AMERICAN MEDICAL SECURITY GROUP INC
Form 10-Q
May 07, 2002

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 quarterly period ended March 31, 2002
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 1-13154

AMERICAN MEDICAL SECURITY GROUP, INC.
(Exact name of Registrant as specified in its charter)

Wisconsin	39-1431799
(State of Incorporation)	(I.R.S. Employer Identification No.)
3100 AMS Boulevard Green Bay, Wisconsin	54313
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (920) 661-1111

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.

Common stock, no par value, outstanding as of April 30, 2002: 12,590,166 shares

AMERICAN MEDICAL SECURITY GROUP, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31,	December 31,

	2002	2001
	(In thousands)	
ASSETS		
Investments:		
Securities available for sale, at fair value:		
Fixed maturities	$ 250,217	$ 269,753
Equity securities-preferred	-	722
Fixed maturity securities held to maturity, at amortized cost	4,303	4,286
Trading securities, at fair value	666	517
Total investments	255,186	275,278
Cash and cash equivalents	17,604	24,975
Other assets:		
Property and equipment, net	34,460	33,381
Goodwill, net	92,944	100,343
Other intangibles, net	3,408	3,591
Other assets	44,744	35,447
Total other assets	175,556	172,762
Total assets	$ 448,346	$ 473,015

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2002	December 31, 2001
	(In thousands)	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Medical and other benefits payable	$ 132,569	$ 135,504
Advance premiums	16,634	16,737
Payables and accrued expenses	26,656	28,032

Notes payable	34,758	40,058
Other liabilities	24,154	23,284
Total liabilities	234,771	243,615
Shareholders' equity:		
Common stock (no par value, $1 stated value, 50,000,000 shares authorized, 16,654,315 issued and 12,590,166 outstanding at March 31, 2002, 16,654,315 issued and 13,955,439 outstanding at December 31, 2001)	16,654	16,654
Paid-in capital	187,892	187,927
Retained earnings	45,900	40,470
Accumulated other comprehensive income (loss) (net of tax benefit of $40,000 at March 31, 2002 and tax expense of $1,024,000 at December 31, 2001)	(74)	1,903
Treasury stock (4,064,149 shares at March 31, 2002 and 2,698,876 shares at December 31, 2001, at cost)	(36,797)	(17,554)
Total shareholders' equity	213,575	229,400
Total liabilities and shareholders' equity	$ 448,346	$ 473,015

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31,	
	2002	2001
	(In thousands, except per share data)	
Revenues:		
Insurance premiums	$ 194,401	$ 222,470
Net investment income	3,924	4,514
Net realized investment gain (loss)	14	(27)
Other revenue	5,405	5,301

Total revenues	203,744	232,258
Expenses:		
Medical and other benefits	131,800	166,580
Selling, general and administrative	62,024	71,411
Interest expense	494	876
Amortization of goodwill and intangibles	183	907
Total expenses	194,501	239,774
Income (loss) before income taxes	9,243	(7,516)
Income tax expense (benefit)	3,813	(2,376)
Net income (loss)	$ 5,430	$ (5,140)
Earnings (loss) per common share:		
Basic	$ 0.39	$ (0.36)
Diluted	$ 0.37	$ (0.36)

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2002	2001
	(In thousands)	
OPERATING ACTIVITIES:		
Net income (loss)	$ 5,430	$ (5,140)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,226	2,427
Net realized investment (gain) loss	(14)	27
Net change in trading securities	(149)	16
Deferred income tax benefit	(2,694)	(2,571)
Changes in operating accounts:		

Other assets	1,870	1,408
Medical and other benefits payable	(2,935)	(12,025)
Advance premiums	(103)	445
Payables and accrued expenses	(1,376)	8,237
Other liabilities	860	(880)
Net cash provided by (used in) operating activities	3,115	(8,056)
INVESTING ACTIVITIES:		
Purchases of available for sale securities	(32,283)	(40,470)
Proceeds from sale of available for sale securities	49,214	43,679
Proceeds from maturity of available for sale securities	-	3,050
Purchases of held to maturity securities	(1,335)	-
Proceeds from maturity of held to maturity securities	1,295	-
Purchases of property and equipment	(2,799)	(1,891)
Net cash provided by investing activities	14,092	4,368
FINANCING ACTIVITIES:		
Purchase of treasury stock	(19,540)	(1,134)
Stock options exercised	262	-
Repayment of notes payable	(5,300)	(300)
Net cash used in financing activities	(24,578)	(1,434)
Cash and cash equivalents:		
Net decrease	(7,371)	(5,122)
Balance at beginning of year	24,975	15,606
Balance at end of period	$ 17,604	$ 10,484

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

March 31, 2002

NOTE A. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements

have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States ("GAAP") for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the American Medical Security Group, Inc. (the "Company") annual report on Form 10-K for the year ended December 31, 2001.

NOTE B. EARNINGS (LOSS) PER COMMON SHARE ("EPS")

Basic EPS are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted EPS are computed by dividing net income (loss) by the weighted average number of common shares outstanding, adjusted for the effect of dilutive employee stock options.

The following table illustrates the computation of EPS and provides a reconciliation of the number of weighted average basic and diluted shares outstanding:

	Three Months Ended March 31,	
	2002	2001
	(In thousands, except share and per share data)	
Numerator:		
Net income (loss)	$ 5,430	$ (5,140)
Denominator:		
Denominator for basic EPS - weighted average shares	13,802,666	14,210,643
Effect of dilutive employee stock options	688,875	-
Denominator for diluted EPS	14,491,541	14,210,643
Earnings (loss) per common share:		
Basic	$ 0.39	$ (0.36)
Diluted	$ 0.37	$ (0.36)

The effect of dilutive securities was excluded from the diluted earnings (loss) per common share computation for the three months ended March 31, 2001 because the Company had a net loss in that period; therefore, their inclusion would have been antidilutive. Certain options to purchase shares were not included in the computation of diluted earnings (loss) per common share because the options' exercise prices were greater than the average market price of the outstanding common shares for the period.

NOTE C. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is defined as net income (loss) plus or minus other comprehensive income (loss). For the Company, under existing accounting standards, other comprehensive income (loss) includes unrealized gains and losses, net of income tax effects, on certain investments in debt and equity securities. Comprehensive income (loss) for the Company is calculated as follows:

	Three Months Ended March 31,	
	2002	2001
	(In thousands)	
Net income (loss)	$ 5,430	$ (5,140)
Unrealized gain (loss) on available for sale securities	(1,977)	3,392
Comprehensive income (loss)	$ 3,453	$ (1,748)

NOTE D. CREDIT AGREEMENT

At March 31, 2002, the Company maintained a revolving bank line of credit agreement with an outstanding balance and maximum commitment of $30.2 million. At December 31, 2001, the outstanding balance and maximum commitment under the credit agreement was $35.2 million. The credit agreement contains customary covenants which, among other matters, require the Company to achieve certain minimum financial results and restrict the Company's ability to incur additional debt, pay future cash dividends and dispose of assets outside the ordinary course of business. The Company was in compliance with all such covenants at March 31, 2002 and anticipates continued compliance in the foreseeable future. Obligations under the credit agreement are secured by the stock of the Company's principal subsidiaries. The Company believes that the implementation of Statement of Financial Accounting Standards No. 142, as described in Note F below, will not adversely impact the Company's compliance with its debt covenants.

The credit agreement was amended in March 2002 to allow for the repurchase on March 22, 2002, of 1.4 million shares of the Company's common stock at a total cost of $19.5 million, including related transaction costs, from the Company's largest shareholder, Blue Cross & Blue Shield United of Wisconsin, and revise the minimum financial requirements under certain covenants and the schedule of mandatory future commitment reductions.

NOTE E. CONTINGENCIES

In February 2000, a class action lawsuit was filed against the Company in the state of Florida alleging the Company did not follow Florida law when it discontinued writing certain health insurance policies and offered new policies in 1998. Plaintiffs claim the Company wrongfully terminated policies, improperly notified insureds of conversion rights and charged improper premiums for the new policies. Plaintiffs also alleged that the Company's renewal rating methodology violates Florida law. Plaintiffs are seeking unspecified damages. A bench trial on the liability issues of the case was held in March 2002. On April 24, 2002, a judgment was rendered against the Company and the damages portion of the lawsuit is expected to be heard before a jury later this year. Management believes the Company acted in compliance with applicable Florida law with regard to the discontinuance and replacement of insurance policies and with regard to its

renewal rating practices.

In a separate administrative proceeding based on similar facts with similar issues, the Florida Department of Insurance issued a complaint against the Company in May 2001, challenging the Company's rating and other practices in Florida. On April 25, 2002, the Administrative Law Judge found in favor of the Company and held that the evidence presented by the Florida Department of Insurance did not support a conclusion that the Company had violated any provisions of the Florida insurance statutes or regulations. The Administrative Law Judge recommended that the administrative complaint be dismissed. The Commissioner of the Florida Department of Insurance must accept the Administrative Law Judge's findings of fact but may make modifications to conclusions of law. In light of the conflicting findings in these cases, the Company intends to request that the court in the class action lawsuit reconsider its ruling. If the ruling is not reconsidered, the Company intends to appeal the ruling.

The Company is involved in the foregoing and various other legal and regulatory actions occurring in the normal course of business. Based on current information including consultation with outside counsel, management believes any ultimate liability that may arise from the above-mentioned and all other legal and regulatory actions would not materially affect the Company's consolidated financial position or results of operations. However, management's evaluation of the likely impact of these actions could change in the future and an unfavorable outcome could have a material adverse effect on the Company's consolidated financial position, results of operations or cash flow of a future period.

NOTE F. RECENT ACCOUNTING PRONOUNCEMENTS

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("Statement 142"). Statement 142 impacts the Company in two ways. First, goodwill is no longer amortized. Second, goodwill is subject to an initial impairment test in accordance with Statement 142, and any remaining balance of goodwill will be subject to future annual impairment testing.

Effective January 1, 2002, in accordance with Statement 142, the Company reclassified an intangible asset, net of related deferred taxes, into goodwill because it did not meet the new recognition criteria for an intangible asset to be recognized apart from goodwill. The amortization period used prior to 2002 for this intangible asset was the same as the amortization period for goodwill.

The Company's other intangible asset will continue to be amortized on a straight-line basis over its remaining useful life of five years. This intangible asset had a gross carrying amount of $7.3 million and accumulated amortization of $3.7 million at December 31, 2001. Future amortization expense for this intangible asset is expected to be approximately $0.7 million for each of the next five years.

The Company is in the process of performing the first of the required impairment tests of goodwill by comparing the fair value of the Company's reporting units to their carrying amounts (book value), including goodwill as of January 1, 2002. At December 31, 2001, the Company's book value per share was $16.30 and was significantly higher than the $12.45 quoted market price per share. The Company has not yet determined what the effect of these tests will be on the earnings and financial position of the Company. If management determines that the quoted market price per share is the appropriate measure of the Company's fair value, the resulting impairment would be greater than 50% of the

amount of goodwill on the Company's December 31, 2001 balance sheet. If it is determined that an impairment exists as of January 1, 2002, the charge will be reported as the cumulative effect of a change in accounting principle in the Company's consolidated financial statements and will have no impact on cash flows or the statutory-basis capital and surplus of the Company's insurance subsidiaries.

For comparative purposes, the following table illustrates net loss and net loss per share for the first quarter of the prior year adjusted to exclude the effects of adopting Statement 142:

	Three Months Ended March 31,	
	2002	2001
	(In thousands, except per share amounts)	
Reported net income (loss)	$ 5,430	$ (5,140)
Add back: Goodwill amortization	-	671
Adjusted net income (loss)	$ 5,430	$ (4,469)
Basic earnings (loss) per common share:		
Reported net income (loss)	$ 0.39	$ (0.36)
Goodwill amortization	-	0.05
Adjusted net income (loss)	$ 0.39	$ (0.31)
Diluted earnings (loss) per common share:		
Reported net income (loss)	$ 0.37	$ (0.36)
Goodwill amortization	-	0.05
Adjusted net income (loss)	$ 0.37	$ (0.31)

NOTE G. SEGMENT INFORMATION

The Company has two reportable segments: 1) health insurance products; and 2) life insurance products. The Company's health insurance products consist of the following coverages related to small employer group preferred provider organization products: MedOneSM (for individuals and families) and small employer group medical, self funded medical, dental and short-term disability. Life insurance products consist primarily of group term-life insurance. The "All Other" segment includes operations not directly related to the business segments and unallocated corporate items (i.e., corporate investment income, interest expense on corporate debt, amortization of goodwill and intangibles and unallocated overhead expenses). The reportable segments are managed separately because they differ in the nature of the products offered and in profit margins.

The Company evaluates segment performance based on profit or loss before income taxes, not including gains and losses on the Company's investment portfolio. The accounting policies of the reportable segments are the same as

those used to report the Company's consolidated financial statements. Significant intercompany transactions have been eliminated prior to reporting reportable segment information.

A reconciliation of segment income (loss) before income taxes to consolidated income (loss) before income taxes is as follows:

	Three Months Ended March 31,	
	2002	2001
	(In thousands)	
Health segment	$ 8,342	$ (8,506)
Life segment	1,423	1,750
All other	(522)	(760)
Income (loss) before income taxes	$ 9,243	$ (7,516)

Operating results and statistics for each of the Company's segments are as follows:

	Three Months Ended March 31,	
	2002	2001
	(In thousands)	
HEALTH SEGMENT		
OPERATING RESULTS		
Revenues:		
Insurance premiums	$ 190,720	$ 216,974
Net investment income	1,934	2,450
Other revenue	4,460	4,230
Total revenues	197,114	223,654
Expenses:		
Medical and other benefits	130,564	164,197
Selling, general and administrative	58,208	67,963
Total expenses	188,772	232,160
Income (loss) before income taxes	$ 8,342	$ (8,506)
FINANCIAL STATISTICS		
Loss ratio	68.5%	75.7%
Expense ratio	28.2%	29.4%
Combined ratio	96.7%	105.1%

Membership at End of Period:		
Health:		
Fully insured medical	329,531	424,632
Self funded medical	43,128	49,260
Stand-alone dental	166,822	178,283
Total health (a)	539,481	652,175

(a) Total health membership for the Company at March 31, 2001 of 652,683 includes health maintenance organization ("HMO") membership of 508. HMO operations are not included in health segment operating results.

	Three Months Ended March 31,	
	2002	2001
	(In thousands)	
LIFE SEGMENT		
OPERATING RESULTS		
Revenues:		
Insurance premiums	$ 3,678	$ 4,963
Net investment income	150	174
Other revenue	32	42
Total revenues	3,860	5,179
Expenses:		
Medical and other benefits	1,218	1,992
Selling, general and administrative	1,219	1,437
Total expenses	2,437	3,429
Income before income taxes	$ 1,423	$ 1,750
Financial Statistics		
Loss ratio	33.1%	40.1%
Expense ratio	32.3%	28.1%
Combined ratio	65.4%	68.2%
Membership at End of Period	174,126	230,426

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

OVERVIEW

American Medical Security Group, Inc., together with its subsidiary companies (the "Company"), is a provider of individual and small employer group insurance products. The Company's principal product offerings are health insurance for small employer groups and health insurance products marketed to individuals and families ("MedOneSM"). The Company also offers dental, life, prescription drug, disability and accidental death insurance, and provides self funded benefit administration. The Company markets its products in 32 states and the District of Columbia through independent agents. The Company has approximately 75 sales managers located in sales offices throughout the United States to support the independent agents. The Company's products generally provide discounts to insureds that utilize preferred provider organizations ("PPOs"). The Company owns a preferred provider network and also contracts with other networks to ensure cost-effective health care choices to its members.

RESULTS OF OPERATIONS

The Company reported net income of $5.4 million or $0.37 per diluted share for the first quarter of 2002. This compares to a net loss of $5.1 million or $0.36 per share for the first quarter of 2001. The improvement in profitability from the first quarter of the prior year primarily reflects improvement in the small employer group loss ratio, a charge related to legal matters in the first quarter of 2001, and a change in accounting for goodwill and other intangible assets.

The improvement in the small employer group loss ratio is attributed to management's strategic plan including increased premium rates on new and renewal business, focused marketing efforts for small employer group products in markets with the best prospects for profitability and future growth, and redesigned products to meet the changing needs of today's insurance consumers.

The results for the first quarter of 2001 reflect an after-tax charge of $5.8 million or $0.41 per share for legal matters related to an adverse ruling in a lawsuit brought against the Company by Skilstaf, Inc. Effective January 1, 2002, the Company adopted new rules on accounting for goodwill and other intangible assets. Goodwill is no longer amortized, but is instead tested annually for impairment. The first quarter 2001 results include goodwill amortization of $671,000 or $0.05 per share. See Note F to the Company's condensed consolidated financial statements for further discussion regarding the impact of the accounting method change.

INSURANCE PREMIUMS AND MEMBERSHIP

Insurance premiums for the three months ended March 31, 2002 decreased 12.6% to $194.4 million from $222.5 million for the same period in 2001. The decrease primarily resulted from a decline in membership in select unprofitable small employer group and exited markets and high lapse rates of existing membership in core markets, partially offset by rising premium rates on the continuing block of business. Average fully insured medical premium per member per month for the first quarter of 2002 increased by 15.0% to $168, compared to the first quarter of 2001, reflecting significant rate actions taken by the Company. As a result of the Company's actions to change its product mix, redefine its markets, increase profitability, and reposition itself for the future, quarterly insurance premiums are expected to level before improving later in 2002.

Total medical and dental membership declined from 652,683 members at

March 31, 2001 to 539,481 members at March 31, 2002. The membership decrease is primarily the result of the Company's success in terminating business in several unprofitable markets, including exited markets, and premium rate increases resulting in lower new sales and higher lapses on existing business. The Company's MedOneSM product for individuals and families continues to grow as a percentage of the Company's overall business reflecting management's strategy to change the Company's mix of business. MedOneSM membership now accounts for 46%

of the Company's medical membership in force. At the end of 2000 and 2001, MedOneSM membership accounted for 34% and 45%, respectively. Management considers the MedOneSM product to be a key strategic product and continues to take steps to accelerate membership and premium growth in this market.

NET INVESTMENT INCOME

Net investment income for the three months ended March 31, 2002 decreased to $3.9 million from $4.5 million for the three months ended March 31, 2001. The decrease in net investment income is due primarily to a decrease in the average annual investment yield. The average annual investment yield was 6.0% for the first quarter of 2002 compared to 6.6% for the first quarter of 2001. Invested assets in March 2002 have declined primarily as a result of the repurchase of 1.4 million shares of the Company's common stock for a total cost of $19.5 million, including related transaction costs, from Blue Cross & Blue Shield United of Wisconsin ("BCBSUW").

LOSS RATIO

The health segment loss ratio for the first quarter of 2002 was 68.5% compared to 75.7% for the first quarter of 2001. The significant improvement was due to management's actions and strategies to increase premium rates and combat medical inflation. These actions included premium rate increases, claims cost control initiatives and the exit from unprofitable small employer group markets. The reduction also reflects increased sales of MedOneSM products, which are priced for a lower loss ratio but have higher selling and administrative costs. As anticipated, claim costs per member per month have increased slightly, but were surpassed by increased premiums per member per month. Average premium per member per month for the first quarter of 2002 increased 15.0% compared with the first quarter of 2001. Average claims costs increased only 4.1% over the same period.

The life segment loss ratio for the three months ended March 31, 2002 was 33.1% compared to 40.1% for the three months ended March 31, 2001. The life segment loss ratio tends to fluctuate from quarter to quarter as actual life claims experience fluctuates. The life segment loss ratio for the three month period ended March 31, 2002 is consistent with historical averages and anticipated average future results for this segment.

In determining the liability for unpaid claims at December 31, 2001, the Company anticipated an effect on claims expense from the events of the September 11, 2001 and subsequent bio-terrorism attacks. The Company has not discerned a material adverse affect related to these events and therefore, no longer holds reserves for these matters as of March 31, 2002.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE RATIO

The selling, general and administrative ("SG&A") expense ratio includes commissions and selling expenses, administrative expenses (less other revenues), and premium taxes and assessments. The SG&A expense ratio for health segment

products for the three months ended March 31, 2002 was 28.2%. This compares to the first quarter of 2001 SG&A expense ratio of 25.2%, excluding the non-recurring legal charge. The first quarter 2001 reported SG&A expense ratio, including the non-recurring legal charge, was 29.4%. The increase from the prior year, excluding the non-recurring legal charge, largely reflects a product mix change driven by growth in the MedOneSM business, which has higher selling and administrative costs but lower claim costs than small employer group products. Lower premium volume also contributed to the increase in the SG&A ratio.

The health segment combined ratio, which represents the sum of the health loss and expense ratios was 96.7% for the three months ended March 31, 2002 compared to 100.9% for the same period in the prior year, excluding the non-recurring legal charge. The first quarter 2001 combined ratio, including the non-recurring legal charge, was 105.1%.

LIQUIDITY AND CAPITAL RESOURCES

The Company's sources of cash flow consist primarily of insurance premiums, administrative fee revenue and investment income. The primary uses of cash include payment of medical and other benefits, SG&A expenses and debt service costs. Positive cash flows are invested pending future payments of medical and other benefits and other operating expenses. The Company's investment policies are designed to maximize yield, preserve principal and provide liquidity to meet anticipated payment obligations.

The Company's cash provided by operations was $3.1 million for the three months ended March 31, 2002. This compares to cash used in operations of $8.1 million for the three months ended March 31, 2001. The improvement in cash flow primarily reflects increased profitability of the Company. Management expects cash flow to remain positive for the year 2002.

The Company is well capitalized and has a debt to total capital ratio of 14.0% at March 31, 2002, which is low by industry standards.

The Company's investment portfolio consists primarily of investment grade bonds and has limited exposure to equity securities. At March 31, 2002 and December 31, 2001, greater than 99% of the Company's investment portfolio was invested in bonds. The bond portfolio had an average quality rating of AA at March 31, 2002 and December 31, 2001, as measured by Standard & Poor's Corporation. The majority of the bond portfolio was classified as available for sale. The Company has no investment in mortgage loans, non-publicly traded securities (except for principal only strips of U.S. Government securities), real estate held for investment or financial derivatives.

The Company's principal insurance subsidiary, United Wisconsin Life Insurance Company ("UWLIC"), is domiciled in Wisconsin, which requires certain minimum levels of regulatory capital and surplus and which may restrict dividends to UWLIC's parent company. The Wisconsin Commissioner of Insurance may disapprove any dividend which, together with other dividends paid in the prior 12 months, exceeds the regulatory maximum, computed as the lesser of 10% of statutory surplus or total statutory net gain from operations as of the end of the preceding calendar year. Based upon UWLIC's financial statements as of December 31, 2001, as filed with the insurance regulators, and dividends paid in 2002, UWLIC is restricted from paying dividends without prior regulatory approval.

The National Association of Insurance Commissioners has adopted

risk-based capital ("RBC") standards for health and life insurers designed to evaluate the adequacy of statutory capital and surplus in relation to various business risks faced by such insurers. The RBC formula is used by state insurance regulators as an early warning tool to identify insurance companies that potentially are inadequately capitalized. At December 31, 2001, each of the Company's insurance subsidiaries had RBC ratios that were substantially above the levels which would require action by the Company or a regulator.

On March 19, 2002, the Company entered into a stock purchase agreement with Cobalt Corporation ("Cobalt") and its wholly owned subsidiary, BCBSUW, the Company's largest shareholder, to repurchase 1.4 million shares of the Company's common stock owned by BCBSUW at a total cost of $19.5 million, including related transaction costs. To effect the stock repurchase, which was completed on March 22, 2002, the Company received a $20.0 million dividend from UWLIC with regulatory approval. Also in conjunction with the stock repurchase, the Company, Cobalt and BCBSUW agreed to an underwritten secondary offering of at least 3.0 million shares of the remaining shares of the Company's common stock owned by BCBSUW. On April 19, 2002, the Company filed a registration statement with the Securities and Exchange Commission to offer 3.5 million shares owned by BCBSUW. The Company has committed to pay a portion of the expenses of the offering, which is expected to occur in the second quarter of 2002.

At March 31, 2002, the Company maintained a revolving bank line of credit agreement with an outstanding balance and maximum commitment of $30.2 million. At December 31, 2001, the outstanding balance and maximum commitment under the credit agreement was $35.2 million. In February 2002, in accordance with the revolving bank line of credit, the Company paid $5.0 million of the outstanding balance. The Company's obligations under the credit agreement are guaranteed by its subsidiary, American Medical Security Holdings, Inc. ("AMS Holdings"), and secured by pledges of the stock of AMS Holdings and UWLIC, the Company's primary insurance subsidiary.

The credit agreement contains customary covenants which, among other matters, require the Company to achieve certain minimum financial results and restrict the Company's ability to incur additional debt, pay future cash dividends and dispose of assets outside the ordinary course of business. The Company was in compliance with all such covenants at March 31, 2002 and anticipates continued compliance in the foreseeable future. The Company believes that the implementation of Statement of Financial Accounting Standards No. 142, as described in Note F to the condensed consolidated financial statements, will not adversely impact the Company's compliance with its debt covenants. The credit agreement was amended in March 2002 to allow for the repurchase of the 1.4 million shares from BCBSUW and revise the minimum financial requirements of certain covenants and the schedule of mandatory future commitment reductions.

CAUTIONARY FACTORS

This report and other documents or oral presentations prepared or delivered by and on behalf of the Company contain or may contain "forward-looking statements" within the meaning of the safe harbor provisions of the United States Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements based upon management's expectations at the time such statements are made and are subject to risks and uncertainties that could cause the Company's actual results to differ materially from those contemplated in the statements. Readers are cautioned not to place undue reliance on the forward-looking statements. When used in written documents or oral presentations, the terms "anticipate," "believe," "estimate," "expect," "forecast," "objective," "plan," "possible," "potential," "project" and similar

expressions are intended to identify forward-looking statements. In addition to the assumptions and other factors referred to specifically in connection with such statements, factors that could cause the Company's actual results to differ materially from those contemplated in any forward-looking statements include, among others, the following:

- Unexpected increases in health care costs resulting from advances in medical technology, increased utilization of medical services and prescription drugs resulting from bioterrorism or otherwise, possible epidemics and natural or man-made disasters and other factors affecting the delivery and cost of health care that are beyond the Company's control. There are also known trends, such as the aging of the population, that can have an uncertain effect on health care costs.

- The Company's ability to distribute and sell its products, including, changes in its business relationships with independent agents who sell the Company's products, the Company's ability to retain key producing sales agents, the Company's ability to expand its distribution network, competitive factors such as the entrance of additional competitors into the Company's markets, competitive pricing practices, the Company's ability to generate new sales, sell new products and retain existing members, the Company's ability to predict future health care cost trends and adequately price its products, and the Company's ability to control expenses during a time of declining revenue and membership.

- Federal and state laws adopted in recent years, currently proposed, such as the Patients' Bill of Rights, or that may be proposed in the future, which affect or may affect the Company's operations, products, profitability or business prospects. Reform laws adopted in recent years generally limit the ability of the Company to use risk selection as a method of controlling costs for its small employer group business.

- Regulatory factors, including delays in regulatory approvals of rate increases and policy forms; regulatory action resulting from market conduct activity and general administrative compliance with state and federal laws; restrictions on the ability of the Company's subsidiaries to transfer funds to the Company or its other subsidiaries in the form of cash dividends, loans or advances without prior approval or notification; the granting and revoking of licenses to transact business; the amount and type of investments that the Company may hold; minimum reserve and surplus requirements; and risk-based capital requirements.

- Factors related to the Company's efforts to maintain an appropriate medical loss ratio in its small employer group health and MedOneSM health business, (including implementing significant rate increases, terminating business in unprofitable markets, and introducing redesigned products), and the willingness of employers and individuals to accept rate increases, premium repricing and redesigned products.

- The development of and changes in claims reserves.

- The effectiveness of the Company's strategy to expand sales of its MedOneSM products for individuals and families, to focus its small employer group health product sales in core markets and to grow its ancillary products, including its dental, life, and self-funded benefit administration business.

- The cost and other effects of legal and administrative proceedings,

including the expense of investigating, litigating and settling any claims or paying any judgments against the Company, and the general increase in litigation involving managed care and medical insurers.

- Adverse outcomes of the Florida class action or other litigation in excess of provisions made by the Company.

- Restrictions imposed by financing arrangements that limit the Company's ability to incur additional debt, pay future cash dividends and transfer assets.

- Changes in rating agency policies and practices and the ability of the Company's insurance subsidiaries to maintain or exceed their A- (Excellent) rating by A.M. Best.

- General economic conditions, including changes in employment, interest rates and inflation that may impact the performance of the Company's investment portfolio or decisions of individuals and employers to purchase the Company's products.

- The Company's ability to maintain attractive preferred provider networks for its insureds.

- Factors affecting the Company's ability to hire and retain key executive, managerial, professional and technical employees.

- Changes in accounting principles and the effects related to such changes.

- Other business or investment considerations that the Company may disclose from time to time in its Securities and Exchange Commission filings or in other publicly disseminated written documents.

The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk has not substantially changed from the year ended December 31, 2001.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

FLORIDA REGULATORY ACTION AND CLASS ACTION LITIGATION

The following is a report (previously included in a Form 8-K dated April 24, 2002) of recent developments in two previously reported legal proceedings and should be read in conjunction with Item 3, Legal Proceedings, in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2001.

In May 2001, the Florida Department of Insurance issued an administrative complaint against the Company's wholly owned subsidiary, United Wisconsin Life Insurance Company ("UWLIC"), challenging UWLIC's rating and other practices in Florida relating to its MedOneSM products. MedOneSM products sold

by the Company in Florida are written pursuant to a group master policy issued to an association domiciled in a state other than Florida. Therefore, management believes the Company is exempt from most of Florida rating requirements and that it has not violated rating or other regulations applicable to the Company. The complaint seeks penalties or other administrative actions including possible suspension or revocation of UWLIC's certificate of authority to do business in Florida. The case was presented to an Administrative Law Judge in a hearing held in January 2002 (the "Administrative Hearing").

In a separate proceeding, a class action lawsuit was filed against two of the Company's subsidiaries, American Medical Security, Inc. ("AMS") and UWLIC in February 2000 in the Circuit Court for Palm Beach County, Florida, by Evelyn Addison and others ("Addison") alleging that the Company failed to follow Florida law in discontinuing writing certain health insurance policies and offering new policies in 1998, and that the Company wrongfully terminated coverage, improperly notified insureds of conversion rights and charged improper premiums for new coverage. Plaintiffs also alleged that the UWLIC's renewal rating methodology violates Florida law. Plaintiffs are seeking unspecified damages. A bench trial on the liability issues of the Addison case was held in Circuit Court in March 2002.

The Company believes that the administrative matter and the Addison case, although procedurally unrelated, arise from essentially the same set of facts and involve substantially similar legal issues. The substantially similar issues in the two cases include: (1) whether group coverage issued by the Company to individuals from 1993 to the present is exempt from most portions of Chapter 627, Part VII, of the Florida Insurance Code, which relates to insurance rates and contracts for group health insurance policies; (2) whether the Company complied with Florida law when it discontinued certain coverage and replaced the discontinued coverage with certain other coverage in 1999; (3) whether Florida law prohibits tier rating of out-of-state groups; and (4) whether the Company properly notified insureds whose coverage had been discontinued of their rights to purchase conversion coverage.

In a Recommended Order entered April 25, 2002, the Administrative Law Judge in the Administrative Hearing found in favor of the Company on all of the above issues and held that the evidence presented by the Florida Department of Insurance did not support a conclusion that UWLIC had violated any provisions of the Florida insurance statutes or regulations. The Administrative Law Judge recommended that all counts of the Department's administrative complaint be dismissed. The Recommended Order has been sent to the Commissioner of the Florida Department of Insurance for entry of a final order. The Commissioner must accept all of the findings of fact in the Recommended Order, but may make modifications to the conclusions of law.

In a Final Judgment entered April 24, 2002, the Circuit Court in Addison found against the Company on all of the above issues and ordered that the question of damages be tried before a jury at a time to be scheduled by the Court. The damages portion of the lawsuit is expected to be heard before a jury later this year.

In light of the conflicting findings of the Administrative Law Judge and the Circuit Court Judge, the Company intends to request that the Court in Addison reconsider its ruling. If the ruling is not reconsidered, the Company intends to appeal the ruling at the conclusion of the damages phase of the trial.

HEALTH ADMINISTRATORS LITIGATION

In February 2000, a $5.4 million verdict was entered against the Company's subsidiaries AMS and UWLIC in the Common Pleas Court of Delaware County, Ohio, Civil Division, in a lawsuit brought against AMS and UWLIC in 1996 by Health Administrators of America, Inc. ("Health Administrators"), an insurance agency owned and operated by a former agent of AMS. The lawsuit alleges breach of written and oral contracts involving commission amounts and fraud. The case was heard and decided by a magistrate who awarded damages to Health Administrators, based on breach of written commission and agent contracts and ruled in favor of the Company on breach of oral contracts and fraud. The Company filed objections with the Common Pleas Court requesting that the magistrate's decision against the Company be reversed. The Common Pleas Court approved the magistrate's decision in April 2000. As a result, the Company filed a notice of appeal with the Court of Appeals, Delaware County, Ohio, Fifth Appellate District. On March 29, 2001, the Court of Appeals affirmed a portion of the verdict, with modifications, representing approximately $3.0 million in damages, and reversed and remanded the remaining issues in the case representing approximately $2.4 million in damages. The Company appealed the $3.0 million portion of the damages to the Ohio Supreme Court, which, in July 2001, declined to take the appeal. The Company paid substantially all of the approximately $3.0 million judgment in December 2001. Briefs have been submitted for the remanded portion of the case, and the parties are awaiting the trial court's decision.

The Company is involved in the foregoing and various other legal and regulatory actions occurring in the normal course of business. Based on current information including consultation with outside counsel, management believes any ultimate liability that may arise from the above-mentioned and all other legal and regulatory actions would not materially affect the Company's consolidated financial position or results of operations. However, management's evaluation of the likely impact of these actions could change in the future and an unfavorable outcome could have a material adverse effect on the Company's consolidated financial position, results of operations or cash flow of a future period.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

See the Exhibit Index following the Signature page of this report, which is incorporated herein by reference.

(b) Reports on Form 8-K

The following reports on Form 8-K were filed or submitted during the first quarter of 2002:

- A Form 8-K dated February 1, 2002, was filed by the Company on February 5, 2002 to report the amendment of the Company's shareholder rights agreement.
- A Form 8-K dated February 5, 2002, was submitted by the Company on February 6, 2002 to furnish under Item 9, Regulation FD Disclosure, a financial presentation included on the Company's website.
- A Form 8-K dated March 19, 2002, was filed by the Company on March 20, 2002 to report that the Company had entered into a stock purchase agreement with Cobalt and BCBSUW.
- A Form 8-K dated March 25, 2002, was filed by the Company on March 26, 2002 to report the completion of the 1.4 million share repurchase from BCBSUW pursuant to the stock purchase agreement.

After the end of the quarter, a Form 8-K dated April 24, 2002, was filed by the Company on April 26, 2002 to report recent developments in two previously reported legal proceedings.

SIGNATURES

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.

DATE: May 7, 2002

AMERICAN MEDICAL SECURITY GROUP, INC.

/S/ GARY D. GUENGERICH
Gary D. Guengerich
Executive Vice President and Chief Financial Officer
(Principal Financial Officer and Chief Accounting Officer and duly authorized to sign on behalf of the Registrant)

AMERICAN MEDICAL SECURITY GROUP, INC.
(Commission File No. 1-13154)

EXHIBIT INDEX
to
FORM 10-Q QUARTERLY REPORT
for quarter ended March 31, 2002

EXHIBIT NO.	Description	Incorporated Herein by Reference to
4.1(a)	Fifth Amendment dated as of March 21, 2002 to Credit Agreement dated as of March 24, 2000 (the "Credit Agreement") among the Registrant, LaSalle Bank National Association and other Lenders	Exhibit 4 to the Registr dated March 25, 2002
4.1(b)	Revised Fifth Amendment dated as of March 21, 2002 to Credit Agreement (replacing Exhibit 4.1(a))	Exhibit 4.3(f)(ii) to t Form S-3 Registration April 19, 2002 (File No.

4.2(a)	Appointment and Assumption Agreement dated December 17, 2001, between the Registrant and Firstar Bank, N.A. appointing LaSalle Bank, N.A. as Rights Agent for the Rights Agreement dated as of August 9, 2001 ("the Rights Agreement") between the Registrant and Firstar Bank, N.A.	Exhibit 4.2 to the Reg 8-K dated February "2/1/02 8-K")
4.2(b)	Amendment dated as of February 1, 2002 to the Rights Agreement	Exhibit 4.1 to the 2/1/0
10.1	Agreement dated February 1, 2002, among the Registrant, Cobalt Corporation and Blue Cross & Blue Shield United of Wisconsin concerning the Rights Agreement	Exhibit 10.1 to the 2/1/
10.2	Stock Purchase Agreement dated as of March 19, 2002 among the Registrant, Cobalt Corporation and Blue Cross & Blue Shield United of Wisconsin	Exhibit 10 to the Regist dated March 19, 2002