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

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

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

FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2001

Commission File Number 2-39729

COTTON STATES LIFE INSURANCE COMPANY

(Exact name of registrant as specified in its charter)

GEORGIA

58-0830929

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification Number)

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

30346

(Address of principal executive offices)

(Zip Code)

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

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

YES [X] NO []

The Registrant as of June 30, 2001, has 6,345,428 shares of common stock outstanding.

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COTTON STATES LIFE INSURANCE COMPANY

FORM 10-Q

FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2001

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INDEPENDENT AUDITORS' REPORT

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

We have reviewed the consolidated condensed balance sheet of Cotton States Life Insurance Company, Inc. as of June 30, 2001, and the related consolidated statements of earnings and comprehensive income for the three-month and six-month periods ended June 30, 2001 and 2000, and the consolidated statements of cash flows for the six month period ended June 30, 2001 and 2000. These consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial

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statements taken as a whole. Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the accompanying consolidated condensed balance sheet of Cotton States Life Insurance Company, Inc. as of December 31, 2000, and the related consolidated statements of earnings, shareholders' equity, cash flows and comprehensive income for the year then ended (not presented herein); and in our report dated February 21, 2001, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2000, is fairly stated in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/S/ KPMG LLP

August 10, 2001
Atlanta, Georgia

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ITEM I - CONSOLIDATED FINANCIAL STATEMENTS

COTTON STATES LIFE INSURANCE COMPANY
Consolidated Condensed Balance Sheets
June 30, 2001 and December 31, 2000
(Amounts in Thousands)

ASSETS	2001 ----- (unaudited)	2000 -----
Investments		
Fixed maturities, held for investment, at amortized cost (fair value \$14,058 in 2001 and \$15,214 in 2000)	\$ 13,753	15,057
Fixed maturities, available for sale, at fair value (amortized cost \$127,538 in 2001 and \$119,813 in 2000)	125,996	116,584
Equity securities, at fair value (cost \$3,808 in 2001 and 3,671 in 2000)	3,586	3,776
First mortgage loans on real estate	1,906	2,098
Policy loans	9,176	8,841
Other invested assets	1,000	1,000
TOTAL INVESTMENTS	----- 155,417	----- 147,356
Cash and cash equivalents	5,587	6,438
Accrued investment income	2,776	2,466
Premiums receivable	2,969	3,316
Reinsurance receivable	6,537	4,377

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Deferred policy acquisition costs	49,414	46,857
Other assets	432	491
	-----	-----
	\$ 223,132	211,301
	=====	=====

LIABILITIES AND SHAREHOLDERS' EQUITY

Policy liabilities and accruals:		
Future policy benefits	138,337	132,655
Policy and contract claims	4,613	2,298
Federal income taxes	6,953	6,266
Other liabilities	7,552	7,348
	-----	-----
TOTAL LIABILITIES	157,455	148,567
	-----	-----
Shareholders' equity:		
Common Stock	6,755	6,755
Additional paid-in capital	1,496	1,496
Accumulated other comprehensive loss	(953)	(1,716)
Retained earnings	62,533	60,320
Less:		
Unearned compensation-restricted stock	(827)	(794)
Treasury stock, at cost, (409 shares in 2001 and 2000)	(3,327)	(3,327)
TOTAL SHAREHOLDERS' EQUITY	65,677	62,734
	-----	-----
	\$ 223,132	211,301
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

COTTON STATES LIFE INSURANCE COMPANY
 Unaudited Consolidated Statements of Earnings
 Three Months and Six Months ending June 30, 2001 and 2000
 (Amounts in thousands, except per share data)

	Three months ended June 30,		Six mon Jun
	2001	2000	2001
	-----	-----	-----
Revenue:			
Premiums	\$ 7,143	\$ 6,384	14,174
Investment income	2,567	2,500	5,115
Realized investment gains	80	126	89
Brokerage commissions	1,096	996	2,000
	-----	-----	-----
TOTAL REVENUE	10,886	10,006	21,378
	-----	-----	-----
Benefits and expenses:			

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Benefits and claims	3,782	3,020	8,500
Interest credited	1,417	1,268	2,633
Amortization of policy acquisition costs	1,195	847	2,122
Operating expenses	2,202	1,922	4,235
	-----	-----	-----
TOTAL BENEFITS AND EXPENSE	8,595	7,057	17,490
	-----	-----	-----
Income before income tax expense	2,291	2,950	3,888
Income tax expense	590	888	1,166
	-----	-----	-----
NET INCOME	\$ 1,701	2,061	2,722
	=====	=====	=====
Basic income per share of common stock			
Net Income	\$ 0.27	0.32	0.43
	=====	=====	=====
Diluted income per share of common stock			
Net income	\$ 0.26	0.31	0.42
	=====	=====	=====
Weighted average number of shares			
used in computing income per share			
Basic	6,345	6,345	6,345
	=====	=====	=====
Diluted	6,532	6,466	6,530
	=====	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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COTTON STATES LIFE INSURANCE COMPANY
 Unaudited Consolidated Statements of Cash Flows
 Six months ended June 30, 2001 and 2000
 (Amounts in Thousands)

	2001	2000
	-----	-----
Cash flows from operating activities:		
Net income	\$ 2,722	3,585
Adjustments to reconcile net income to net cash provided from operating activities:		
Increase in policy liabilities and accruals	7,997	4,720
(Increase) in deferred policy acquisition costs	(2,711)	(2,929)
Increase in liability for income taxes	175	641
(Increase) in amounts receivable and amounts due from reinsurers	(1,813)	(629)
Increase in amounts due affiliate	584	1,133
Other, net	(499)	(256)
	-----	-----
Net cash provided from operating activities	6,455	6,265
	-----	-----
Cash flows from investing activities:		
Purchase of fixed maturities available for sale	(35,333)	(7,871)
Purchase of equity securities	(1,536)	(1,909)

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Sale of fixed maturities available for sale	24,925	--
Sale of equity securities	1,399	864
Proceeds from maturities of fixed maturities held for investment	1,300	1,010
Proceeds from maturity and redemption of fixed maturities held for sale	2,651	5,635
Principal collected on first mortgage loans	192	430
Net increase in policy loans	(335)	(83)
Other, net	(58)	(165)
	-----	-----
Net cash used in investing activities	(6,795)	(2,089)
	-----	-----
Cash flows from financing activities:		
Cash dividends paid	(510)	(510)
Purchase of treasury stock	--	(145)
Stock issued under executive compensation plans	--	135
	-----	-----
Net cash used by financing activities	(510)	(520)
	-----	-----
Net increase (decrease) in cash and cash equivalents:	(851)	3,656
Cash and cash equivalents:		
Beginning of period	6,438	6,106
	-----	-----
END OF PERIOD	\$ 5,587	\$ 9,762
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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COTTON STATES LIFE INSURANCE COMPANY
 Unaudited Consolidated Statements of Comprehensive Income
 Three Months and Six Months ending June 30, 2001 and 2000
 (Amounts in Thousands)

	Three months ended June 30,		
	2001	2000	2
	-----	-----	-----
Net income:	\$ 1,701	2,061	
Other comprehensive income (loss), before tax:			
Unrealized gains (losses) on securities available for sale	(830)	(522)	
Reclassification adjustment for realized gains included in net income	(80)	(127)	
	-----	-----	-----

TOTAL OTHER COMPREHENSIVE INCOME

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(LOSS), BEFORE TAX	(910)	(649)
Income tax expense (benefit) related to items of other comprehensive income	(354)	(221)
Other comprehensive income (loss), net of tax	(556)	(428)
TOTAL COMPREHENSIVE INCOME	\$ 1,145	1,633

See accompanying notes to unaudited consolidated financial statements.

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COTTON STATES LIFE INSURANCE COMPANY
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2001 AND DECEMBER 31, 2000

NOTE 1 - BASIS OF PRESENTATION

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

The consolidated financial statements for the three months and six months ended June 30, 2001 are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in the Company's annual report on Form 10-K for the year ended December 31, 2000.

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

NOTE 2 - ACCOUNTING PRONOUNCEMENTS

Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities became effective beginning January 1, 2001. However, due to the Company's limited use of derivative financial instruments, SFAS No. 133 had no impact on the Company's consolidated financial position, results of operations

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or cash flows.

The FASB also issued SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (a replacement of SFAS No. 125)" in September 2000. At this time, the Company does not anticipate this standard having a significant impact on the Company's financial position or income.

The FASB recently issued SFAS No. 141, "Business combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets," in June 2001. Based on current information available, the Company does not anticipate these standards having a significant impact on the Company's financial position or income.

NOTE 3 - BUSINESS SEGMENTS

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

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distributed through independent agents as well as exclusive agents, and brokerage operations all involve third party products distributed through the Company's exclusive and independent agents.

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

	Six Months Ended June 30, (Dollars in thousands)	
	2001	2000
	-----	-----
Individual life insurance:		
Premiums	\$ 9,155	8,756
Investment income	4,723	4,599
Realized investment gains	82	--
	-----	-----
Total revenue	\$ 13,960	13,355
	=====	=====
Net income	\$ 1,521	2,244
	=====	=====
Guaranteed and simplified issue life insurance:		
Premiums	\$ 5,019	3,754
Investment income	386	233
Realized investment gains	7	--
	-----	-----

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Total revenue	\$ 5,412	3,987
	=====	=====
Net income	\$ 243	265
	=====	=====
Brokerage:		
Commission income	\$ 1,974	1,902
Investment income	32	69
Realized investment gains	--	244
	-----	-----
Total revenue	\$ 2,006	2,215
	=====	=====
Net income	\$ 958	1,076
	=====	=====
Total net income	\$ 2,722	3,585
	=====	=====

NOTE 4 - CONTINGENCIES

The Company has initiated legal action to recover the proceeds of a \$900,000 reinsurance policy. The Company expects that the ultimate recovery of the full amount is very likely.

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

FORWARD-LOOKING STATEMENTS

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

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

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Company does not achieve all of these key factors, then the Company's actual performance could vary materially from the forward-looking statements made herein. The Company disclaims any obligation to update forward-looking information.

RESULTS OF OPERATIONS (DOLLARS IN THOUSANDS)

PREMIUMS	2001 -----	SIX MONTHS ENDED JUNE 30, 2000 -----	INCREASE -----
Guaranteed and simplified issue life insurance	\$ 5,019	3,754	34%
Individual life insurance:			
Traditional life	3,150	3,021	4%
Universal life	6,005	5,735	5%
	-----	-----	
Total individual life insurance	9,155	8,756	5%
	-----	-----	
 TOTAL PREMIUMS	 \$ 14,174 =====	 12,510 =====	 13%

Guaranteed and simplified issue life insurance premiums continued to show significant growth as a result of higher production by the independent agency force which increased 5% to 4,200 agents under contract at June 30, 2001 compared to 4,000 at June 30, 2000. 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.

Individual life insurance products are principally sold by the Company's exclusive agent producers. Individual life premiums have increased 5% for the six month period. The exclusive agency force of 296 as of June 30, 2001 increased 2% compared to the same date last year.

INVESTMENT INCOME

Investment income increased 4% compared to the first six months of 2000 reflecting growth in the average investment portfolio. The annualized average yield decreased to 6.6% compared to 6.9% for the first six months 2000 due to the economic impact of lower interest rates.

BROKERAGE COMMISSIONS

Exclusive agents also sell products that the Cotton States Group does not underwrite (both life and property and casualty). Property and casualty business lines, principally non-standard auto, continue to show strong growth with commissions increasing 14% compared to the first half of last year.

BENEFITS AND CLAIMS

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

SIX MONTHS ENDED JUNE 30, (DOLLARS IN THOUSANDS)			
	2001		2000
BENEFITS AND CLAIMS	----- BENEFITS AND CLAIMS	% OF PREMIUM	----- BENEFITS AND CLAIMS
Guaranteed and simplified issue	\$ 3,584	71%	2,740
Individual life insurance			
Traditional life	2,485	79%	1,746
Universal life	2,431	40%	1,652
	-----		-----
Total individual life insurance	4,916	54%	3,398
	-----		-----
TOTAL BENEFITS AND CLAIMS	\$ 8,500	60%	6,138
	=====		=====

Although individual life benefits were below management's expectations for the quarter, they are up year to date compared to last years experience. The Company has purchased excess reinsurance coverage to protect itself against calendar year losses in excess of \$10 million. Through June 30, 2001, no aggregate excess reinsurance recoveries have been recognized as the Company has not reached the aggregate threshold.

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INTEREST CREDITED TO POLICYHOLDERS

Interest credited to universal life contracts increased 4% reflecting growth in universal life policy accumulations. The annual interest rate credited to universal life contract accumulations was 6.2% for both six month periods of 2001 and 2000.

AMORTIZATION OF POLICY ACQUISITION COSTS AND OPERATING EXPENSES

The amortization of policy acquisition costs as a percentage of premiums was 15% and is slightly higher than the Company's expected range of 12-14% due to higher lapses in the traditional lines of business which reflects increased term rate competition in the market place.

Operating expense as a percentage of premiums decreased to 30% for the first six months compared to 31% for the same period last year. The Company continues to realize increasing cost efficiencies from recently implemented digital imaging and automated policy processing technologies.

INCOME TAX EXPENSE

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The effective tax rate for the first six months of 2001 was 30% compared to 33% for the same period last year. The effective tax rate is based on the estimated annual rate.

NET INCOME

	SIX MONTHS ENDED JUNE 30, (DOLLARS IN THOUSANDS)		
NET INCOME	2001	2000	INCREASE
	-----	-----	-----
Guaranteed and simplified issue	\$ 243	265	(8%)
Individual life insurance:			
Traditional	286	720	(60%)
Universal life	1,235	1,524	(19%)
	-----	-----	
Total individual life insurance	1,521	2,244	(32%)
	-----	-----	
Brokerage operations	958	1,076	(11%)
	-----	-----	
Net Income	\$ 2,722	3,585	(24%)
	=====	=====	

Despite continued growth in premiums and cost efficiencies, higher mortality costs, compared to our excellent results last year, and a decrease in realized investment gains in the brokerage operations accounted for the decrease in net income for the first half of the year.

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Realized capital gains contributed 3% and 5% to net income for the first six months of 2001 and 2000, respectively.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

CREDIT RISK

Credit Risk is the risk that issuers of securities owned by the Company will default, or other parties, including reinsurers, which owe the Company money, will not pay. The Company attempts to minimize these risks by following a conservative investment strategy and by contracting with reinsuring companies

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that meet high standards for rating criteria and other qualifications. The Company invests in government, governmental agency and high quality corporate bonds having an A rating or better. The fixed maturity portfolio had an average rating of AA- at June 30, 2001.

INTEREST RATE RISK

The Company's fixed maturity investments are subject to interest rate risk. The Company manages the impact of interest rate fluctuation through cash flow modeling. Liabilities for interest sensitive products are carried at full account value. The fixed maturity portfolio at June 30, 2001 and December 31, 2000 had an effective duration of 4.6 years and 4.8 years respectively.

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

	(AMOUNTS IN THOUSANDS)	
	ESTIMATED FAIR VALUE JUNE 30, 2001	ESTIMATED FAIR VALUE AFTER 100 BASIS POINT CHANGE IN INTEREST RATES
FIXED MATURITIES	-----	-----
Held for investment	\$ 14,058	100 bp decrease \$ 14,758 100 bp increase \$ 13,383
Available for sale	\$ 125,996	100 bp decrease \$132,270 100 bp increase \$119,948

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOW

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

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

The Company's principal long-term obligations are fixed contractual obligations incurred in the sale of its life insurance products. The premiums billed for these products are based on conservative and actuarially sound assumptions as to mortality, persistency and interest. The Company believes these assumptions will produce revenues sufficient to meet its future contractual benefit obligations

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and operating expenses, and provide an adequate profit margin to finance future growth without a major entry into the debt or equity markets.

INVESTMENTS

Since December 31, 2000, there has not been a material change in mix or credit quality of the Company's investment portfolio. All purchases have been fixed maturities available for sale and over 91% of the holdings at June 30, 2001 and December 31, 2000 are rated "A" or better. Due to lower interest rates the Company experienced an increase in the fair value of bonds of approximately \$1.7 million year to date.

MORTGAGE LOANS

The Company's mortgage loan policy stipulates that the Company will loan no more than 80% of the value on residential loans and no more than 75% of the value on commercial loans. The Company grants loans only to employees (excluding officers and directors) and agents.

The geographic distribution of the loan portfolio is:

NO. OF LOANS		STATE	BOOK VALUE (AMOUNTS IN THOUSANDS)	
JUNE 30, ----- 2001 ----- ----	DECEMBER 31, ----- 2000 ----- ----		JUNE 30, ----- 2001 ----- ----	DECEMBER 31, ----- 2000 ----- ----
3	3	Alabama	\$ 121	130
6	6	Florida	338	354
34	36	Georgia	1,447	1,614
-----	-----		-----	-----
43	45		\$1,906	2,098
=====	=====		=====	=====

Two loans representing \$103 thousand in principal are over 30 days delinquent. The loan-to-value ratio on delinquent loans is 28%.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

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

The Company has initiated legal action to recover the proceeds of a \$900,000 reinsurance policy. The Company expects that the ultimate recovery of the full amount is very likely.

Item 2. Changes in Securities and Use of Proceeds

NONE

Item 3. Defaults Upon Senior Securities

NONE

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

NONE

Item 5. Other Information

NONE

Item 6. Exhibits and Reports on Form 8-K

Exhibit 11 - Statement re Computation of Per Share Earnings

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COTTON STATES LIFE INSURANCE COMPANY
REGISTRANT

Date: 8/13/01

/s/ J. Ridley Howard

J. Ridley Howard, Chairman
President and Chief Executive Officer

Date: 8/13/01

/s/ Roger W. Fisher

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