

VESTA INSURANCE GROUP INC  
Form 10-Q  
May 14, 2002

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

(Mark One)

☒ **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 1-12338**

**VESTA INSURANCE GROUP, INC.**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State of other jurisdiction of  
incorporation or organization)

**63-1097283**  
(I.R.S. Employer  
Identification No.)

**3760 River Run Drive**  
**Birmingham, Alabama**  
(Address of principal executive offices)

**35243**  
(Zip Code)

**(205) 970-7000**  
(Registrant's telephone number, including area code)

**Not Applicable**  
(Former name, former address and former fiscal year, if changed since last report)

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 ☐ No

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

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The number of shares outstanding of the registrant's common stock,  
\$.01 par value, as of May 10, 2002  
36,473,394

**Vesta Insurance Group, Inc.**

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**Part I**  
**Item 1. Financial Statements**  
**Vesta Insurance Group, Inc.**  
**Consolidated Balance Sheets**  
**(Amounts in thousands except share and per share data)**

	<b>March 31, 2002</b>	<b>De</b>
	-----	---
	(unaudited)	
Assets:		
Investments:		
Fixed maturities available for sale - at fair value (cost: 2002 - \$810,102; 2001 - \$785,049)	\$ 818,747	
Equity securities-at fair value: (cost: 2002- \$34,299; 2001- \$32,298)	28,137	
Mortgage and collateral loans	43,035	
Policy loans	63,179	
Short-term investments	41,622	
Other invested assets	48,016	
	-----	---
Total investments	1,042,736	
Cash	21,781	
Accrued investment income	17,700	

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Premiums in course of collection (net of allowances for losses of \$2,684 in 2002 and 2001)	77,956	
Reinsurance balances receivable	397,029	
Reinsurance recoverable on paid losses	93,783	
Deferred policy acquisition costs	91,942	
Property and equipment	20,080	
Deferred income taxes	35,754	
Goodwill and other intangible assets	134,089	
Other assets	38,127	
	-----	----
Total assets	\$ 1,970,977	=====
Liabilities:		
Policy liabilities	\$ 689,004	
Losses and loss adjustment expenses	298,661	
Unearned premiums	271,225	
Federal Home Loan Bank advances	179,692	
Short term debt	29,961	
Long term debt	74,791	
Other liabilities	147,238	
	-----	----
Total liabilities	1,690,572	
Commitments and contingencies: See Note B		
Deferrable Capital Securities	22,445	
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized, issued: 2002 - 0 and 2001 - 0	--	
Common stock, \$.01 par value, 100,000,000 shares authorized, issued: 2002 - 37,528,111 and 2001 - 36,994,464	375	
Additional paid-in capital	248,313	
Accumulated other comprehensive income, net of tax expense of \$869 and \$4,191 in 2002 and 2001, respectively	1,614	
Retained earnings	33,829	
Treasury stock (1,054,717 shares and 923,972 shares at cost at March 31, 2002 and December 31, 2001, respectively)	(7,412)	
Unearned stock	(18,759)	
	-----	----
Total stockholders' equity	257,960	
	-----	----
Total liabilities, deferrable capital securities and stockholders' equity	\$ 1,970,977	=====

See accompanying Notes to Consolidated Financial Statements

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(amounts in thousands except per share data)

	Three months ended March 31,	
	2002	2001
	(unaudited)	
Revenues:		
Net premiums written	\$ 151,097	\$ 61,212
Change in unearned premiums	(39,306)	4,183
Net premiums earned	111,791	65,395
Policy fees	3,418	1,253
Agency fees and commissions	18,380	
Net investment income	13,681	15,603
Realized gains (losses)	1,085	1,706
Other	3,374	2,088
Total revenues	151,729	86,045
Expenses:		
Policyholder benefits	10,645	8,057
Losses and loss adjustment expenses incurred	70,694	38,701
Policy acquisition expenses	21,274	14,402
Operating expenses	42,753	14,653
Interest on debt	3,951	4,658
Goodwill and other intangible amortization	84	526
Total expenses	149,401	80,997
Income from continuing operations before taxes, minority interest, and deferrable capital securities	2,328	5,048
Income tax expense	859	1,787
Minority interest, net of tax	424	249
Deferrable capital security distributions, net of tax	129	383
Net income from continuing operations	916	2,629
Income (loss) from discontinued operations, net of tax	(64)	5
Extraordinary gain on debt extinguishments, net of tax	897	--
Net income	1,749	2,634
Preferred stock dividend	--	(163)
Gain on redemption of preferred securities, net of tax	210	565
Net income available to common shareholders	\$ 1,959	\$ 3,036
Net income from continuing operations per share - Basic	\$ 0.03	\$ 0.14
Net income available to common shareholders per share - Basic	\$ 0.06	\$ 0.16
Net income from continuing operations per share - Diluted	\$ 0.03	\$ 0.13
Net income available to common shareholders per share - Diluted	\$ 0.06	\$ 0.15
Statements of Comprehensive Income		
Net income	\$ 1,749	\$ 2,634
Other comprehensive income, net of tax:		
Unrealized holding (losses) gains on available-for-sale securities net of tax of \$(2,943) and \$1,666, respectively	(5,465)	3,094
Less realized gains on available-for-sale securities net of tax		

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of \$380 and \$597, respectively	705	1,109
	-----	-----
	(6,170)	1,985
Gain on redemption of preferred securities, net of tax of \$113 and \$305, respectively.	210	565
	-----	-----
Comprehensive (loss) income	\$ (4,211)	\$ 5,184
	=====	=====

See accompanying Notes to Consolidated Financial Statements

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## Vesta Insurance Group, Inc. Consolidated Statements of Cash Flows (amounts in thousands)

	Three months ended 2002	
	-----	(unaudited)
Operating Activities:		
Net income	\$ 1,749	
Adjustments to reconcile net income to cash used in operations		
Changes in:		
Loss and LAE reserves, and future policy liabilities	19,604	
Unearned premium reserves	55,615	
Reinsurance balances receivable	(33,702)	
Premiums in course of collection	(28,187)	
Reinsurance recoverable on paid losses	(8,748)	
Other assets and liabilities	19,327	
Policy acquisition costs deferred	(49,123)	
Policy acquisition costs amortized	25,482	
Realized gains	(1,085)	
Amortization and depreciation	1,079	
Extraordinary gain	(897)	
	-----	-----
Net cash provided by (used in) operations	1,114	
Investing Activities:		
Investments sold, matured, and called:		
Fixed maturities available for sale	74,629	
Equity securities	988	
Investments acquired:		
Fixed maturities available for sale	(89,036)	
Equity securities	(2,989)	
Net increase (decrease) in other invested assets	1,693	
Net cash received (paid) for acquisition	9,006	
Net decrease in short-term investments	(421)	
Additions to property and equipment	(670)	
	-----	-----

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Net cash (used in) provided from investing activities	(6,800)
<b>Financing Activities:</b>	
Net change in FHLB borrowings	11,078
Change in long and short-term debt	(3)
Net deposits and withdrawals from insurance liabilities	(5,441)
Issuance of common stock	--
Acquisition of common stock	(821)
Dividends paid	(925)
	-----
Net cash provided by (used in) financing activities	3,888
Increase (decrease) in cash	(1,798)
Cash at beginning of period	23,579
	-----
Cash at end of period	\$ 21,781
	=====

See accompanying Notes to Consolidated Financial Statements

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**Vesta Insurance Group, Inc.**  
**Notes to Consolidated Financial Statements**  
(amounts in thousands except per share amounts)

### **Note A-Significant Accounting Policies**

*Basis of Presentation:* The accompanying unaudited interim financial statements have been prepared in conformity with accounting principles generally accepted in the United States and, in the opinion of management, reflect all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of results for such periods. The results of operations and cash flows for any interim period are not necessarily indicative of results for the full year. These financial statements should be read in conjunction with the financial statements and related notes which have been issued by the Company and filed with the Securities and Exchange Commission.

*Reclassifications:* Certain amounts in the financial statements presented have been reclassified from amounts previously reported in order to be comparable between years. These reclassifications have no effect on previously reported stockholders' equity or net income during the periods involved.

*New Accounting Standards:* In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations." SFAS No. 141 address financial accounting and reporting for business combinations. The standard eliminates the pooling of interests method of accounting for business combinations and requires that all intangible assets be accounted for separately from goodwill. Vesta has applied the requirements of SFAS No. 141 to all acquisitions after July 1, 2001, as required, and will account for future acquisitions in accordance with the new guidance.

In June of 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. We adopted SFAS No. 142 effective January 1, 2002. See Note F for additional disclosures related to the adoption of SFAS 142.

In October of 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001 and was written to provide a single model for the disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121 "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Vesta adopted SFAS No. 144 effective January 1, 2002. Such adoption resulted in no material impact on Vesta's financial position, results of operations or cash flows.

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*Income per Share.* Basic EPS is computed by dividing income available to common shareholders by the weighted average common shares outstanding for the period. Diluted EPS is calculated by adding to shares outstanding the additional net effect of potentially dilutive securities or contracts which could be exercised or converted into common shares except when the additional shares would produce anti-dilutive results.

Reconciliation of income available to common shareholders and average shares outstanding for the three months ending March 31, 2002 and 2001 are as follows:

	Three months ended March 31, 2002	2001
Net income available to common shareholders	\$ 1,959	\$ 3,036
Preferred stock dividends on convertible preferred stock	--	163
Adjusted net income available to common shareholders	\$ 1,959	\$ 3,199
Weighted average shares outstanding-basic (1)	33,305	18,857
Stock options and restricted stock	591	336
Weighted average convertible preferred stock (1)	--	1,901
Weighted average shares outstanding-diluted (1)	33,896	21,094

(1) Reflects weighted averages. At March 31, 2002, Vesta had 36.5 million shares outstanding and zero shares of convertible preferred stock outstanding. Weighted average shares outstanding for earnings per share purposes do not include shares held by the Agent's Stock Incentive Plan Trust that have not been allocated to participants.

Earnings per share for discontinued operations and extraordinary gains for the three months ended March 31, 2002 and 2001 are as follows:

	2002	2001
Basic Earnings per share:		
Discontinued Operations	\$ 0.00	\$ 0.00
Extraordinary Gain	\$ 0.03	--
Diluted Earnings per share:		
Discontinued Operations	\$ 0.00	\$ 0.00
Extraordinary Gain	\$ 0.03	--

### Note B-Commitments and Contingencies

#### *Securities Litigation*

On October 26, 2001, Vesta executed a definitive agreement to settle the securities litigation that had been pending since June 1998 against Vesta and certain current and former officers and directors. On December 10, 2001, the Court approved settlement of the consolidated class action securities litigation in U.S. District Court in Alabama as to Vesta and its officers and directors for a total of \$61 million in cash. A related derivative action lawsuit in the Circuit Court of Jefferson County, Alabama was also dismissed with prejudice. Vesta funded \$21.0 million towards the settlement and the Company's excess directors and officers liability carriers funded the remaining \$40.0 million. Vesta used its line of credit to finance its portion of the settlement and recorded a pre-tax one-time charge of approximately \$25 million against earnings to cover Vesta's contribution to the settlement and other expenses incurred. We have now filed a claim with two of our upper level excess D&O insurers for their part of the settlement and related expenses. We have recorded a receivable of \$5.4 million, which represents the amount currently due from those two excess D&O insurers.

Vesta determined to participate in the funding of the settlement and to take the related one-time charge against earnings as a result of the Cincinnati Insurance Company's attempted rescission of their \$25 million directors and officers liability policy and denial of coverage. Vesta has

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sued Cincinnati in Alabama state court alleging that its actions were taken in bad faith and is vigorously pursuing that claim. The Cincinnati case is scheduled for trial in August 2002.

### *Indemnification Agreements and Liability Insurance*

Pursuant to Delaware law and our by-laws, we are obligated to indemnify our current and former officers and directors for certain liabilities arising from their employment with or services to Vesta, provided that their conduct complied with certain requirements. Pursuant to these obligations, we have been advancing costs of defense and other expenses on behalf of certain current and former officers and directors, subject to an undertaking from such individuals to repay any amounts advanced in the event a court determines that they are not entitled to indemnification.

### *Arbitration*

As discussed in previous SEC filings, in 1998 we corrected our accounting for assumed reinsurance business through restatement of our previously issued financial statements. Similar corrections were made on a statutory accounting basis through recording cumulative adjustments in Vesta Fire's 1997 statutory financial statements. The impact of this correction has been reflected in amounts ceded under our 20 percent whole account quota share treaty which was terminated on June 30, 1998 on a run-off basis. We believe such treatment is appropriate under the terms of this treaty and have calculated the quarterly reinsurance billings presented to the three treaty participants accordingly. The aggregate amount included herein as recoverable from such reinsurers totaled \$55.9 million at March 31, 2002. Additionally, we have previously collected approximately \$48.5 million from the drawdown of collateral on hand.

NRMA Insurance Ltd. ("NRMA"), one of the participants in the 20% whole account quota share treaty, filed a lawsuit in the United States District Court for the Northern District of Alabama contesting our billings. NRMA sought rescission of the treaty and a temporary restraining order preventing us from drawing down approximately \$34.5 of collateral. We filed a demand for arbitration as provided for in the treaty and also filed a motion to compel arbitration which was granted in the United States District action. Vesta reached an agreement with NRMA to collect the \$34.5 million of collateral in exchange for posting a \$25 million letter of credit in favor of NRMA to fund any amounts NRMA may recover as a result of the arbitration. We also filed for arbitration against Alfa Mutual Insurance Company and Dorinco Reinsurance Company, the other two participants on the treaty and all those arbitrations are in the discovery stages. Additionally, Alfa recently filed a Motion for Declaratory Judgement asking the arbitration panel to order that there is no enforceable agreement between Alfa and Vesta. We are vigorously opposing such motion, which is scheduled for hearing in June 2002. Presently, the hearing in the NRMA arbitration is scheduled for October 2002. Hearing dates for the Alfa and Dorinco arbitrations are not presently scheduled. While management believes its interpretation of the treaty's terms and computations based thereon are correct, these matters are in arbitration and their ultimate outcome cannot be determined at this time.

During 1999, F&G Re (on behalf of USF&G), filed for arbitration under two aggregate stop loss reinsurance treaties whereby F&G Re assumed certain risk from the Vesta. F&G Re is seeking to cancel the treaties and avoid its obligation. Based on the terms of the two treaties, Vesta will be entitled to recoveries of approximately \$30.0 million as losses from prior accident years mature. Vesta has recorded a reinsurance recoverable of \$30.0 million at December 31, 2001 related to these two treaties. The hearing in this arbitration began on February 11, 2002. The hearing was adjourned on February 15, 2002 and scheduled to resume on June 11, 2002. While management believes that USF&G is not entitled to rescission, the ultimate outcome cannot be determined at this time.

We are in arbitration with CIGNA Property and Casualty Insurance Company (now ACE USA) under a personal lines insurance quota share reinsurance agreement, whereby we assumed certain risks from CIGNA. During September 2000, CIGNA filed for arbitration under the reinsurance agreement, seeking payment of the balances that CIGNA claims are due under the terms of the treaty. In addition, during the fourth quarter, the treaty was terminated on a cut-off basis. Vesta is seeking recoupment of all improper claims payments and excessive expense allocations and charges from CIGNA. The arbitration was bifurcated into two phases with phase one concentrating on the interpretation of the intent of the parties related to the expense reimbursement provisions of the treaty at the time it was entered and phase two related to any issues between the parties after the Company conducts an audit of expenses related to the treaty. The phase one hearing was held in February 2002 and the panel ruled that (i) the Company is responsible for the payment of ceding commissions provided for in the treaty and should pay any outstanding billings for commissions and paid claims, plus interest; and (ii) the Company may proceed with an audit of expenses ceded to the treaty and (iii) the parties should identify any further issues to be brought before the arbitration panel for phase two of the hearing. The Phase II hearing has not yet been scheduled.

If the amounts recoverable under the relevant treaties are ultimately determined to be materially less than the amounts that we have reported as recoverable, we may incur a significant, material, and adverse impact on our financial condition and results of operations.

### *Other Litigation*

On January 14, 2002, the Company's subsidiary, American Founders, was notified of a lawsuit in Texas naming it as a defendant and brought by a creditor of the former parent of the subsidiary. This lawsuit (subsequently identified as the Blitz lawsuit) alleges, among other



things, that American Founders redeemed its Series A and Series C preferred stock issues at less than "reasonably equivalent value". American Founders believes that the

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allegations brought against it in this lawsuit are without merit and intends to mount a vigorous defense in this action. In the opinion of management, resolution of the Blitz lawsuit is not expected to have a material adverse effect on the financial position of the Company. However, depending on the amount and timing, an unfavorable resolution of this matter could materially affect American Founders' future operations or cash flows in a particular period.

Vesta, through its subsidiaries, is routinely a party to pending or threatened legal proceedings and arbitration relating to the regular conduct of its insurance business. These proceedings involve alleged breaches of contract, torts, including bad faith and fraud claims and miscellaneous other specified relief. Based upon information presently available, and in light of legal and other defenses available to Vesta and its subsidiaries, management does not consider liability from any threatened or pending litigation regarding routine matters to be material.

#### **Note C-Segment Information**

We operate several segments, which are distinguishable by their product offerings. The accounting policies of the operating segments are the same as used in preparing the consolidated financial statements. Segment pre-tax income is generally income before income tax, and minority interest, if any. Premiums, policy fees, other income, loss and benefit expenses, and amortization of deferred acquisition costs are attributed directly to each operating segment. Operating expenses are allocated to the segments in a manner which most appropriately reflects the operations of that segment. Net investment income and interest expense are allocated only to those segments for which such amounts are considered an integral part of the financial results for that segment.

A brief description of each segment is as follows:

##### **Standard Property-Casualty**

The standard property-casualty segment primarily consists of the marketing and distribution of personal lines products including residential property and private passenger auto coverages. Vesta's products are distributed primarily through approximately 1,500 independent agencies in 24 states. Our standard personal auto line targets drivers over age thirty-five with above average driving records and our residential property products cover the full range of homes.

##### **Life and Health Insurance**

On June 30, 2000, we entered the life and annuity business through an investment in American Founders Financial Corporation, a holding company for two life insurance companies domiciled in Texas and we entered the health insurance business through the acquisition of Aegis Financial Corporation in December 2000. American Founders and Aegis have approximately \$2.5 billion (face value) of life and annuity products in force and approximately \$22.5 million of health insurance premiums in force at March 31, 2002. American Founders markets traditional life products, universal life products, fixed-rate annuities, pension contracts and related products through independent agents throughout the majority of the United States. Aegis Financial markets health insurance products through captive agents throughout the United States.

##### **Specialty Underwriting**

Specialty underwriting includes our fronting operations and any underwriting risk retained from premiums written through our non-standard auto agencies. In fronting arrangements, we write targeted property-casualty insurance coverages and reinsure substantially all of the risks to reinsurers in exchange for fees. This business takes advantage of our certificates of authority granting us license to write insurance in many states. Income from fronting arrangements is primarily generated on a fee-for-service basis. For the premium written through our non-standard auto agencies, we determine based on market conditions, and the prospective results of the underlying business, whether to keep 100% of the underwriting risk or reinsure this risk to various reinsurers. Our decision on how much underwriting risk to retain is dependent on the current rating environment and the amount of commissions offered by the reinsurers.

##### **Agency**

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The agency segment consists of our agency retail and wholesale operations. The primary sources of revenue are agents' commissions and fees collected by retailers and fees and commissions collected by wholesalers. These revenue streams are not risk-bearing.

## Corporate and Other

Our corporate and other segment primarily consists of unallocated net investment income, unallocated interest expense, and certain overhead expenses not directly associated with a particular segment.

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A summary of segment results for the three months ended March 31, 2002 and 2001 is as follows:

	Standard Property- Casualty	Life and Health Insurance	Specialty Underwriting	Agency	C a
<b>2002</b>					
Revenues:			(in thousands)		
Premiums earned	\$ 67,843	\$ 8,074	\$ 35,874		
Agency fees and commissions	--	--	--	\$ 23,588	
Net investment income	--	9,419	--	--	
Policy fees	1,302	983	1,133	--	
Realized gains	--	942	--	--	
Other	--	337	1,608		
Total revenues	69,145	19,755	38,615	23,588	
Expenses:					
Loss, LAE and policyholder benefits	47,079	10,645	23,615	--	
Policy acquisition costs	15,415	1,749	9,318	--	
Operating expenses	9,172	3,286	3,296	20,736	
Interest on debt	--	1,576	--	120	
Goodwill and other intangible amortization	--	--	--	--	
Total expenses	71,666	17,256	36,229	20,856	
Pre-tax income (loss) from continuing operations	(2,521)	\$ 2,499	\$ 2,386	\$ 2,732	
Operating segment assets:					
Investments and other assets	\$ 288,866	\$ 908,188	\$ 124,576	\$ 63,204	
Deferred acquisition costs	51,955	23,987	11,889	4,111	
	\$ 340,821	\$ 932,175	\$ 136,465	\$ 67,315	
<b>2001</b>					
Revenues:			(in thousands)		
Premiums earned	\$ 56,847	\$ 7,465	\$ 1,083		

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Net investment income	--	10,780	--	\$ 157
Policy fees	355	898	--	--
Realized gains	--	601	--	--
Other	--	52	843	442
	-----	-----	-----	-----
Total revenues	57,202	19,796	1,926	599
Expenses:				
Loss, LAE and policyholder benefits	37,902	8,057	799	--
Policy acquisition costs	12,058	2,122	222	--
Operating expenses	6,362	3,761	61	1389
Interest on debt	--	2,430	--	--
Goodwill and other intangible amortization	--	--	--	--
	-----	-----	-----	-----
Total expenses	56,322	16,370	1,082	1,389
Pre-tax income (loss) from continuing operations	\$ 880	\$ 3,426	\$ 844	\$ (790)
	=====	=====	=====	=====
Operating segment assets:				
Investments and other assets	\$ 206,867	\$ 907,847	\$ 8,219	\$ 27,114
Deferred acquisition costs	26,203	17,660	345	--
	-----	-----	-----	-----
	\$ 233,070	\$ 925,507	\$ 8,564	\$ 27,114
	=====	=====	=====	=====

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### Note D-Stock Transactions

In the first quarter of 2002, we issued 533,647 shares of common stock in exchange for \$4.6 million face amount of our 8.75% Senior Notes and \$.8 million face amount of our 8.5% Deferrable Capital Securities. In connection with this transaction we recorded an after tax extraordinary gain on extinguishment of debt of \$.9 million and an after tax gain on redemption of preferred securities of \$.2 million.

### Note E-Acquisitions

In January 2002, we completed three acquisitions. We acquired certain assets of InsureOne Agency and the renewal rights to a book of non-standard automobile business, the non-standard automobile related assets of Harbor Insurance Group, and the common stock of Old American Investments. Combined purchase prices are estimated to be \$22.3 million with \$15.3 million due at closing and \$7.0 million due upon the occurrence of certain future events. The transactions have been accounted for as purchases. Summarized below is an initial allocation of assets and liabilities acquired (in thousands except per share amounts and unaudited):

Assets acquired:	
Cash	\$ 27,716
Property, Plant & Equipment	3,148
Other assets	29,572
Goodwill and other	
Intangible assets	24,913
	-----
Total assets	\$ 85,349
	=====
Liabilities acquired:	
Unearned premiums	35,731
Other liabilities	27,321
	-----
Total liabilities	\$ 63,052
	=====

**Note F-Goodwill and Other Intangible Assets**

In June, 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and other Intangible Assets," having a required effective date for fiscal years beginning after December 15, 2001. Under the new rules, Goodwill and other 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.

We adopted the new rules on accounting for goodwill and other intangible assets effective January 1, 2002. Application of the non-amortization provisions of SFAS No. 142 is expected to result in an increase in net income of approximately \$2.6 million during 2002. The standard requires a transitional impairment test during the period of adoption to be completed by June 30, 2002. As implementation guidance continues to evolve, this transitional impairment test has not been finalized, and we do not know the impact this transitional impairment test may have on our financial position and results of operations.

During the three months ended March 31, 2001, we recorded \$.3 million in amortization of goodwill. The impact of amortization of goodwill on net income for the three months ended March 31, 2001 was as follows (in thousands, except per share data):

	Three months ended March 31, 2001
	-----
Reported net income	\$ 2,634
Add back:	
Goodwill amortization, net of income taxes	342
	-----
Net income excluding goodwill amortization, net of income taxes	\$ 2,976
	=====
Basic net income per common share	
Reported net income	\$ 0.14
Add back:	
Goodwill amortization, net of income taxes	0.02
	-----
Net income excluding goodwill amortization, net of income taxes	\$ 0.16
	=====
Weighted average number of common shares outstanding (basic)	18,857
Diluted net income per common share	

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Reported net income	\$ 0.13
Add back:	
Goodwill amortization, net of income taxes	0.01
	-----
Net income excluding goodwill amortization, net of income taxes	\$ 0.15
	=====
Weighted average number of common shares outstanding (diluted)	21,094

The changes in the carrying amount of goodwill and other intangible assets for the year ended December 31, 2001 and for the three months ended March 31, 2002 are as follows (in thousands):

Balance as of January 1, 2000	\$ 17,797
Goodwill and other intangible assets acquired	94,857
Amortization	(3,394)
	-----
Balance as of December 31, 2001	109,260
Goodwill and other intangible assets acquired	24,913
Amortization	(84)
Transitional impairment charge	--
	-----
Balance as of March 31, 2002	\$ 134,089
	=====

The \$134.1 million balance at March 31, 2002 consists of \$127.4 million of goodwill and \$6.7 million of other intangible assets. Other intangible assets include brand name, trademark and the value of certain policy renewal rights.

Amortization expense recorded on the intangible assets for each of the three-month periods ended March 31, 2002 and 2001 was \$.1 million and \$0, respectively. The estimated amortization expense for each of the five succeeding fiscal years is as follows (in thousands):

For the year ended December 31,	
2002	\$ 336
2003	300
2004	250
2005	200
2006	200

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

### Results of Operations

Vesta writes insurance on selected personal lines risks only. Our standard property-casualty writings are balanced between risks of property damage (faster determination of ultimate loss but highly unpredictable) and casualty exposure (more predictable but takes longer to determine

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the ultimate loss). We also write life, annuity, and health insurance business. Additionally, we are actively involved in the writing of insurance on our policies for the benefit of reinsurance companies, commonly referred to as servicing carrier or fronting, which generates fee-for-service income.

Our revenues from operations are derived primarily from net premiums earned on risks written by our insurance subsidiaries, investment income and investment gains or losses. Our expenses consist primarily of payments for claims and underwriting expenses, including agents' commissions, fees and operating expenses.

### *Comparison of First Quarter 2002 to First Quarter 2001*

Income available to common shareholders decreased by \$1.0 million, to a \$2.0 million income for the quarter ended March 31, 2002, from \$3.0 million for the quarter ended March 31, 2001. On a diluted per share basis, net income available to common shareholders for the first quarter of 2002 was \$.06 per share versus net income of \$.15 per share for the first quarter of 2001.

### *Standard Property-Casualty*

Net premiums written for standard property-casualty lines increased by \$45.5 million, or 87.2%, to \$97.7 million for the quarter ended March 31, 2002, from \$52.2 million for the quarter ended March 31, 2001. Net premiums earned for standard property-casualty lines increased \$11.0 million, or 19.4% to \$67.8 million for the quarter ended March 31, 2002, from \$56.8 million for the quarter ended March 31, 2001. The increase in net premiums written and net premiums earned is primarily attributable to the acquisition of Florida Select in April 2001, and increased writings in Texas, partially offset by decreases in other lines of business.

Loss and loss adjustment expenses ("LAE") for standard property-casualty lines increased by \$9.2 million, or 24.3%, to \$47.1 million for the quarter ended March 31, 2002, from \$37.9 million for the quarter ended March 31, 2001. The loss and LAE ratio for property-casualty lines for the quarter ended March 31, 2002 was 68.1% as compared to 66.3% at March 31, 2001. The increase in the loss and LAE incurred and the loss and LAE ratio is primarily attributable to deteriorating underwriting results in the current period in our automobile lines, storm losses in Texas, and an increase in earned premium. The deterioration in our underwriting results is being primarily driven by increases in frequency and severity of claims in certain states.

Policy acquisition expenses increased \$3.4 million for the quarter-to-quarter comparison, consistent with the increase in earned premium. Operating expenses increased by \$2.8 million, to \$9.2 million for the quarter ended March 31, 2002, as we incurred increased expenses from our Texas operations.

### *Life and Health Insurance*

American Founders and Aegis have approximately \$2.2 billion (face value) of life and annuity products in force and \$22.7 million of health insurance premiums in force at March 31, 2002. Life insurance premiums and policy fees were \$4.1 million for the quarter ended March 31, 2002 compared to \$3.3 million for the comparable prior period in 2000. The increase is attributable to the acquisition of Washington Life in August 2001. Health insurance premiums totaled \$5.0 million for the quarter ended March 31, 2002 versus \$5.2 million for the comparable prior period. Health insurance benefits incurred totaled \$3.0 million for the quarter and health insurance commission expense was \$1.5 million. Pre-tax income decreased by \$.9 million primarily due to higher mortality in two older acquired blocks and lower than expected investment income.

### *Specialty Underwriting*

Net premiums written for specialty underwriting increased by \$43.8 million to \$45.3 million for the quarter ended March 31, 2002, from \$1.5 million for the quarter ended March 31, 2001. Net premiums earned for specialty underwriting increased to \$35.9 million for the quarter ended March 31, 2002, from \$1.1 million for the quarter ended March 31, 2001. The increase in net premiums written and net premiums earned is primarily attributable to the acquisition certain assets of Insure One and the related book of business from its affiliated insurance companies and increased retained amounts from other fronting programs. Fronting fees increased \$.8 million to \$1.6 million on higher written premium.

Loss and loss adjustment expenses ("LAE") for specialty underwriting increased by \$22.8 million to \$23.6 million for the quarter ended March 31, 2002, from \$.8 million for the quarter ended March 31, 2001. The loss and LAE ratio for the quarter ended March 31, 2002 was 63.8% as compared to 73.8% at March 31, 2001. The increase in the loss and LAE incurred and the decrease in the loss and LAE ratio is primarily attributable to the inclusion of underwriting results of the business produced by our affiliated agency, Insure One, which are better than the underwriting results from our traditional fronting programs.

Policy acquisition expenses increased \$9.1 million for the quarter-to-quarter comparison, consistent with the increase in earned premium. Operating expenses increased by \$3.2 million, to \$3.3 million for the quarter ended March 31, 2002, as we incurred increased expenses from our

increase operations.

#### *Agency*

Our Agency operations increased its revenues by \$23.4 million to \$23.6 million as a result of acquisitions completed in the fourth quarter of 2001 and the first quarter of 2002. Operating expenses increased by \$19.3 million to \$20.7 million as we integrated the acquired operations with our existing operations.

#### *Net Investment Income*

Net investment income decreased by \$1.9 million, or 12.2%, to \$13.7 million for the quarter ended March 31, 2002, from \$15.6 million for the quarter ended March 31, 2001. The weighted average yield on invested assets (excluding realized and unrealized gains) was 6.7% for the quarter ended March 31, 2002, compared with 6.6% for the quarter ended March 31, 2001. The decrease in investment income is primarily attributable to a decrease in the weighted average yield as yields have generally declined in recent months, the investment of funds in our investment portfolio in new operating entities and a reduction in investment income from our collateral loan portfolio.

#### *Federal Income Taxes*

Federal income taxes decreased by \$.9 million to \$.9 million for the quarter ended March 31, 2002 as a result of less income in the current period compared to the prior period.

#### **Liquidity and Capital Resources**

Vesta is a holding company whose principal asset is its investment in the capital stock of the companies constituting the Vesta Insurance Group, a group of wholly owned insurance companies including Vesta Fire Insurance Corporation and a majority ownership in a life insurance holding company which includes American Founders Life Insurance Company and a majority ownership in Instant Insurance Holdings, Inc. The insurance subsidiaries comprising the Vesta Group are individually supervised by various state insurance regulators, but given our organizational structure, Vesta Fire is our only operating subsidiary that can pay dividends directly to our holding company. Vesta Fire is an Illinois domestic insurance company.

#### *Dividends and Management Fees*

The principal uses of funds at the holding company level are to pay operating expenses, principal and interest on outstanding indebtedness and deferrable capital securities and dividends to stockholders if declared by the Board of Directors. During the last three years, our insurance subsidiaries have produced operating results and paid management fees and dividends sufficient to fund our needs. As a holding company with no other business operations, we rely primarily on fees generated by our management agreement with our insurance subsidiaries and dividend payments from Vesta Fire to meet our cash requirements (including our debt service) and to pay dividends to our stockholders.

Transactions between Vesta and its insurance subsidiaries, including the payment of dividends and management fees to Vesta by such subsidiaries, are subject to certain limitations under the insurance laws of those subsidiaries' domiciliary states. The insurance laws of the state of Illinois, where Vesta Fire is domiciled, permit the payment of dividends out of earned surplus in any year which, together with other dividends or distributions made within the preceding 12 months, do not exceed the greater of 10% of statutory surplus as of the end of the preceding year or the net income for the preceding year, with larger dividends payable only after receipt of prior regulatory approval. On October 29, 2001, the Illinois Insurance Department published a Company Bulletin that indicates that the Department interprets these dividend limitations to prohibit the payment of dividends if the insurer has negative or zero "unassigned funds" at the end of the prior year, as reported on its statutorily required annual statement. Our lead insurance subsidiary, Vesta Fire, reported negative "unassigned funds" on its annual statement for 2001. Accordingly, we may not be able to declare and pay a dividend from our lead insurance company subsidiary for the foreseeable future without prior approval.

We believe that the Illinois Insurance Department's willingness to approve the payment of a dividend by Vesta Fire to our holding company will depend on a variety of factors, such as the impact to the holding company if the dividend is not paid and the impact to Vesta Fire if the

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dividend is paid. For example, the payment of a dividend may cause non-compliance with the Illinois Department of Insurance's "reserve reconciliation test," which requires Vesta Fire to maintain a minimum amount of liquid, high quality assets. At December 31, 2001, Vesta Fire's qualifying assets exceeded its minimum by approximately \$8.8 million. If the payment of a dividend would jeopardize Vesta Fire's ability to comply with this reserve reconciliation test, then the Illinois Department of Insurance may not approve it. Accordingly, there can be no assurance that Vesta Fire will be able to obtain the requisite regulatory approval for the payment of dividends.

We rely primarily on fees earned under our management agreement with our insurance company subsidiaries to meet our cash requirements (including debt service) and to pay dividends to our stockholders. This management agreement, which provided approximately \$25 million to our holding company in 2001, is subject to certain regulatory standards which generally require its terms and fees to be fair and reasonable. The Illinois Department of Insurance may review this agreement from time to time to insure the reasonableness of its terms and fees, and it is possible that such terms and fees could be modified to reduce the amounts available to our holding company. Assuming the management agreement is not modified in a material respect, we believe that this management agreement will provide us with funds sufficient to meet our anticipated needs (including debt service) for at least the next twelve months.

On March 3, 2000, we established a revolving credit facility with First Commercial Bank, Birmingham, Alabama ( First Commercial ). In May, 2001 we increased the amounts available and increased the term of the credit facility to the following:

- a \$15 million unsecured line which bears interest at First Commercial's prime rate +1/4%;
- an additional \$15 million line which bears interest at First Commercial's prime rate, secured by a pledge of the revenues received under the management contract between our wholly owned management company, J. Gordon Gaines, Inc., and our operating insurance subsidiaries.

Each of these credit facilities mature on April 30, 2003. As of March 31, 2002, the principal amount outstanding under these credit facilities was approximately \$30.0 million. Effective as of March 30, 2002, each of these credit agreements have been amended to restructure the financial covenants

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contained therein. The amended covenants require us to maintain certain minimum (i) consolidated net income, (ii) consolidated debt to capital ratios, (iii) credit ratings, (iv) GAAP net worth, (v) interest coverage ratio and (vi) risk based capital. As of March 31, 2002, we were in compliance with all of these covenants.

### *Contingent Obligations*

As part of its ongoing reinsurance recoverable arbitrations, we have obtained letters of credit for the benefit of certain parties. Our principal operating subsidiary, Vesta Fire is contingently liable under the terms of these letters of credit. For our reinsurance arbitrations, we have obtained letters of credit totaling \$33.7 million for which we are contingently liable.

Additionally, as part of our specialty lines underwriting retained, we have obtained letters of credit or other pledges of securities totaling \$29.2 million securing our obligations under the various reinsurance agreements.

### *Cash Flows*

The principal sources of funds for our insurance subsidiaries are premiums, investment income and proceeds from the sale or maturity of invested assets. Such funds are used principally for the payment of claims, operating expenses, commissions and the purchase of investments. As is typical in the insurance industry, we collect cash in the form of premiums and invest that cash until claims are paid. Cash collected from premiums and cash paid for claims is included in cash flow from operations, while the cash impact from our investing activities is included in cash flow from investing activities. In periods such as 2001 and 2000, where we are exiting certain lines of business such as commercial lines and reinsurance assumed lines we are funding the payout of commercial and reinsurance assumed claims through the liquidation of invested assets, consistent with the historical insurance business model. However, this generates cash outflows from operations that can be misleading.



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On a consolidated basis, net cash provided by operations for the quarter ended March 31, 2002 and 2001, was \$1.1 million and \$(16.5) million, respectively. Net cash (used in) provided by investing activities was \$(6.8) million and \$48.1 million for the quarter ended March 31, 2002 and 2001, respectively as we used cash to fund the discontinuance of the reinsurance assumed and commercial lines of business in 2000 through the liquidation of our investment portfolio. Net cash provided by (used in) financing activities was \$3.9 million and \$(13.9) million for the quarter ending March 31, 2002 and 2001.

### *New Accounting Pronouncements*

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations." SFAS No. 141 address financial accounting and reporting for business combinations. The standard eliminates the pooling of interests method of accounting for business combinations except for qualifying business combinations and requires that all intangible assets be accounted for separately from goodwill. Vesta has applied the requirements of SFAS No. 141 to all acquisitions after July 1, 2001, as required, and will account for future acquisitions in accordance with the new guidance.

In June of 2001, the Financial Accounting Standards Board issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

Vesta adopted the provisions of SFAS No. 142 effective January 1, 2002. Additionally, SFAS No. 142 requires that goodwill be tested annually for impairment and the initial goodwill impairment test is required to be completed within six months of adoption. Vesta has not completed its initial goodwill impairment test and has not yet determined what effect the impairment tests will have on its financial position or results of operations. Vesta expects that the elimination of goodwill amortization will positively impact pretax net income by approximately \$2.6 million in fiscal year 2002.

In October of 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 is effective for fiscal years beginning after December 15, 2001 and was written to provide a single model for the disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121 "Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, "Reporting the results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Vesta adopted SFAS No. 144 effective January 1, 2002. Such adoption resulted in no material impact on Vesta's financial position, results of operations or cash flows.

### **Market Risk of Financial Instruments**

Vesta's principal assets are financial instruments, which are subject to the market risk of potential losses from adverse changes in market rates and prices. Our primary risk exposures are interest rate risk on fixed maturity investments, mortgages and collateral loans and annuity liabilities and equity price risk for stocks. Vesta manages its exposure to market risk by selecting investment assets with characteristics such as duration, yield and liquidity to reflect the underlying characteristics of the related insurance. There have been no material changes to the information about our market risk set forth in our Annual Report on Form 10-K for the year ended December 31, 2001.

### **Special Note Regarding Forward-Looking Statements**

Any statement contained in this report which is not a historical fact, or which might otherwise be considered an opinion or projection concerning the Company or its business, whether express or implied, is meant as and should be considered a forward-looking statement as that term is defined in the Private Securities Litigation Reform Act of 1996. Forward-looking statements are based on assumptions and opinions concerning a variety of known and unknown risks, including but not necessarily limited to changes in market conditions, natural disasters and other catastrophic events, increased competition, changes in availability and cost of reinsurance, changes in governmental regulations, and general economic conditions, as well as other risks more completely described in our filings with the Securities and Exchange Commission, including our most recent Annual Report on Form 10-K. If any of these assumptions or opinions prove incorrect, any forward-looking statements made on the basis of such assumptions or opinions may also prove materially incorrect in one or more respects.

## **PART II**

### **Item 1. Legal Proceedings**

#### *Securities Litigation*

On October 26, 2001, Vesta executed a definitive agreement to settle the securities litigation that had been pending since June 1998 against Vesta and certain current and former officers and directors. On December 10, 2001, the Court approved settlement of the consolidated class action securities litigation in U.S. District Court in Alabama as to Vesta and its officers and directors for a total of \$61 million in cash. A related derivative action lawsuit in the Circuit Court of Jefferson County, Alabama was also dismissed with prejudice. Vesta funded \$21.0 million towards the settlement and the Company's excess directors and officers liability carriers funded the remaining \$40.0 million. Vesta used its line of credit to finance its portion of the settlement and recorded a pre-tax one-time charge of approximately \$25 million against earnings to cover Vesta's contribution to the settlement and other expenses incurred. We have now filed a claim with two of our upper level excess D&O insurers for their part of the settlement and related expenses. We have recorded a receivable of \$5.4 million, which represents the amount currently due from those two excess D&O insurers.

Vesta determined to participate in the funding of the settlement and to take the related one-time charge against earnings as a result of the Cincinnati Insurance Company's attempted rescission of their \$25 million directors and officers liability policy and denial of coverage. Vesta has sued Cincinnati in Alabama state court alleging that its actions were taken in bad faith and is vigorously pursuing that claim. The Cincinnati case is scheduled for trial in August 2002.

#### *Indemnification Agreements and Liability Insurance*

Pursuant to Delaware law and our by-laws, we are obligated to indemnify our current and former officers and directors for certain liabilities arising from their employment with or services to Vesta, provided that their conduct complied with certain requirements. Pursuant to these obligations, we have been advancing costs of defense and other expenses on behalf of certain current and former officers and directors, subject to an undertaking from such individuals to repay any amounts advanced in the event a court determines that they are not entitled to indemnification.

#### *Arbitration*

As discussed in previous SEC filings, in 1998 we corrected our accounting for assumed reinsurance business through restatement of our previously issued financial statements. Similar corrections were made on a statutory accounting basis through recording cumulative adjustments in Vesta Fire's 1997 statutory financial statements. The impact of this correction has been reflected in amounts ceded under our 20 percent whole account quota share treaty which was terminated on June 30, 1998 on a run-off basis. We believe such treatment is appropriate under the terms of this treaty and have calculated the quarterly reinsurance billings presented to the three treaty participants accordingly. The aggregate amount included herein as recoverable from such reinsurers totaled \$55.9 million at March 31, 2002. Additionally, we have previously collected approximately \$48.5 million from the drawdown of collateral on hand.

NRMA Insurance Ltd. ("NRMA"), one of the participants in the 20% whole account quota share treaty, filed a lawsuit in the United States District Court for the Northern District of Alabama contesting our billings. NRMA sought rescission of the treaty and a temporary restraining order preventing us from drawing down approximately \$34.5 of collateral. We filed a demand for arbitration as provided for in the treaty and also filed a motion to compel arbitration which was granted in the United States District action. Vesta reached an agreement with NRMA to collect the \$34.5 million of collateral in exchange for posting a \$25 million letter of credit in favor of NRMA to fund any amounts NRMA may recover as a result of the arbitration. We also filed for arbitration against Alfa Mutual Insurance Company and Dorinco Reinsurance Company, the other two participants on the treaty and all those arbitrations are in the discovery stages. Additionally, Alfa recently filed a Motion for Declaratory Judgement asking the arbitration panel to order that there is no enforceable agreement between Alfa and Vesta. We are vigorously opposing such motion, which is scheduled for hearing in June 2002. Presently, the hearing in the NRMA arbitration is scheduled for October 2002. Hearing dates for the Alfa and Dorinco arbitrations are not presently scheduled. While management believes its interpretation of the treaty's terms and computations based thereon are correct, these matters are in arbitration and their ultimate outcome cannot be determined at this time.

During 1999, F&G Re (on behalf of USF&G), filed for arbitration under two aggregate stop loss reinsurance treaties whereby F&G Re assumed certain risk from the Vesta. F&G Re is seeking to cancel the treaties and avoid its obligation. Based on the terms of the two treaties, Vesta will be entitled to recoveries of approximately \$30.0 million as losses from prior accident years mature. Vesta has recorded a reinsurance recoverable of \$30.0 million at December 31, 2001 related to these two treaties. The hearing in this arbitration began on February 11, 2002. The hearing was adjourned on February 15, 2002 and scheduled to resume on June 11, 2002. While management believes that USF&G is not entitled to rescission, the ultimate outcome cannot be determined at this time.

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We are in arbitration with CIGNA Property and Casualty Insurance Company (now ACE USA) under a personal lines insurance quota share reinsurance agreement, whereby we assumed certain risks from CIGNA. During September 2000, CIGNA filed for arbitration under the reinsurance agreement, seeking payment of the balances that CIGNA claims are due under the terms of the treaty. In addition, during the fourth quarter, the treaty was terminated on a cut-off basis. Vesta is seeking recoupment of all improper claims payments and excessive expense allocations and charges from CIGNA. The arbitration was bifurcated into two phases with phase one concentrating on the interpretation of the intent of the parties related to the expense reimbursement provisions of the treaty at the time it was entered and phase two related to any issues between the parties after the Company conducts an audit of expenses related to the treaty. The phase one hearing was held in February 2002 and the panel ruled that (i) the Company is responsible for the payment of ceding commissions provided for in the treaty and should pay any outstanding billings for commissions and paid claims, plus interest; and (ii) the Company may proceed with an audit of expenses ceded to the treaty and (iii) the parties should identify any further issues to be brought before the arbitration panel for phase two of the hearing. The Phase II hearing has not yet been scheduled.

If the amounts recoverable under the relevant treaties are ultimately determined to be materially less than the amounts that we have reported as recoverable, we may incur a significant, material, and adverse impact on our financial condition and results of operations.

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### *Other Litigation*

On January 14, 2002, the Company's subsidiary, American Founders, was notified of a lawsuit in Texas naming it as a defendant and brought by a creditor of the former parent of the subsidiary. This lawsuit (subsequently identified as the Blitz lawsuit) alleges, among other things, that American Founders redeemed its Series A and Series C preferred stock issues at less than "reasonably equivalent value". American Founders believes that the allegations brought against it in this lawsuit are without merit and intends to mount a vigorous defense in this action. In the opinion of management, resolution of the Blitz lawsuit is not expected to have a material adverse effect on the financial position of the Company. However, depending on the amount and timing, an unfavorable resolution of this matter could materially affect American Founders' future operations or cash flows in a particular period.

Vesta, through its subsidiaries, is routinely a party to pending or threatened legal proceedings and arbitration relating to the regular conduct of its insurance business. These proceedings involve alleged breaches of contract, torts, including bad faith and fraud claims and miscellaneous other specified relief. Based upon information presently available, and in light of legal and other defenses available to Vesta and its subsidiaries, management does not consider liability from any threatened or pending litigation regarding routine matters to be material.

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**Item 2. Changes in Securities**

In the first quarter of 2002, we exchanged 533,647 shares of our common stock for \$4.6 million principal amount of our 8.75% Senior Notes due 2025 and \$.8 million of our 8.5% Deferrable Capital Securities. The transactions were not registered under the Securities Act of 1933 in reliance on the exemption afforded by Section 3(a)(9) thereof.

**Item 3. Defaults Upon Senior Securities**

None

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

None

**Item 5. Other information**

None

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

**a) EXHIBITS**

10.1 Second Amendment to Credit Agreement (Secured) effective as of March 30, 2002.

10.2 Second Amendment to Credit Agreement (Unsecured) effective as of March 30, 2002.

**b) Reports on Form 8-K.**

Current reports were filed on Form 8-K on January 17 and March 4, 2002 in connection with press releases.

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**Signatures**

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

Vesta Insurance Group, Inc.

Date: May 13, 2002

/s/ W. Perry Cronin

W. Perry Cronin  
*Senior Vice President  
and Chief Financial Officer  
(Principal Financial Officer)*

Date: May 13, 2002

/s/ Hopson B. Nance

Hopson B. Nance  
*Vice President and Controller  
(Principal Accounting Officer)*

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