ended March 31, 2006, we realized pretax investment gains of $14 million (after-tax, $9 million, or $.02 per diluted share) primarily as a result of the execution of bond swaps that took advantage of tax loss carryforwards. For the quarter ended March 31, 2005, we realized pretax gains of $3 million (after-tax, $2 million, or nil per diluted share) as a result of securities sales. Impairment charges were immaterial during the three months ended March 31, 2006 and 2005.

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Unrealized Investment Gains and Losses

The net effect on shareholders' equity of unrealized gains and losses from investment securities at the following dates was:

(In millions)	March 31, 2006	December 31, 2005
Unrealized gains on securities available for sale	$1,513	$2,452
Unamortized unrealized gains on securities transferred to held to maturity	420	430
Deferred income taxes	(634)	(965)
Shareholders' equity, net unrealized gains on investment securities	$1,299	$1,917

Special Purpose and Variable Interest Entities

As part of our investment activities, we own investments in qualified special purpose entities (QSPEs). At March 31, 2006, available-for-sale QSPEs totaled $2.2 billion at fair value ($2.3 billion at amortized cost, or 4.9% of total debt securities), compared with $2.2 billion at fair value ($2.3 billion at amortized cost, or 5.0% of total debt securities) at December 31, 2005. We have no equity interests in any of the QSPEs, nor do we have control over these entities. Therefore, our loss exposure is limited to the cost of our investment.

We also own yen-denominated investments in variable interest entities (VIEs) totaling $1.8 billion at fair value ($1.9 billion at amortized cost, or 4.1% of total debt securities) at March 31, 2006. We have concluded that we are the primary beneficiary of VIEs totaling $1.5 billion at fair value ($1.7 billion at amortized cost) and we have consolidated our interests in these VIEs in accordance with FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities. The activities of these VIEs are limited to holding debt securities and utilizing the proceeds from the debt securities to service our investments therein. The terms of the debt securities mirror the terms of the notes held by Aflac. The consolidation of these investments does not impact our financial position or results of operations. We also have interests in VIEs that we are not required to consolidate totaling $219 million at fair value ($221 million at amortized cost) as of March 31, 2006. The notes representing our interests in these VIEs are reported as fixed-maturity securities on the balance sheet. The loss on any of our VIE investments would be limited to its cost.

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Security Lending

We lend fixed-maturity securities to financial institutions in short-term security lending transactions. These securities continue to be carried as investment assets on our balance sheet during the term of the loans and are not recorded as sales. We receive cash or other securities as collateral for such loans. These short-term security lending arrangements increase investment income with minimal risk. Our security lending policy requires that the fair value of the securities received as collateral and cash received as collateral be 102% or more of the fair value of the loaned securities. At March 31, 2006, we had security loans outstanding with a fair value of $453 million, and we held cash in the amount of $467 million as collateral for these loaned securities. At December 31, 2005, we had security loans outstanding with a fair value of $605 million, and we held cash in the amount of $622 million as collateral for these loaned securities. For additional information, see Notes 1 and 3 of the Notes to the Consolidated Financial Statements in our annual report to shareholders for the year ended December 31, 2005.

4. FINANCIAL INSTRUMENTS

We have only limited activity with derivative financial instruments. We do not use them for trading purposes, nor do we engage in leveraged derivative transactions.

We have outstanding cross-currency swap agreements related to the $450 million senior notes (Note 5). We have designated the foreign currency component of these cross-currency swaps as a hedge of the foreign currency exposure of our investment in Aflac Japan. The notional amounts and terms of the swaps match the principal amount and terms of the senior notes.

The components of the fair value of the cross-currency swaps were reflected as an asset or (liability) in the balance sheet as follows:

(In millions)	March 31, 2006	December 31, 2005
Interest rate component	$ 8	$ 6
Foreign currency component	(22)	(22)
Accrued interest component	10	4
Total fair value of cross-currency swaps	$ (4)	$ (12)

The following is a reconciliation of the foreign currency component of the cross-currency swaps as included in accumulated other comprehensive income for the three-month periods ended March 31.

(In millions)	2006	2005
Balance, beginning of period	$ (22)	$ (91)
Increase (decrease) in fair value of cross-currency swaps	8	15
Interest rate component not qualifying for hedge accounting reclassified to net earnings	(8)	7
Balance, end of period	$ (22)	$ (69)

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5. NOTES PAYABLE

A summary of notes payable follows:

(In millions)	March 31, 2006	December 31, 2005
6.50% senior notes due April 2009 (principal amount $450)	$ 450	$ 450
Yen-denominated Samurai notes:		
.87% notes due June 2006 (principal amount 40 billion yen)	341	339
.96% notes due June 2007 (principal amount 30 billion yen)	255	254
.71% notes due July 2010 (principal amount 40 billion yen)	341	339
Capitalized lease obligations payable through 2011	13	13
Total notes payable	$ 1,400	$ 1,395

In 2001, 2002, and 2005 the Parent Company issued yen-denominated Samurai notes, each of which had five-year maturities. Each series of Samurai notes may only be redeemed prior to maturity upon the occurrence of a tax event as specified in the respective bond agreement and are not available to U.S. residents or entities.

For our yen-denominated loans, the principal amount as stated in dollar terms will fluctuate from period to period due to changes in the yen/dollar exchange rate. We have designated these yen-denominated notes payable as a hedge of the foreign currency exposure of our investment in Aflac Japan.

The Parent Company filed a Shelf Registration Statement with Japanese regulatory authorities in February 2006 to issue up to 100 billion yen of yen-denominated Samurai notes in Japan. If issued, these securities will not be available to U.S. persons or entities.

In 1999, we issued $450 million of senior notes. These notes are redeemable at our option at any time with a redemption price equal to the principal amount of the notes being redeemed plus a make-whole premium. We have entered into cross-currency swaps related to these notes (see Note 4).

We were in compliance with all of the covenants of our notes payable at March 31, 2006. No events of default or defaults occurred during the three months ended March 31, 2006.

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6. SHAREHOLDERS' EQUITY

The following table is a reconciliation of the number of shares of the Company's common stock for the three-month periods ended March 31:

(In thousands of shares)	2006	2005
Common stock - issued		
:		
Balance, beginning of period	654,522	