AMERICAN MEDICAL SECURITY GROUP INC
Form 10-Q
August 14, 2001

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 JUNE 30, 2001
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 July 31, 2001: 14,009,083 shares

AMERICAN MEDICAL SECURITY GROUP, INC.

INDEX

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

Condensed Consolidated Balance Sheets
June 30, 2001 and December 31, 2000......................3

Condensed Consolidated Statements of Operations
Three months ended June 30, 2001 and 2000; Six months
ended June 30, 2001 and 2000.............................5

Condensed Consolidated Statements of Cash Flows
Six months ended June 30, 2001 and 2000..................6

Notes to Condensed Consolidated Financial Statements
June 30, 2001..7

Item 2. Management's Discussion and Analysis of Financial Condition
and Results of Operations................................12

Item 3. Quantitative and Qualitative Disclosures About Market Risk..16

PART II. OTHER INFORMATION

Item 1. Legal Proceedings..17

Item 4. Submission of Matters to Vote of Security Holders...........17

Item 6. Exhibits and Reports on Form 8-K...........................18

Signatures...19

Exhibit Index..EX-1

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2001
	(IN T
ASSETS	
Investments:	
Securities available for sale, at fair value:	

Fixed maturities	$ 260,159
Equity securities-preferred	2,450
Fixed maturity securities held to maturity, at amortized cost	4,303
Trading securities, at fair value	332
Total investments	267,244
Cash and cash equivalents	12,123
Other assets:	
Property and equipment, net	33,576
Goodwill and other intangibles, net	105,748
Other assets	42,319
Total other assets	181,643
Total assets	$ 461,010

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2001
	(IN T
LIABILITIES AND SHAREHOLDERS' EQUITY	
Liabilities:	
Medical and other benefits payable	$ 131,851
Advance premiums	16,140
Payables and accrued expenses	33,047
Notes payable	40,658
Other liabilities	20,470
Total liabilities	242,166
Shareholders' equity:	
Common stock (no par value, $1 stated value, 50,000,000 shares authorized, 16,654,315 issued and 13,995,783 outstanding at June 30, 2001, 16,654,315 issued and 14,270,945 outstanding at December 31, 2000)	16,654

Paid-in capital	187,956
Retained earnings	32,621
Accumulated other comprehensive loss (net of tax benefit of $517,000 at June 30, 2001 and $2,126,000 at December 31, 2000)	(960)
Treasury stock (2,658,532 shares at June 30, 2001 and 2,383,370 shares at December 31, 2000, at cost)	(17,427)
Total shareholders' equity	218,844
Total liabilities and shareholders' equity	$ 461,010

See Notes to Condensed Consolidated Financial Statements

4

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six
	2001	2000	2001
	(IN THOUSANDS, EXCEPT PER SHARE		
Revenues:			
Insurance premiums	$ 213,645	$ 240,537	$ 436,
Net investment income	4,405	4,886	8,
Realized investment losses	(152)	(112)	(
Other revenue	5,408	5,015	10,
Total revenues	223,306	250,326	455,
Expenses:			
Medical and other benefits	156,174	182,012	322,
Selling, general and administrative	62,873	62,684	134,
Interest expense	744	883	1,
Amortization of goodwill and intangibles	907	947	1,
Total expenses	220,698	246,526	460,
Income (loss) before income taxes	2,608	3,800	(4,
Income tax expense (benefit)	1,142	1,540	(1,
Net income (loss)	$ 1,466	$ 2,260	$ (3,

Net income (loss) per common share:			
Basic	$ 0.10	$ 0.15	$ (0
Diluted	$ 0.10	$ 0.15	$ (0

See Notes to Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Mo Ju
	2001
	(IN T
OPERATING ACTIVITIES:	
Net income (loss)	$ (3,674)
Adjustments to reconcile net income (loss) to net cash used in operating activities:	
Depreciation and amortization	5,071
Net realized investment gains	179
Increase in trading securities	(72)
Deferred income tax expense (benefit)	(1,891)
Changes in operating accounts:	
Other assets	4,891
Medical and other benefits payable	(13,459)
Advance premiums	(1,428)
Payables and accrued expenses	7,145
Other liabilities	(238)
Net cash used in operating activities	(3,476)
INVESTING ACTIVITIES:	
Purchases of available for sale securities	(66,407)
Proceeds from sale of available for sale securities	67,593
Proceeds from maturity of available for sale securities	4,750
Proceeds from maturity of held to maturity securities	-
Purchases of property and equipment	(3,697)
Proceeds from sale of property and equipment	-
Net cash provided by (used in) investing activities	2,239
FINANCING ACTIVITIES:	
Issuance of common stock	-
Purchase of treasury stock	(1,646)

Borrowings under line of credit agreement	-
Repayment on line of credit agreement	-
Repayment of notes payable	(600)
Net cash used in financing activities	(2,246)
Cash and cash equivalents:	
Net decrease	(3,483)
Balance at beginning of year	15,606
Balance at end of period	$ 12,123

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

June 30, 2001

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 and six month periods ended June 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. 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. ("AMSG" or the "Company") annual report on Form 10-K for the year ended December 31, 2000.

NOTE B. EARNINGS (LOSS) PER COMMON SHARE

Basic earnings (loss) per common share are computed by dividing net income (loss) by the weighted average number of common shares outstanding. Diluted earnings (loss) per common share 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 provides a reconciliation of the number of weighted average basic and diluted shares outstanding:

	Three Months Ended June 30,		Six Months June 30
	2001	2000	2001
Weighted average common shares outstanding - basic	14,041,590	15,100,507	14,125,650
Effect of dilutive stock options	52,485	55,635	-
Weighted average common shares outstanding - diluted	14,094,075	15,156,142	14,125,650

The effect of dilutive securities was excluded from the diluted earnings (loss) per common share computation for the six months ended June 30, 2001 because the Company had a net loss in this 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.

7

NOTE C. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is defined as net income (loss) plus or minus other comprehensive income (loss), which for the Company, under existing accounting standards, 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 June 30,		Six Months June 30
	2001	2000	2001
		(IN THOUSANDS)	
Net income (loss)	$ 1,466	$ 2,260	$ (3,674)
Unrealized gain (loss) on available for sale securities	(404)	(200)	2,988
Comprehensive income (loss)	$ 1,062	$ 2,060	$ (686)

NOTE D. CREDIT AGREEMENT

At June 30, 2001, the Company maintained a revolving bank line of credit agreement ("Credit Agreement") with a maximum commitment of $35.2 million and a $10.0 million sublimit for swingline loans. At June 30, 2001, the outstanding

balance of advances under the Credit Agreement was $35.2 million. The Credit Agreement contains customary covenants which, among other matters, require the Company to achieve 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 Credit Agreement was amended in April 2001 to revise the Company's applicable interest rate on outstanding loans and the schedule of mandatory future commitment reductions including a $4.8 million maximum commitment reduction from $40.0 million to $35.2 million on April 27, 2001. Revised future annual principal amounts due for all of the Company's debt as of June 30, 2001 are $0.6 million for 2001, $6.2 million for 2002, $11.2 million for 2003, $12.5 million for 2004, and $10.2 million for 2005.

NOTE E. CONTINGENCIES

On August 26, 1999, a $6.9 million verdict was entered against the Company in a lawsuit filed by Skilstaf, Inc. which principally alleged breach of contract involving the timing of claims payments. Following an adverse decision from the appeals court on March 12, 2001, the Company recognized an additional accrual during the first quarter of 2001 representing the full potential loss including punitive damages and other expenses. The Company has petitioned the United States Supreme Court to review the case. In July 2001, at the direction of the district court, the Company paid the full amount of the verdict plus interest, even though final resolution of the case by the United States Supreme Court is pending. The plaintiff has posted a letter of credit to secure repayment of the verdict in the event of a decision favorable to the Company.

On February 7, 2000, a $5.4 million verdict was entered against the Company in a lawsuit filed by Health Administrators, Inc., an insurance agency owned and operated by a former agent of the Company, which alleged breach of contract involving commission amounts due to such agent. On March 29, 2001, the Ohio Court of Appeals affirmed a portion of the verdict, with modification, representing approximately $3.0 million in damages, and reversed and remanded the remaining issue 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 declined to take the appeal. The remanded portion of the case is awaiting further action by the trial court. Management believes that the Company has adequately provided for losses which may result from this case.

8

The Company is involved in various other legal and regulatory matters occurring in the normal course of its business. The Company's financial results for the six months ended June 30, 2001 reflect a first quarter pre-tax charge of $9.0 million ($5.9 million after-tax) to cover estimated potential losses and related expenses for legal related matters. In the opinion of management, adequate provision has been made for losses which may result from legal and regulatory actions; accordingly, the outcome of these matters is not expected to have a material adverse effect on the consolidated financial statements.

NOTE F. NEW ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board issued Statements of Financial Accounting Standards No. 141, BUSINESS COMBINATIONS, and No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS, effective for fiscal years beginning after December 15, 2001. Under the new rules, goodwill (and intangible assets deemed to have indefinite lives) will no longer be amortized but will be subject to annual impairment tests in accordance with the Statements. Other intangible assets will continue to be amortized over their useful lives. Based on the Company's current accounting policy of measuring goodwill impairment based on undiscounted cash flows, there is no goodwill impairment indicated.

The Company will apply the new rules on accounting for goodwill and other intangible assets beginning in the first quarter of 2002. Application of the nonamortization provisions of the Statement is expected to result in an increase in net income of approximately $2.4 million ($0.17 per share) per year. The Company will perform the first of the required impairment tests of goodwill and intangible assets deemed to have indefinite lives as of January 1, 2002 by comparing the fair value of the Company's reporting units to their carrying amounts (book value), including goodwill. In determining the fair value of the Company's reporting units, management will consider valuation techniques such as the quoted market price of the Company's stock, the present value of future cash flows and market comparison of similar assets and liabilities. As of June 30, 2001, the Company's book value per share was significantly higher than the quoted market value of a share of stock. The Company has not yet determined what the effect of these tests will be on the earnings and financial position of the Company. If it is determined that an impairment exists as of January 1, 2002, the charge recognized would be reported as the cumulative effect of a change in accounting principle in the Company's GAAP basis consolidated financial statements and would have no impact on cash flows or the statutory basis capital and surplus of the Company's insurance subsidiaries.

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 group preferred provider organization products: MedOne (for individuals and families) and small group medical, self funded medical, dental and short-term disability. Life 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 Company's All Other segment also includes data for its health maintenance organization ("HMO") subsidiary. 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. 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 June 30,		Six Months June 30
	2001	2000	2001
	(IN THOUSANDS)		
Health segment	$ 1,321	$ 548	$ (7,185)
Life segment	1,598	2,790	3,348

All other	(311)	462	(1,071)
Income (loss) before income taxes	$ 2,608	$ 3,800	$ (4,908)

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

	Three Months Ended June 30,		Six Months June 30
	2001	2000	2001
	(IN THOUSANDS)		
HEALTH SEGMENT			
OPERATING RESULTS			
Revenues:			
Insurance premium	$ 209,124	$ 228,437	$ 426,098
Net investment income	2,265	2,353	4,715
Other revenue	4,357	4,020	8,587
Total revenues	215,746	234,810	439,400
Expenses:			
Medical and other benefits	154,981	175,569	319,178
Selling, general and administrative	59,444	58,693	127,407
Total expenses	214,425	234,262	446,585
Income (loss) before income taxes	$ 1,321	$ 548	$ (7,185)
FINANCIAL STATISTICS			
Loss ratio	74.1%	76.9%	74.9%
Expense ratio	26.3%	23.9%	27.9%
Combined ratio	100.4%	100.8%	102.8%
Membership at End of Period:			
Health:			
Fully insured medical	394,387	498,415	
Self funded medical	45,462	50,680	
Stand-alone dental	186,990	179,760	
Total health	626,839	728,855	

(a) Total health membership for the Company of 626,867 and 740,335 at June 30, 2001 and 2000 includes HMO membership of 28 and 11,480, respectively. HMO operations are not included in health segment operating results.

	Three Months Ended June 30,		Six Months June 30
	2001	2000	2001
	(IN THOUSANDS)		
LIFE SEGMENT			
OPERATING RESULTS			
REVENUES:			
Insurance premiums	$ 4,483	$ 5,774	$ 9,446
Net investment income	162	157	336
Other revenue	40	58	82
Total revenues	4,685	5,989	9,864
Expenses:			
Medical and other benefits	1,690	1,547	3,682
Selling, general and administrative	1,397	1,652	2,834
Total expenses	3,087	3,199	6,516
Income before income taxes	$ 1,598	$ 2,790	$ 3,348
FINANCIAL STATISTICS			
Loss ratio	37.7%	26.8%	39.0%
Expense ratio	30.3%	27.6%	29.1%
Combined ratio	68.0%	54.4%	68.1%
Membership at End of Period	211,547	270,600	

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 ("AMSG" or the "Company"), is a provider of health care benefits and insurance products for individuals and small employer groups. The Company's principal product offerings are (1) health insurance for small employer groups and (2) health insurance for individuals and families ("MedOne"). The Company also offers life, dental, prescription drug, disability and accidental death

insurance, and provides stop-loss reinsurance and benefit administration for self funded employer groups. The Company's products are actively marketed in 32 states and the District of Columbia through independent agents. The Company's products generally provide discounts to insureds that utilize preferred provider organizations ("PPOs"). AMSG owns a preferred provider network and also contracts with other networks to ensure cost-effective health care choices to its customers.

RESULTS OF OPERATIONS

The Company reported net income of $1.5 million or $0.10 per share for the second quarter of 2001. This compares to net income of $2.3 million or $0.15 per share for the second quarter of 2000. The decrease in income from the second quarter of the prior year primarily reflects (1) a higher selling, general and administrative expense ratio from higher agent commissions and issue costs resulting from the company's change in product mix, (2) lower premium revenues, and (3) lower investment income. Partially offsetting these factors was an improvement in the health loss ratio.

For the six months ended June 30, 2001, the Company reported a net loss of $3.7 million or $0.26 per share, compared to net income of $3.9 million or $0.26 per share for the same period in 2000. The six month results for 2001 reflect an after-tax charge of $5.9 million or $0.41 per share taken in the first quarter for legal related matters. See "Part II., Item 1. Legal Proceedings" for a detailed discussion.

Excluding the effect of the legal accrual recorded in the first quarter, the results for the second quarter of 2001 represent the third consecutive quarter of improved earnings for the Company. The Company's recent improvement in performance results from its pricing actions as well as early benefits from implementation of management's strategic plan. The Company's health loss ratio has declined for the third consecutive quarter and is at its lowest point in more than two years. Management anticipates that the trend of health loss ratio and earnings improvement will continue during the remainder of 2001. Management now anticipates earnings to be between $0.42 and $0.52 per share for the full year of 2001, excluding the first quarter legal accrual.

INSURANCE PREMIUMS AND MEMBERSHIP

Insurance premiums for the three months ended June 30, 2001 decreased 11.2% to $213.6 million from $240.5 million for the same period in 2000. For the six month period ended June 30, 2001, insurance premiums decreased to $436.1 million from $488.4 million for the same period in the prior year. The decrease primarily resulted from a decline in membership in select unprofitable small group and exited markets, partially offset by rising premium rates on the continuing block of business. Average fully insured medical premium per member per month for the second quarter of 2001 increased by 14.2% to $153, compared to the second quarter of 2000, reflecting significant rate actions taken by the Company. Insurance premiums for the Company's MedOne product increased 27.1% from the second quarter of the prior year. Management considers the MedOne product to be a key strategic product and continues to take steps to accelerate membership and premium growth in this market through an expanded agent force and additional regional and national distribution agreements.

Total medical and dental membership declined from 740,335 members at June 30, 2000 to 626,867 members at June 30, 2001. The membership decrease is a result of the Company's success in terminating business in several unprofitable markets, including exited markets, and lower sales due to aggressive premium

rate increases. Based on the most recent sales projections and the rate of membership terminations, management anticipates 2001 insurance premiums will be down approximately 10% from 2000 and membership will be down approximately 15% before beginning to improve early in 2002. The expected improvement in insurance premiums and membership in 2002 should result from management's efforts to add distribution outlets and the introduction of promising new products.

NET INVESTMENT INCOME

Net investment income includes investment income and realized gains and losses on investments. Investment gains and losses are realized in the normal investment process in response to market opportunities. Net investment income for the three months ended June 30, 2001 decreased to $4.3 million from $4.8 million for the three months ended June 30, 2000. Net investment income was $8.7 million for the six months ended June 30, 2001 compared to $9.7 for the same period in 2000. The decrease in net investment income is due primarily to a decrease in average invested assets. Average invested assets at cost were $268.8 million for the second quarter of 2001. In comparison, average invested assets were $298.6 million for the second quarter of 2000. The average annual investment yield was 6.6% for both periods. Invested assets have declined primarily as a result of the repurchase of company stock and negative operating cash flows.

OTHER REVENUE

Other revenue, which primarily consists of administrative fee income from claims processing and other administrative services, increased to $5.4 million for the quarter compared to $5.0 million for the second quarter of 2000, and to $10.7 million for the six months ended June 30, 2001 from $9.9 million for the same period in 2000. The increase from the prior year is primarily due to an increase in fees charged for administrative services.

LOSS RATIO

The health loss ratio for the second quarter of 2001 was 74.1% compared to 76.9% for the second quarter of 2000. The health loss ratio for the six months ended June 30, 2001 was 74.9% compared to 76.7% for the six months ended June 30, 2000. The significant improvement was due to management's actions and strategies to increase premiums and combat medical inflation. These actions included premium rate increases, claims cost control initiatives and the exit from unprofitable small group markets. The reduction also reflects increased sales of MedOne 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 more than offset by increased premiums per member per month. Management believes its pricing strategies will maintain premium increases ahead of expected claim costs, which should further improve the loss ratio during 2001.

The life segment loss ratio for the three months ended June 30, 2001 was 37.7% compared to 26.8% for the three months ended June 30, 2000. The life segment loss ratio for the current reporting period is consistent with the Company's average historical trend and anticipated future experience for this segment. The life segment loss ratio reported for the second quarter of the prior year was unusually low due to an unexpected decrease in actual life claims experience for that period. The life segment loss ratio for the six months ended June 30, 2001 was 39.0% compared with 32.4% for the six months ended June 30, 2000.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSE RATIO

The selling, general and administrative ("SG&A") expense ratio includes commissions and selling expenses, administrative expenses, and premium taxes and

assessments. The SG&A expense ratio for health segment products for the three months ended June 30, 2001 was 26.3%. This compares to 23.9% reported for the three months ended June 30, 2000. Excluding the non-recurring legal accrual recorded during the first quarter of 2001, the SG&A expense ratio for health segment products for the six months ended June 30, 2001 was 25.8%

compared with 24.0% for the same period in 2000. The increase is due to higher agent commissions and issue costs resulting from the Company's change in product mix and the effects of lower premium volume.

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 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 used in operations was $3.5 million for the six months ended June 30, 2001. This compares to cash used in operations of $7.7 million for the six months ended June 30, 2000. The improvement in cash flow primarily reflects a leveling of claim inventories and a slow-down in terminated business. Management expects cash flow to be negative for the full year of 2001 due to the payment of litigation matters during the third quarter.

The Company's investment portfolio consists primarily of investment grade bonds and has limited exposure to equity securities. At June 30, 2001, $264.5 million or 99.0% of the Company's investment portfolio was invested in bonds. At December 31, 2000, $267.0 million or 99.0% of the Company's investment portfolio was invested in bonds. The bond portfolio had an average quality rating of Aa3 at June 30, 2001 and December 31, 2000, as measured by Moody's Investor Service. 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 insurance subsidiaries operate in states that require certain levels of regulatory capital and surplus and may restrict dividends to their parent companies. Based upon the financial statements of the Company's insurance subsidiaries as of December 31, 2000, as filed with the insurance regulators, no dividends may be paid by these subsidiaries 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, 2000, the Company's principal insurance company subsidiaries had RBC ratios that were substantially above the levels which would require regulatory action.

During 2000, the Company's Board of Directors authorized an increase to the Company's share repurchase program to a maximum allowable repurchase of $18.0 million. The Company purchased 88,900 shares of its outstanding common stock during the second quarter of 2001, bringing the total purchased to 2.7 million shares at an aggregate purchase price of $17.4 million.

In determining when and whether to purchase future shares under the stock repurchase program, management considers market price, the number of shares actively traded in the market, indications of seller interest, the number of shares held by large shareholders, the effect of purchases on shareholder value and other relevant factors. Because of the unpredictability of these factors, no assurance can be given as to how many, if any, shares may be repurchased in the future.

At June 30, 2001, the Company maintained a revolving bank line of credit agreement ("Credit Agreement") with a maximum commitment of $35.2 million and a $10.0 million sublimit for swingline loans. At June 30, 2001, the outstanding balance of advances under the Credit Agreement was $35.2 million. The Credit Agreement contains customary covenants which, among other matters, require the Company to achieve 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 Credit Agreement was amended in April 2001 to revise the Company's applicable interest rate on outstanding loans and the schedule of mandatory future commitment reductions including a $4.8 million maximum commitment reduction from $40.0 million to $35.2 million on April 27, 2001. Revised future annual principal amounts due for all of the Company's debt as of June 30, 2001 are $0.6 million for 2001, $6.2 million for 2002, $11.2 million for 2003, $12.5 million for 2004, and $10.2 million for 2005.

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," "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 the aging of the population, advances in medical technology, increased utilization of medical services and prescription drugs, health care inflation (particularly technology-driven procedures and drug costs), possible epidemics and natural disasters and other factors affecting the delivery and cost of health care that are beyond the Company's control.

-- The Company's ability to profitably 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 customers, 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 health care reform 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 insurers and health plans to use risk selection as a method of controlling costs for small 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 deal with adverse medical loss ratio in its small group health business (which include implementing significant rate increases, terminating business in unprofitable markets, and introducing redesigned products), including the willingness of employers and individuals to accept rate increases, premium repricing and redesigned products.

-- The development of and changes in claims reserves, particularly for highly regulated markets and exited markets where insureds may be inclined to increase utilization prior to termination of their policies.

-- The effectiveness of the Company's strategy to expand sales of its MedOne products for individuals and families, to focus its small group health product sales in core markets and to grow its ancillary products, including its life, dental 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 against the Company, and the general increase in litigation involving managed care and medical insurers.

-- Adverse outcomes of litigation against 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 interest rates and inflation that may impact the performance on 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.

-- The Company's ability to integrate effectively the operational, managerial and financial aspects of future acquisitions.

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

-- Other business or investment considerations that may be disclosed from time to time in the Company's Securities & 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, 2000.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On August 26, 1999, a $6.9 million verdict was entered against American Medical Security, Inc. ("AMS Inc."), the Company's third party administrator ("TPA") subsidiary, in the United States District Court for the Middle District of Alabama. The decision was made in a lawsuit brought against AMS Inc. by Skilstaf, Inc. ("Skilstaf"), an Alabama employee leasing company, in January 1998 alleging that AMS Inc. delayed claims payments under a contract with Skilstaf. Skilstaf sought unspecified damages. The contract, which was entered into in 1992 and terminated by Skilstaf in 1996, was a TPA contract for Skilstaf's self funded employee benefit plan. AMS Inc. has argued that this case is governed by the Employee Retirement Income Security Act of 1974, as amended, which preempts all state law causes of action and limits damages to contract damages. AMS Inc.'s post-trial motion to set aside the jury's finding was denied by the court on March 20, 2000. As a result, AMS Inc. filed a notice of appeal with the Eleventh Circuit Federal Appeals Court on April 17, 2000. On March 12, 2001, the Company received the Court of Appeal's decision, rendered on March 9, 2001, affirming the decision of the District Court. On March 30, 2001, AMS Inc. filed a petition with the Court of Appeals for a rehearing by the full Court of Appeals, which was denied on May 4, 2001. On August 1, 2001, the Company filed a petition with the United States Supreme Court for a writ of certiorari to review the decision of the Court of Appeals. In July 2001, at the direction of the district court, the Company paid the full amount of the verdict plus interest, even though final resolution of the case by the United States Supreme Court is pending. The plaintiff has posted a letter of credit to secure repayment of the verdict in the event of a decision favorable to the Company.

On February 7, 2000, a $5.4 million verdict was entered against AMS Inc. and United Wisconsin Life Insurance Company ("UWLIC"), the Company's insurance subsidiary, in the Common Pleas Court of Delaware County, Ohio, Civil Division, in a lawsuit brought against AMS Inc. and UWLIC in 1996 by Health Administrators of America, Inc. ("Health Administrators"), an insurance agency owned and operated by a former agent of AMS Inc. 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 AMS Inc.

and UWLIC on breach of oral contracts and fraud. On February 22, 2000, AMS Inc. and UWLIC filed objections with the Common Pleas Court requesting that the magistrate's decision against AMS Inc. and UWLIC be reversed. The Common Pleas Court approved the magistrate's decision on April 10, 2000. As a result, AMS Inc. and UWLIC filed a notice of appeal with the Court of Appeals, Delaware County, Ohio, Fifth Appellate District on April 18, 2000. 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 issue in the case representing approximately $2.4 million in damages. On May 2, 2001, the Company appealed the $3.0 million portion of the damages to the Ohio Supreme Court, which, on July 25, 2001, declined to take the appeal. The remanded portion of the case is awaiting further action by the trial court. Management believes the Company has adequately provided for losses that may result from this case.

The Company is involved in various legal and regulatory actions occurring in the normal course of its business. In the opinion of management, adequate provision has been made for losses which may result from litigation and other legal and regulatory actions; accordingly, the outcome of these matters is not expected to have a material adverse effect on its consolidated financial statements.

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

The Annual Meeting of Shareholders of the Company was held on May 15, 2001 for the purpose of electing four directors for terms expiring at the 2004 Annual Meeting of Shareholders. All four of the Company's nominees were elected. The voting results for the election were as follows:

ELECTION OF DIRECTORS FOR TERMS EXPIRING IN 2004:

Mark A. Brodhagen:	
For	13,852,597 shares
Withheld	47,235 shares
Abstained	0
Broker Non-Votes	0
Eugene A. Menden:	
For	13,850,784 shares
Withheld	49,048 shares
Abstained	0
Broker Non-Votes	0
Samuel V. Miller:	
For	13,852,846 shares
Withheld	46,986 shares
Abstained	0
Broker Non-Votes	0
Michael T. Riordan:	
For	13,853,102 shares
Withheld	46,730 shares
Abstained	0
Broker Non-Votes	0

Further information concerning these matters, including the names of the directors whose terms continued after the meeting, is contained in the Company's Proxy Statement dated March 30, 2001 with respect to the 2001 Annual Meeting of Shareholders.

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

A Form 8-K dated May 18, 2001, was submitted by the Company to furnish under Item 9, Regulation FD Disclosure, a financial presentation included on the Company's website. The Company also filed a Form 8-K dated August 9, 2001, to report the adoption of a shareholder rights plan.

18

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: AUGUST 14, 2001

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)

19

AMERICAN MEDICAL SECURITY GROUP, INC.
(COMMISSION FILE NO. 1-13154)

EXHIBIT INDEX
TO
FORM 10-Q QUARTERLY REPORT
for quarter ended June 30, 2001

EXHIBIT NO.	DESCRIPTION	INCORPORATED HEREIN BY REFERENCE TO
3	Articles of Amendment to Restated Articles of Incorporation with Respect to Designation, Preferences, Limitations and Relative Rights of Series B Junior	

	Cumulative Preferred Stock	
4	Rights Agreement, dated as of August 9, 2001, between American Medical Security Group, Inc. and Firstar Bank, N.A., as Rights Agents, including the form of Right Certificate as Exhibit B thereto.	Exhibit 1 to the Registrant Registration Statement on F filed on August 14, 2001 an to the Registrant's Current Form 8-K dated August 9, 20 field on August 14, 2001.

EX-1