

COTTON STATES LIFE INSURANCE CO /

Form 10-K

March 29, 2004

Table of Contents

Securities and Exchange Commission

Washington, D. C. 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2003

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 2-39729

Cotton States Life Insurance Company

(Exact name of registrant as specified in its charter)

Georgia

58-0830929

(State of incorporation
and jurisdiction)

(I.R.S. Employer
Identification No.)

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

30346

(Address of principal executive offices)

(Zip code)

Registrant's telephone number, including area code: (404) 391-8600

Securities registered pursuant to Section 12(b) of the Act:

NONE

Securities registered pursuant to Section 12(g) of the Act:

EXEMPT-UNDER SECTION 12(g)(2)(G)

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Indicate by check mark whether the registrant 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 and has been subject to the filing requirements for at least the past 90 days. YES ☒ NO ☐

Indicate by check mark if the disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2)

YES ☐ NO ☒

The aggregate market value of the voting and non-voting common equity held by non affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity as of the last business day of the registrant's most recently completed second quarter was \$42,583,352 based on the closing price of \$10.09 on June 30, 2003, as reported on the NASDAQ National Market.

As of March 26, 2004, there were 6,322,737 shares of registrant's common stock outstanding.

The Exhibit Index is located on Page 71

The total number of pages in this document is 78

TABLE OF CONTENTS

PART I

ITEM 1. BUSINESS

ITEM 2. PROPERTIES

ITEM 3. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

PART II

ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

ITEM 6. SELECTED FINANCIAL DATA

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Consolidated Balance Sheets

Consolidated Statements of Earnings

Consolidated Statements of Shareholders' Equity

Consolidated Statements of Cash Flows

Consolidated Statements of Comprehensive Income

Notes to Consolidated Financial Statements

REPORT OF INDEPENDENT AUDITORS

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

ITEM 9A. CONTROLS AND PROCEDURES

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE COMPANY

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

SIGNATURES

EX-3.2 AMENDED & RESTATED BYLAWS OF THE REGISTRANT

EX-10.3.3 AMENDED & RESTATED EMPLOYMENT AGREEMENT

EX-21 SUBSIDIARIES OF THE REGISTRANT

EX-23.1 CONSENT OF INDEPENDENT AUDITORS

EX-23.2 CONSENT OF INDEPENDENT ACCOUNTANTS

EX-31.1 SECTION 302 CERTIFICATION OF THE CEO

EX-31.2 SECTION 302 CERTIFICATION OF THE CFO

EX-32 SECTION 906 CERTIFICATION OF THE CEO AND CFO

Table of Contents

PART I

ITEM 1. BUSINESS

General

Cotton States Life Insurance Company (the Company) was organized under the laws of the State of Georgia in 1955. The Company is currently licensed to transact business in Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee and Virginia. The Company currently markets only individual life insurance, payroll deduction life insurance, guaranteed issue and simplified issue life insurance and individual annuities.

In July of 1989, the Company formed CSI Brokerage Services, Inc. (CSI). CSI brokers insurance products for the Company's exclusive agents not offered by the Company's affiliated property and casualty companies.

In November of 1989, the Company acquired 60% of the outstanding common stock of Cotton States Marketing Resources, Inc. (CSMR). During 1992, the Company acquired the remaining 40% of CSMR's stock. CSMR brokers through the Company's exclusive agents other insurance companies' life and accident and health products not underwritten by the Company.

On February 21, 2002, the Company filed notice of its intent to withdraw its multi-line exclusive agents from Kentucky primarily due to losses incurred by the Company's affiliate, Cotton States Mutual Insurance Company. Without objection from the Kentucky Department of Insurance, the Company's withdrawal plan was accepted pursuant to Kentucky insurance regulations.

It was announced on December 30, 2003 that the Cotton States Insurance Group (which includes the Company and Cotton States Mutual Insurance Company) and COUNTRY Insurance & Financial Services (COUNTRY), located in Bloomington, Illinois, entered into definitive agreements regarding the acquisition of the Company by merger. Under the Agreement and Plan of Merger, the Company's shareholders will receive \$20.25 cash for each share of outstanding common stock of the Company. As a result, the Company will become a privately-held company and a wholly-owned subsidiary of COUNTRY. Subject to regulatory approval, shareholder approval, and other conditions set forth in the Agreement and Plan of Merger, it is anticipated that the transaction will close during the second quarter of 2004.

Principal Products and Methods of Distribution

The Company's operations can be grouped into three major segments: (i) individual life insurance, (ii) guaranteed issue and simplified issue life insurance, and (iii) brokerage operations. These segments are differentiated primarily by their respective methods of distribution and the nature of related products, as the Company's operations in each segment are concentrated within its southeastern states geographic market. Individual life insurance products are distributed through the Company's multi-line exclusive agents, guaranteed issue and simplified issue products are distributed through independent agents as well as exclusive agents, and brokerage operations involve third party products distributed through the Company's exclusive and independent agents. The Company does not group items on the consolidated balance sheet into segments, nor does it analyze those items by segment when making management decisions. The Company allocates net investment income and net realized gains to its individual life insurance and guaranteed issue and simplified issue life insurance segments based on the ratio of each segment's reserves to total reserves. Net investment income and net realized gains for the Company's brokerage segment is based on actual amounts earned by its brokerage subsidiaries.

Table of Contents

	2003	2002	2001
Individual life insurance:			
Premiums	\$ 19,979,437	19,347,710	18,658,255
Net investment income	7,905,844	8,857,310	9,458,445
Realized investment gains	1,624,312	935,571	24,969
	<hr/>	<hr/>	<hr/>
Total revenue	29,509,593	29,140,591	28,141,669
Policyholder benefits and claims	10,606,712	9,478,267	8,821,942
Interest credited	5,912,341	5,904,423	5,527,001
Amortization of deferred policy acquisition costs	2,829,148	2,084,635	3,248,281
Other operating expenses	6,350,370	5,143,895	5,257,470
	<hr/>	<hr/>	<hr/>
Total benefits and expenses	25,698,571	22,611,220	22,854,694
	<hr/>	<hr/>	<hr/>
Segment profit before income taxes	3,811,022	6,529,371	5,286,975
	<hr/>	<hr/>	<hr/>
Guaranteed issue and simplified issue life insurance:			
Premiums	14,358,260	12,438,241	10,529,996
Net investment income	1,036,838	952,774	775,780
Realized investment gains	213,531	101,134	2,532
	<hr/>	<hr/>	<hr/>
Total revenue	15,608,629	13,492,149	11,308,308
Policyholder benefits and claims	11,311,624	9,332,175	7,656,444
Amortization of deferred policy acquisition costs	2,262,856	1,676,350	1,218,431
Other operating expenses	1,854,716	2,001,826	1,913,723
	<hr/>	<hr/>	<hr/>
Total benefits and expenses	15,429,196	13,010,351	10,788,598
	<hr/>	<hr/>	<hr/>
Segment profit before income taxes	179,433	481,798	519,710
	<hr/>	<hr/>	<hr/>
Brokerage:			
Brokerage commissions	4,906,455	4,242,470	4,190,482
Net investment income	8,047	18,880	48,397
Realized investment gains			
	<hr/>	<hr/>	<hr/>
Total revenue	4,914,502	4,261,350	4,238,879

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Operating expenses	<u>1,003,102</u>	<u>966,955</u>	<u>1,106,448</u>
Segment profit before income taxes	<u>3,911,400</u>	<u>3,294,395</u>	<u>3,132,431</u>
Combined segment profit before income taxes	7,901,855	10,305,564	8,939,116
Group life insurance and individual accident and health results	<u>(58,444)</u>	<u>(35,819)</u>	<u>(74,560)</u>
Income before federal income taxes	<u>\$ 7,843,411</u>	<u>10,269,745</u>	<u>8,864,556</u>

Narrative Description of Business Segments

(i) Individual Life

The major forms of individual life insurance offered by the Company include universal life, graded premium whole life, participating whole life, term life, various supplemental riders including, but not limited to, accidental death, disability waiver and guaranteed insurability, and disability income riders. These products are sold by the Company's 251 multi-line exclusive agents in Alabama, Florida, Georgia, and Tennessee.

Table of Contents

The Company offers its insurance through multi-line exclusive agents who also write all lines of property and casualty insurance offered by Cotton States Mutual Insurance Company (Mutual) and its subsidiary, Shield Insurance Company (Shield) (collectively, the Cotton States Group). See Item 13 of this report for an explanation of the relationship between the Company, Mutual, and Shield. Multi-line exclusive agents are under contract to the Company, Mutual, and Shield, and are paid on a commission basis. The Company's multi-line exclusive agents are located in the following states:

Number of Agents December 31,		
2003	2002	State
46	52	Alabama
23	24	Florida
163	169	Georgia
19	27	Tennessee
Total	251	272

Unless the need for a medical examination is indicated by the application or an investigation, the Company writes individual life insurance based on age without requiring blood and specimen in the following maximum amounts:

Age Group	Maximum Insurance
0-17	\$ 100,000
18-40	74,999
41-50	50,000
51 and over	25,000

As of December 31, 2003, less than 2.3% of the Company's individual life premiums were represented by what the Company believes to be substandard risks. Substandard life insurance risks are accepted by the Company at increased rates. The Company has no fixed maximum on the size of substandard policies and will entertain any application on which it can obtain reinsurance which it believes to be adequate.

The Company, as do others in the insurance industry, reinsures with other companies portions of the individual life insurance policies it underwrites. Reinsurance enables an insurance company to write a policy in an amount larger than the risk it desires to assume. A contingent liability exists on insurance ceded to the reinsurer which might become a liability of the Company in the event that the reinsurer fails to meet its obligations under the reinsurance treaty.

The Company presently retains, with respect to individual life policies, generally no more than \$100,000 of insurance on any one life, which may be reduced, depending upon the age and the physical classification of the insured. All accidental death riders are 100% reinsured.

(ii) Guaranteed Issue and Simplified Issue Whole Life Insurance

The Company offers Guaranteed Issue and Simplified Issue whole life insurance through its multi-line agency force and approximately 4,700 independent agents. The independent agents sell these products in all states in which the Company is licensed to conduct business.

Both plans are level-premium, cash value permanent life insurance products issued from \$2,500 to \$35,000 face amounts. Both plans are frequently used by individuals to cover final expenses. They are designed to be sold as companion plans using a simple application with no medical exams or tests. If all health questions asked of the applicant by the Company can be answered NO, the Simplified Issue policy may be issued. Otherwise, the Guaranteed Issue policy will be issued.

Table of Contents

Guaranteed Issue whole life is available for issue ages 46-80. The death benefit in policy years one through three is limited to a return of premium plus 10%. However, the full death benefit is payable in all years in case of accidental death. After three years, the full death benefit is payable for any cause of death.

Simplified Issue whole life is available for issue ages 0-80. The full death benefit is payable from the issue date.

(iii) Brokerage

The Company owns two brokerage subsidiaries, CSI and CSMR. CSI provides the Company with commission income from brokerage agreements with other property and casualty insurance carriers. These carriers supply the Company's multi-line agents with property and casualty products that the Company's affiliated property and casualty companies do not underwrite, such as non-standard auto insurance, crop hail insurance, multi-peril crop insurance, mobile home insurance, poultry house insurance and flood insurance.

Approximately 69% of CSI's brokerage revenues come from the sale of non-standard auto insurance through two carriers. Approximately 11% of CSI's revenue comes from the sale of crop hail and multi-peril crop insurance through one carrier.

CSMR provides the Company with commission income from brokerage agreements with other life and health insurance companies. These companies supply the Company's multi-line agents with life and health products that the Company does not choose to underwrite, such as individual major-medical policies, impaired risk life insurance, first to die life insurance, and group life and health insurance. CSMR has contracted with approximately 4,700 independent agents to write the Company's Guaranteed Issue and Simplified Issue whole life insurance. Approximately 53% of CSMR's brokerage revenues come from the sale of life and health insurance through five carriers.

For further information regarding the Company's business segments, see Item 7, Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations.

Investments

Insurance company investments must comply with applicable laws and regulations which prescribe the kind, quality and concentration of investments. In general, these laws and regulations permit investments in federal, state and municipal obligations, corporate bonds, preferred and common equity securities, mortgage loans, real estate and certain other investments, subject to specified limits and certain other qualifications.

The investments of the Company are directed by the Company's Vice President of Finance and Assistant Treasurer under the supervision of the Company's Board of Directors. The Company follows an investment policy which is regularly reviewed and revised. The Company's policy emphasizes investment grade, fixed maturity securities and maximization of after-tax yields and places certain restrictions to limit portfolio concentrations and market exposure. Sales of securities are undertaken, with resulting gains or losses, in order to enhance after-tax yield and keep the portfolio in line with current market conditions.

Competition

The life insurance industry is highly competitive and includes a large number of insurance companies, many of which have substantially greater financial resources, broader and more diversified product lines, more favorable ratings from A.M. Best and Standard & Poor's, and larger staffs than the Company. The operating results of companies in the life insurance industry have historically been subject to significant fluctuations due to competition, economic conditions, interest rates, investment performance, maintenance of insurance

Table of Contents

ratings from rating agencies and other factors. Competitive factors applicable to the Company's business include product mix, policy benefits, service to policyholders, and premium rates. The Company believes that its current benefits and premium rates are generally competitive with those offered by other companies and that service to policyholders and prompt and fair payment of claims continue to be important factors in the Company's ability to remain competitive.

The Company has certain advantages that it believes better enable it to keep its premium rates competitive with similar policies offered by competing companies, including the following:

1. The Company offers most of its insurance through the same agents who write property and casualty insurance for Mutual and Shield. The sale of insurance through the same agents who sell property and casualty insurance enables the Company to incur less agency development and sales expense than is customary in the industry;
2. Because the Company's agents can provide customers with coverage for all major lines of individual insurance they may utilize account selling. Account selling enables insureds to contact one agent regarding their total insurance needs; and
3. The Company shares certain facilities, equipment and personnel with Mutual and Shield. The Company believes that sharing these expenses has a favorable impact on the ratio of expenses to premium income and enables the Company to enjoy economies of scale.

Regulation

General. The Company is subject to regulation and supervision in all jurisdictions in which it conducts business. In general, state insurance laws establish supervisory agencies with broad administrative powers relating to, among other things, the granting and revoking of licenses to transact business, regulation of trade practices, premium rate levels, premium rate increases, licensing of agents, approval of content and form of policies, maintenance of specified minimum statutory reserves and statutory capital and surplus, deposits of securities, form and content of required financial statements, nature of investments, and limitations on dividends to stockholders. The purpose of such regulation and supervision is primarily to provide safeguards for policyholders rather than to protect the interests of shareholders. The Company is domiciled in Georgia and is therefore subject to regulation under Georgia laws.

The National Association of Insurance Commissioners (NAIC) is a voluntary association of all of the state insurance commissioners in the United States. The primary function of the NAIC is to develop model laws on key insurance regulatory issues that can be used as guidelines for individual states in adopting or enacting insurance legislation. While the NAIC model laws are accorded substantial deference within the insurance industry, these laws are not binding on insurance companies unless enacted into state law and variations from the model laws from state to state are common.

Change of Control. Any transactions that would constitute a change in control of the Company would generally require prior approval by the insurance department of the State of Georgia, the Company's state of domicile, and may require pre-acquisition notification in those states that have adopted pre-acquisition notification provisions and in which the Company is admitted to transact business. In conjunction with the proposed Agreement and Plan of Merger with COUNTRY, filings have been made for approval of the transaction under the insurance laws of Georgia, Illinois, and Connecticut.

Product Approvals. Generally, before an insurance company is permitted to market an individual insurance product in a particular state, it must obtain regulatory approval from that state and adhere to that state's insurance laws and regulations, which include, among other things, specific requirements regarding the form, language, premium rates and policy benefits of that product. Such regulation may delay the introduction of new products and may impede, or

impose burdensome conditions on, rate increases or other actions that the Company may wish to take in order to enhance its operating results. In addition, federal or state legislation

Table of Contents

or regulatory pronouncements may be enacted that may prohibit or impose restrictions on the ability to sell certain types of insurance products or impose other restrictions on the Company's operations. No assurances can be given that future legislative or regulatory changes will not adversely affect the Company's business, financial condition or results of operations.

Risk-Based Capital (RBC). In order to enhance the regulation of insurer solvency, the NAIC has adopted a formula and model law to implement RBC requirements for most life and health insurance companies which is designed to determine minimum capital requirements based on insurance and investment risks and to raise the level of protection that statutory surplus provides for policyholder obligations. Under laws adopted by individual states, insurers having total adjusted capital that is less than that required by the RBC calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy.

The RBC law provides for four levels of regulatory action. The extent of regulatory intervention and action increases as the level of surplus to RBC falls. The first level, the company action level as defined by the NAIC, requires an insurer to submit a plan of corrective actions to the regulator if surplus falls below 200% of the RBC amount. The regulatory action level, as defined by the NAIC, requires an insurer to submit a plan containing corrective actions and requires the relevant insurance commissioner to perform an examination or other analysis and issue a corrective order if surplus falls below 150% of the RBC amount. The authorized control level, as defined by the NAIC, authorizes the relevant insurance commissioner to take whatever regulatory actions considered necessary to protect the best interest of the policyholders and creditors of the insurer which may include the actions necessary to cause the insurer to be placed under regulatory control, i.e., rehabilitation or liquidation, if surplus falls below 100% of the RBC amount. The fourth action level is the mandatory control level as defined by the NAIC, which requires the relevant insurance commissioner to place the insurer under regulatory control if surplus falls below 70% of the RBC amount.

The formulas have not been designed to differentiate among adequately capitalized companies that operate with higher levels of capital. Therefore, it is inappropriate and ineffective to use the formulas to rate or to rank these companies. At December 31, 2003, the Company had total adjusted capital in excess of amounts requiring company or regulatory action at any prescribed RBC action level.

Dividends. Dividends paid by the Company are subject to the regulations of the insurance laws and practices of the Georgia Department of Insurance. Generally, the Georgia Insurance Code allows life and health insurance companies to make dividend payments equal to or less than the greater of 10% of statutory surplus as regards policyholders as of the preceding December 31 or the net gain from operations, excluding realized gains or losses, for the twelve (12) month period ending on the preceding December 31. Dividends exceeding the applicable threshold are considered extraordinary and require the prior approval of the Georgia Insurance Commissioner. Pursuant to the Agreement and Plan of Merger with COUNTRY, the Company agreed that after March 31, 2004 it would not declare any regular quarterly dividends until such time as either the agreement is terminated or the merger is consummated.

Guaranty Associations. The Company may be required, under the solvency or guaranty laws of most states in which they do business, to pay assessments (up to prescribed limits) to fund policyholder losses or liabilities of insurance companies that become insolvent. Non-affiliated insurance company insolvencies increase the possibility that such assessments may be required. These assessments may be deferred or forgiven under most guaranty laws if they would threaten an insurer's financial strength and, in certain instances, may be offset against future premium taxes. The incurrence and amount of such assessments may increase in the future without notice. The Company pays the amount of such assessments as they are incurred. Assessments that cannot be offset against future premium taxes are charged to expense. Assessments that qualify for offset against future premium taxes are capitalized and are offset against such future premium taxes. As a result of such assessments, the Company paid approximately \$2,500 during the year ended December 31, 2003.

Table of Contents

Employees

In addition to its principal officers, the Company shares 121 salaried employees with Shield and Mutual. The Company pays an allocated portion of the shared employees' salaries, either based upon the Company's premium income in relation to the premium income of Mutual and Shield or the actual time expended on each company's affairs. The Company and its subsidiaries also have 35 salaried employees who work on a full-time basis in its home office, where all administrative functions, such as underwriting, billing and collection of premiums, are centralized and from which all sales activities are directed. None of the Company's employees is subject to a collective bargaining agreement. The Company believes its employee relations are good.

Available Information

The Company's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on the Company's website at www.cottonstatesinsurance.com via a link to the SEC website. These reports are made available at no cost.

The Company's Code of Ethics is available on its website at www.cottonstatesinsurance.com and is available without charge in print to any shareholder who makes a request by writing to Corporate Secretary, Cotton States Life Insurance Company, 244 Perimeter Center Parkway N.E., Atlanta, Georgia 30346.

ITEM 2. PROPERTIES

The Company, Mutual, and Shield occupy offices located at 244 Perimeter Center Parkway, Atlanta, Georgia. The building is owned by a general partnership composed of Mutual and Gold Kist Inc. ("Gold Kist"). The Company has no ownership interest in the partnership. The facility consists of a three-story office building containing approximately 260,000 square feet of space of which the Company, Mutual and Shield share approximately 90,000 square feet. The Company believes that the facility is suitable to its business. Rental expense is allocated to the Company based on its proportionate share of square footage occupied.

ITEM 3. LEGAL PROCEEDINGS

The Company is a defendant in various actions incidental to the conduct of its business. While the ultimate outcome of these matters cannot be estimated with certainty, management does not believe the actions are reasonably likely to result in a material loss to the Company.

The Company has reached partial settlement regarding \$900,000 in reinsurance coverage. In addition, a lawsuit was initiated by the Company in the third quarter of 2001. To date the Company has received approximately \$475,000 and continues to seek additional recoveries against the reinsurance brokers through already existing legal channels. During the fourth quarter of 2003 the Company determined it to be probable that approximately \$200,000 of the outstanding balance would be uncollectible. Accordingly, the Company has reduced the receivable by that amount and charged the amount to benefits expense in the accompanying financial statements. The Company believes the remaining amount outstanding to be fully recoverable and has included it in reinsurance receivable on the consolidated balance sheet.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of shareholders by the Company during the fourth quarter of 2003. The Company expects to submit the matter of the proposed merger with COUNTRY for a vote by shareholders in the second quarter of 2004.

Table of Contents**PART II****ITEM 5. MARKET FOR THE COMPANY'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES**

On January 1, 2004, there were approximately 1,383 shareholders of record of the Company's common stock. The stock (symbol CSLI) is traded over-the-counter on the NASDAQ National Market System. Price history as provided by NASDAQ and dividends declared during the past two years are presented below:

		Stock Price (1)		Dividend Declared
		High	Low	
2003	First Quarter	\$11.00	8.10	.04
	Second Quarter	10.55	9.40	.04
	Third Quarter	10.50	9.00	.04
	Fourth Quarter	19.80	9.90	.04
2002	First Quarter	\$10.50	9.41	.04
	Second Quarter	10.55	9.45	.04
	Third Quarter	10.14	7.72	.04
	Fourth Quarter	10.10	8.25	.04

(1) The prices presented above are sale prices which represent price between broker-dealers and do not include mark-ups or mark-downs or any commission to the broker-dealer. Therefore, the prices presented above do not reflect prices in actual transactions.

Securities Authorized for Issuance Under Equity Compensation Plans

The Equity Compensation Plan Information is set forth in Item 12 of this Form 10-K.

Table of Contents**ITEM 6. SELECTED FINANCIAL DATA****Ten-Year Selected Financial Data**

	2003	2002	2001	2000	1999
As of December 31					
Total assets	\$ 283,772,372	261,810,004	234,780,338	211,300,570	190,516,318
Total liabilities	\$ 198,163,258	180,439,595	162,135,020	147,029,701	134,565,951
Total shareholders equity	\$ 85,609,114	81,370,409	72,645,318	64,270,869	55,950,367
Book value per share	\$ 13.54	12.86	11.47	10.13	8.84
Closing price per share	\$ 19.72	9.54	9.60	11.50	8.63
Years ended December 31					
Premiums	\$ 35,882,106	33,092,092	30,220,737	26,816,523	23,302,097
Net investment income, realized investment gains and brokerage income	\$ 15,695,028	15,108,138	14,500,606	14,693,886	13,555,085
Total revenue	\$ 51,577,134	48,200,230	44,721,343	41,510,409	36,857,182
Benefits and expenses	\$ 43,733,723	37,930,485	35,856,787	30,657,137	26,673,847
Net income	\$ 5,282,301	7,308,874	6,445,672	7,606,215	7,327,945

Basic net income per share	\$ 0.84	1.15	1.02	1.20	1.16
Diluted net income per share	\$ 0.80	1.13	.99	1.18	1.14
Dividends per share	\$.160	.160	.160	.160	.160

	1998	1997	1996	1995	1994
As of December 31					
Total assets	\$ 180,773,289	165,337,309	148,824,187	139,381,979	124,412,468
Total liabilities	\$ 125,857,189	115,941,296	105,910,335	99,694,942	90,855,648
Total shareholders equity	\$ 54,916,100	49,396,013	42,913,852	39,687,037	33,556,820
Book value per share	\$ 8.63	7.72	6.71	6.23	5.28
Closing price per share	\$ 14.88	15.25	7.60	4.80	3.63
Years ended December 31					
Premiums	\$ 19,935,354	17,620,184	15,400,543	15,061,541	15,128,529
Net investment income, realized investment gains and brokerage income	\$ 12,365,999	11,308,794	9,458,474	8,814,035	7,597,136
Total revenue	\$ 32,301,353	28,928,978	24,859,017	23,875,576	22,725,665
Benefits and expenses	\$ 21,916,010	20,451,884	18,735,863	18,548,121	18,333,697

	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net income	\$ 7,240,585	6,304,558	4,832,577	4,070,871	3,303,024
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Basic net income per share	\$ 1.13	.99	.76	.64	.54
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Diluted net income per share	\$ 1.10	.96	.74	.63	.51
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Dividends per share	\$.160	.126	.102	.072	.060
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

Note: All share and per share amounts have been adjusted for the following stock splits:

October 1995	five-for-four
April 1997	five-for-four
January 1998	three-for-two

Table of Contents

ITEM 7 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF CONSOLIDATED FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Significant Events

On December 30, 2003, it was announced that the Cotton States Insurance Group (which includes the Company and Mutual) and COUNTRY, located in Bloomington, Illinois, entered into definitive agreements regarding the acquisition of the Company by merger. Under the Agreement and Plan of Merger, the Company's shareholders will receive \$20.25 cash for each share of outstanding common stock of the Company. As a result, the Company will become a privately-held company. Subject to regulatory approval, shareholder approval, and other conditions to closing set forth in the Agreement and Plan of Merger, it is anticipated that the transaction will close during the second quarter of 2004.

Forward-Looking Statements

The following discussion contains forward-looking statements that are not strictly historical and that involve risks and uncertainties. Such statements include, without limitations, any statements containing the words believe, anticipate, estimate, expect, intend, plan, seek, and similar expressions. Investors are cautioned about such statements, including, without limitation, statements regarding projections of earnings, revenues, expected mortality rates, investment spreads and yields and their effects on net earnings, the ability to consummate the contemplated transaction with COUNTRY and the timing thereof, if at all, and the anticipated financial results and benefits of the proposed transaction with COUNTRY. The forward-looking statements set forth herein involve certain risks, uncertainties, estimates, and assumptions that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, without limitation, the following:

The Company and COUNTRY must satisfy certain conditions to closing set forth in the Agreement and Plan of Merger, including, without limitation, receipt of necessary regulatory approvals and shareholder approval, which may not occur.

Insurance is a highly competitive industry, and the Company encounters significant competition in all lines of business from other insurance companies, many of which have greater financial resources than the Company, as well as competition from other providers of financial services.

Since insurance is a regulated business, with a high public profile, it is always possible that legislation may be enacted which would have an adverse effect on the Company's business.

The Company is subject to government regulation in each of the states in which it conducts business. Such regulation is vested in state agencies having broad administrative power dealing with many aspects of the insurance business, which may include premium rates, marketing practices, advertising, policy forms, and capital adequacy. The Company cannot predict the form of any future regulatory initiatives or its impact on the Company's operations or its effect on the Company's financial performance.

Increased public and regulatory concerns regarding the financial stability of insurance companies have resulted in policyholders placing greater emphasis upon company ratings and have created some measure of competitive advantage for insurance carriers with higher ratings. As of the date of this Annual Report on Form 10-K, A.M. Best & Co., a leading insurance company rating agency, has assigned a B++ (Very Good) rating to the Company. If this rating is downgraded from its current level, sales of the Company's products could be adversely affected.

The Company's financial results may fluctuate from year-to-year or be adversely affected on account of fluctuations in policy claims received by the Company.

Table of Contents

The Company's investments are subject to risks. The Company's invested assets are subject to customary risks of defaults and changes in market values. Factors that may affect the overall default rate on, and market value of, the Company's invested assets include interest rate levels, financial market performance, and general economic conditions.

Through underwriting and reinsurance, the Company has attempted to limit its mortality and morbidity exposure and has established reserves for claims and future policy benefits based on accepted actuarial methodologies. There can be no assurance, however, that these estimated reserves will prove to be sufficient or that the Company will not experience adverse mortality or morbidity experience which would result in operating losses.

In order to reduce risk and to increase its underwriting capacity, the Company obtains reinsurance from reinsurers. The Company is subject to credit risk with respect to its reinsurers because reinsurance does not relieve the Company of its liability to its insureds for the risks ceded to reinsurers. Although the Company places its reinsurance with reinsurers it believes to be financially stable, a reinsurer's subsequent insolvency or inability to make payments under the terms of a reinsurance treaty could have a material adverse effect on the Company.

The Company is in direct competition with a large number of insurance companies, many of which offer a greater number of products through a greater number of agents and have greater resources than the Company. This competitive environment could result in lower premiums, less favorable underwriting terms and conditions, loss of underwriting opportunities and reduced profitability.

The Company expressly disclaims any obligation to update these forward-looking statements.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Company has identified the following estimates as critical in that they involve a higher degree of judgment and are subject to a significant degree of variability: deferred policy acquisition costs, investments, reserves, and accounting for income taxes. In developing these estimates management makes subjective and complex judgments that are inherently uncertain and subject to material change as facts and circumstances develop. Although variability is inherent in these estimates, management believes the amounts provided are appropriate based upon the facts available upon compilation of the financial statements.

Deferred Policy Acquisition Costs

Policy acquisition costs, which include commissions and certain other expenses that vary with and are primarily associated with acquiring business, are deferred and amortized with interest over the estimated lives of the contracts, usually 30 years. The principal expenses deferred are commissions and certain expenses of the policy issue, underwriting and agency departments. Policy acquisition costs deferred were \$11.1 million in 2003, \$10.2 million in 2002, and \$9.8 million in 2001. For statutory accounting purposes, such costs are expensed as incurred.

These deferred costs are recorded as an asset commonly referred to as deferred policy acquisition costs (DAC). The carrying value of the Company's DAC asset was \$63.8 million and \$57.7 million at December 31, 2003 and 2002, respectively.

Table of Contents

Statement of Financial Accounting Standard (SFAS) No. 60 Accounting and Reporting by Insurance Enterprises applies to our traditional life policies. For traditional life policies, deferred costs are amortized in proportion to the ratio of the annual premium income to the total present value of expected premium income. Future premium income is estimated using actuarial assumptions established at policy issue such as mortality, persistency and interest. Assumptions established at policy issue are based on anticipated experience, which, together with interest and expense assumptions, provide a margin for adverse deviation. Should the liabilities for future policy benefits plus the present value of expected future gross premiums for a product be insufficient to provide for expected future benefits and expenses for that product, deferred acquisition costs will be written off and thereafter, if required, a premium deficiency reserve will be established by a charge to income. Changes in the assumptions for mortality, persistency and interest could result in material changes to the financial statements.

SFAS No. 97 Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments applies to our universal life-type contracts. Acquisition costs are deferred and recognized as expense as a constant percentage of gross profit using assumptions as to mortality, persistency, maintenance expense and interest margins established at policy issue without provision for adverse deviation. First-year excess expense charges are also deferred and accreted to income in the same manner as deferrable costs are amortized. The amortized percentage of gross profit is revised periodically to reflect emerging actual experience and any material changes in expected future experience. Changes in the emerged actual experience or changes in expected future experience for mortality, persistency, maintenance expense and interest margins could result in material changes to the financial statements.

Investments

Investment income is an important source of revenue, and the Company's return on invested assets has a material effect on net income. The Company's investment policy is subject to the requirements of insurance regulatory authorities. In addition, certain assets are held on deposit in specified states and invested in specified securities in order to comply with state law. Although the Company closely monitors its investment portfolio, available yields on newly invested funds and gains or losses on existing investments depend primarily on general market conditions.

Investment policy is determined by the Board of Directors of the Company. The Company's current investment policy is to balance its portfolio between long-term and short-term investments so as to achieve long-term returns consistent with the preservation of capital and maintenance of adequate liquidity to meet the payment of the Company's policy benefits and claims. The Company's invested asset maturities correspond with the Company's expectations regarding anticipated cash flow payments based on the Company's policy benefit and claim cycle. The Company invests primarily in fixed maturity securities of the U.S. government and its related agencies, investment grade fixed maturity corporate securities and mortgage-backed securities.

The Company's investments in equity securities and the majority of its investments in fixed maturity securities are classified as "available-for-sale" as defined in SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. Accordingly, these securities are carried at fair value with the after-tax difference from amortized cost reflected in stockholder's equity as a component of accumulated other comprehensive income. Approximately 2% of the Company's investments in fixed maturity investments are classified as "held-for-investment" as defined in SFAS No. 115 and are carried at amortized cost. Policy loans are carried at the outstanding balance, which approximates fair value. Other investments primarily consist of mortgage loans and a partnership interest. Mortgage loans on real estate are recorded at the outstanding principal balance adjusted for amortization of premiums or discounts and net of valuation allowances, if any. The partnership is carried at cost.

Table of Contents

The following table provides information on the Company's fixed maturity investments as of December 31 (dollars in thousands):

Type of Investments	2003		2002	
	Carrying Value	Percent	Carrying Value	Percent
Fixed maturities, held for investment:				
Public utilities	\$ 1,848	1.0	\$ 3,848	2.4
All other corporate bonds	1,500	0.8	3,200	2.0
Total fixed maturities held for investment	3,348	1.8	7,048	4.4
Fixed maturities, available for sale:				
United States government and government agencies and authorities	76,551	42.1	73,597	46.2
Foreign governments	5,149	2.8	3,390	2.1
Public utilities	4,145	2.3	7,492	4.7
All other corporate bonds	92,864	51.0	67,828	42.6
Total fixed maturities available for sale	178,709	98.2	152,307	95.6
Total fixed maturities	\$182,057	100.0	\$159,355	100.0

Mortgage-backed securities comprised 22% of the Company's fixed maturity portfolio at December 31, 2003 as compared to 21% at December 31, 2002. Mortgage-backed securities are subject to risks associated with variable pre-payments. This may result in these securities having a different actual cash flow and maturity than expected at the time of purchase. Securities that have an amortized cost greater than par and are backed by mortgages that prepay faster than expected will incur a reduction in yield or a loss. Those securities with an amortized cost lower than par that prepay faster than expected will generate an increase in yield or a gain. In addition, the Company may incur reinvestment risks if market yields are lower than the book yields earned on the securities. Prepayments occurring slower than expected have the opposite impact. The Company may incur disinvestment risks if market yields are higher than the book yields earned on the securities and the Company is forced to sell the securities. The degree to which a security is susceptible to either gains or losses is influenced by (a) the difference between its amortized cost and par, (b) the relative sensitivity of the underlying mortgages backing the assets to prepayment in a changing interest rate environment and (c) the repayment priority of the securities in the overall securitization structure. There are negligible default risks in the mortgage-backed securities portfolio as a whole as the vast majority of the assets are either guaranteed by U.S. government-sponsored entities or are supported in the securitization structure by junior securities enabling the assets to achieve high investment grade status.

Other-Than-Temporary Impairments

One of the significant estimations inherent in the valuation of investments is the evaluation of other-than-temporary impairments. The evaluation of impairments is a quantitative and qualitative process, which is subject to risks and uncertainties and is intended to determine whether declines in the fair value of investments should be recognized in current period earnings. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition or near term recovery prospects and the effects of changes in interest rates. The Company's accounting policy requires that a decline in the value of a security below its amortized cost basis be assessed to determine if the decline is other-than-temporary. If so, the security is deemed to be other-than-temporarily impaired, and a charge is recorded in net realized capital losses equal to the difference between the fair value and amortized cost basis of the security. The fair value of the other-than-temporarily impaired investment becomes its new

Table of Contents

cost basis. The Company has a security monitoring process that identifies securities that, due to certain characteristics, as described below, are subjected to an enhanced analysis on a quarterly basis.

Securities that are depressed by 20% or more for 12 months or by 30% for six months are presumed to be other-than-temporarily impaired unless the depression is the result of rising interest rates or significant objective verifiable evidence supports that the security price is temporarily depressed and is expected to recover within a reasonable period of time. Securities depressed less than 20% or depressed 20% or more but for less than 12 months or depressed 30% or more but for less than six months are also reviewed to determine if an other-than-temporary impairment is present. The primary factors considered in evaluating whether a decline in value for securities is other-than-temporary include: (a) the length of time and the extent to which the fair value has been less than cost, (b) the financial condition, credit rating and near-term prospects of the issuer, (c) whether the debtor is current on contractually obligated interest and principal payments and (d) the intent and ability of the Company to retain the investment for a period of time sufficient to allow for recovery.

Reserves

The Company establishes and carries as liabilities actuarially determined reserves which are calculated to meet the Company's estimated future obligations. Reserves for life insurance and disability contracts are based on actuarially recognized methods using prescribed morbidity and mortality tables in general use in the United States, which are modified to reflect the Company's actual experience when appropriate. These reserves are computed at amounts that, with additions from estimated premiums to be received and with interest on such reserves compounded annually at certain assumed rates, are expected to be sufficient to meet the Company's policy obligations at their maturities or in the event of an insured's death. Changes in or deviations from the assumptions used for mortality, morbidity, expected future premiums and interest can significantly affect the Company's reserve levels and related future operations. Reserves also include unearned premiums, premium deposits, claims incurred but not reported and claims reported but not yet paid. Reserves for assumed and ceded reinsurance are computed in a manner that is comparable to direct insurance reserves.

The liability for policy benefits for universal life-type contracts is equal to the balance that accrues to the benefit of policyholders, including credited interest, amounts that have been assessed to compensate the Company for services to be performed over future periods, and any amounts previously assessed against policyholders that are refundable on termination of the contract.

Accounting for Income Taxes

The Company accounts for income taxes using the asset and liability method prescribed by SFAS No. 109,

Accounting for Income Taxes. Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Income tax expense recognized by the Company in any one year is impacted by the extent to which the Company qualifies for the small life company deduction. The small life company deduction is 60% of life insurance company taxable income up to a maximum taxable income of \$3 million. This deduction is phased out on taxable income above \$3 million up to and including a maximum of \$15 million. To the extent, if any, that the Company's taxable income exceeds \$3 million, its effective federal income tax rate will increase.

Table of Contents

Recent Accounting Pronouncements

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148 Accounting for Stock-Based Compensation Transition and Disclosure, which is effective for financial statements issued after December 15, 2002. The adoption of SFAS No. 148 did not affect the Company's results of operations or financial position. The Company has complied with the disclosure requirements of SFAS No. 148 in these consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for financial statements issued for periods ending after December 15, 2003. There is no impact on the Company's financial position or results of operations for 2003 under FIN 46. The Company also expects no impact in future periods under FIN 46.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 addresses certain financial instruments that, under previous guidelines, could be accounted for as equity, but now must be classified as liabilities in the statement of financial position. These financial instruments include: (a) mandatorily redeemable financial instruments, (b) obligations to repurchase the issuer's equity shares by transferring assets, and (c) obligations to issue a variable number of shares. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The implementation of SFAS No. 150 did not have an impact on the Company's consolidated financial statements.

Consolidated Results of Operations

Executive Summary

The Company is headquartered in Atlanta, Georgia and sells individual life insurance products through a distribution force consisting of 251 multi-line exclusive agents and approximately 4,700 independent agents as of December 31, 2003. Payroll deduction universal life products are also marketed through a third party administrator. The Company's two brokerage subsidiaries generate commission income from brokerage agreements with other non-affiliated property and casualty and life and health insurance carriers.

The Company's profitability is primarily a factor of the following:

The volume of life insurance business in force, which is driven by the level of sales and the persistency of the business written.

The ability to price life insurance products to earn acceptable margins over the cost of providing benefits and the expenses of acquiring and administering the products. Competitive conditions, mortality experience, persistency, investment results and our ability to maintain expenses in accordance with pricing assumptions drive the Company's margins.

The amount of spread (excess of net investment income earned over interest credited) earned on universal life contract holders' account balances.

The ability of the brokerage subsidiaries to generate commission income through the sale of other companies' products.

Table of Contents

The ability to manage the investment portfolio to maximize investment returns while providing adequate liquidity for obligations to policyholders and minimizing the risk of defaults or impairments of invested assets.

The ability to manage the level of operating expenses.

Consolidated Summary of Results of Operation

(Dollars in thousands)	2003	2002	2001	2003 vs. 2002 Change	2002 vs. 2001 Change
Premiums	\$35,882	\$33,092	\$30,221	8.4%	9.5%
Net investment income	8,951	9,829	10,283	(8.9)	(4.4)
Brokerage commissions	4,906	4,242	4,190	15.7	1.2
Net realized capital gains	1,838	1,037	27	77.3	NM
Total Revenue	51,577	48,200	44,721	7.0	7.8
Benefits and claims	23,479	20,117	17,552	16.7	14.6
Interest credited	5,913	5,904	5,527	0.1	6.8
Amortization of deferred policy acquisition costs	5,092	3,761	4,466	35.4	(15.8)
Operating expenses	9,250	8,148	8,311	13.5	(2.0)
Total Benefits and Expenses	43,734	37,930	35,856	15.3	5.8
Income Before Income Tax Expense	7,843	10,270	8,865	(23.6)	15.9
Income tax expense	2,561	2,961	2,419	(13.5)	22.4
Net Income	\$ 5,282	\$ 7,309	\$ 6,446	(27.7)	13.4

NM = Not Meaningful

Net Income

Following is a summary of net income by business segment for the years ended December 31 (dollars in thousands):

2003	2002	2003 vs. 2002 Change	2001	2002 vs. 2001 Change
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Guaranteed issue and simplified issue	\$ 123	\$ 355	(65)%	\$ 397	(11)%
Individual life insurance:					
Traditional	525	1,477	(64)	763	94
Universal life	<u>2,092</u>	<u>3,329</u>	(37)	<u>3,276</u>	2
Total individual life insurance	2,617	4,806		4,039	19
Brokerage operations	2,582	2,174	19	2,067	5
Other lines	<u>(40)</u>	<u>(26)</u>	(54)	<u>(57)</u>	54
Net Income	<u>\$5,282</u>	<u>\$7,309</u>	(28)	<u>\$6,446</u>	13

2003 results declined as compared to 2002 due primarily to a significant increase in fourth quarter 2003

Table of Contents

mortality experience in the Company's individual life products. Additionally, 2003 results reflect an increase in operating expenses as compared to 2002, caused by an increase in standard operating costs as well as transaction costs associated with the anticipated merger with COUNTRY. Continued growth in premiums, mortality that was consistent with management's expectations, and lower operating expenses accounted primarily for the improved results in 2002 compared to 2001. In addition, 2002 results reflect a favorable adjustment to the amortization of policy acquisition costs resulting from updating actuarial assumptions. Other lines consist of the Company's participation in a federally sponsored group life pool and income from a closed block of individual accident and health business.

Premiums

Premiums from individual life, guaranteed issue and simplified issue products, and other lines are as follows (dollars in thousands):

	2003	2002	2003 vs. 2002 Change	2001	2002 vs. 2001 Change
Guaranteed issue and simplified issue life insurance	\$ 14,358	\$ 12,438	15%	\$ 10,530	18%
Individual life insurance:					
Traditional life	6,810	6,776	1	6,285	8
Universal life	13,170	12,572	5	12,373	2
Total individual life insurance	19,980	19,348	3	18,658	4
Other lines	1,544	1,306	18	1,033	26
Total premiums	\$ 35,882	\$ 33,092	8	\$ 30,221	10

Guaranteed issue and simplified issue life insurance premiums continued to show significant growth for the three year period from 2001 to 2003, primarily as a result of sustained production by the Company's independent agency force which had approximately 4,700 agents under contract at December 31, 2003 compared to approximately 4,300 in 2002 and approximately 4,400 in 2001. This product is also distributed by the Company's multi-line exclusive agents and is available for purchase over the Internet at the Company's home page (www.cottonstatesinsurance.com).

Individual life insurance products are principally sold by the Company's exclusive agent producers. Growth in individual life premiums largely reflects an increase in production of the Company's universal life product. The exclusive agency force of 251 as of December 31, 2003 compares to 272 as of the same date in 2002 and 266 in 2001. Other premiums consist of the Company's participation in a federally sponsored group life pool and income from a closed block of individual accident and health business.

Table of Contents***Investment Income and Realized Gains and Losses***

The following table summarizes the Company's investment results for the years ended December 31 (dollars in thousands):

	2003	2002	2001
Net investment income - excluding policy loan income	\$8,182	\$ 9,086	\$ 9,607
Policy loan income	769	743	676
	<u> </u>	<u> </u>	<u> </u>
Net investment income - total	\$8,951	\$ 9,829	\$10,283
	<u> </u>	<u> </u>	<u> </u>
Yield on average invested assets ⁽¹⁾	5.0%	6.0%	6.7%
	<u> </u>	<u> </u>	<u> </u>
Gross gains on sales	\$2,460	\$ 4,080	\$ 1,093
Gross losses on sales	(266)	(1,195)	(1,066)
Impairments	(356)	(1,848)	
	<u> </u>	<u> </u>	<u> </u>
Net realized capital gains, before tax	\$1,838	\$ 1,037	\$ 27
	<u> </u>	<u> </u>	<u> </u>

- (1) Represents net investment income (excluding net realized capital gains (losses)) divided by average invested assets at cost or amortized cost, as applicable. Average invested assets are calculated by dividing the sum of the beginning and ending period amounts by two.

The average gross annual yield on fixed maturities declined in both 2003 and 2002 due to declining market reinvestment interest rates. The Company's portfolio has an average effective duration of approximately four years, which reflects the medium-term nature of its liabilities. As a result, a significant portion of the portfolio matures and is reinvested each year. Market interest rates dropped significantly from mid-2002 to mid-2003. The average yield on a five-year U.S. Treasury note declined from 4.45% for the first half of 2002 to 3.18% for the second half of 2002 to 2.75% for the first half of 2003, and increased to 3.20% for the last half of 2003. At December 31, 2003, the market yield for five year U.S. Treasury Securities was 3.27%. The Company anticipates that the investment yield on its portfolio will continue to decline if market interest rates remain at 2003 levels.

Due to favorable market conditions caused by lower interest rates, the Company realized net gains of approximately \$2,194,000, \$2,885,000 and \$27,000 in 2003, 2002, and 2001, respectively, from the sale of fixed maturity and equity securities.

During the first quarter of 2003 the Company realized a pre-tax investment loss of \$356,000 from the write-down of the carrying value of 12 equity securities. These write-downs were the result of the Company determining that an other-than-temporary impairment had occurred.

During 2002 the Company sold a security out of its held-to-maturity portfolio due to evidence of a significant deterioration in the issuer's creditworthiness. At the time of sale the security had an amortized cost of \$499,768. The Company realized a loss of \$49,768 on the transaction.

During the second quarter of 2002 the Company realized a pre-tax investment loss of \$850,000 from the write-down of the carrying value of a WorldCom, Inc. debt security. This write-down was the result of the Company determining that an other-than-temporary impairment had occurred. This debt security was subsequently disposed of in the third quarter of 2002 at an additional loss of \$41,000.

During the third quarter of 2002 the Company realized a pre-tax investment loss of \$120,000 from the write-down of the carrying value of Intel common stock. This write-down was the result of the Company determining that an other-than-temporary impairment had occurred.

Table of Contents

During the fourth quarter of 2002 the Company realized a pre-tax investment loss of \$460,000 from the write-down of the carrying value of ten equity securities and a pre-tax investment loss of \$418,000 from the write-down of the Company's investment in a limited partnership. These write-downs were the result of the Company determining that an other-than-temporary impairment had occurred.

Brokerage Commissions

Exclusive agents sell products that the Cotton States Group does not underwrite (both life and property and casualty) but are provided through the Company's brokerage operations, and for which the Company receives override commission. Brokerage commissions increased 16% in 2003 compared to 2002 due primarily to increased sales of non-standard automobile policies. Brokerage commissions for 2002 were flat as compared to 2001 due to decreased override commissions on the sale of multi-peril crop and crop hail products. This decrease in brokerage commissions was partially offset by an 11% increase in commissions on the sale of non-standard automobile policies.

Benefits and Claims

Life benefits and claims, including reserve increases on traditional life and guaranteed issue and simplified issue products, are as follows (dollars in thousands):

	2003		2002		2001	
	Benefits and Claims	% of Premium	Benefits and Claims	% of Premium	Benefits and Claims	% of Premium
Guaranteed issue and simplified issue	\$11,312	79	\$ 9,332	75	\$ 7,656	73
Individual life insurance:						
Traditional life	5,392	79	4,772	70	4,622	73
Universal life	5,214	40	4,706	37	4,201	34
Total individual life insurance	10,606	53	9,478	49	8,823	47
Other benefits and claims	1,561	101	1,307	100	1,073	104
Total Benefits and Claims	\$23,479	65	\$20,117	61	\$17,552	58

Benefits and claims, as a percentage of premium, fluctuate within a normal range reflecting volatility in mortality, changes in mix of business, and age of policyholders. Guaranteed issue and simplified issue experience for the three year period is consistent with the Company's future expectations for those products as the block of business matures. Individual life benefits increased in 2003 compared to 2002 due to a significant increase in mortality in the Company's traditional life and universal life products during the fourth quarter of 2003. Individual life benefits increased in 2002 compared to 2001 due to higher traditional life reserve increases, which were the result of an overall improvement in persistency. Death benefits for 2002 were consistent with management's expectations.

Due to the Company's small size, quarterly fluctuations, even when they remain within the normal range, will affect the total benefits and claims for the fiscal year. During 2003, 2002, and 2001, the Company experienced emerged mortality of 104%, 88%, and 89% of expected mortality, respectively, related to its traditional individual life insurance business. In addition, the Company's general policy is to retain, with respect to individual life policies, generally no more than \$100,000 of insurance on any one life and has also routinely purchased annual aggregate stop loss reinsurance coverage in excess of 120% of expected mortality. The Company did not experience any material impact on reinsurance costs as a result of the events of September 11, 2001.

The Company has reached a partial settlement regarding \$900,000 in reinsurance coverage. In addition,

Table of Contents

a lawsuit was initiated by the Company in the third quarter of 2001. To date the Company has received approximately \$475,000 and continues to seek additional recoveries against the reinsurance brokers through already existing legal channels. During the fourth quarter of 2003 the Company determined it to be probable that approximately \$200,000 of the outstanding balance would be uncollectible. Accordingly, the Company has reduced the receivable by that amount and charged the amount to benefits expense in the accompanying financial statements. The Company believes the remaining amount outstanding to be fully recoverable and has included it in reinsurance receivable on the consolidated balance sheet.

Other benefits and claims consist of participation in a federally sponsored group life pool and benefits on a closed block of individual accident and health business.

Interest Credited to Policyholders

Interest credited to universal life contracts for 2003 was flat as compared to 2002 and increased 7% in 2002 as compared to 2001 reflecting growth in universal life policy accumulations, offset by reductions to the annual interest rate credited to policyholders in 2003 and 2002. The annual interest rate credited to policyholders of universal life contracts was 5.75% for the first two months of 2003. Effective March 1, 2003, the annual rate credited to policyholders changed to 5.4%. The annual rate credited to policyholders was 5.75% for the final three months of 2002 and was 6.25% for the first nine months of 2002 and for the year 2001.

Amortization of Policy Acquisition Costs and Operating Expenses

The amortization of policy acquisition costs as a percentage of premium was 14% in 2003 compared to 11% in 2002 and 15% in 2001. Amortization for 2003 is within the Company's expected range of 12-14%. The amortization of policy acquisition costs for 2002 reflects a favorable adjustment from updating actuarial assumptions and a decrease in the annual interest rate credited to policyholders. The adjustment represented a slow down of amortization as a result of higher estimated future profits from the improvement in mortality levels on universal life products. The after tax effect on net income for 2002 was \$186,000 or \$.03 per share. Amortization in 2001 reflects higher lapses in the traditional lines of business which reflects increased term rate competition in the market place.

Operating expenses as a percentage of premiums were 26% for 2003 compared to 25% in 2002 and 28% in 2001. The increase in 2003 compared to 2002 reflects normal increases in standard operating costs plus certain costs associated with the anticipated merger with COUNTRY. These costs were anticipated by management. The Company experienced some expense savings in 2002 primarily due to the reduction of certain performance based compensation costs.

Income Tax Expense

The effective tax rate for 2003 was 33% compared to 29% in 2002 and 27% in 2001. The four percentage point increase from 2002 to 2003 and the two percentage point increase from 2002 to 2001 are the result of decreases in the allowable small company deduction.

Table of Contents**Financial Condition*****Investments***

The investment portfolios are managed based on the underlying characteristics and nature of the Company's respective liabilities and within established risk parameters. (For a further discussion of the Company's approach to managing risks, see the Investment Credit Risk section in Item 7A.)

The investment portfolios are managed by three non-affiliated investment managers. Company management, under the direction of the Board of Directors, is responsible for monitoring and managing the asset/liability profile, establishing investment objectives and guidelines and determining, within specified risk tolerances and investment guidelines, the appropriate asset allocation, duration, convexity and other characteristics of the portfolios. Security selection and monitoring are performed by the investment managers' asset class specialists working within dedicated portfolio management teams.

The Company's primary investment objective is to maximize after-tax returns consistent with acceptable risk parameters, including the management of the interest rate sensitivity of invested assets and the generation of sufficient liquidity relative to that of policyholder and corporate obligations.

Return on invested assets is an important element of the Company's financial results. Significant fluctuations in the fixed maturity or equity markets could weaken the Company's financial condition or its results of operations. Additionally, changes in market interest rates may impact the period of time over which certain investments, such as mortgage-backed securities, are repaid and whether certain investments are called by the issuers. Such changes may, in turn, impact the yield on these investments and also may result in reinvestment of funds received from calls and prepayments at rates below the average portfolio yield. Net investment income and net realized capital gains and losses accounted for approximately 21%, 23%, and 23% of the Company's consolidated revenues for the years ended December 31, 2003, 2002 and 2001, respectively.

Fluctuations in interest rates affect the Company's return on, and the fair value of, fixed maturity investments, which comprised approximately 92% and 91% of the fair value of its invested assets as of December 31, 2003 and 2002, respectively. Other events beyond the Company's control could also adversely impact the fair value of these investments. Specifically, a downgrade of an issuer's credit rating or default of payment by an issuer could reduce the Company's investment return.

The following table identifies the invested assets by type held as of December 31, 2003 and 2002 (dollars in thousands):

	2003		2002	
	Amount	Percent	Amount	Percent
Fixed maturities held for investment, at cost	\$ 3,348	1.7	\$ 7,048	4.0
Fixed maturities available for sale, at fair value	178,709	90.4	152,307	87.4
Equity securities, at fair value	3,220	1.6	2,520	1.4
Mortgage loans, at cost	1,028	0.5	1,320	0.8
Policy loans, at outstanding balance	10,707	5.4	10,426	6.0
Other invested assets	582	0.4	582	0.4
Total Investments	\$197,594	100.0	\$174,203	100.0

Table of Contents

The following table provides information on the Company's fixed maturity investments as of December 31 (dollars in thousands):

Type of Investments	2003		2002	
	Carrying Value	Percent	Carrying Value	Percent
Fixed maturities, held for investment:				
Public utilities	\$ 1,848	1.0	\$ 3,848	2.4
All other corporate bonds	1,500	0.8	3,200	2.0
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Total fixed maturities held for investment	3,348	1.8	7,048	4.4
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Fixed maturities, available for sale:				
United States government and government agencies and authorities	76,551	42.1	73,597	46.2
Foreign governments	5,149	2.8	3,390	2.1
Public utilities	4,145	2.3	7,492	4.7
All other corporate bonds	92,864	51.0	67,828	42.6
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Total fixed maturities available for sale	178,709	98.2	152,307	