

AMERICAN PHYSICIANS SERVICE GROUP INC

Form 10-Q

November 04, 2004

=====

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE
SECURITIES EXCHANGE ACT OF 1934
FOR THE PERIOD ENDED SEPTEMBER 30, 2004

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 0-11453

AMERICAN PHYSICIANS SERVICE GROUP, INC.
(Exact name of registrant as specified in its charter)

TEXAS
(State or other jurisdiction of
incorporation or organization)

75-1458323
(I.R.S. Employer
identification No.)

1301 CAPITAL OF TEXAS HIGHWAY AUSTIN, TEXAS 78746
(Address of principal executive offices) (Zip Code)

(512) 328-0888 (Registrant's telephone number,
including area code)

Indicate by check mark whether the registrant (1) has filed all reports required
to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934
during the preceding 12 months (or for such shorter period that the registrant
was required to file such reports), and (2) has been subject to such filing
requirements for the past 90 days.

YES X NO
----- -----

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

TITLE OF EACH CLASS	NUMBER OF SHARES OUTSTANDING at	OCTOBER 25, 2004
-----		-----
Common Stock, \$.10 par value		2,599,171

=====

PART I

FINANCIAL INFORMATION

2

AMERICAN PHYSICIANS SERVICE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except per share data)

Item 1 - Financial Statements

	Three Months Ended September 30,	
	2004	2003
	-----	-----
Revenues:		
Financial services	\$3,846	\$5,941
Insurance services	3,747	3,108
	-----	-----
Total revenues	7,593	9,049
Expenses:		
Financial services	3,423	4,958
Insurance services	2,704	2,388
General and administrative	429	469
Gain on sale of assets	-	-
	-----	-----
Total expenses	6,556	7,815
	-----	-----
Operating income	1,037	1,234
Gain (loss) on investments (Note 4)	(2,374)	-
Gain on forgiveness of debt (Note 5)	-	-
	-----	-----
Income (loss) from operations before interest, income taxes and minority interest	(1,337)	1,234
Interest income	99	59
Other income (loss)	21	(33)
Interest expense	2	5
Income tax expense (benefit)	(386)	474
Minority interests	1	77
Equity in earnings of unconsolidated affiliates	-	25
	-----	-----

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Net income (loss)	\$ (834)	\$729
	=====	=====

See accompanying notes to condensed consolidated financial statements.

- 3 -

AMERICAN PHYSICIANS SERVICE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS, continued
(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
	----	----	----	----
Net income (loss) per common share				
Basic:				
Income (loss) from operations	\$ (0.32)	\$ 0.34	\$ 0.22	\$ 0.92
	----	-----	----	----
Net income (loss)	\$ (0.32)	\$ 0.34	\$ 0.22	\$ 0.92
	=====	=====	=====	=====
Diluted:				
Income (loss) from operations	\$ (0.32)	\$ 0.31	\$ 0.19	\$ 0.86
	----	-----	----	----
Net income (loss)	\$ (0.32)	\$ 0.31	\$ 0.19	\$ 0.86
	=====	=====	=====	=====
Basic weighted average shares outstanding	2,589	2,168	2,523	2,146
	=====	=====	=====	=====
Diluted weighted average shares outstanding	2,589	2,357	2,823	2,284
	=====	=====	=====	=====

See accompanying notes to condensed consolidated financial statements.

- 4 -

AMERICAN PHYSICIANS SERVICE GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	September 30, 2004	December 31, 2003
	-----	-----
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$6,646	\$8,989
Trading account securities	66	67

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Notes receivable	777	16
Management fees and other receivables	941	1,079
Deposit with clearing organization	660	500
Receivable from clearing organization	66	67
Income tax receivable	628	1,678
Net deferred income taxes	-	532
Prepaid expenses and other current assets	568	565
	-----	-----
Total current assets	10,352	13,493
Notes receivable, less current portion	204	436
Property and equipment, net	603	378
Investment in available-for-sale equity securities (Note 6)	7,700	8,729
Investment in available-for-sale fixed income securities (Note 7)	4,688	897
Goodwill	1,247	1,257
Deferred income taxes - non-current	704	-
Other assets	360	448
	-----	-----
Total Assets	\$ 25,858	\$ 25,638
	=====	=====

See accompanying notes to condensed consolidated financial statements.

- 5 -

AMERICAN PHYSICIANS SERVICE GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30 2004

LIABILITIES AND SHAREHOLDERS' EQUITY	(Unaudited)
Current liabilities:	
Accounts payable - trade	\$1
Payable to clearing broker	
Accrued incentive compensation	1,7
Accrued expenses and other liabilities (Note 8)	1,2
Deferred income tax liability - current	3
Deferred gain (Note 4)	4

Total current liabilities	4,1

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Payable under loan participation agreements	7
Deferred income tax liability	-----
Deferred gain, net of current portion (Note 4)	
 Total liabilities	 4,9
Minority interests	
Contingencies (Note 3)	
Shareholders' Equity:	
Preferred stock, \$1.00 par value, 1,000,000	
shares authorized, none issued or outstanding	
Common stock, \$0.10 par value, shares authorized 20,000,000;	
2,599,172 and 2,454,667 issued and outstanding at 09/30/04	
and 12/31/03, respectively	2
Additional paid-in capital	7,3
Retained earnings	12,4
Accumulated other comprehensive income (loss), net of taxes	8

 Total shareholders' equity	 20,9

 Total Liabilities and Shareholders' Equity	 \$25,8
	=====

See accompanying notes to condensed consolidated financial statements.

- 6 -

AMERICAN PHYSICIANS SERVICE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Mon

	2004

Cash flows from operating activities:	
 Net Income	 \$ 54
Adjustments to reconcile net income to cash provided by operating activities:	
Depreciation and amortization	22
Forgiveness of debt and other	7
Minority interest in consolidated earnings	-
Undistributed gain of affiliates	-
Gain on sale of assets	(7)
Gain on sale of investment	(5)
Loss on other investments	2,12

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Changes in operating assets and liabilities:	
Trade receivables	-
Trading account securities	
Income tax receivable	1,05
Deferred income tax	(54)
Receivable from clearing organization	(16)
Management fees & other receivables	13
Prepaid expenses & other assets	
Deferred income	(36)
Accrued expenses & other liabilities	(1,19)

Net cash provided by operating activities	1,76
Cash flows from investing activities:	
Capital expenditures	(36)
Proceeds from the sale of available-for-sale equity and fixed income securities	1,11
Purchase of available-for-sale equity securities	(4,19)
Receipts from affiliates	-
Funds loaned to others	(62)
Collection of notes receivable	-

Net cash used in investing activities	(4,06)
Cash flows from financing activities:	
Exercise of stock options	93
Purchase and cancellation of treasury stock	(47)
Dividends paid	(51)
Distribution to minority interest	-

Net cash provided by (used in) financing activities	(5)
Net change in cash and cash equivalents	\$ (2,34)
Cash and cash equivalents at beginning of period	8,98

Cash and cash equivalents at end of period	\$ 6,64
	=====

See accompanying notes to condensed consolidated financial statements.

- 7 -

AMERICAN PHYSICIANS SERVICE GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE LOSS
For the nine months ended September 30, 2003 and September 30, 2004

(In thousands)

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

	Common Stock	Additional Paid-In Capital	Retained Earnings	Comprehensive Income (loss)	Accumu Oth Compre Income
Balance December 31, 2002 (audited)	\$ 213	\$ 5,584	\$ 9,515		\$ 1,
Comprehensive income:					
Net income	--	--	1,965	\$1,965	
Other comprehensive income:					
Unrealized loss on securities, net of taxes of \$1,152	--	--	--	(2,236)	(2,
Comprehensive loss	--	--	--	\$ (271)	
Stock options exercised	14	493	--		
Treasury stock purchase	--	--	--		
Cancelled treasury stock	(4)	--	(203)		
Balance Sept 30, 2003 (unaudited)	\$ 223	\$ 6,077	\$11,277	\$ --	\$ (
Balance December 31, 2003 (audited)	\$ 245	\$ 6,918	\$ 12,314	\$ --	\$
Comprehensive income:					
Net income	--	--	549	\$ 549	
Other comprehensive income:					
Unrealized gain on securities, net of taxes of \$616	--	--	--	1,195	1
Comprehensive income:	--	--	--	\$ 1,744	
Treasury stock purchase	--	--	--		
Stock options exercised	19	919	--		
Dividends paid	--	--	(518)		
Cancelled treasury stock	(4)	(468)			
Forgiveness of Uncommon Care Debt	--	--	114		
Balance Sept 30, 2004 (unaudited)	\$ 260	\$ 7,369	\$12,459	\$ --	\$

See accompanying notes to condensed consolidated financial statements.

- 8 -

AMERICAN PHYSICIANS SERVICE GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2004
(Unaudited)

1. GENERAL

The accompanying unaudited condensed consolidated financial statements have

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

been prepared in conformity with accounting principles generally accepted in the United States of America and 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. The consolidated financial statements for the nine months ended September 30, 2004 and 2003 reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. Such adjustments consist of only items of a normal recurring nature. These consolidated financial statements have not been audited by our independent certified public accountants. The operating results for the interim periods are not necessarily indicative of results for the full fiscal year.

The notes to consolidated financial statements appearing in our Annual Report on Form 10-KSB for the year ended December 31, 2003 filed with the Securities Exchange Commission should be read in conjunction with this Quarterly Report on Form 10-Q. There have been no significant changes in the information reported in those notes other than from normal business activities.

Certain reclassifications have been made to amounts in prior periods to be consistent with the 2004 presentation.

2. MANAGEMENT'S ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. CONTINGENCIES

We are involved in various claims and legal actions that have arisen in the ordinary course of business. Management believes that any liabilities arising from these actions will not have a significant adverse effect on our financial condition or results of operations.

- 9 -

4. GAIN (LOSS) ON INVESTMENTS

On September 4, 2003 we purchased from Financial Industries Corporation ("FIC") (OTC: FNIN.PK) and a foundation 339,879 shares of FIC's common stock as an investment. Earlier in 2003 we had purchased 45,121 FIC shares in the open market. The 385,000 shares represent an approximate 4% ownership in FIC. The aggregate purchase price was approximately \$5,647,000, which was all sourced from our cash reserves. The shares purchased from FIC and the foundation are not registered, but are subject to a registration rights agreement requiring FIC's best efforts to register them within one year of the transaction. Due to FIC's delay in filing its 2003 Form 10-K and its March 31, 2004 and June 30, 2004 Forms 10-Q, it has not been able to register these shares and was delisted from the NASDAQ exchange in July, 2004.

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

By September 30, 2004, the value of our investment in FIC had declined significantly. On October 12, 2004, we determined that this decline in market price should be considered "other than temporary" as defined in Statements of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. Consequently, we recorded a pretax charge to earnings of \$2,374,000 in the current period. The charge reduces our cost basis in FIC from \$5,647,000, or \$14.67 per share, to \$3,273,000, or \$8.50 per share which is equal to the quoted market price of FIC shares on September 30, 2004. As discussed in our Form 10-Q dated June 30, 2004, we believe the decline in the market price of FIC has been brought about by its failure to file its 2003 Form 10-K and its subsequent de-listing from the NASDAQ Stock Market. We had expected FIC to bring its filings current and pursue restoring its exchange listing by September 30, 2004. These events have not yet occurred. While we currently continue to have the ability and the intent to hold the stock indefinitely, we concluded that the additional uncertainty created by the late filings together with the lack of current financial information dictated that the decline should be viewed as other than temporary. The effect on our financial statements as a result of this write-down was to reduce pre-tax income by \$2,374,000, increase unrealized holding gains by \$1,567,000 and increase our deferred tax liability by \$807,000.

Partially offsetting this write-down were gains resulting from the sale of available-for-sale equity securities. During the three and nine months ended September 30, 2004, we received proceeds of zero and approximately \$1,118,000, respectively, and recognized gains of zero and \$245,000, respectively, resulting from these sales.

Additionally, during the three and nine months ended September 30, 2004, we recognized \$122,000 and \$366,000, respectively, of deferred gain related to the November 2001 sale and subsequent leaseback of real estate to Prime Medical. Due to our continuing involvement in the property, we deferred recognizing approximately \$2,400,000 of the approximately \$5,100,000 gain and are recognizing it in earnings, as a reduction of rent expense, monthly through November 2006. A total of \$1,057,000 remains to be recognized in the coming twenty-six months. In addition, 15% of the gain (\$760,000) related to our then 15% ownership in the purchaser, was deferred. As our ownership percentage in Prime declines through our sales of Prime common stock, we recognize these gains proportionately to our reduction of our interest in Prime. During the first nine months of 2004 and 2003, we recognized \$56,000 and \$8,000, respectively, of these deferred gains, leaving a balance of approximately \$180,000 remaining to be recognized.

- 10 -

5. GAIN ON FORGIVENESS OF DEBT

We recorded zero and \$76,000 during the three and nine months ended September 30, 2004, respectively, as gain on forgiveness of debt. This represents that amount of liability that was released in the respective period by participants in our loan to an affiliate, net of \$15,000 interest due them from prior period payments made by Uncommon Care. Due to poor operating results, Uncommon Care was in default and not making scheduled payments under its loan agreement with us in which the participations had been sold. As a result, the loan participants released us from any obligations under the participation agreements. That portion of the releases entered into with related parties, totaling \$114,000, was taken directly into equity. The effect of these transactions on our balance sheet for the period ended September 30, 2004 was to reduce the long-term liability account, "Payable under loan participation agreements", by \$204,000.

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

6. INVESTMENT IN AVAILABLE-FOR-SALE EQUITY SECURITIES

A significant portion of this balance sheet account is comprised of our investment in FIC common stock. As mentioned in Footnote 4 above, during the current quarter, we recognized an "other than temporary" impairment loss and, accordingly, our cost basis in the 385,000 shares of FIC common stock we own was reduced from \$14.67 per share to \$8.50 per share. We classify all of these shares as securities available-for-sale and record temporary unrealized changes in their value, net of tax, in our balance sheet as part of Accumulated Other Comprehensive Income (Loss) in Stockholders' Equity. The effect of the "other than temporary" impairment loss of \$2,374,000 was to reclassify from accumulated other comprehensive income the unrealized losses to realized losses in the statement of operations.

As part of this transaction we were granted options to purchase an additional 323,000 shares of FIC's common stock at \$16.42 per share. There is a significant revenue-related performance requirement that must be met before these options are exercisable. There are presently no registered FIC shares available to issue upon the exercise of these options. We have assigned no value to these options.

7. INVESTMENT IN AVAILABLE-FOR-SALE FIXED INCOME SECURITIES

We have invested primarily in U.S. government-backed securities with maturities varying from in one to three years, as well as two corporate bonds with Standard and Poor's ratings of no lower than B (investment grade).

- 11 -

8. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities consists of the following:

	September 30 2004 (Unaudited)	December 31 2003
	-----	-----
Commissions payable	\$ 827,000	\$ 964,000
Taxes payable	127,000	116,000
Vacation	158,000	158,000
401(k) plan matching	148,000	121,000
Other accrued liabilities	25,000	126,000
	-----	-----
	\$1,285,000	\$1,485,000
	=====	=====

9. NET INCOME PER SHARE

Basic income per share is based on the weighted average shares outstanding without any dilutive effects considered. Diluted income per share reflects dilution from all contingently issuable shares, such as options and convertible debt. A reconciliation of earnings and weighted average shares outstanding used

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

in the calculation of basic and diluted earnings per share from operations follows:

	For the Three Months Ended September 30, 2004		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Income (loss) from operations	\$ (834,000)		
Basic EPS			
Income (loss) available to common stockholders	(834,000)	2,589,000	\$ (0.32) =====
Diluted EPS			
Effect of dilutive securities	--	--	
	-----	-----	
Income (loss) available to common stockholders and assumed conversions	\$ (834,000) =====	2,589,000 =====	\$ (0.32) =====

- 12 -

	For the Three Months Ended September 30, 2003		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Income from operations	\$ 729,000		
Basic EPS			
Income available to common stockholders	729,000	2,168,000	\$ 0.34 =====
Diluted EPS			
Effect of dilutive securities	--	189,000	
	-----	-----	
Income available to common stockholders and assumed conversions	\$ 729,000 =====	2,357,000 =====	\$ 0.31 =====

	For the Nine Months Ended September 30, 2004		
	Income (Numerator)	Shares (Denominator)	Per Share Amount
Income from operations	\$ 549,000		

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Basic EPS			
Income available to common stockholders	549,000	2,523,000	\$ 0.22 =====
Diluted EPS			
Effect of dilutive securities	--	300,000	
	-----	-----	
Income available to common stockholders and assumed conversions	\$ 549,000 =====	2,823,000 =====	\$ 0.19 =====

- 13 -

For the Nine Months Ended September 30, 2003

	Income (Numerator)	Shares (Denominator)	Per Share Amount
Income from operations	\$ 1,965,000		
Basic EPS			
Income available to common stockholders	1,965,000	2,146,000	\$ 0.92 =====
Diluted EPS			
Effect of dilutive securities	--	138,000	
	-----	-----	
Income available to common stockholders and assumed conversions	\$ 1,965,000 =====	2,284,000 =====	\$ 0.86 =====

10. SEGMENT INFORMATION

The Company's segments are distinct by type of service provided. Comparative financial data for the three and nine month periods ended September 30, 2004 and 2003 are shown as follows:

	Three months ended September 30, 2004	2003
	-----	-----
Operating Revenue		
Financial services	\$ 3,846,000	\$ 5,941,000
Insurance services	3,747,000	3,108,000
Corporate	100,000	400,000
	-----	-----
Total Segment Revenues	\$ 7,693,000 =====	\$ 9,449,000 =====

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Reconciliation to Consolidated

Statement of Operations:

Total segment revenues	\$ 7,693,000	\$ 9,449,000
Less: Intercompany dividends	(100,000)	(400,000)
	-----	-----
Total Revenues	\$ 7,593,000	\$ 9,049,000
	=====	=====

Operating Income

Financial services	\$ 423,000	\$ 983,000
Insurance services	1,043,000	720,000
Corporate	(429,000)	(469,000)
	-----	-----
Total segments operating income	1,037,000	1,234,000

- 14 -

	Three months ended September 30, 2004	2003
	-----	-----
Loss on investments	(2,374,000)	--
	-----	-----
Income (loss) from operations before interest, income taxes and minority interest	(1,337,000)	1,234,000
Interest income	99,000	59,000
Other gain (loss)	21,000	(33,000)
Interest expense	2,000	5,000
Income tax expense (benefit)	(386,000)	474,000
Minority interest	1	77,000
Equity in gain of unconsolidated affiliates	--	25,000
	-----	-----
Net income (loss)	\$ (834,000)	\$ 729,000
	=====	=====

Nine months ended September 30,
2004

Operating Revenue:

	2004	2003
	-----	-----
Financial services	\$ 11,905,000	\$ 14,777,000
Insurance services	10,273,000	7,832,000
Corporate	1,700,000	1,577,000
	-----	-----
Total Segment Revenues	\$ 23,878,000	\$ 24,186,000
	=====	=====

Reconciliation to Consolidated

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Statement of Operations:		
Total segment revenues	\$ 23,878,000	\$ 24,186,000
Less: Intercompany dividends	(1,700,000)	(1,577,000)
	-----	-----
Total Revenues	\$ 22,178,000	\$ 22,609,000
	=====	=====
Operating Income		
Financial services	\$ 1,581,000	\$ 2,416,000
Insurance services	2,567,000	1,769,000
Corporate	(1,441,000)	(1,345,000)
	-----	-----
Total segments operating income	2,707,000	2,840,000
Gain (loss) on investments	(2,130,000)	89,000
Gain on forgiveness of debt	76,000	--
	-----	-----

- 15 -

	Nine months ended September 30, 2004	2003
	-----	-----
Income from operations before interest, income taxes and minority interest	653,000	2,929,000
Interest income	254,000	229,000
Other gain (loss)	39,000	(55,000)
Interest expense	4,000	7,000
Income tax expense	392,000	1,207,000
Minority interest	1	184,000
Equity in gain of unconsolidated affiliates	--	260,000
	-----	-----
Net income	\$ 549,000	\$ 1,965,000
	=====	=====

11. SALE OF APS CONSULTING

Effective November 1, 2003, APS Consulting was able to obtain third party financing and repay their note payable to us in exchange for our agreeing to discount the note by \$35,000. We provided no guarantees or credit enhancements in connection with APS Consulting securing this financing. Accordingly, we no longer have a risk of loss related to these operations and have recognized the transaction as a divestiture. As a result, we ceased consolidation of APS Consulting financial statements effective November 1, 2003. Our consolidated statements of operations for the three and nine months ended September 30, 2003 have been adjusted to reflect this divestiture. Specifically, revenues of \$990,000 and \$2,662,000 have been reversed, expenses of \$826,000 and \$2,068,000 have been reversed, and the operating profit of \$164,000 and \$594,000 was

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

reversed for the three and nine month periods ended September 30, 2003, respectively, from federal income taxes and minority interest. There was no change to the net income as of September 30, 2003 as a result of these reversals because, prior to the disposal transaction, we consolidated the division's operations, but recognized a 100% minority interest in its earnings. As the division had earnings in the prior period presented, there were no earnings attributable to discontinued operations, after adjustments made to reclassify its revenue, expenses and the related minority interest.

- 16 -

12. STOCK-BASED COMPENSATION

We have adopted the disclosure-only provisions of Statement of Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS 123"), as amended by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure", but measure compensation expense for our stock-based employee compensation plans using the intrinsic value method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees. Proforma disclosures of net income and earnings per share as if the fair value-based method prescribed by SFAS 123 had been applied in measuring compensation expense follow. For purposes of the proforma disclosures, the estimated fair value of the options is amortized to expense over the option's vesting periods.

	Three Months Ended September 30,	
	2004	2003
	----	----
Net Income (loss) as reported	\$(834,000)	\$729,000
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(77,000)	(59,000)
	-----	-----
Pro forma net income (loss)	\$(911,000)	\$670,000
	=====	=====
Net income (loss) per share		
Basic - as reported	\$(0.32)	\$ 0.34
	=====	=====
Basic - pro forma	\$(0.35)	\$ 0.31
	=====	=====
Diluted - as reported	\$(0.32)	\$ 0.31
	=====	=====
Diluted - pro forma	\$(0.35)	\$ 0.29
	=====	=====

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

	Nine Months Ended September 30,	
	2004	2003
	----	----
Net Income as reported	\$ 549,000	\$1,965,000
Deduct: Total additional stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(250,000)	(178,000)
	-----	-----
Pro forma net income	\$ 299,000	\$1,787,000
	=====	=====
Net income per share		
Basic - as reported	\$ 0.22	\$ 0.92
	=====	=====
Basic - pro forma	\$0.12	\$ 0.83
	=====	=====
Diluted - as reported	\$ 0.19	\$ 0.86
	=====	=====
Diluted - pro forma	\$ 0.11	\$ 0.78
	=====	=====

- 17 -

13. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2004, the Financial Accounting Standards Board ("FASB") issued an exposure draft entitled "Share-Based Payment, an Amendment of FASB Statements No. 123 and 95." This proposed statement addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed Statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees", and generally would require instead that such transactions be accounted for using a fair-value-based method. As proposed, this statement would be effective for the Company on January 1, 2005. We are currently evaluating the effect this proposed standard will have on our financial position or results of operations.

In September 2004, the FASB approved a Staff Position to delay the implementation of EITF 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-1"). EITF 03-1 provides guidance for determining when an investment is impaired and whether the impairment is other than temporary. EITF 03-1 also incorporates into its consensus the required disclosures about unrealized losses on investments

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

announced by the EITF in late 2003 and adds new disclosure requirements relating to cost-method investments. The approved delay will apply to all securities within the scope of EITF 03-1 and is expected to end when new guidance is issued and comes into effect. The original requirements prescribed by EITF 03-1 and SAB 59 will remain in effect. We are currently monitoring the progress of this guidance as adoption of EITF 03-1 may have an effect on our financial position or results of operations.

- 18 -

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Forward-Looking Statements

Our statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding our expectations, hopes, intentions or strategies regarding the future. You should not place undue reliance on forward-looking statements. All forward-looking statements included in this report are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. It is important to note that our actual results could differ materially from those in the forward-looking statements. In addition to any risks and uncertainties specifically identified in the text surrounding the forward-looking statements, you should consult our reports on Forms 10-KSB and our other filings under the Securities Act of 1933 and the Securities Exchange Act of 1934, for factors that could cause our actual results to differ materially from those presented.

The forward-looking statements included herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors and legislative, judicial and other governmental authorities and officials. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Any of these assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate.

GENERAL

We provide (1) financial services, including brokerage and investment services to individuals and institutions, and (2) insurance services, including management and agency services to medical malpractice insurance companies.

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

FINANCIAL SERVICES. We provide investment and investment advisory services to institutions and individuals throughout the United States through the following subsidiaries:

- 19 -

- o APS FINANCIAL. APS Financial is a fully licensed broker/dealer that provides brokerage and investment services primarily to institutional and high net worth individual clients. APS Financial also provides portfolio accounting, analysis, and other services to insurance companies, banks and public funds. We recognize commissions revenue, and the related compensation expense, on a trade date basis.
- o ASSET MANAGEMENT. Asset Management manages fixed income and equity assets for institutional and individual clients on a fee basis. We recognize fee revenues monthly based on the amount of funds under management.

INSURANCE SERVICES. Through Insurance Services we provide management and agency services to medical malpractice insurance companies through the following subsidiary:

- o FMI. APS Facilities Management, Inc., dba APMC Insurance Services, Inc., or FMI, provides management and administrative services to APIE, a regional insurance exchange that sells medical professional liability insurance only to its physician subscribers, who pay annual insurance premiums and maintenance fees to APIE. APIE is governed by a physician board of directors. Pursuant to a management agreement and the direction of this board, FMI manages and operates APIE, including performing policy issuance, claims investigation and settlement, and all other management and operational functions. As a management fee, FMI receives a percentage of APIE's earned premiums and a portion of APIE's profit, subject to a cap based on premium levels. We recognize revenues for the management fee portion based on a percentage of earned premium on a monthly basis, and we recognize revenues for the management fee portion based on profit sharing when it is reasonably certain the managed company will have an annual profit, generally in the fourth quarter. FMI's assets are not subject to APIE policyholder claims.

In addition, as of September 30, 2004, we have the following significant investments accounted for as available-for-sale securities: (1) we own approximately 555,000 shares of Prime Medical common stock, representing less than 3% of its outstanding common stock, and (2) we own 385,000 shares of Financial Industries Corporation, representing approximately 4% of its outstanding common stock. We account for these investments as available-for-sale securities, which means they are reflected on our consolidated balance sheets at fair value, and fluctuations in fair value are recognized as unrealized gains or losses excluded from earnings and reported as a separate component of stockholders' equity, net of income taxes. As discussed later in this report, we recorded an "other than temporary" impairment loss from market value declines in our FIC holdings totaling \$2,374,000.

- 20 -

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, we evaluate our estimates, including those related to, impairment of assets; bad debts; income taxes; and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies and estimates affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. We periodically review the carrying value of our assets to determine if events and circumstances exist indicating that assets might be impaired. If facts and circumstances support this possibility of impairment, our management will prepare undiscounted and discounted cash flow projections, which require judgments that are both subjective and complex. Management may also obtain independent valuations.

Our financial services revenues are composed primarily of commissions on securities trades and asset management fees. Revenues related to securities transactions are recognized on a trade date basis. Asset management fees are recognized as a percentage of assets under management during the period based upon the terms of agreements with the applicable customers.

Our insurance services revenues are primarily related to management fees based on the earned premiums of the managed company and include a profit sharing component, as defined in the management agreement, related to the managed company's annual earnings. Management fees are recorded, based upon the terms of the management agreement, in the period the related premiums are earned by the managed company. The managed company recognizes premiums as earned ratably over the terms of the related policy. The profit sharing component is recognized when it is reasonably certain the managed company will have an annual profit, and, typically, has been recognized during the fourth quarter.

Effective November 1, 2003, our former consulting subsidiary, APS Consulting, paid off the negotiated remainder of the note due us, allowing us to cease accounting for them as a variable interest entity. Consequently, we have reclassified the three and nine months ended September 30, 2003 income statements to reflect the disposition of APS Consulting.

- 21 -

On September 4, 2003 we purchased from Financial Industries Corporation ("FIC") (OTC: FNIN.PK) and a foundation 339,879 shares of FIC's common stock as an investment. Earlier in 2003 we had purchased 45,121 FIC shares in the open market. The 385,000 shares represents an approximate 4% ownership in FIC. The aggregate purchase price was approximately \$5,647,000, which was all sourced from our cash reserves. The shares purchased from FIC and the foundation are not registered, but are subject to a registration rights agreement requiring FIC's best efforts to register them within one year of the transaction. Due to FIC's delay in filing its 2003 Form 10-K and its March 31, 2004 and June 30, 2004 Forms 10-Q, it has not been able to register these shares and was delisted from the NASDAQ exchange in July, 2004. Through the quarter ended June 30, 2004, we

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

determined that the unrealized losses of \$2,075,000 resulting from the fair market value decline were temporary market declines and accordingly had recognized such unrealized losses in other comprehensive income (loss).

By September 30, 2004, the value of our investment in FIC had declined significantly. On October 12, 2004, we determined that this decline in market price should be considered "other than temporary" as defined in Statements of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. Consequently, we recorded a pretax charge to earnings of \$2,374,000 in the current period. The charge reduces our cost basis in FIC from \$5,647,000, or \$14.67 per share, to \$3,273,000, or \$8.50 per share which is equal to the quoted market price of FIC shares on September 30, 2004. As discussed in our Form 10-Q dated June 30, 2004, we believe the decline in the market price of FIC has been brought about by its failure to file its 2003 Form 10-K and its subsequent de-listing from the NASDAQ Stock Market. We had expected FIC to bring its filings current and pursue restoring its exchange listing by September 30, 2004. These events have not yet occurred. While we currently continue to have the ability and the intent to hold the stock indefinitely, we concluded that the additional uncertainty created by the late filings together with the lack of current financial information dictated that the decline should be viewed as other than temporary. The effect on our financial statements as a result of this write-down was to reduce pre-tax income by \$2,374,000, increase unrealized holding gains by \$1,567,000 and increase deferred tax liability by \$807,000. We will continue to closely monitor FIC's situation.

- 22 -

RESULTS OF OPERATIONS

REVENUES

Revenues from operations decreased \$1,456,000 (16%) and \$431,000 (2%) in the three and nine months ended September 30, 2004, respectively, compared to the same periods in 2003. Our income from continuing operations before interest, income taxes and minority interest decreased \$2,571,000 and \$2,276,000 (78%) in the current year three and nine months, respectively, compared to the same periods in 2003. Our net income decreased \$1,563,000 and \$1,416,000 (72%) in the current year three and nine months, respectively, compared to the same periods in 2003. Our diluted net income per share declined \$0.61 and \$0.67 (78%) in the current year three and nine months, respectively, compared to the same periods in 2003 as a result of the current quarter loss. The reasons for these changes are described below.

FINANCIAL SERVICES

Our financial services revenues decreased \$2,095,000 (35%) and \$2,872,000 (19%) in the three and nine months ended September 30 2004, respectively, compared to the same periods in 2003. The decrease in both current year periods was due to lower commission revenues at APS Financial, the broker/dealer division of our financial services segment. APS Financial derives most of its revenue from trading in the fixed income market, both in investment and non-investment securities. A decline in customer trading activity was responsible for decreased revenues in the current quarter. This quarter experienced generally declining rates in the middle of the treasury curve. However, our investors still were hesitant to commit funds in the market amid

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

the uncertainties of continually rising oil prices, health of the economy and labor force, foreign military commitments and costs, election year jitters and future Federal Reserve actions. Although still down from the previous year, there was evidence of increased interest and activity in non-investment grade bond markets, while the treasury and other high grade markets were marked with lackluster trading. Our results during the current quarter were consistent with many of the reported results of large public securities trading firms.

Our financial services expense decreased \$1,535,000 (31%) and \$2,037,000 (16%) in the three and nine months ended September 30, 2004, respectively, compared to the same periods in 2003. The primary reason for the current quarter decrease is a \$1,336,000 (37%) and \$1,680,000 (20%) decrease in commission expense in the current year three and nine months, respectively, compared to the same periods in 2003 resulting from the decrease in commission income mentioned above. In addition, incentive compensation costs were down \$286,000 (54%) and \$512,000 (39%) in the current year periods compared to the same periods in 2003 as a result of lower profits and higher minimum performance criteria placed upon management at APS Financial for 2004.

- 23 -

INSURANCE SERVICES

Our insurance services revenues from our premium-based insurance management segment, APS Insurance Services, increased \$639,000 (21%) and \$2,441,000 (31%) in the three and nine months ended September 30, 2004, respectively, compared to the same periods in 2003. The primary reason for the current year increase is the fact that management fee revenues increased \$453,000 (25%) and \$1,125,000 (21%) in the three and nine month periods ended September 30, 2004 compared to the same periods in 2003. These higher management fees are the result of an increase in earned premium of approximately \$12.1 million for the year. Further contributing to the 2004 increase is a \$123,000 (10%) and \$1,120,000 (43%) increase in respective current year three and nine month pass-through commissions earned by third party agents resulting from approximately \$12.4 million in additional written premium this year compared to 2003. Net income is not affected by outside sales commissions as these agents are paid commissions equivalent to the revenue earned. Lastly, our risk management fees earned increased \$68,000 (135%) and \$169,000 (143%) in the current year periods compared to the same periods in 2003 as a result of a greater number of doctor groups receiving this service as well as an increase in the rate charged.

Insurance services expenses increased \$316,000 (13%) and \$1,643,000 (27%) in the three and nine months ended September 30, 2004, respectively, compared to the same periods in 2003. The current year increase is primarily due to the above-mentioned increase in respective current year three and nine month third party pass-through commissions paid. In addition, salaries expense was \$48,000 (7%) and \$195,000 (10%) higher in the three and nine months, respectively, as a result of personnel additions, including a high-level management position to help meet our growing financial reporting requirements, as well as normal annual merit raises. Also, depreciation and amortization expense increased \$30,000 (97%) and \$101,000 (128%) in the current three and nine months, respectively, primarily as a result of amortizing the non-compete agreement that was created upon the repurchase of the 20% minority interest in October, 2003. Partially offsetting these increases was a current quarter decrease in advertising. Advertising declined \$19,000 (72%) and \$121,000 (78%) in the current three and nine months as a result of re-branding efforts of the business during 2003.

GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses decreased \$40,000 (9%) but increased

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

\$144,000 (11%) in the three and nine months ended September 30, 2004, respectively, compared to the same periods in 2003. The current quarter decrease was due to lower legal and audit fees, the result of non-recurring expenses incurred in connection with our 2003 investment in Financial Industries. Partially offsetting this current year three month

- 24 -

decline was a \$28,000 increase in professional fees resulting from fees incurred in connection with Sarbanes-Oxley internal controls procedures. Current year nine month costs are higher due to increases in incentive compensation expense of \$155,000 (68%) as the monthly accrual has been raised in order to better match anticipated annual earnings. The majority of last year's management incentive costs were expensed in the final quarter of 2003 as it was not until then that we were able to more accurately estimate 2003 earnings.

GAIN ON SALE OF ASSETS

Gain on sale of assets primarily represents the recognition of deferred income. Approximately \$760,000 of the \$5,100,000 deferred gain on the sale of real estate to Prime Medical in 2001 was due to our ownership interest in Prime and is recognized upon the reduction of our ownership percentage in Prime Medical through the sale of its stock. In the first nine months of 2004, we recognized approximately \$56,000 from the sale of Prime Medical common stock versus a gain of \$8,000 in the same period of 2003.

GAIN (LOSS) ON INVESTMENTS

The current three month loss was due to a write-down of our investment in Financial Industries common stock. During the quarter, we determined that the decline in market value of FIC common stock should be considered other than temporary and we recorded a pretax charge to earnings of \$2,374,000 in the current period. This charge reduced our cost basis in FIC from \$5,647,000, or \$14.67 per share, to \$3,273,000, or \$8.50 per share which is equal to the quoted market price of FIC shares on September 30, 2004. As discussed in our Form 10-Q dated June 30, 2004, we believe the decline in the market price of FIC has been brought about by its failure to file its 2003 Form 10-K and its subsequent de-listing from the NASDAQ Stock Market. We had expected FIC to bring its filings current and pursue restoring its exchange listing by September 30, 2004. These events have not yet occurred. While we currently continue to have the ability and the intent to hold the stock indefinitely, we concluded that the additional uncertainty created by the late filings together with the lack of current financial information dictated that the decline should be viewed as other than temporary.

Partially offsetting this write-down was gains recorded earlier in 2004 totaling \$245,000 resulting from the sale of available-for-sale equity securities.

- 25 -

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

GAIN ON FORGIVENESS OF DEBT

We recorded \$76,000 in the nine months ended September 30, 2004 as a gain on forgiveness of debt. This represents that amount of liability that were released in the current year by participants in our loan to this affiliate, net of \$15,000 in expenses associated with these releases. Due to poor operating results, Uncommon Care was in default and not making scheduled payments under its loan agreement with us in which the participations had been sold. As a result, the loan participants released us from any obligations under the participation agreements. That portion of the releases entered into with related parties, totaling \$114,000, was taken directly into equity. The effect of these transactions on our balance sheet for the period ended September 30, 2004 was to reduce the long-term liability account, "Payable under loan participation agreements", by \$204,000.

INTEREST INCOME

Our interest income increased \$40,000 (68%) and \$25,000 (11%) in the three and nine month periods ended September 30, 2004 compared to the same periods in 2003. The current year three month increase was due to an increase in interest earned on securities traded at APS Financial resulting from holding securities in inventory for a longer period of time than normal.

OTHER INCOME (LOSS)

Our other income rose \$54,000 and \$94,000 for the three and nine months ended September 30, 2004, respectively compared to the same periods in 2003. The increase in the current year represents primarily management fees received from our former consulting division. In the same period in 2003, management fees from our former consulting division were eliminated from earnings since they were still consolidated and, as such, fees paid by them to us were eliminated as an inter-company item. In addition, inventory losses at APS Financial totaled \$25,000 during the current year nine month period, which was \$33,000 lower than the same period in 2003.

- 26 -

MINORITY INTERESTS

During the first nine months of 2003, minority interests represented the combination of two outside interests in subsidiaries of the Company: a twenty percent interest in Insurance Services owned by FPIC Insurance Group, Inc. and a three percent interest in APS Asset Management, a subsidiary of the financial services subsidiary of the Company (APS Investment Services), owned by key individuals within APS Asset Management. Minority interests decreased in the current year due to the repurchase of the 20% minority interest in Insurance Services from the minority interest holder, FPIC Insurance Group effective October 1, 2003.

LIQUIDITY AND CAPITAL RESOURCES

WORKING CAPITAL

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

Our net working capital was \$6,212,000 and \$8,537,000 at September 30, 2004 and December 31, 2003, respectively. The decrease in the current year was due in part to cash used to purchase long-term available-for-sale fixed income and equity securities. Partially offsetting this was cash received from operations as well as tax refunds received in 2004 in excess of estimated tax payments made on 2004 earnings. Historically, we have maintained a strong working capital position and, as a result, we have been able to satisfy our operational and capital expenditure requirements with cash generated from our operating and investing activities. These same sources of funds have also allowed us to pursue investment and expansion opportunities consistent with our growth plans.

Although there can be no assurance our operating activities will provide positive cash flow in 2004, we are optimistic that our working capital requirements will be met for the foreseeable future for the following reasons: (1) our current cash position is very strong, with a balance of approximately \$6.6 million comprising 26 percent of our total assets; (2) our investments in available-for-sale equity and fixed income securities could provide an additional \$12.3 million should the need arise; and (3) we established a line of credit in November 2003 that is described below.

- 27 -

LINE OF CREDIT

During November 2003, we established a \$3.0 million line of credit with PlainsCapital Bank. The loan called for interest payments only to be made on any amount drawn until April 15, 2004, when the entire amount of the note, principal and interest then remaining unpaid, became due and payable. We have since renewed this line of credit for a period of one year following the April 15, 2004 maturity date. At September 30, 2004, there were no draws taken against this line of credit. We are in compliance with the covenants of the loan agreement, including requirements for a minimum of \$5.0 million of unencumbered liquidity and a minimum 2 to 1 debt to worth ratio.

CAPITAL EXPENDITURES

Our capital expenditures for equipment were \$362,000 in the nine months of 2004. We expect capital expenditures in 2004 to be approximately \$400,000, including \$270,000 in improvements to our reporting software. Our 2004 capital expenditure budget is expected to be funded through cash on hand.

ADOPTION OF RECENT ACCOUNTING PRONOUNCEMENTS

In March 2004, the Financial Accounting Standards Board ("FASB") issued an exposure draft entitled "Share-Based Payment, an Amendment of FASB Statements No. 123 and 95." This proposed statement addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The proposed Statement would eliminate the ability to account for share-based compensation transactions using APB Opinion No. 25, "Accounting for Stock Issued to Employees", and generally would require instead that such transactions be accounted for using a fair-value-based method. As proposed, this statement would be effective for the Company on January 1, 2005. We are currently unable to determine what effect this statement will have on our financial position or

results of operations, if any.

- 28 -

In March 2004, the FASB reached a consensus on EITF 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("EITF 03-1"). EITF 03-1 provides guidance for determining when an investment is impaired and whether the impairment is other than temporary. EITF 03-1 also incorporates into its consensus the required disclosures about unrealized losses on investments announced by the EITF in late 2003 and adds new disclosure requirements relating to cost-method investments. The impairment accounting guidance is effective for reporting periods beginning after September 15, 2004 and the new disclosure requirements for annual reporting periods ending after September 15, 2004. We are currently evaluating the impact that adoption of the impairment guidance contained in EITF 03-1 may have on our financial position or results of operations.

Item 3.

CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. As of the end of the period covered by this report, and under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of these disclosure procedures. Based on this evaluation and subject to the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective in reaching a reasonable level of assurance of achieving management's desired controls and procedures objectives.

There have been no changes in internal controls over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to affect, our internal control over financial reporting.

As part of a continuing effort to improve our business processes we are evaluating our internal controls and may update certain controls to accommodate any modifications to our business processes or accounting procedures.

- 29 -

PART II

OTHER INFORMATION

-Item 1. LEGAL PROCEEDINGS

We are involved in various claims and legal actions that have arisen in the ordinary course of business. Management believes that any liabilities arising from these actions will not have a significant adverse effect on our financial condition or results of operations.

Item 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Items 2(a) through(d) are inapplicable.

(e) Stock Repurchases

Period	(a) Total Number of shares Purchased (1)	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs
-----	-----	-----	-----
July 1, 2004-July 31, 2004	2,100	\$ 9.80	--
August 1, 2004-August 31, 2004	4,337	\$ 9.42	4,215
Sept 1, 2004-Sept 30, 2004	76	\$ 10.00	76

(1) Of the total shares purchased 6,100 were purchased in open market transactions and 413 were purchased in private transactions. Our share repurchase program was announced August 17,2004 and authorizes the purchase of up to \$ 2million of common stock.

Item 6. EXHIBITS AND REPORTS ON FORM 8-K

Edgar Filing: AMERICAN PHYSICIANS SERVICE GROUP INC - Form 10-Q

(a) Exhibits

31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 906 Certification of Chief Executive Officer
32.2	Section 906 Certification of Chief Financial Officer

(b) Reports on Form 8-K.

Report filed October 15, 2004 concerning an other than temporary write-down totaling approximately \$2.4 million of our investment in Financial Industries Corporation.