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COTTON STATES LIFE INSURANCE CO /
Form 10-Q
May 14, 2001

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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 ENDED MARCH 31, 2001

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 NO

The Registrant as of March 31, 2001, has 6,345,428 shares of common stock outstanding.

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COTTON STATES LIFE INSURANCE COMPANY

FORM 10Q

FOR THE THREE MONTHS ENDED MARCH 31, 2001

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INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS
COTTON STATES LIFE INSURANCE COMPANY, INC.:

We have reviewed the consolidated balance sheet of Cotton States Life Insurance Company, Inc. as of March 31, 2001, and the related consolidated summary of earnings and statements of cash flows and comprehensive income for the three-month periods ended March 31, 2001 and 2000. These consolidated financial statements are the responsibility of the Company's management.

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 of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the accompanying consolidated condensed balance sheet of Cotton States Life Insurance Company, Inc. as of December 31, 2000, and the related consolidated statements of earnings,

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shareholders' equity, cash flows and comprehensive income for the year then ended (not presented herein); and in our report dated February 21, 2001, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2000, is fairly stated in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/S/ KPMG LLP

May 9, 2001
Atlanta, Georgia

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ITEM I - CONSOLIDATED FINANCIAL STATEMENTS

The following consolidated statements have been prepared by management. In management's opinion, all adjustments and reclassifications necessary for a fair statement of financial position at March 31, 2001 and December 31, 2000 and the results of operations for the three months ended March 31, 2001 and 2000 have been made.

COTTON STATES LIFE INSURANCE COMPANY
Consolidated Balance Sheets
March 31, 2001 and December 31, 2000
(Amounts in Thousands)

	2001 (unaudited)	2000
ASSETS		
Investments		
Fixed maturities, held for investment, at amortized cost (fair value \$15,414 in 2001 and \$15,214 in 2000)	\$ 15,055	15,000
Fixed maturities, available for sale, at fair value (amortized cost \$124,119 in 2001 and \$119,813 in 2000)	123,796	116,000
Equity securities, at fair value (cost \$3,673 in 2001 and \$3,671 in 2000)	3,272	3,000
First mortgage loans on real estate	1,988	2,000
Policy loans	9,071	8,000
Short-term investments	5,044	3,000
Other invested assets	1,000	1,000
TOTAL INVESTMENTS	159,226	150,000
Cash	--	2,000
Accrued investment income	2,148	2,000
Premiums receivable	2,605	3,000
Reinsurance receivable	4,560	4,000
Deferred policy acquisition costs	48,088	46,000
Other assets	487	500

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	-----	-----
	\$ 217,114	211
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Policy liabilities and accruals:		
Future policy benefits	135,666	132
Policy and contract claims	2,861	2
Federal income taxes	6,945	6
Other liabilities	6,839	7
	-----	-----
TOTAL LIABILITIES	152,311	148
	-----	-----
Shareholders' equity:		
Common Stock	6,755	6
Additional paid-in capital	1,496	1
Accumulated other comprehensive loss	(397)	(1)
Retained earnings	61,086	60
Less:		
Unearned compensation-restricted stock	(810)	
Treasury stock, at cost, (409 shares in 2001 and 2000)	(3,327)	(3)
	-----	-----
TOTAL SHAREHOLDERS' EQUITY	64,803	62
	-----	-----
	\$ 217,114	211
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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COTTON STATES LIFE INSURANCE COMPANY
 Unaudited Consolidated Summary of Earnings
 Three months ending March 31, 2001 and 2000
 (Amounts in thousands, except per share data)

	Three months ended	
	March 31,	
	2001	2000
	-----	-----
Revenue:		
Premiums	\$ 7,031	6,126
Investment income	2,549	2,402
Realized investment gains	9	117
Brokerage commissions	903	907
	-----	-----
TOTAL REVENUE	10,492	9,552
	-----	-----

Benefits and expenses:

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Benefits and claims	4,718	3,118
Interest credited	1,217	1,268
Amortization of policy acquisition costs	928	853
Operating expenses	2,032	1,889
	-----	-----
TOTAL BENEFITS AND EXPENSES	8,895	7,128
	-----	-----
Income before income tax expense	1,597	2,424
Income tax expense	576	901
	-----	-----
NET INCOME	\$ 1,021	1,523
	=====	=====
Basic income per share of common stock		
Operating income	\$ 0.16	0.23
	=====	=====
Net Income	\$ 0.16	0.24
	=====	=====
Diluted income per share of common stock		
Operating income	\$ 0.16	0.23
	=====	=====
Net income	\$ 0.16	0.24
	=====	=====
Weighted average number of shares used in computing income per share		
Basic	6,345	6,346
	=====	=====
Diluted	6,520	6,467
	=====	=====

Operating income excludes realized gains, net of tax
See accompanying notes to unaudited consolidated financial statements.

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COTTON STATES LIFE INSURANCE COMPANY
Unaudited Consolidated Statements of Cash Flows
Three months ending March 31, 2001 and 2000

	2001	2000
	-----	-----
Cash flows from operating activities:		
Net income	\$ 1,021	
Adjustments to reconcile net income to net cash provided from operating activities:		
Increase in policy liabilities and accruals	3,574	
(Increase) in deferred policy acquisition costs	(1,535)	
Increase (decrease) in liability for income taxes	(137)	

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Increase (decrease) in amounts receivable and amounts due from reinsurers	528	
(Decrease) increase in amounts payable to affiliates	(254)	
Other, net	160	
	-----	----
Net cash provided from operating activities	3,357	
	-----	----
Cash flows from investing activities:		
Purchase of fixed maturities available for sale	(15,470)	(
Purchase of equity securities	(1,214)	(
Sale of equity securities	1,212	
Proceeds from maturities of fixed maturities held for investment	--	
Proceeds from maturity and redemption of fixed maturities available for sale	11,149	
Principal collected on first mortgage loans	110	
Net increase in policy loans	(230)	
Other, net	(53)	
	-----	----
Net cash used in investing activities	(4,496)	(
	-----	----
Cash flows from financing activities:		
Cash dividends paid	(255)	
Purchase of Treasury Stock	--	
Stock issued under executive compensation plans	--	
	-----	----
Net cash used by financing activities	(255)	
	-----	----
Net (decrease) in cash and cash equivalents:	(1,394)	(
	-----	----
Cash and cash equivalents:		
Beginning of period	6,438	
	-----	----
END OF PERIOD	\$ 5,044	
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

COTTON STATES LIFE INSURANCE COMPANY
 Unaudited Consolidated Statements of Comprehensive Income
 Three Months ending March 31, 2001 and 2000
 (Amounts in thousands)

Three months ended March 31,	
2001	2000
-----	-----

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Net income:	\$ 1,021	1,523
Other comprehensive income (loss), before tax:		
Unrealized gains on securities available for sale	2,144	538
Reclassification adjustment for realized (gains) included in net income	(9)	(117)
	-----	-----
TOTAL OTHER COMPREHENSIVE INCOME BEFORE TAX	2,135	421
	-----	-----
Income tax expense related to items of other comprehensive income	816	135
	-----	-----
Other comprehensive income net of tax	1,319	286
	-----	-----
TOTAL COMPREHENSIVE INCOME	\$ 2,340	1,809
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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COTTON STATES LIFE INSURANCE COMPANY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2001 AND DECEMBER 31, 2000

NOTE 1 - BASIS OF PRESENTATION

The accompanying consolidated 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 inter-company transactions and balances are eliminated in the consolidation.

The consolidated financial statements for the three months ended March 31, 2001 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 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, 2000.

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 period have been made. All such adjustments are of a normal and recurring nature. The results of operations are not necessarily indicative of the results of operations that the Company may achieve for the entire year.

NOTE 2 - ACCOUNTING PRONOUNCEMENTS

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Financial Accounting Standards Board ("FASB") SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137 and 138, is effective for years beginning January 1, 2001. The standard requires that all derivatives be recorded as an asset or liability, at fair value, regardless of the purpose or intent for holding the derivative. If a derivative is not utilized as a hedge, all gains and losses from the change in the derivative's estimated fair value are recognized in earnings. All gains and losses from the change in estimated fair value of certain derivatives utilized as hedges are recognized in earnings or other comprehensive income depending on the type of hedge relationship. Due to the Company's limited use of derivative financial instruments, the adoption of SFAS No. 133, as amended, did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

NOTE 3 - BUSINESS SEGMENTS

The Company's operations include the following three major segments, differentiated primarily by their respective methods of distribution and the nature of related products: individual life insurance, guaranteed and simplified issue life insurance, and brokerage operations. The Company's operations in each segment are concentrated within its southeastern state geographic market. Individual life insurance products are distributed through the Company's multi-line exclusive agents, guaranteed and simplified issue products are distributed through independent agents as well as exclusive agents, and brokerage operations all involve third party products distributed through the Company's exclusive and independent agents.

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Total revenue and operating income by business segment are as follows:

	Three Months Ended March 31, (Dollars in thousands)	
	2001 -----	2000 -----
Individual life insurance:		
Premiums	\$4,571	4,322
Other revenue	2,365	2,254
	-----	-----
Total revenue	\$6,936	6,576
	=====	=====
Operating income	\$ 489	967
	=====	=====
Guaranteed and simplified issue life insurance:		
Premiums	\$2,460	1,804
Other revenue	172	107
	-----	-----
Total revenue	\$2,632	1,911
	=====	=====
Operating income	\$ 88	53

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	=====	=====
Brokerage:		
Commission income	\$ 903	907
Other revenue	21	158
	-----	-----
Total revenue	\$ 924	1,065
	=====	=====
Operating income	\$ 438	426
	=====	=====
Total operating income	\$1,015	1,446
Realized gains, net of tax	6	77
	-----	-----
Net income	\$1,021	\$1,523
	=====	=====

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

FORWARD-LOOKING STATEMENTS

Statements made in the following discussion that states the Company's or management's intentions, hopes, beliefs, expectations or predictions of the future are forward-looking statements. Without limiting the foregoing, forward-looking statements include statements which represent the Company's beliefs concerning future levels of sales and redemption of the Company's products, investment spreads and yields, or the earnings and profitability of the Company's activities.

Forward-looking statements are necessarily based on estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the Company's control and many of which are subject to change. These uncertainties and contingencies could cause actual results to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable developments. Some may be national in scope, such as general economic conditions, changes in tax law and changes in interest rates. Some may be related to the insurance industry generally, such as pricing competition, regulatory developments and industry consolidation. Others may relate to the Company specifically, such as credit, volatility and other risks associated with the Company's investment portfolio. Investors are also directed to consider other risks and uncertainties discussed in documents filed by the Company with the Securities and Exchange Commission. If the Company's assumptions and estimates are incorrect or do not come to fruition, or if the Company does not achieve all of these key factors, then the Company's actual performance could vary materially from the forward-looking statements made herein. The Company disclaims any obligation to update forward-looking information.

RESULTS OF OPERATIONS
(DOLLARS IN THOUSANDS)

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PREMIUMS	THREE MONTHS ENDED MARCH 31,		
	2001	2000	INCREASE
Guaranteed and simplified issue life insurance	\$2,460	1,804	36%
Individual life insurance:			
Traditional life	1,590	1,424	12%
Universal life	2,981	2,898	3%
Total individual life insurance	4,571	4,322	6%
TOTAL PREMIUMS	\$7,031	6,126	15%

Guaranteed and simplified issue life insurance premiums continued to show significant growth as a result of higher production by the Company's independent agency force which increased 11% to 3,900 agents under contract at March 31, 2001 compared to 3,500 at March 31, 2000. This product is also distributed by the

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Company's multi-line exclusive agents and is available for purchase over the Internet at the Company's home page.

Individual life insurance products are principally sold by the Company's exclusive agent producers. Individual life premiums have increased 6% for the three month period, principally influenced by the customer's preference for whole life insurance. The exclusive agency force of 297 as of March 31, 2001 is three fewer than at the same date last year.

INVESTMENT INCOME

Investment income increased 6% compared to the first three months of 2001 reflecting growth in the average investment portfolio. The annualized average yield decreased slightly to 6.6% compared to 6.8% for the first quarter of 2000.

BROKERAGE

Exclusive agents also sell products that the Cotton States Group does not underwrite (both life and property and casualty). Growth in brokerage income for the first quarter was flat due to lower override commissions with selected life insurance carriers. Other property and casualty business lines continue to show growth with commissions increasing 5%.

BENEFITS AND CLAIMS

Life benefits and claims, including reserve increases on traditional life and guaranteed and simplified issue products are as follows:

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THREE MONTHS ENDED
MARCH 31,
(DOLLARS IN THOUSANDS)

	2001 ----- BENEFITS AND CLAIMS	% OF PREMIUM	2000 ----- BENEFITS AND CLAIMS
BENEFITS AND CLAIMS			
Guaranteed and simplified issue	\$1,807	73%	1,321
Individual life insurance			
Traditional life	1,375	86%	813
Universal life	1,536	52%	984
	-----		-----
Total individual life insurance	2,911	64%	1,797
	-----		-----
	TOTAL BENEFITS AND CLAIMS	67%	3,118
	=====		=====

Individual life benefits as a percentage of premium reflects increased mortality for the quarter. With \$5 billion of in-force life insurance, a one percent variance in projected mortality, which was experienced during the quarter, will occur periodically. The Company offsets effects of mortality in excess of \$10 million with stop loss reinsurance which, for accounting purposes, can only be considered on an annual basis.

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INTEREST CREDITED TO POLICYHOLDERS

Interest credited to universal life contracts decreased 4% reflecting a small decline in universal life policy accumulations. The annual interest rate credited to universal life contract accumulations was 6.2% for both three month periods of 2001 and 2000.

AMORTIZATION OF POLICY ACQUISITION COSTS AND OPERATING EXPENSES

The amortization of policy acquisition costs as a percentage of premiums was 13% and is within the Company's expected range of 12-14%.

Operating expense as a percentage of premiums continued to decrease dropping to 29% for the first three months compared to 31% for the same period last year. The Company continues to realize increasing cost efficiencies from recently implemented digital imaging and automated policy processing technologies. This allows the Company to increase production without increasing costs.

INCOME TAX EXPENSE

The effective tax rate for the first three months of 2001 was 36% compared to 37% for the same period last year. The tax rates reflect the increase in deferred policy acquisition costs and other temporary differences which are taxed at 34% and do not reflect the impact of the small company deduction.

NET INCOME

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	THREE MONTHS ENDED MARCH 31, (DOLLARS IN THOUSANDS)		
NET INCOME	2001	2000	INCREASE
	-----	-----	-----
Operating income:			
Guaranteed and simplified issue	\$ 88	53	66%
	-----	-----	
Individual life insurance:			
Traditional	69	304	(77)%
Universal life	420	663	(37)%
	-----	-----	
Total individual life insurance	489	967	(49)%
	-----	-----	
Brokerage operations	438	426	3%
	-----	-----	
Total operating income	1,015	1,446	(30)%
Realized gains	6	77	(92)%
	-----	-----	
Net Income	\$1,021	1,523	(33)%
	=====	=====	

Despite continued growth in premiums and cost efficiencies, the increase in mortality, which is expected to return to normal levels, accounted for the decrease in operating income for the first quarter.

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QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

CREDIT RISK

Credit Risk is the risk that issuers of securities owned by the Company will default, or other parties, including reinsurers, which owe the Company money, will not pay. The Company attempts to minimize these risks by following a conservative investment strategy and by contracting with reinsuring companies that meet high standards for rating criteria and other qualifications. The Company invests in government, governmental agency and high quality corporate bonds having an A rating or better. The fixed maturity portfolio had an average rating of AA- at March 31, 2001.

INTEREST RATE RISK

The Company's fixed maturity investments are subject to interest rate risk. The Company manages the impact of interest rate fluctuation through cash flow modeling. Liabilities for interest sensitive products are carried at full account value. The fixed maturity portfolio at March 31, 2001 and December 31, 2000 had an effective duration of 4.8 years.

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The table below summarizes the Company's interest rate risk and shows the effect of a hypothetical 100 basis point (bp) increase in interest rates on the market values of the fixed investment portfolio. The selection of a 100 basis point increase in interest rates should not be construed as a prediction by the Company's management of future market events, but rather, to illustrate the potential impact of such events. These calculations may not fully capture the impact of the changes in the ratio of long-term rates to short-term rates.

	(AMOUNTS IN THOUSANDS)	
FIXED MATURITIES	ESTIMATED FAIR VALUE MARCH 31, 2001	ESTIMATED FAIR VALUE AFTER 100 BASIS POINT CHANGE IN INTEREST RATES
-----	-----	-----
Held for investment	\$ 15,414	100 bp decrease \$ 15,670 100 bp increase \$ 15,166
Available for sale	\$ 123,796	100 bp decrease \$125,259 100 bp increase \$122,039

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOW

Premiums and investment income are the Company's major sources of cash flow used to meet its short-term and long-term cash requirements.

Short-term obligations consist primarily of operating expenses and policyholder benefits. The Company has been able to meet these funding requirements out of operating cash flow. The Company does not anticipate that it will become necessary to sell long-term investments to meet short-term obligations.

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The Company's principal long-term obligations are fixed contractual obligations incurred in the sale of its life insurance products. The premiums billed for these products are based on conservative and actuarially sound assumptions as to mortality, persistency and interest. The Company believes these assumptions will produce revenues sufficient to meet its future contractual benefit obligations and operating expenses, and provide an adequate profit margin to finance future growth without a major entry into the debt or equity markets.

INVESTMENTS

Since December 31, 2000, there has not been a material change in mix or credit quality of the Company's investment portfolio. All purchases have been fixed maturities available for sale and over 93% of the holdings at March 31, 2001 and December 31, 2000 are rated "A" or better. Due to the improvement in bond market conditions, the Company experienced an increase in the market value of bonds of approximately \$2.9 million for the quarter.

MORTGAGE LOANS

The Company's mortgage loan policy stipulates that the Company will loan no more than 80% of the value on residential loans and no more than 75% of the value on

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commercial loans. The Company grants loans only to employees (excluding officers and directors) and agents.

The geographic distribution of the loan portfolio is:

NO. OF LOANS		STATE	BOOK VALUE	
MARCH 31,	DECEMBER 31,		(AMOUNTS IN THOUSANDS)	
-----	-----	-----	-----	-----
2001	2000		2001	2000
----	----		-----	-----
3	3	Alabama	\$ 126	130
6	6	Florida	346	354
35	36	Georgia	1,516	1,614
--	--		-----	-----
44	45		\$1,988	2,098
==	==		=====	=====

Two loans representing \$109 thousand in principal are over 30 days delinquent. The loan-to-value ratio on delinquent loans is 29%.

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ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information required by item 305 of Regulation S-K is contained in "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in this Form 10-Q.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is a defendant in various actions incidental to the conduct of its business. The Company intends to vigorously defend the litigation and while the ultimate outcome of these matters cannot be estimated with certainty, management does not believe the actions will result in any material loss to the Company.

Item 2. Changes in Securities and Use of Proceeds

NONE

Item 3. Defaults Upon Senior Securities

NONE

Item 4. Submission of Matters to a Vote of Security Holders

NONE

Item 5. Other Information

NONE

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Item 6. Exhibits and Reports on Form 8-K

Exhibit 11 - Statement re Computation of Per Share Earnings

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.

COTTON STATES LIFE INSURANCE COMPANY
REGISTRANT

Date: 5/10/01

/s/ J. Ridley Howard

J. Ridley Howard, Chairman
President and Chief Executive Officer

Date: 5/10/01

/s/ Roger W. Fisher

Roger W. Fisher
Senior Vice President, Chief Financial Officer
and Treasurer