

COTTON STATES LIFE INSURANCE CO /

Form 10-Q

August 13, 2003

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Quarterly Report Under Section 13 or 15(d) of
The Securities Exchange Act of 1934

For the three months and six months ended June 30, 2003

Commission File Number 2-39729

COTTON STATES LIFE INSURANCE COMPANY

(Exact name of registrant as specified in its charter)

GEORGIA

58-0830929

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification Number)

244 Perimeter Center Parkway, N.E., Atlanta, Georgia

30346

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (770) 391-8600

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 twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to the filing requirements for at least the past 90 days.

YES x NO o

Indicate by check mark whether the registrant is an accelerated Filer (as defined in Rule 126.2 of the Exchange Act).

YES o NO x

The Registrant as of June 30, 2003, has 6,322,737 shares of common stock outstanding.

COTTON STATES LIFE INSURANCE COMPANY

FORM 10-Q

FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2003

INDEX

	Page
PART 1 - FINANCIAL INFORMATION	
Item 1. Financial Statements	1
Independent Accountants' Review Report	1
Consolidated Condensed Balance Sheets as of June 30, 2003 and December 31, 2002	2
Consolidated Condensed Statements of Earnings for the Three Months and Six Months Ended June 30, 2003 and 2002	3
Consolidated Condensed Statements of Cash Flows for the Six Months Ended June 30, 2003 and 2002	4
Consolidated Condensed Statements of Comprehensive Income for the Three Months and Six Months Ended June 30, 2003 and 2002	5
Notes to Unaudited Consolidated Condensed Financial Statements	6
Item 2. Management's Discussion and Analysis of Consolidated Condensed Financial Condition and Results of Operations	11
Item 3. Quantitative and Qualitative Disclosures about Market Risk	19
Item 4. Controls and Procedures	20
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	21
Item 2. Changes in Securities and Use of Proceeds	21
Item 3. Defaults Upon Senior Securities	21
Item 4. Submission of Matters to a Vote of Security Holders	21
Item 5. Other Information	21
Item 6. Exhibits and Reports on Form 8-K	21
SIGNATURES	21

INDEPENDENT ACCOUNTANTS REVIEW REPORT

**To the Board of Directors and Shareholders of
Cotton States Life Insurance Company:**

We have reviewed the accompanying consolidated condensed balance sheet of Cotton States Life Insurance Company and subsidiaries as of June 30, 2003, and the related consolidated condensed statements of earnings, comprehensive income and cash flows for the three-month and six-month periods ended June 30, 2003. These financial statements are the responsibility of the Company's management. The consolidated condensed statements of earnings, comprehensive income and cash flows for the three-month and six-month periods ended June 30, 2002 were reviewed by other accountants whose report (dated August 6, 2002) stated that they were not aware of any material modifications that should be made to those statements for them to be in conformity with accounting principles generally accepted in the United States.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated condensed financial statements at June 30, 2003, and for the three-month and six-month periods then ended for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Cotton States Life Insurance Company and subsidiaries as of December 31, 2002, and the related consolidated statements of earnings, comprehensive income and cash flows for the year then ended and in our report dated February 25, 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of December 31, 2002, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Atlanta, Georgia
August 6, 2003

COTTON STATES LIFE INSURANCE COMPANY

ITEM I. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

The following consolidated condensed financial statements have been prepared by management. In management's opinion, all adjustments and reclassifications necessary for a fair statement of financial position at June 30, 2003 and December 31, 2002 and the results of operations for the three-months and six-months ended June 30, 2003 and 2002 have been made.

Consolidated Condensed Balance Sheets

	June 30, 2003	December 31, 2002
	(unaudited)	
ASSETS		
Investments:		
Fixed maturities, held for investment, at amortized cost (fair value of \$4,556,377 in 2003 and \$7,324,373 in 2002)	\$ 4,347,914	7,048,175
Fixed maturities, available for sale, at fair value (amortized cost of \$166,386,186 in 2003 and \$146,159,339 in 2002)	175,171,159	152,307,406
Equity securities, at fair value (cost of \$2,665,941 in 2003 and \$2,984,720 in 2002)	2,779,285	2,519,895
First mortgage loans on real estate	1,218,517	1,320,330
Policy loans	10,474,348	10,425,612
Other invested assets	582,000	582,000
	<u>194,573,223</u>	<u>174,203,418</u>
Total investments	194,573,223	174,203,418
Cash and cash equivalents	8,596,820	18,913,861
Accrued investment income	2,427,246	2,406,298
Amounts receivable, principally premiums	3,859,064	3,777,671
Amount due from reinsurers	4,577,467	4,263,828
Deferred policy acquisition costs	60,597,752	57,686,410
Federal income tax receivable	169,028	98,457
Other assets	645,930	460,061
	<u>\$ 275,446,530</u>	<u>261,810,004</u>
	<u>\$ 275,446,530</u>	<u>261,810,004</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Policy liabilities and accruals:		
Future policy benefits	\$ 167,709,247	160,424,107
Policy claims and benefits payable	2,734,694	3,241,343
	<u>170,443,941</u>	<u>163,665,450</u>
Total policy liabilities and accruals	170,443,941	163,665,450
Federal income taxes:		
Current		
Deferred	12,741,536	11,181,184
Other liabilities	6,087,005	5,592,961
	<u>189,272,482</u>	<u>180,439,595</u>
Total liabilities	189,272,482	180,439,595
Shareholders' equity:		
Common stock of \$1 par value. Authorized 20,000,000 shares; issued: 6,987,331 shares in 2003 and 6,929,347 shares in 2002; outstanding: 6,322,737 shares in 2003 and 6,328,737 shares in 2002; restricted: 232,827 shares in 2003 and 174,843 shares in 2002	6,987,331	6,929,347
Additional paid-in capital	3,762,724	3,434,018

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Accumulated other comprehensive income, net of tax	5,194,607	3,226,975
Retained earnings	74,658,151	72,035,550
Less:		
Unearned compensation restricted stock	(880,701)	(764,543)
Treasury stock, at cost (431,767 shares in 2003 and 425,767 shares in 2002)	(3,548,064)	(3,490,938)
	<u>86,174,048</u>	<u>81,370,409</u>
Total shareholders equity	<u>\$275,446,530</u>	<u>261,810,004</u>

See accompanying notes to unaudited consolidated condensed financial statements.

COTTON STATES LIFE INSURANCE COMPANY

Unaudited Consolidated Condensed Statements of Earnings
 Three Months and Six Months ending June 30, 2003 and 2002

	Three months ended June 30,		Six months ended June 30,	
	2003	2002	2003	2002
Revenue:				
Premiums	\$ 8,824,057	8,007,993	17,023,006	15,674,310
Investment income	2,136,131	2,427,037	4,456,668	4,898,973
Realized investment gains (losses)	843,452	(48,821)	1,235,899	108,151
Brokerage commissions	1,119,656	1,124,817	2,197,625	2,133,103
Total revenue	12,923,296	11,511,026	24,913,198	22,814,537
Benefits and expenses:				
Benefits and claims	5,483,542	4,628,159	10,292,718	8,984,955
Interest credited	1,465,818	1,516,837	2,968,432	2,963,067
Amortization of policy acquisition costs	1,281,489	949,468	2,307,691	1,930,734
Operating expenses	2,391,136	2,132,222	4,774,556	4,422,525
Total benefits and expense	10,621,985	9,226,686	20,343,397	18,301,281
Income before income tax expense	2,301,311	2,284,340	4,569,801	4,513,256
Income tax expense	730,459	590,622	1,437,213	1,288,370
Net income	\$ 1,570,852	1,693,718	3,132,588	3,224,886
Basic income per share of common stock	\$ 0.25	0.27	0.50	0.51
Diluted income per share of common stock	\$ 0.23	0.26	0.47	0.50
Weighted average number of shares used in computing income per share				
Basic	6,323,363	6,339,964	6,324,328	6,337,709
Diluted	6,614,624	6,501,457	6,615,016	6,498,206
Dividends paid per share	\$ 0.04	0.04	0.08	0.08

See accompanying notes to unaudited consolidated condensed financial statements.

COTTON STATES LIFE INSURANCE COMPANY

Unaudited Consolidated Condensed Statements of Cash Flows
Six months ended June 30, 2003 and 2002

	Six months ended June 30,	
	2003	2002
Cash flows from operating activities:		
Net income	\$ 3,132,588	3,224,886
Adjustments to reconcile net income to net cash provided from operating activities:		
Realized investment gains	(1,235,899)	(108,151)
Increase in policy liabilities and accruals	6,778,491	7,433,934
(Increase) in deferred policy acquisition costs	(2,677,528)	(3,189,458)
Increase in liability for income taxes	396,656	163,371
(Increase) decrease in amounts receivable and amounts due from reinsurers	(395,032)	561,429
Increase (decrease) in amounts due affiliate	246,230	(485,657)
Other, net	723,890	34,113
Net cash provided from operating activities	<u>6,969,396</u>	<u>7,634,467</u>
Cash flows from investing activities:		
Purchase of fixed maturities available for sale	(72,369,150)	(53,636,454)
Purchase of equity securities	(451,021)	(1,104,600)
Sale of fixed maturities held for investment		450,000
Sale of fixed maturities available for sale	37,714,114	38,777,033
Sale of equity securities	441,175	1,084,643
Proceeds from maturities of fixed maturities held for investment	2,700,000	1,000,000
Proceeds from maturity and redemption of fixed maturities held for sale	15,456,245	7,822,348
Principal collected on first mortgage loans	101,813	131,524
Net increase in policy loans	(48,736)	(284,514)
Other, net	(263,764)	73,563
Net cash used in investing activities	<u>(16,719,324)</u>	<u>(5,686,457)</u>
Cash flows from financing activities:		
Cash dividends paid	(509,987)	(509,987)
Purchase of treasury stock	(57,126)	(10,453)
Stock issued under executive compensation plans		65,232
Net cash used by financing activities	<u>(567,113)</u>	<u>(455,208)</u>
Net (decrease) increase in cash and cash equivalents:	<u>(10,317,041)</u>	<u>1,492,802</u>
Cash and cash equivalents:		
Beginning of period	<u>18,913,861</u>	<u>13,187,601</u>
End of period	<u>\$ 8,596,820</u>	<u>14,680,403</u>

See accompanying notes to unaudited consolidated condensed financial statements.

COTTON STATES LIFE INSURANCE COMPANY

Unaudited Consolidated Condensed Statements of Comprehensive Income
 Three Months and Six Months ended June 30, 2003 and 2002

	Three months ended June 30,		Six months ended June 30,	
	2003	2002	2003	2002
Net income	\$ 1,570,852	1,693,718	3,132,588	3,224,886
Other comprehensive income (loss), before tax:				
Change in fair value of securities available for sale	3,149,407	2,073,243	4,217,159	29,446
Reclassification adjustment for realized (gains) losses included in net income	(843,452)	48,821	(1,235,899)	(108,151)
Total other comprehensive income (loss), before tax	2,305,955	2,122,064	2,981,260	(78,705)
Income tax expense related to items of other comprehensive income	784,024	838,303	1,013,628	4,100
Other comprehensive income (loss), net of tax	1,521,931	1,283,761	1,967,632	(82,805)
Total comprehensive income	\$ 3,092,783	2,977,479	5,100,220	3,142,081

See accompanying notes to unaudited consolidated condensed financial statements.

Cotton States Life Insurance Company
Notes to Unaudited Consolidated Condensed Financial Statements
June 30, 2003

Note 1 Basis of Presentation

The accompanying consolidated condensed financial statements include the accounts of Cotton States Life Insurance Company and its wholly owned subsidiaries CSI Brokerage Services, Inc., and CS Marketing Resources, Inc. Significant intercompany transactions and balances are eliminated in the consolidation.

The consolidated condensed financial statements for the three months and six months ended June 30, 2003 are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in the Company's annual report on Form 10-K for the year ended December 31, 2002.

In the opinion of management, all adjustments and reclassifications necessary to present fairly the financial position and the results of operations and cash flows for the interim periods have been made. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of the results of operations that the Company may achieve for the entire year.

Certain prior year amounts in the accompanying consolidated condensed financial statements have been reclassified in order to conform with current year presentation.

Note 2 Stock-Based Compensation

In accordance with APB Opinion No. 25, \$270,000 and \$154,000 in compensation expense was recorded in the six months ended June 30, 2003 and 2002, respectively, for the various stock option and restricted stock awards granted. Had the Company determined compensation cost based on the fair value at the grant date for its stock options and restricted stock awards under SFAS No. 123, Accounting for Stock-Based Compensation, the Company's net income, basic net income per share, and diluted net income per share would have been reduced to the pro forma amounts indicated below:

**Notes to Unaudited Condensed Consolidated Financial Statements
(continued)**

	Three months ended June 30,	
	2003	2002
Net income:		
As reported	\$ 1,570,852	1,693,718
Pro forma	\$ 1,555,466	1,678,332
Basic net income per share:		
As reported	\$ 0.25	0.27
Pro forma	\$ 0.25	0.27