AMERICAN MEDICAL SECURITY GROUP INC
Form 10-Q
May 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 MARCH 31, 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 April 30, 2001: 14,058,783 shares

AMERICAN MEDICAL SECURITY GROUP, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2001
	(IN T
ASSETS	
Investments:	

Securities available for sale, at fair value:	
Fixed maturities	$ 261,136
Equity securities-preferred	2,278
Fixed maturity securities held to maturity, at amortized cost	4,312
Trading securities, at fair value	244
Total investments	267,970
Cash and cash equivalents	10,484
Other assets:	
Property and equipment, net	33,143
Goodwill and other intangibles, net	106,655
Other assets	46,265
Total other assets	186,063
Total assets	$ 464,517

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2001
	(IN T
LIABILITIES AND SHAREHOLDERS' EQUITY	
Liabilities:	
Medical and other benefits payable	$ 133,285
Advance premiums	18,013
Payables and accrued expenses	34,139
Notes payable	40,958
Other liabilities	19,828

Total liabilities	246,223
Shareholders' equity:	
Common stock (no par value, $1 stated value, 50,000,000 shares authorized, 16,654,315 issued and 14,084,683 outstanding at March 31, 2001, 16,654,315 issued and 14,270,945 outstanding at December 31, 2000)	16,654
Paid-in capital	187,956
Retained earnings	31,155
Accumulated other comprehensive loss (net of tax benefit of $301,000 at March 31, 2001 and $2,126,000 at December 31, 2000)	(556)
Treasury stock (2,569,632 shares at March 31, 2001 and 2,383,370 shares at December 31, 2000, at cost)	(16,915)
Total shareholders' equity	218,294
Total liabilities and shareholders' equity	$ 464,517

See Notes to Condensed Consolidated Financial Statements

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AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three M Mar
	2001
	(IN THOUSANDS, E
Revenues:	
Insurance premiums	$ 222,470
Net investment income	4,487
Other revenue	5,301
Total revenues	232,258
Expenses:	
Medical and other benefits	166,580

Selling, general and administrative	71,411
Interest expense	876
Amortization of goodwill and intangibles	907
Total expenses	239,774
Income (loss) before income taxes	(7,516)
Income tax expense (benefit)	(2,376)
Net income (loss)	$ (5,140)
Net income (loss) per common share:	
Basic	$ (0.36)
Diluted	$ (0.36)

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three M Mar
	2001
	(IN T
OPERATING ACTIVITIES:	
Net income (loss)	$ (5,140)
Adjustments to reconcile net income (loss) to net cash used in operating activities:	
Depreciation and amortization	2,427
Net realized investment losses	27
Decrease in trading securities	16
Deferred income tax expense (benefit)	(2,571)
Changes in operating accounts:	
Other assets	1,408

Medical and other benefits payable	(12,025)
Advance premiums	445
Payables and accrued expenses	8,237
Other liabilities	(880)
Net cash used in operating activities	(8,056)
INVESTING ACTIVITIES:	
Purchases of available for sale securities	(40,470)
Proceeds from sale of available for sale securities	43,679
Proceeds from maturity of available for sale securities	3,050
Proceeds from maturity of held to maturity securities	-
Purchases of property and equipment	(1,891)
Proceeds from sale of property and equipment	-
Net cash provided by (used in) investing activities	4,368
FINANCING ACTIVITIES:	
Issuance of common stock	-
Purchase of treasury stock	(1,134)
Borrowings under line of credit agreement	-
Repayment on line of credit agreement	-
Repayment of notes payable	(300)
Net cash used in financing activities	(1,434)
Cash and cash equivalents:	
Net decrease	(5,122)
Balance at beginning of year	15,606
Balance at end of period	$ 10,484

See Notes to Condensed Consolidated Financial Statements

AMERICAN MEDICAL SECURITY GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

March 31, 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 generally accepted accounting principles 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 month periods ended March 31, 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 En March 31,	
	2001	
Weighted average common shares outstanding - basic	14,210,643	1
Effect of dilutive stock options	-	
Weighted average common shares outstanding - diluted	14,210,643	1

The effect of dilutive securities was excluded from the diluted earnings (loss) per common share computation for the three months ended March 31, 2001 because the Company had a net loss in 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.

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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 March 31,	
	2001	2000
	(IN THOUSANDS	
Net income (loss)	$ (5,140)	$ 1,6
Unrealized gain on available for sale securities	3,392	3
Comprehensive income (loss)	$ (1,748)	$ 1,9

NOTE D. CREDIT AGREEMENT

At March 31, 2001, the Company maintained a revolving bank line of credit agreement ("Credit Agreement") with a maximum commitment of $40.0 million and a $10.0 million sublimit for swingline loans. At March 31, 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 January 2001 and April 2001 to revise the minimum financial requirements of certain covenants. The April 2001 amendment also revised the Company's applicable interest rate on outstanding loans and revised the schedule of mandatory future commitment reductions including a $4.8 million commitment reduction on April 27, 2001. Revised future annual principal amounts due for all of the Company's debt as of March 31, 2001 are $0.9 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. On April 17, 2000, the Company filed its notice of appeal of this decision with the Eleventh Circuit Federal Appeals Court. Based upon the nature of the case and consultation with legal counsel, management had expected the verdict to be reversed or substantially reduced following appeal. Consequently, the Company initially established an immaterial accrual for this case reflecting potential contractual damages only. However, on March 12, 2001, the Company received an adverse decision affirming the jury verdict. On May 4, 2001, the Eleventh Circuit Court denied the Company's petition for a rehearing by the full court of appeals. The Company is preparing its appeal to the United States Supreme Court. Management believes strongly in its position, however, given the current status of the case, the Company recognized an additional accrual during the first quarter of 2001 representing the full potential loss including punitive damages and other expenses.

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 April 18, 2000, the Company filed a notice of appeal with an Ohio Appeals Court requesting reversal of the decision. On March 29, 2001, the Court of Appeals rendered a decision remanding

certain agent contract issues related to $2.4 million in damages back to the lower court for further consideration. The Court of Appeals decision upheld $3.0 million awarded by the lower court in regard to a commission contract. On May 2, 2001, the Company filed an appeal with the Ohio

Supreme Court appealing the decision of the Appeals Court with respect to that portion of the lower court's decision upheld by the Court of Appeals.

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 three months ended March 31, 2001 reflect a 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. 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 March 31,	
	2001	2000
	(IN THOUSANDS)	
Health segment	$ (8,506)	$ 7
Life segment	1,750	2,2
All other	(760)	(1
Income (loss) before income taxes	$ (7,516)	$ 2,8

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

	Three Months Ended March 31,	
	2001	2000
	(IN THOUSANDS)	
HEALTH SEGMENT		
OPERATING RESULTS		
Revenues:		
Insurance premiums	$ 216,974	$ 232,9
Net investment income	2,450	2,5
Other revenue	4,230	3,9
Total revenues	223,654	239,4
Expenses:		
Medical and other benefits	164,197	178,5
Selling, general and administrative	67,963	60,2
Total expenses	232,160	238,7
Income (loss) before income taxes	$ (8,506)	$ 7
FINANCIAL STATISTICS		
Loss ratio	75.7%	76.
Expense ratio	29.4%	24.
Combined ratio	105.1%	100.
Membership at End of Period:		
Health:		
Fully insured medical	424,632	520,7
Self funded medical	49,260	49,8
Stand-alone dental	178,283	188,5
Total health	652,175	759,0

(a) Total health membership for the Company of 652,683 and 776,639 at March 31, 2001 and 2000 includes HMO membership of 508 and 17,554, respectively. HMO operations are not included in health segment operating results.

	Three Months Ended March 31,	
	2001	2000
	(IN THOUSANDS)	
LIFE SEGMENT		
OPERATING RESULTS		
REVENUES:		
Insurance premiums	$ 4,963	$ 6,0
Net investment income	174	1
Other revenue	42	
Total revenues	5,179	6,2
Expenses:		
Medical and other benefits	1,992	2,2
Selling, general and administrative	1,437	1,7
Total expenses	3,429	4,0
Income before income taxes	$ 1,750	$ 2,2
FINANCIAL STATISTICS		
Loss ratio	40.1%	37.
Expense ratio	28.1%	28.
Combined ratio	68.2%	65.
Membership at End of Period	230,426	280,8

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 a net loss of $5.1 million or $0.36 per share for the first quarter of 2001. The first quarter results reflect an after-tax charge of $5.9 million or $0.41 per share in response to an adverse decision rendered by the Eleventh Circuit Federal Court of Appeals in a lawsuit brought against the Company. See "Part II., Item 1. Legal Proceedings" for a detailed discussion of the case.

Excluding the non-recurring charge, income for the first quarter of 2001 was $710,000 or $0.05 per share. This compares to net income of $1.7 million or $0.11 per share reported for the first quarter of the prior year. The decrease in income from the first quarter of the prior year primarily reflects a higher selling, general and adminstrative expense ratio from higher agent commissions and issue costs resulting from the company's change in product mix, lower premium revenues, and lower investment income, partially offset by an improvement in the health loss ratio.

INSURANCE PREMIUMS AND MEMBERSHIP

Insurance premiums for the three months ended March 31, 2001 decreased 10.2% to $222.5 million from $247.9 million for the same period in 2000 primarily as a result of a decline in membership in select unprofitable small group and exited markets, partially offset by rising MedOne membership and rising premium rates on the continuing block of business. Average fully insured medical premium per member per month for the first quarter of 2001 increased by 11.5% to $146, compared to the first quarter of 2000, reflecting significant rate actions taken by the Company. Insurance premiums for the Company's MedOne product increased 30.0% from the first 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 776,639 members at March 31, 2000 to 652,683 members at March 31, 2001. The membership decrease is a result of (1) the Company's success in terminating business in several unprofitable markets, including exited markets, (2) lower sales due to aggressive premium rate increases and (3) the run-off of the block of group health business acquired on January 1, 1999 from Continental Assurance Company ("CNA"). Based on the most recent sales projections and the rate of membership terminations, management anticipates membership to continue to decline approximately 10% during the remainder of 2001 and insurance premiums to decline by 5% to 10%.

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 March 31, 2001 decreased to $4.5 million from $4.9 million for the three months ended March 31, 2000. The decrease in net investment income is due primarily to a decrease in average invested assets. Average invested assets at cost were $272.1 million for the three months ended March 31, 2001. In comparison, average invested assets were $297.4 million for the same period one year prior.

OTHER REVENUE

Other revenue, which primarily consists of administrative fee income from claims processing and other administrative services, increased to $5.3 million for the quarter compared to $4.9 million for the first quarter of 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 first quarter of 2001 was 75.7% compared to 76.6% for the first quarter of 2000. The significant improvement was due to management's actions and strategies to increase premiums and manage medical inflation. These actions included premium rate increases, claims cost control initiatives and the exit from unprofitable small group markets. The improvement also reflects increased sales of MedOne products, which are priced for a lower loss ratio due to its increased deductibles and copayments. As anticipated, claim costs have increased slightly, but were more than offset by increased premiums. 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 March 31, 2001 was 40.1% compared to 37.7% for the three months ended March 31, 2000. The increase in the life segment loss ratio was due to an unexpected increase in life claims experience during the period.

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. Excluding the non-recurring legal accrual, the SG&A expense ratio for health segment products for the three months ended March 31, 2001 was 25.2%. This compares to 24.2% reported for the three months ended March 31, 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.

FUTURE EXPECTATIONS

Management continues to take actions to improve profitability through aggressive pricing, product redesign, new product introduction, and targeted focus on profitable markets and products. Management expects the Company's profitability to improve during 2001 as a result of the continued implementation of management's strategic plan. Based on current revenue and cost projections, management expects second quarter earnings to be approximately $0.06 to $0.08 per share. For the full year 2001, management anticipates earnings between $0.35 and $0.45 per share, excluding the non-recurring charge. See "Cautionary Factors" below for a detailed discussion of risks and uncertainties that may cause actual results to differ materially from management's expectations.

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 $8.1 million for the three months ended March 31, 2001. This compares to cash used in operations of $5.5 million for the three months ended March 31, 2000. The decrease in cash flows is primarily the result of a reduction in the claims backlog during the quarter, along with faster claim submission and payment patterns, and lower new sales volume. Management expects cash flow from operations to be positive for the year 2001.

The Company's investment portfolio consists primarily of investment grade bonds and has limited exposure to equity securities. At March 31, 2001, $265.4 million or 99.1% of the Company's investment portfolio was invested in bonds. At December 31, 2000, $267.0 million or 99.1% of the Company's investment portfolio was invested in bonds. The bond portfolio had an average quality rating of Aa3 at March 31, 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 prior to December 2001, at which time the aggregate amount available without regulatory approval is $7.3 million.

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 186,262 shares of its outstanding common stock during the first quarter of 2001, bringing the total purchased to 2.6 million shares at an aggregate purchase price of $16.9 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 March 31, 2001, the Company maintained a revolving bank line of credit agreement ("Credit Agreement") with a maximum commitment of $40.0 million and a $10.0 million sublimit for swingline loans. At March 31, 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 January 2001 and April 2001 to revise the minimum financial requirements of certain covenants. The April 2001 amendment also revised the Company's applicable interest rate on outstanding loans and revised the schedule of mandatory future

commitment reductions including a $4.8 million commitment reduction on April 27, 2001. Revised future annual principal amounts due for all of the Company's debt as of March 31, 2001 are $0.9 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:

- Increasing health care costs resulting from the aging of the population, advances in medical technology, increased utilization of medical services and drugs, health care inflation (particularly technology-driven procedures and pharmacy 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 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 for MedOne products, competitive factors such as the entrance of additional competitors into the Company's markets, competitive pricing practices, the Company's ability to sell new products and retain existing customers, and the Company's ability to predict future health care cost trends and adequately price its products.

- 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.

- Possible restrictions on cash flow resulting from a denial by state regulators of the payment of dividends by the Company's insurance company subsidiaries.

- 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 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.

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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. The Company is preparing to petition the United States Supreme Court for a writ of certiorari and intends to continue its strenuous appeal of this decision.

On February 7, 2000, a $5.4 million verdict was entered against AMS Inc. and UWLIC 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. Health Administrators filed a cross-appeal on July 10, 2000. Oral arguments were heard on October 5, 2000. On March 29, 2001, the Court of Appeals rendered a decision remanding certain agent contract issues related to $2.4 million in damages back to the lower court for further consideration. The Court of Appeals decision upheld $3.0 million awarded by the lower court in regard to a commission contract. On May 2, 2001, AMS and UWLIC filed an appeal with the Supreme Court for the State of Ohio appealing the

decision of the Court of Appeals with respect to that portion of the lower court's decision upheld by the Court of Appeals.

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 the Skilstaf litigation, the Health Administrators litigation and other legal and regulatory actions; accordingly, the outcome of these matters is not expected to have a material adverse effect on the consolidated financial statements.

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 February 21, 2001, was filed by the Company to disclose under Item 9, Regulation FD Disclosure, a financial presentation included on the Company's website.

The Company also filed a Form 8-K dated March 12, 2001, to report under Item 5, Other Events, the Company's announcement to take a nonrecurring charge resulting from an adverse decision in the Skilstaf litigation.

SIGNATURES

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

DATE: MAY 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)

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

EXHIBIT INDEX
TO
FORM 10-Q QUARTERLY REPORT
for quarter ended March 31, 2001

EXHIBIT NO.	DESCRIPTION	INCORPORATED HEREIN BY REFERENCE TO
4	Fourth Amendment dated as of April 27, 2001 to Credit Agreement dated as of March 24, 2000 among the Registrant, LaSalle Bank National Association and other Lenders	

EX-1