METHANEX CORP
Form 6-K
October 28, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 6-K
REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16
UNDER THE SECURITIES EXCHANGE ACT OF 1934
FOR THE MONTH OF OCTOBER 2011
METHANEX CORPORATION
(Registrant s name)
SUITE 1800, 200 BURRARD STREET, VANCOUVER, BC V6C 3M1 CANADA
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F o Form 40-F þ

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes o No þ

If Yes is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82__________.

NEWS RELEASE

Methanex Corporation
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For immediate release

METHANEX REPORTS THIRD QUARTER RESULTS METHANOL DEMAND HEALTHY

OCTOBER 26, 2011

For the third quarter of 2011, Methanex reported Adjusted EBITDA[1] of $134.8 million and net income attributable to Methanex shareholders of $62.3 million ($0.67 basic net income per common share and $0.59 per share on a diluted basis[2]). This compares with Adjusted EBITDA[1] of $103.7 million and net income attributable to Methanex shareholders of $40.5 million ($0.44 basic net income per common share and $0.43 per share on a diluted basis[2]) for the second quarter of 2011.

Bruce Aitken, President and CEO of Methanex commented, Our new Egypt and Medicine Hat plants operated very well, making a significant contribution to our earnings. In addition, methanol demand and pricing were higher in the third quarter. Entering the fourth quarter, methanol demand continues to be healthy and the longer term outlook is excellent, as there is little new capacity being added to the industry over the next few years to meet expected demand growth.

Mr. Aitken concluded, We have a healthy balance sheet with US$261 million of cash on hand and an undrawn credit facility. With the additions of Egypt and Medicine Hat earlier this year, we are in a stronger position to generate cash flows, invest in strategic opportunities to grow the Company, and continue to deliver on our commitment to return excess cash to shareholders.

A conference call is scheduled for October 27, 2011 at 12:00 noon ET (9:00 am PT) to review these third quarter results. To access the call, dial the Conferencing operator ten minutes prior to the start of the call at (416) 695-6616, or toll free at (800) 396-7098. A playback version of the conference call will be available for three weeks at (905) 694-9451, or toll free at (800) 408-3053. The passcode for the playback version is 1632584. There will be a simultaneous audio-only webcast of the conference call, which can be accessed from our website at www.methanex.com. The webcast will be available on our website for three weeks following the call.

Methanex is a Vancouver-based, publicly traded company and is the world s largest supplier of methanol to major international markets. Methanex shares are listed for trading on the Toronto Stock Exchange in Canada under the trading symbol MX , on the NASDAQ Global Market in the United States under the trading symbol MEOH , and on the foreign securities market of the Santiago Stock Exchange in Chile under the trading symbol Methanex . Methanex can be visited online at www.methanex.com.

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FORWARD-LOOKING INFORMATION WARNING

This Third Quarter 2011 press release contains forward-looking statements with respect to us and the chemical industry. Refer to *Forward-Looking Information Warning* in the attached Third Quarter 2011 Management s Discussion and Analysis for more information.

[1] *Adjusted EBITDA is a non-IFRS measure which does not have any standardized meaning prescribed by IFRS. Adjusted EBITDA represents the amount that is attributable to Methanex shareholders and is calculated by deducting the amount of Adjusted EBITDA associated with the 40% non-controlling interest in the methanol facility in Egypt. Refer to Additional Information Supplemental Non-IFRS Measures for a reconciliation to the most comparable IFRS measure.*

[2] *For the third quarter of 2011, diluted net income per common share is $0.08 lower than basic net income per common share. The large difference between diluted and basic net income per common share is due to the basis for the calculation of diluted net income per common share differing from the accounting treatment for certain types of share-based compensation. See note 8 of the Company s condensed consolidated interim financial statements for the calculation of diluted net income per common share.*

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For further information, contact:
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Interim Report
For the
Three Months Ended
September 30, 2011

At October 26, 2011 the Company had 93,232,020 common shares issued and outstanding and stock options exercisable for 3,467,134 additional common shares.

Share Information

Methanex Corporation s common shares are listed for trading on the Toronto Stock Exchange under the symbol MX, on the Nasdaq Global Market under the symbol MEOH and on the foreign securities market of the Santiago Stock Exchange in Chile under the trading symbol Methanex.

Transfer Agents & Registrars

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Investor Information

All financial reports, news releases and corporate information can be accessed on our website at www.methanex.com.

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THIRD QUARTER MANAGEMENT S DISCUSSION AND ANALYSIS

Except where otherwise noted, all currency amounts are stated in United States dollars. This Third Quarter 2011 Management s Discussion and Analysis (MD&A) dated October 26, 2011 for Methanex Corporation (the Company) should be read in conjunction with the Company s condensed consolidated interim financial statements for the periods ended September 30, 2011, June 30, 2011 and March 31, 2011, which are prepared in accordance with International Accounting Standards (IAS) 34, Interim Financial Reporting, as issued by the International Accounting Standards Board (IASB), as well as the 2010 Annual Consolidated Financial Statements and the MD&A included in the Methanex 2010 Annual Report, which were prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP). The Methanex 2010 Annual Report and additional information relating to Methanex is available on SEDAR at www.sedar.com and on EDGAR at www.sec.gov. For a discussion of the Company s adoption of International Financial Reporting Standards (IFRS), refer to page 11 of this MD&A.

	Three Months Ended			**Nine Months Ended**	
($ millions, except where noted)	**Sep 30 2011**	Jun 30 2011	Sep 30 2010[7]	**Sep 30 2011**	Sep 30 2010[7]
Production (thousands of tonnes) (attributable to Methanex shareholders)	**1,035**	1,050	895	**2,886**	2,627
Sales volumes (thousands of tonnes):					
Produced methanol (attributable to Methanex shareholders)	**983**	970	885	**2,801**	2,709
Purchased methanol	**672**	664	792	**2,171**	2,074
Commission sales [1]	**235**	231	101	**638**	358
Total sales volumes	**1,890**	1,865	1,778	**5,610**	5,141
Methanex average non-discounted posted price ($ per tonne) [2]	**445**	421	334	**434**	339
Average realized price ($ per tonne) [3]	**377**	363	286	**369**	291
	134.8	103.7	55.9	**316.4**	199.0

Adjusted EBITDA (attributable to Methanex shareholders) [4]					
Cash flows from operating activities	**119.1**	77.6	61.4	**321.3**	169.8
Adjusted cash flows from operating activities (attributable to Methanex shareholders) [5]	**103.6**	86.5	64.7	**270.4**	209.3
Net income attributable to Methanex shareholders	**62.3**	40.5	28.7	**137.5**	70.5
Basic net income per common share attributable to Methanex shareholders	**0.67**	0.44	0.31	**1.48**	0.76
Diluted net income per common share attributable to Methanex shareholders [6]	**0.59**	0.43	0.31	**1.38**	0.75
Common share information (millions of shares):					
Weighted average number of common shares	**93.2**	93.0	92.2	**93.0**	92.2
Diluted weighted average number of common shares	**94.4**	94.6	93.3	**94.4**	93.4
Number of common shares outstanding, end of period	**93.2**	93.2	92.2	**93.2**	92.2

1 Commission sales represent volumes marketed on a commission basis related to the 36.9% of the Atlas methanol facility and 40% of the Egypt methanol facility that we do not own.

2 Methanex average non-discounted posted price represents the average of our non-discounted posted prices in North America, Europe and Asia Pacific weighted by sales volume. Current and historical pricing information is available at www.methanex.com.

3 Average realized price is calculated as revenue, excluding commissions earned and the Egypt non-controlling interest share of revenue, divided by the total sales volumes of produced and purchased methanol.

4 Adjusted EBITDA is a non-IFRS measure which does not have any standardized meaning prescribed by IFRS. Adjusted EBITDA represents the amount that is attributable to Methanex shareholders and is calculated by deducting the amount of Adjusted EBITDA associated with the 40% non-controlling interest in the methanol facility in Egypt. Refer to Additional Information Supplemental Non-IFRS Measures for a reconciliation to the most comparable IFRS measure.

5 Adjusted cash flows from operating activities is a non-IFRS measure which does not have any standardized meaning prescribed by IFRS. Adjusted cash flows from operating activities is calculated by deducting changes in non-cash working capital and the amount of cash flows from operating activities associated with the 40% non-controlling interest in the methanol facility in Egypt. Refer to Additional Information Supplemental Non-IFRS Measures for a reconciliation to the most comparable IFRS measure.

6 For the third quarter of 2011, diluted net income per common share is $0.08 lower than basic net income per common share. The large difference between diluted and basic net income per common share is due to the basis for the calculation of diluted net income per common share differing from the accounting treatment for certain types of share-based compensation. See note 8 of the Company s condensed consolidated interim financial

statements for the calculation of diluted net income per common share.

[7] These amounts have been restated in accordance with IFRS and have not been previously disclosed.

PRODUCTION SUMMARY

(thousands of tonnes)	Q3 2011 Capacity[1]	Q3 2011 Production	Q2 2011 Production	Q3 2010 Production	YTD Q3 2011 Production	YTD Q3 2010 Production
Chile I, II, III and IV	**950**	**116**	142	194	**441**	727
Atlas (Trinidad) (63.1% interest)	**288**	**170**	263	284	**696**	618
Titan (Trinidad)	**225**	**224**	186	217	**531**	658
New Zealand [2]	**213**	**209**	207	200	**619**	624
Egypt (60% interest)	**190**	**191**	178		**400**	
Medicine Hat	**118**	**125**	74		**199**	
	1,984	**1,035**	1,050	895	**2,886**	2,627

[1] *The production capacity of our production facilities may be higher than original nameplate capacity as, over time, these figures have been adjusted to reflect ongoing operating efficiencies at these facilities.*

[2] *The production capacity of New Zealand represents only our 0.85 million tonne per year Motunui facility that we restarted in late 2008. Practical operating capacity will depend partially on the composition of natural gas feedstock and may differ from the stated capacity above. We also have additional potential production capacity that is currently idled in New Zealand (refer to the New Zealand section on page 3 for more information).*

Chile

During the third quarter of 2011, we produced 116,000 tonnes in Chile operating one plant at approximately 40% capacity. We continue to operate our methanol facilities in Chile significantly below site capacity. This is primarily due to curtailments of natural gas supply from Argentina refer to the Management s Discussion and Analysis included in our 2010 Annual Report for more information.

Lower production at our Chile facilities during the third quarter of 2011 compared with the second quarter of 2011 was due to the need for the state-owned energy company Empresa Nacional del Petroleo (ENAP) to satisfy incremental natural gas demand for residential purposes in southern Chile during the winter season when residential energy demand is at its peak, as well as declines in the deliverability from existing gas fields. Lower methanol production in Chile for the first nine months of 2011 compared with the same period in 2010 is due primarily to lower gas deliveries from ENAP and declines in deliverability from existing gas fields.

Our goal is to progressively increase production at our Chile site with natural gas from suppliers in Chile. We are pursuing investment opportunities with ENAP, GeoPark Chile Limited (GeoPark) and others to help accelerate natural gas exploration and development in southern Chile. We are working with ENAP to develop natural gas in the Dorado Riquelme block. Under the arrangement, we fund a 50% participation in the block and, as at September 30, 2011, we had contributed approximately $105 million. Over the past few years, we have also provided GeoPark with $57 million (of which approximately $40 million had been repaid at September 30, 2011) to support and accelerate GeoPark s natural gas exploration and development activities. GeoPark has agreed to supply us with all natural gas sourced from the Fell block under a ten-year exclusive supply arrangement that commenced in 2008. During the third quarter of 2011, substantially all production at our Chilean facilities was produced with natural gas supplied from the Fell and Dorado Riquelme blocks.

Other investment activities are also supporting the acceleration of natural gas exploration and development in areas of southern Chile. In late 2007, the government of Chile completed an international bidding round to assign oil and natural gas exploration areas that lie close to our production facilities and announced the participation of several international oil and gas companies. For two of the exploration blocks, we are participating in a consortium with other

international oil and gas companies with GeoPark as the operator. We have approximately 15% participation in the consortium and at September 30, 2011, we had contributed $3 million for our share of the exploration costs. In 2010, the Chilean government initiated a new round allocating further exploration acreage to international oil and gas companies. Contracts for these new exploration areas are currently under negotiation.

While significant investments have been made in the last few years for natural gas exploration and development in southern Chile, the timelines for significant increases in gas production are much longer than we had originally anticipated and existing gas fields are experiencing declines. As a result, the short-term outlook for gas supply in Chile continues to be challenging. We are examining the viability of utilizing coal gasification as a feedstock and relocation of capacity to an alternative location.

The future operating rate of our Chile site is primarily dependent on demand for natural gas for residential purposes, which is higher in the southern hemisphere winter, production rates from existing natural gas fields, and the level of natural gas deliveries from future exploration and development activities in southern Chile. We cannot provide assurance regarding the production rates from existing natural gas fields or that we, ENAP, GeoPark or others will be successful in the exploration and development of natural gas or that we will obtain any additional natural gas from suppliers in Chile on commercially acceptable terms. As a result, we cannot provide assurance in the level of natural gas supply or that we will be able to source sufficient natural gas to operate any capacity in Chile or that we will have sufficient future cash flows from Chile to support the carrying value of our Chilean assets and that this will not have an adverse impact on our results of operations and financial condition.

Trinidad

Our equity ownership of methanol facilities in Trinidad represents over 2.0 million tonnes of cost-competitive annual capacity. During the third quarter of 2011 we produced 394,000 tonnes compared with 449,000 tonnes during the second quarter of 2011. Lower production in the third quarter of 2011 compared with the second quarter of 2011 was primarily due to an unplanned outage at our Atlas facility which lasted approximately 21 days. We restarted operations at the Atlas facility in mid-August and have since operated the plant at approximately 70% of capacity. We expect to maintain operating the plant at approximately 70% of capacity until the next major turnaround currently scheduled for early 2012. Although our Titan facility operated at full capacity during the third quarter we did experience some gas curtailments late in the third and into the fourth quarter due to upstream outages. We are engaged with key stakeholders to find a solution to this issue, but in the meantime expect to continue to experience some gas curtailments to our Trinidad site.

New Zealand

Our New Zealand facilities provide cost-competitive capacity and are underpinned by shorter term natural gas supply contracts. During the third quarter of 2011, we produced 209,000 tonnes compared with 207,000 tonnes during the second quarter of 2011. We are currently operating one 850,000 tonne per year plant at our Motunui facility in New Zealand and we have natural gas contracts with a number of gas suppliers that will allow us to continue to operate this plant through 2012. We also have an additional 1.38 million tonnes per year of idled capacity in New Zealand, including a second 850,000 tonne per year Motunui plant and a 530,000 tonne per year plant at our nearby site in Waitara Valley. These facilities provide the potential to increase production in New Zealand depending on the methanol supply and demand dynamics and the availability of economically priced natural gas feedstock. We believe there has been continued improvement in the natural gas supply outlook in New Zealand and we are focused on accessing additional natural gas supply to increase production in New Zealand. We are continuing to pursue opportunities to obtain economically priced natural gas with suppliers in New Zealand to operate a second plant.

Egypt

The 1.26 million tonne per year methanol plant in Egypt commenced commercial operations in mid-March and has continued to operate well since that time. During the third quarter of 2011, the Egypt methanol facility (60% interest) produced 191,000 tonnes compared with 178,000 tonnes during the second quarter of 2011. We have a 60% interest in the facility and have marketing rights for 100% of the production.

Medicine Hat

Our 470,000 tonne per year facility in Medicine hat, Alberta was restarted in late April 2011, and has continued to operate well since that time. During the third quarter of 2011, we produced 125,000 tonnes compared with 74,000 tonnes during the second quarter of 2011. We have a program in place to purchase natural gas on the Alberta gas market and we have contracted sufficient volumes of natural gas to meet over 80% of our natural gas requirements when operating at capacity for the period to March 2013 with the remainder of natural gas purchased on the spot market. We believe that the long term natural gas dynamics in North America will support the long term operation of this facility.

FINANCIAL RESULTS

For the third quarter of 2011, we recorded Adjusted EBITDA of $134.8 million and net income attributable to Methanex Corporation shareholders of $62.3 million ($0.67 basic net income per common share and $0.59 per share on a diluted basis). This compares with Adjusted EBITDA of $103.7 million and net income attributable to Methanex Corporation shareholders of $40.5 million ($0.44 basic net income per common share and $0.43 per share on a diluted basis) and Adjusted EBITDA of $55.9 million and net income attributable to Methanex Corporation shareholders of $28.7 million ($0.31 basic and diluted net income per common share) for the second quarter of 2011 and third quarter of 2010, respectively.

For the nine months ended September 30, 2011, we recorded Adjusted EBITDA of $316.4 million and net income attributable to Methanex Corporation shareholders of $137.5 million ($1.48 basic net income per common share and $1.38 per share on a diluted basis). This compares with Adjusted EBITDA of $199.0 million and net income attributable to Methanex Corporation shareholders of $70.5 million ($0.76 basic net income per common share and $0.75 per share on a diluted basis) during the same period in 2010.

For the three and nine month periods ended September 30, 2011, share-based compensation created additional volatility in our earnings due to significant changes in our share price. We grant share-based awards as an element of compensation and, as more fully discussed on page 6, certain of these awards are marked to market each quarter with the changes in fair value recognized in earnings for the proportion of the service that has been rendered at the reporting date. During the third quarter of 2011, our share price experienced a significant decline and this resulted in a share-based compensation recovery. The amount of share-based compensation expense (recovery) included in net income and Adjusted EBITDA is as follows:

	Three Months Ended			Nine Months Ended	
($ millions)	**Sep 30 2011**	Jun 30 2011	Sep 30 2010	**Sep 30 2011**	Sep 30 2010
Share-based compensation expense (recovery)	**$ (21)**	$ 2	$ 9	**$ (9)**	$ 18

Included in the share-based compensation expense (recovery) is the fair value adjustment related to tandem share appreciation rights (TSARs). TSARs are share-based awards that may be settled in cash or common shares at the holder s option. TSARs are accounted for as if they are cash-settled and as a result, a fair value adjustment is included in share-based compensation expense (recovery) each quarter. For purposes of calculating diluted net income per common share, the more dilutive of the cash-settled method or equity-settled method is used. For the three and nine month periods ended September 30, 2011, diluted net income per common share is lower than basic net income per common share by $0.08 and $0.10, respectively, primarily due to the impact of TSARs being treated as equity-settled for purposes of calculating diluted net income per common share. See note 8 of the Company s condensed consolidated interim financial statements for the calculation of diluted net income per common share.

EARNINGS ANALYSIS

Our operations consist of a single operating segment the production and sale of methanol. In addition to the methanol that we produce at our facilities, we also purchase and re-sell methanol produced by others and we sell methanol on a commission basis. We analyze the results of all methanol sales together, excluding commission sales volumes. The key drivers of change in our Adjusted EBITDA for methanol sales are average realized price, sales volume and cash costs.

We own 60% of the 1.26 million tonne per year Egypt methanol facility and we account for this investment using consolidation accounting, which results in 100% of the revenues and expenses being included in our financial statements with the other investors interest in the methanol facility being presented as non-controlling interests. For purposes of reviewing our operations, we analyze Adjusted EBITDA in the discussion below excluding the amounts associated with the other investors 40% non-controlling interest.

For a further discussion of the definitions and calculations used in our Adjusted EBITDA analysis, refer to *How We Analyze Our Business*. Also, refer to the *Supplemental Non-IFRS Measures* section on page 12 for a reconciliation of Adjusted EBITDA to the most comparable IFRS measure.

Adjusted EBITDA (attributable to Methanex shareholders)
The changes in Adjusted EBITDA resulted from changes in the following:

($ millions)	**Q3 2011 compared with Q2 2011**	**Q3 2011 compared with Q3 2010**	**YTD Q3 2011 compared with YTD Q3 2010**
Average realized price	$ 22	$ 151	$ 388
Sales volume	2		12
Total cash costs	7	(72)	(283)
	$ 31	$ 79	$ 117

Average realized price

	Three Months Ended			Nine Months Ended	
($ per tonne, except where noted)	**Sep 30 2011**	Jun 30 2011	Sep 30 2010	**Sep 30 2011**	Sep 30 2010
Methanex average non-discounted posted price [1]	**445**	421	334	**434**	339
Methanex average realized price	**377**	363	286	**369**	291
Average discount	**15%**	14%	14%	**15%**	14%

1 *Methanex average non-discounted posted price represents the average of our non-discounted posted prices in North America, Europe and Asia Pacific weighted by sales volume. Current and historical pricing information is available at www.methanex.com.*

Throughout the third quarter of 2011, methanol demand continued to be healthy despite the increase in concern around the global economy. Industry supply and demand conditions are favorable, and as a result, the pricing environment has been relatively stable (refer to Supply/Demand Fundamentals section on page 9 for more information). Our average non-discounted posted price for the third quarter of 2011 was $445 per tonne compared with $421 per tonne for the second quarter of 2011 and $334 per tonne for the third quarter of 2010. Our average realized price for the third quarter of 2011 was $377 per tonne compared with $363 per tonne for the second quarter of 2011 and $286 per tonne for the third quarter of 2010. The change in our average realized price for the third quarter of 2011 increased Adjusted EBITDA by $22 million compared with the second quarter of 2011 and increased Adjusted EBITDA by $151 million compared with the third quarter of 2010. Our average realized price for the nine months ended September 30, 2011 was $369 per tonne compared with $291 per tonne for the same period in 2010 and this increased Adjusted EBITDA by $388 million.

Sales volume

Total methanol sales volumes excluding commission sales volumes for the third quarter of 2011 were comparable to the second quarter of 2011 and the third quarter of 2010. Total methanol sales volumes excluding commission sales were higher for the nine months ended September 30, 2011 compared with the nine months ended September 30, 2010 by 189,000 tonnes and this increased Adjusted EBITDA by $12 million. We increased our sales volumes in 2011 compared with 2010 primarily as a result of increased supply from the Egypt and Medicine Hat methanol facilities.

Total cash costs

The primary driver of changes in our total cash costs are changes in the cost of methanol we produce at our facilities and changes in the cost of methanol we purchase from others. Most of our production facilities are underpinned by

natural gas purchase agreements with pricing terms that include base and variable price components. The variable component is adjusted in relation to changes in methanol prices above pre-determined prices at the time of production. We supplement our production with methanol produced by others through methanol offtake contracts and purchases on the spot market to meet customer needs and support our marketing efforts within the major global markets. We have adopted the first-in, first-out method of accounting for inventories and it generally takes between 30 and 60 days to sell the methanol we produce or purchase. Accordingly, the changes in Adjusted EBITDA as a result of changes in natural gas costs and purchased methanol costs will depend on changes in methanol pricing and the timing of inventory flows.

The impact on Adjusted EBITDA from changes in our cash costs are explained below:

($ millions)	**Q3 2011 compared with Q2 2011**	**Q3 2011 compared with Q3 2010**	**YTD Q3 2011 compared with YTD Q3 2010**
Methanex-produced methanol costs	$ (8)	$ (37)	$ (89)
Proportion of produced methanol sales		12	(3)
Purchased methanol costs	(6)	(63)	(177)
Logistics costs	1	(4)	(16)
Other, net	(3)	(10)	(25)
Change in Adjusted EBITDA before changes in share-based compensation	$ (16)	$ (102)	$ (310)
Share-based compensation	23	30	27
Change in Adjusted EBITDA	$ 7	$ (72)	$ (283)

Methanex-produced methanol costs

We purchase natural gas for the Chile, Trinidad, Egypt and New Zealand methanol facilities under natural gas purchase agreements where the terms include a base price and a variable price component linked to the price of methanol. For all periods presented, changes in natural gas costs associated with produced methanol were primarily due to the impact of changes in methanol prices and the timing of inventory flows.

Proportion of produced methanol sales

The cost of purchased methanol is generally higher than the cost of produced methanol. Accordingly, an increase in the proportion of produced methanol sales results in a decrease in our overall cost structure for a given period. For the third quarter of 2011 compared with the second quarter of 2011, the impact of higher sales volumes from our Egypt and Medicine Hat facilities was offset by lower sales of methanol produced at our Atlas and Chile facilities. For the third quarter of 2011 compared with the third quarter of 2010, higher sales of produced methanol, primarily due to the impact of sales volumes from the Egypt and Medicine Hat facilities, increased EBITDA by $12 million.

For the nine month period ended September 30, 2011 compared with nine month period ended September 30, 2010, the impact of higher sales volumes from our Egypt and Medicine Hat facilities was offset by lower sales of methanol produced at our Chile and Titan facilities.

Purchased methanol costs

Purchased methanol costs were higher for all periods presented primarily as a result of higher methanol pricing.

Logistics costs

For the third quarter of 2011 compared with the second quarter of 2011, logistics costs were similar. For the three and nine month periods ended September 30, 2011 compared with same periods in 2010, logistics costs were higher by $4 million and $16 million, respectively, due primarily to higher bunker fuel costs.

Other, net

For the third quarter of 2011 and the nine month period ended September 30, 2011 compared with the comparable periods in 2010, other costs were higher primarily as a portion of fixed manufacturing costs were charged directly to earnings rather than to inventory due to lower production at our facilities in Chile and Trinidad as well as the impact of a weaker US dollar on the cost structure of our operations.

Share-based compensation

We grant share-based awards as an element of compensation. Share-based awards granted include stock options, share appreciation rights, tandem share appreciation rights, deferred share units, restricted share units and performance share

units.

For stock options, the cost is measured based on an estimate of the fair value at the date of grant using the Black-Scholes option pricing model and this grant-date fair value is recognized as compensation expense over the related service period with no subsequent re-measurement in fair value. Accordingly, share-based compensation expense associated with stock options will not vary significantly from period to period. Commencing in 2010, we granted share appreciation rights (SARs) and tandem share appreciation rights (TSARs) to replace grants of stock options with the objective to reduce dilution to shareholders. SARs and TSARs are units that grant the holder the right to receive a cash payment upon exercise for the difference between the market price of the Company s common shares and the exercise price, which is determined at the date of grant. SARs and TSARs are measured based on estimated fair value each quarter, which is determined using the Black-Scholes option pricing model.

Deferred, restricted and performance share units are grants of notional common shares that are redeemable for cash upon vesting based on the market value of the Company s common shares and are non-dilutive to shareholders. Performance share units have an additional feature where the ultimate number of units that vest will be determined by the Company s total shareholder return in relation to a predetermined target over the period to vesting. The number of units that will ultimately vest will be in the range of 50% to 120% of the original grant. For deferred, restricted and performance share units, the fair value is initially measured at the grant date and subsequently re-measured each quarter based on the market value of the Company s common shares.

For all the share-based awards with the exception of stock options, the initial value and any subsequent change in fair value is recognized in earnings over the related service period for the proportion of the service that has been rendered at each reporting date. Accordingly, share-based compensation associated with these share-based awards may vary significantly from period to period as a result of changes in the share price.

As a result of the decrease in our share price during the third quarter of 2011, we recorded a share-based compensation recovery of $21 million. This compares with share-based compensation expense of $2 million for the second quarter of 2011 and $9 million for the third quarter of 2010. For the nine month period ending September 30, 2011, we recorded a share-based compensation recovery of $9 million compared with a share-based compensation expense of $18 million for the same period in 2010.

Depreciation and Amortization

Depreciation and amortization was $44 million for the third quarter of 2011 compared with $40 million for the second quarter of 2011 and $35 million for the third quarter of 2010. The increase in depreciation and amortization for both periods is primarily a result of the commencement of depreciation associated with the methanol facilities in Egypt (100% basis) and Medicine Hat and higher unabsorbed depreciation attributable to an unplanned outage at our Atlas facility which lasted approximately 21 days.

Depreciation and amortization was $113 million for the nine month period ended September 30, 2011 compared with $106 million in the same period in 2010 primarily due to the commencement of depreciation associated with the methanol facilities in Egypt (100% basis) and Medicine Hat.

Finance Costs

	Three Months Ended			Nine Months Ended	
($ millions)	**Sep 30 2011**	Jun 30 2011	Sep 30 2010	**Sep 30 2011**	Sep 30 2010
Finance costs before capitalized interest	**$ 17**	$ 17	$ 18	**$ 51**	$ 51
Less capitalized interest			(10)	**(7)**	(28)
Finance costs	**$ 17**	$ 17	$ 8	**$ 44**	$ 23

Capitalized interest relates to interest costs capitalized during the construction of the 1.26 million tonne per year methanol facility in Egypt (100% basis). The Egypt methanol facility commenced production in mid-March 2011 and

accordingly, we ceased capitalization of interest costs from this date.

Finance Income and Other Expenses

	Three Months Ended			Nine Months Ended	
($ millions)	**Sep 30 2011**	Jun 30 2011	Sep 30 2010	**Sep 30 2011**	Sep 30 2010
Finance income and other expenses	**$ (2)**	$ 1	$ (1)	**$ 5**	$

Finance income and other expenses for the third quarter of 2011 was $2 million expense compared with $1 million income for the second quarter of 2011 and a $1 million expense for the third quarter of 2010. Finance income and other expenses for the nine month period ended September 30, 2011 was $5 million income compared with nil for the nine month period ended September 30, 2010. The change in finance income and other expenses for all periods presented was primarily due to the impact of changes in foreign exchange rates.

Income Taxes

The effective tax rate for the third quarter of 2011 was approximately 20% compared with approximately 25% for the second quarter of 2011. We earn the majority of our pre-tax earnings in Trinidad, Egypt, Chile, Canada and New Zealand. In Trinidad and Chile, the statutory tax rate is 35% and in Egypt, the statutory tax rate is 25%. Our Atlas facility in Trinidad has partial relief from corporation income tax until 2014. During the third quarter of 2011, we earned a higher proportion of our consolidated income from methanol produced in Canada and New Zealand, where we have unrecognized loss carryforwards, and this contributed to a lower effective tax rate compared with the second quarter of 2011.

In Chile the tax rate consists of a first tier tax that is payable when income is earned and a second tier tax that is due when earnings are distributed from Chile. The second tier tax is initially recorded as future income tax expense and is subsequently reclassified to current income tax expense when earnings are distributed.

SUPPLY/DEMAND FUNDAMENTALS

We estimate that methanol demand is growing at a rate of approximately 6% in 2011 and is currently approximately 49 million tonnes on an annualized basis. Increases in demand have been driven by both traditional and energy derivatives in Asia (particularly in China). Entering the fourth quarter of 2011, despite recent elevated concerns around the global economic outlook, we have not seen any significant impact on global methanol demand.

Traditional derivatives account for about two-thirds of global methanol demand and are correlated to industrial production.

Methanex Non-Discounted Regional Posted Prices[1]

(US$ per tonne)	**Oct 2011**	**Sep 2011**	**Aug 2011**	**Jul 2011**
United States	459	459	459	426
Europe[2]	439	404	426	418
Asia	470	470	470	420

1 Discounts from our posted prices are offered to customers based on various factors.

2 320 for Q4 2011 (Q3 2011 295) converted to United States dollars.

Energy derivatives account for about one third of global methanol demand and over the last few years high energy prices have driven strong demand growth for methanol into energy applications such as gasoline blending and DME, primarily in China. Methanol blending into gasoline in China has been particularly strong and we believe that future growth in this application is supported by recent regulatory changes in that country. Many provinces in China have implemented fuel blending standards, and an M85 (or 85% methanol) national standard took effect December 1, 2009. We believe demand potential into energy derivatives will be stronger in a high energy price environment.

During the third quarter of 2011, as a result of steady demand and planned and unplanned industry outages, market conditions were favorable and pricing was stable. Our average non-discounted price for October 2011 is approximately $458 per tonne and we recently announced our North America non-discounted price for November at $459 per tonne, which is unchanged from October.

Over the next few years, there is little new capacity expected to come on-stream outside China. There is a 0.85 million tonne plant expected to restart in Beaumont, Texas in 2012 and a 0.7 million tonne plant expected to start up in Azerbaijan in 2014. We expect that production from new capacity in China will be consumed in that country and that higher cost production capacity in China will need to operate in order to satisfy demand growth.

LIQUIDITY AND CAPITAL RESOURCES

Consolidated cash flows from operating activities in the third quarter of 2011 were $119.1 million compared with $77.6 million for the second quarter of 2011 and $61.4 million for the third quarter of 2010. The change in consolidated cash flows from operating activities in the third quarter of 2011 compared with the second quarter of 2011 and the third quarter of 2010 is primarily a result of changes in Adjusted EBITDA, excluding share based compensation expense (recovery), and changes in non-cash working capital.

Adjusted cash flows from operating activities, which excludes the amounts associated with the 40% non-controlling interests in the methanol facility in Egypt and changes in non-cash working capital, were $103.6 million in the third quarter of 2011 compared with $86.5 million for the second quarter of 2011 and $64.7 million for the third quarter of 2010. The change in Adjusted cash flows from operating activities in the third quarter of 2011 compared with the second quarter of 2011 and the third quarter of 2010 is primarily a result of changes in Adjusted EBITDA, excluding share based compensation expense (recovery). Refer to the *Supplemental Non-IFRS Measures* section on page 12 for a reconciliation of Adjusted cash flows from operating activities to the most comparable IFRS measure.

During the third quarter of 2011, we paid a quarterly dividend of $0.17 per share, or $16 million.

The Egypt>1.44 $0.70

From discontinued operations
0.13   (0.14) 0.25   (0.12)

Net income
$0.89 $0.14 $1.69 $0.58

NOTE E   COMMITMENTS AND CONTINGENCIES

The Company is a party to the following material legal proceedings:

Academic Management Services Corp.   Related Litigation

UICI and certain of its current and former directors and officers have been named as defendants in multiple lawsuits arising out of UICI   s announcement in July 2003 of a shortfall in the type and amount of collateral supporting securitized student loan financing facilities of Academic Management Services Corp. (AMS   ), formerly a wholly-owned subsidiary of UICI until its disposition in November 2003.

UICI and certain officers and current and former directors of UICI have been named as defendants in four purported class action suits that are currently pending in federal court in Texas (*Dolores Miele, on behalf of herself and all others similarly situated, v. UICI, Gregory T. Mutz, Ronald L. Jensen, et al,* filed on May 26, 2004 and pending in the United States District Court, Northern District of Texas, Dallas Division as Case No. 3-04-CV-1149-P; *Lois Johnston, v. UICI, Gregory T. Mutz, Ronald L. Jensen, et al,* filed on June 3, 2004 and pending in the United States District Court for the Northern District of Texas, Fort Worth Division, as Case No. 04-CV-418-Y; *Mohammad A. Chaudhry, individually and on behalf of all others similarly situated, v. UICI, Inc., Gregory T. Mutz, Ronald L. Jenson, et al,* filed July 1, 2004 and pending in the United States District Court for the Northern District

of Texas, Fort Worth Division, as Case No. 04-CV-484-Y; and *Ronald Antosko v. UICI, Gregory T. Mutz, Ronald L. Jenson, et al,* filed July 20, 2004 and pending in the United States District Court for the Northern District of Texas, Dallas Division, as Case No. 304CV1575-D). In each of the cases, plaintiffs, on behalf themselves and a purported class of similarly situated individuals have alleged that, among other things, UICI failed to disclose all material facts relating to the condition of the Company s former AMS subsidiary, in violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

UICI has also been named as a nominal defendant in two shareholder derivative suits arising out of the July 2003 AMS announcement (*Bodenhorn v. Gregory T. Mutz, Ronald L. Jensen, et al,* filed June 15, 2004 in the District Court of Tarrant County, Texas, Case No. 048-206108-04*;* and *Suprina v. Gregory T. Mutz, Ronald L. Jensen, et al,* filed June 15, 2004 in the District Court of Tarrant County, Texas, Case No. 352-206106-04). In each of the cases, the plaintiffs seek a recovery on behalf of UICI and have alleged that the individual defendants violated Texas state law by concealing the true condition of Academic Management Services Corp. prior to the July 2003 announcement.

Based upon the Company s initial reading of the complaints, the Company believes that the allegations are without merit, and the Company intends to conduct a vigorous defense in the matter. UICI has agreed to advance the expenses of the individual defendants incurred in connection with the defense of the cases, subject to the defendants undertaking to repay such advances unless it is ultimately determined that they are or would have been entitled to indemnification by UICI under the terms of the Company s bylaws.

Association Group Litigation

Introduction

The health insurance products issued by the Company s insurance subsidiaries in the self-employed market are primarily issued to members of various membership associations that make available to their members the health insurance and other insurance products issued by the Company s insurance subsidiaries. The associations provide their membership with a number of benefits and products, including the opportunity to apply for health insurance underwritten by the Company s health insurance subsidiaries. The Company and/or its insurance company subsidiaries are a party to several lawsuits challenging the nature of the relationship between the Company s insurance companies and the associations that have made available to their members the insurance companies health insurance products. In 2003, the Company recorded a $25.0 million charge associated with the reassessment of loss accruals established for this litigation.

Nationwide Class Action Litigation

As previously disclosed, the Company, The MEGA Life and Health Insurance Company (MEGA) and UICI Marketing, Inc. were named in a purported nationwide class action suit filed on October 30, 2003 (*Eugene A. Golebiowski, individually and on behalf of others similarly situated, v. MEGA, UICI, the National Association for the Self-Employed, et al.)* in the United States District Court for the Northern District of Mississippi, Eastern Division. Plaintiff alleged, among other things, that the relationship between the Company, MEGA, and the National Association for the Self-Employed (the NASE) constitutes an improper marketing scheme devised by the defendants to sell insurance and that the scheme involves the non-disclosure of relationships between the defendants, the undisclosed transfer of association membership dues and fees to the Company, and the utilization of teaser rates that are artificially low and established at an amount below that which would be actuarially recommended. Plaintiff, individually and on behalf of similarly situated class members, asserted several causes of action, including fraudulent concealment, breach of contract, common law liability for non-disclosure, breach of fiduciary and trust duties, civil conspiracy, unjust enrichment, and violation of state deceptive and trade practice acts. Plaintiff seeks declaratory judgments, injunctive, and other equitable relief.

UICI, MEGA and Mid-West National Life Insurance Company of Tennessee (Mid-West) were also named as defendants in an action filed on April 22, 2003 (*Lacy v. The MEGA Life and Health Insurance Company, et al.*) in the Superior Court of California, County of Alameda, Case No. RG03-092881. Plaintiff, purportedly on behalf of the general public of California, alleged that all of the defendants are under common control and operate as a unified business arrangement established for the purpose of, among other things, generating profits through association dues and bypassing and circumventing more stringent state insurance regulations applicable to other California insurance companies. Plaintiff further alleged that defendants have knowingly and intentionally failed to disclose the common ownership and control of the defendant group, the amount and character of association dues,

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administrative fees, and costs of obtaining insurance from MEGA and Mid-West, and that initial premium rates are below the amount actuarially calculated for the purpose of inducing purchases of MEGA and Mid-West policies. Plaintiff asserted that defendants actions constitute a violation of California Business and Professions Code § 17200, for which plaintiff and the California general public are entitled to injunctive, disgorgement, and monetary relief in an unspecified amount.

The Judicial Panel on Multi-District Litigation subsequently transferred the *Lacy* and *Golebiowski* cases to, and such cases are currently pending in, the United States District Court for the Northern District of Texas, Dallas Division (*In re UICI Association Group Insurance Litigation*, MDL Docket No. 1578).

On May 14, 2004, the Company, MEGA, and Mid-West executed a definitive Stipulation of Settlement and Release agreement contemplating, among other things, the full and final settlement of the *Golebiowski* and *Lacy* cases. Pursuant to the terms of the settlement, MEGA and Mid-West have agreed to include enhanced disclosures in their marketing and sales materials with respect to the contractual relationships between UICI and the insurance companies, on the one hand, and the associations, on the other hand, and MEGA and Mid-West have also agreed to enter into an injunction with respect to certain business practices. In addition, members of a to-be-certified nationwide class of current and former MEGA and Mid-West insureds and current and former members of the associations will be entitled to relief in the form of free insurance coverage for a period of months under a personal accident policy to be issued by a UICI subsidiary (covering, among other things, accidental death and out-patient and hospital costs incurred as a result of specified accidents) and discounts on association membership fees. The settlement also contemplates the payment of attorneys fees to counsel for the plaintiffs class. The proposed settlement does not contemplate a release of specific claims by individuals for insurance coverage benefits. The Company believes that the terms of the settlement as contemplated by the Stipulation of Settlement and Release will not have a material adverse effect upon the financial condition or results of operations of the Company.

On July 6, 2004, the Court issued an order granting conditional certification of the nationwide settlement class, confirming appointment of class counsel, granting preliminary approval of the proposed settlement and scheduling a final approval hearing for October 5, 2004. Notice of the settlement was mailed to members of the plaintiff class and published on August 2, 2004. The settlement of the to-be-certified class action litigation remains subject to the final approval of, and granting of a final judgment by, the United States District Court for the Northern District of Texas. There can be no assurance that these conditions to effectiveness of the settlement will in fact be satisfied.

Mississippi Individual Litigation

MEGA was previously a defendant in six cases filed in Mississippi that contained allegations regarding the relationships between MEGA and the NASE (*Bailey, et al. v. MEGA Life, et al.*, filed on February 13, 2003 in the Circuit Court of Chickasaw County, Mississippi; *Tomlin, et al. v. MEGA Life and Health Insurance Company, et al.,* filed on January 28, 2003 in the Circuit Court of Monroe County, Mississippi; *Pride, et al. v. MEGA Life, et al.*, filed on December 31, 2002 in the Circuit Court of Panola County, Mississippi; *Bishop v. John Doe, MEGA Life and Health Insurance Company, et al.*, filed on April 15, 2003 in the Circuit Court of Lafayette County, Mississippi; *Clark, et al. v. MEGA Life and Health Insurance Company, et al.*, filed on April 16, 2003 in the Circuit Court of Tate County, Mississippi; and *Webster, et al. v. The MEGA Life and Health Insurance Company, et al.*, filed on June 18, 2003 in the Circuit Court of the First Judicial District of Chickasaw County, Mississippi). Plaintiffs alleged in the cases, among other things, that MEGA pursued a scheme of deceptive sales practices designed to create the impression that the NASE is an independent entity; that in fact the NASE and MEGA are under common ownership and control ; and that the benefits of NASE membership are negligible and membership is intended to permit the Company to control the insurer/insured relationship.

On February 20, 2004, the Judicial Panel on Multi-District Litigation transferred the *Tomlin, Bailey, Webster, Pride, Clark,* and *Bishop* cases to the United States District Court for the Northern District of Texas (*In re UICI Association Group Insurance Litigation,* MDL Docket No. 1578), for coordinated pretrial proceedings.

Without admitting liability, on April 16, 2004, MEGA executed agreements fully and finally resolving each of the *Tomlin, Pride, Bailey, Bishop, Clark,* and *Webster* cases on terms that did not have a material adverse effect on MEGA s financial condition or results of operations. Following execution of the settlement agreements, in May 2004 the Court entered agreed orders dismissing each of the *Tomlin, Bailey, Bishop, Pride, Clark,* and *Webster* cases with prejudice.

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California Litigation

UICI and MEGA have been named as defendants in a purported class action suit filed on May 6, 2004 (*Diaz v. The MEGA Life and Health Insurance Company, UICI, et al.*) in the Superior Court for the State of California, County of San Bernardino, Rancho, Case No. RCV 080379. Plaintiffs have alleged, on behalf of themselves and as representatives of all other policyholders of MEGA in California, that the defendants are engaged in an illegal and fraudulent marketing scheme in violation of California common law and the California Business and Professions Code §17200. Plaintiffs also have alleged that defendants (i) maintain NASE to illegally avoid premium rate regulation, (ii) fail to issue insurance coverage to members of the NASE on a guaranteed issue basis in violation of California law, (iii) and rescind certificates in violation of California law. Plaintiffs seek injunctive relief and monetary damages in an unspecified amount. The *Diaz* case was removed to the United States District Court for the Central District of California, Eastern Division on July 8, 2004.

UICI and MEGA have been named as defendants in a purported class action filed on May 14, 2004 (*Joyce, et al. v. UICI, MEGA, the National Association for the Self-Employed, et al.*) in the Superior Court for the State of California, County of Los Angeles, Case No. BC315580. Plaintiffs have alleged that defendants breached the implied covenant of good faith and fair dealing and committed fraud, professional negligence, and negligent misrepresentation. In addition, Plaintiffs have alleged, on behalf of themselves and persons similarly situated in the state of California, that defendants violated the unfair competition restrictions of California Business and Professions Code §17200. Plaintiffs seek injunctive relief and monetary damages in an unspecified amount. On June 21, 2004, defendants removed the *Joyce* case to the United States District Court for the Central District of California.

UICI and MEGA have been named as defendants in a suit filed on May 13, 2004 (*Armistead, et al. v. The MEGA Life and Health Insurance Company, UICI, et al.*) in the Superior Court for the State of California, County of San Bernardino, Case No. SCVSS 115480. Plaintiffs have alleged, among other things, that the defendants breached the duty of good faith and fair dealing, breached a contract of insurance and are engaged in an illegal and fraudulent marketing scheme in violation of California common law and the California Business and Professions Code § 17200. Plaintiffs seek injunctive relief and monetary damages in an unspecified amount.

As previously disclosed, UICI and Mid-West were named as defendants in a suit filed on April 2, 2003 (*Correa v. UICI, et al.*) in the Superior Court for the State of California, County of Los Angeles, in which plaintiff alleged, among other things, that defendants engaged in illegal marketing practices in connection with the sale of health insurance. The lawsuit asserted several causes of action, including breach of contract, violation of California Business and Professions Code § 17200, false advertising, and negligent and intentional misrepresentation. On July 3, 2003, the *Correa* case was removed to the United States District Court for the Central District of California. On February 20, 2004, the Judicial Panel on Multi-District Litigation transferred the *Correa* matter to the United Sates District Court for the Northern District of Texas for coordinated pretrial proceedings (*In re UICI Association -Group Insurance Litigation,* MDL Docket No. 1578). On May 7, 2004, the Company agreed, without admitting liability, to finally and fully settle the *Correa* matter on terms that did not have a material adverse effect on the Company s financial condition or results of operations.

As previously disclosed, UICI and Mid-West were named in a lawsuit filed on May 28, 2003 (*Startup, et al. v. UICI, et al.*) in the Superior Court for the State of California, County of Los Angeles, Case No. BC296476. Plaintiffs have alleged, among other things, that UICI and Mid-West breached their duty of good faith and fair dealing in failing to pay medical claims submitted under a Mid-West policy issued to plaintiffs. Plaintiffs also alleged that the relationship between the Alliance for Affordable Services (the Alliance) and Mid-West constitutes an illegal marketing scheme and asserted several causes of action, including breach of contract, violation of California Business and Professions Code § 17200, false advertising, and negligent and intentional misrepresentation. Plaintiffs seek injunctive relief and monetary damages in an unspecified amount. On October 28, 2003, the Court granted defendants

motion to compel arbitration and stayed the case pending arbitration.

As previously disclosed, UICI and Mid-West were named as defendants in a lawsuit filed on July 25, 2003 (*Portune, et al. v. UICI, et al.*) in the Superior Court of the State of California, County of San Bernardino, Case No. RCV 074062. Plaintiffs have alleged, among other things, that UICI and Mid-West breached their duty of good faith and fair dealing in failing to pay medical claims submitted under a Mid-West policy issued to plaintiffs. Plaintiffs also alleged that the relationship between the Alliance and Mid-West constitutes an illegal marketing scheme and asserted several causes of action, including breach of contract, violation of California Business and Professions Code § 17200, false advertising, and negligent and intentional misrepresentation. Plaintiffs seek

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injunctive relief and monetary damages in an unspecified amount. UICI and Mid-West removed the *Portune* case to the United States District Court for the Central District of California, Eastern Division, and the case has been subsequently transferred to the United States District Court for the Central District of California, Western Division. All pending matters in the case have been adjourned by Court order. On February 20, 2004, the Judicial Panel on Multi-District Litigation transferred the *Portune* matter to the United States District Court for the Northern District of Texas for coordinated pretrial proceedings (*In re UICI Association -Group Insurance Litigation,* MDL Docket No. 1578).

As previously disclosed, on September 26, 2003, UICI and MEGA were named as cross-defendants in a lawsuit initially filed on July 30, 2003 (*Retailers Credit Association of Grass Valley, Inc. v. Henderson, et al. v. UICI, et al.*) in the Superior Court of the State of California for the County of Nevada, Case No. L69072. In the suit, cross-plaintiffs have asserted several causes of action, including breach of the implied covenant of good faith and fair dealing, fraud, violation of California Business and Professions Code § 17200, and negligent misrepresentation. Cross-plaintiffs seek injunctive relief and monetary damages in an unspecified amount.

As previously disclosed, UICI and Mid-West were named as defendants in an action filed on December 30, 2003 (*Montgomery v. UICI, et al.*) in the Superior Court of the State of California, County of Los Angeles, Case No. BC308471. Plaintiff alleged that the relationship between the Alliance and Mid-West constitutes an illegal marketing scheme and asserted several causes of action, including breach of contract, breach of the duty of good faith and fair dealing, violation of California Business and Professions Code § 17200, false advertising, and negligent and intentional misrepresentation. Plaintiff seeks injunctive relief and monetary damages in an unspecified amount. On April 23, 2004, the Judicial Panel on Multi-District Litigation issued a conditional transfer order transferring the *Montgomery* matter to the United States District Court for the Northern District of Texas for coordinated pretrial proceedings (*In re UICI Association -Group Insurance Litigation,* MDL Docket No. 1578).

As previously disclosed, UICI and MEGA were named as defendants in an action filed on January 2, 2004 (*Orallo v. UICI, et al.*) in the Superior Court of the State of California, County of Los Angeles, Case No. BC308683. Plaintiff has alleged that the undisclosed relationship between MEGA and the NASE constituted fraudulent and deceptive sales and advertising practices and asserted several causes of action, including breach of contract, breach of the duty of good faith and fair dealing, violation of California Business and Professions Code § 17200, fraud, and negligent and intentional misrepresentation. Plaintiff seeks injunctive relief and monetary damages in an unspecified amount.

As previously disclosed, UICI and MEGA were named as defendants in an action filed on January 20, 2004 (*Springer, et al. v. UICI, et al.*) pending in the Superior Court of the State of California, County of Monterey, Case No. M68493. Plaintiff has alleged that the undisclosed relationship between MEGA and the NASE constituted fraudulent and deceptive sales and advertising practices and asserted several causes of action, including breach of contract, breach of the duty of good faith and fair dealing, violation of California Business and Professions Code § 17200, fraud, and negligent misrepresentation. Plaintiff seeks injunctive relief and monetary damages in an unspecified amount. The *Springer* matter was removed to the United States District Court for the Northern District of California, San Jose Division on May 12, 2004. On July 1, 2004, the Judicial Panel on Multi-District Litigation issued a conditional order transferring the *Springer* matter to the United States District Court for the Northern District of Texas for coordinated pretrial proceedings (*In re UICI Association-Group Insurance Litigation*, MDL Docket No. 1578).

As previously disclosed, UICI and MEGA were named as defendants in an action filed on January 22, 2004 (*Mendoza, et al. v. UICI, et al*) in the Superior Court for the State of California, County of Kern, Case No. S-1500-CV-251813-RJA. Plaintiffs have alleged breach of contract, breach of implied covenant of good faith and fair dealing, fraud, violation of California Business and Professions Code §17200, professional negligence, and negligent misrepresentation. Plaintiffs seek injunctive relief and monetary damages in an unspecified amount.

As previously disclosed, UICI and MEGA were named as defendants in an action filed on December 5, 2003 (*Valenzuela v. UICI, MEGA, the National Association for the Self-Employed, et al.*) in the Superior Court for the State of California, County of San Diego, Case No. GINO34307. Plaintiff has alleged breach of contract, breach of implied covenant of good faith and fair dealing, fraud, violation of California Business and Professions Code § 17200, professional negligence, and negligent misrepresentation. Plaintiff seeks injunctive relief and monetary damages in an unspecified amount. The case was removed to the United States District Court for the Southern District of California on March 29, 2004. On April 23, 2004, the Judicial Panel on Multi-District Litigation issued a conditional transfer order transferring the matter to the United States District Court for the Northern District of

Texas for coordinated pretrial purposes (*In re UICI Association -Group Insurance Litigation,* MDL Docket No. 1578).

Texas Litigation

As previously disclosed, UICI and MEGA were formerly named as defendants in a purported class action suit filed on April 22, 2003 (*Garcia v. UICI, et al.*) in the District Court of Starr County, Texas, 381st Judicial District, Case No. DC-03-135. Plaintiffs, on behalf of themselves and a purported class of similarly situated individuals, asserted, among other things, that MEGA, the NASE Group Trust, and the NASE are under common control and ownership and operate as a unified business arrangement that is used solely for the purpose of generating profits through association dues and avoiding state insurance regulations. Plaintiffs alleged that defendants have used false and deceptive advertising and sales practices in connection with the sale of insurance in Texas in violation of the Texas Insurance Code, and plaintiffs further alleged conversion and breach of contract, for which they asked for a return of all association dues and administrative fees collected by the defendants. On May 13, 2004, the Company agreed, without acknowledging any fault, liability or wrongdoing of any kind, to settle the *Garcia* case, on terms that did not have a material adverse effect on the Company s financial condition or results of operations. On May 14, 2004, the Court issued an order dismissing the case with prejudice.

Oklahoma Litigation

MEGA was named as a defendant in a lawsuit filed on April 22, 2004 (*Verrill, et al. v. The MEGA Life and Health Insurance Company, et al*.) in the District Court of Cleveland County, Oklahoma, Case No. CJ-04-670W. Plaintiffs have alleged that defendants breached a duty of good faith owed to plaintiffs, and that defendants engaged in fraudulent, deceptive or predatory practices in the marketing of health insurance and association memberships. Plaintiffs seek monetary relief for alleged actual, exemplary and punitive damages.

As previously disclosed, UICI and MEGA were named as defendants in a lawsuit filed on May 2, 2003 (*Grigsby, et al. v. The MEGA Life and Health Insurance Company, et al*.) in the District Court of Oklahoma County, Oklahoma, Case No. CJ-2003-3759. Plaintiffs have alleged that the defendants defrauded them into purchasing a health insurance policy and an association membership and that MEGA acted in bad faith and in breach of its contractual obligations in processing their health claims. Plaintiffs further allege that the defendants knowingly misrepresented, among other things, their relationship with the NASE and that plaintiffs were purchasing true group insurance. Plaintiffs seek actual and punitive damages.

UICI and MEGA were also named as defendants in a lawsuit filed on November 20, 2003 (*Thomas, et al. v. The MEGA Life and Health Insurance Company, et al.*), in the District Court of Cleveland County, Oklahoma, Case No. CJ-2003-1965. Plaintiffs have alleged defendants defrauded them into purchasing a health insurance policy and acted in bad faith and in breach of their contractual obligations in processing plaintiffs health claims. Plaintiffs have further alleged UICI is the alter ego of MEGA.

Arkansas Litigation

As previously disclosed, on January 21, 2004, MEGA, UICI, and UICI Marketing Inc. were named as defendants in a purported class action suit (*Tremor v. The MEGA Life and Health Insurance Company, et al*.) filed in the Circuit Court of Saline County, Arkansas, Case No. CV 2004-41-3. The suit alleges that the defendants knowingly misrepresented, among other things, the relationships of defendants, and brings claims for fraudulent concealment, breach of contract, common law liability for actual and punitive damages for non-disclosure, breach of fiduciary and trust duties, civil conspiracy, unjust enrichment, violation of the Arkansas Deceptive Trade Practices Act, and declaratory and injunctive relief. The *Tremor* case was removed to the United States District Court for the Eastern District of Arkansas, Western Division on February 23, 2004. On April 23, 2004, the Judicial Panel on Multi-District

Litigation issued an order transferring the matter to the United States District Court for the Northern District of Texas for coordinated pretrial proceedings (*In re UICI Association Group Insurance Litigation,* MDL Docket No. 1578).

In an action filed on April 5, 2004, MEGA, UICI, and UICI Marketing Inc. were named as defendants in a purported class action suit (*Jessie Powell v. The MEGA Life and Health Insurance Company, et al*.) pending in the Circuit Court of Phillips County, Arkansas, Case No. CV 2004-106. The suit alleges that the defendants knowingly misrepresented, among other things, the relationships of defendants, and brings claims for fraudulent concealment, breach of contract, common law liability for actual and punitive damages for non-disclosure, breach of fiduciary and

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trust duties, civil conspiracy, unjust enrichment, violation of the Arkansas Deceptive Trade Practices Act, and declaratory and injunctive relief. The *Powell* case was removed to the United States District Court for the Eastern District of Arkansas, Eastern Division on May 11, 2004. On July 1, 2004 the Judicial Panel on Multi-District Litigation issued a conditional transfer order transferring the matter to the United States District Court for the Northern District of Texas for coordinated pretrial proceedings (*In re UICI Association -Group Insurance Litigation,* MDL Docket No. 1578).

New Mexico Litigation

UICI and MEGA have been named as defendants in an action filed on February 11, 2002 (*Martha R. Powell and Keith P. Powell v. UICI, MEGA, the National Association for the Self-Employed, et al.*) pending in the Second Judicial District Court for the County of Bernalillo, New Mexico, Cause No. CV-2 002-1156. Plaintiffs have alleged breach of contract, fraud, negligent misrepresentation, civil conspiracy breach of third-party beneficiary contract, breach of the duty of good faith and fair dealing, breach of fiduciary duty, negligence, and violations of the New Mexico Insurance Practices Act, the New Mexico Insurance Code and the New Mexico Unfair Practices Act. Plaintiff seeks injunctive relief and monetary damages in an unspecified amount. A special master has been appointed for discovery purposes and defendants are currently in the process of responding to discovery requests.

Idaho Litigation

The Company and Mid-West are currently named as defendants in five pending suits in Idaho state court (*Skinner, et al. v. Mid-West, UICI, et al.*, and *Hansen v. Mid-West, UICI, et al.*, each filed on August 22, 2002 and pending in the District Court for the County of Lemhi, Idaho; *Petersen, et al. v. Mid-West, et al.*, filed on August 2, 2002, *Murphy, et al. v. Mid-West, et al.*, filed January 25, 2002, and *Graybeal, et al. v. Mid-West, et al*., filed December 20, 2002, each pending in the District Court for the County of Twin Falls, Idaho).

Plaintiffs in the *Skinner* and *Hansen* cases allege that the insurance products they purchased were more expensive and provided less coverage than represented by the agent who sold the policies, and that they have not been paid on health claims submitted pursuant to those certificates. Plaintiffs in *Skinner* and *Hansen* claim damages, including punitive damages, and attorneys fees. The Company moved for partial summary judgment with respect to plaintiffs breach of contract and bad faith claims in both cases. The Court ruled in favor of the Company, and dismissed those claims with prejudice. Mid-West filed a motion in *Skinner* to dismiss plaintiff Judy Skinner for lack of standing to assert the claims alleged in the Complaint. The Court granted this motion with respect to the breach of contract and bad faith claims and denied the motion with respect to the fraud and intentional infliction of emotional distress claims. Mid-West filed a motion for partial summary judgment in *Hansen* based on similar standing arguments. The Court denied the motion. Discovery has commenced in each case. The *Skinner* case is scheduled for trial in October 2005, and trial in *Hansen* is scheduled to commence in August 2005.

Plaintiffs in *Peterson, Murphy,* and *Graybeal* have alleged, among other things, that the Mid-West certificates that they purchased were of a lesser quality than represented, and that they have not been paid for certain claims submitted under the certificates. Plaintiffs in *Peterson* purport to represent a class of similarly situated persons. Plaintiffs in each of the actions claim damages, including punitive damages, and attorneys fees. The Idaho Supreme Court has ruled that the *Murphy* plaintiffs were not required to arbitrate their disputes with Mid-West. Discovery has commenced in these cases. The trial in *Peterson* is scheduled to begin in July 2005, and the trial in *Graybeal* is scheduled to begin in January 2006. The trial date has been set in *Murphy* for December 14, 2004.

Other Litigation Matters

The Company and its subsidiaries are parties to various other pending legal proceedings arising in the ordinary course of business, including some asserting significant damages arising from claims under insurance policies, disputes with agents and other matters. Based in part upon the opinion of counsel as to the ultimate disposition of such lawsuits and claims, management believes that the liability, if any, resulting from the disposition of such proceedings will not be material to the Company s financial condition or results of operations.

NOTE F SEGMENT INFORMATION

The Company s operating segments are: (i) Insurance, which includes the businesses of the Self-Employed Agency Division, the Group Insurance Division, the Life Insurance Division and Other Insurance; and (ii) Other Key Factors.

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The Other Key Factors segment includes investment income not allocated to the Insurance segment, realized gains or losses on sale of investments, the operations of the Company s AMLI Realty Co. subsidiary, certain other general expenses related to corporate operations, the Company s investment in Healthaxis, Inc. until sold on September 30, 2003, minority interest, interest expense on corporate debt and variable stock-based compensation.

Allocations of investment income and certain general expenses are based on a number of assumptions and estimates, and the business segments reported operating results would change if different methods were applied. Certain assets are not individually identifiable by segment and, accordingly, have been allocated by formulas. Segment revenues include premiums and other policy charges and considerations, net investment income, fees and other income. Management does not allocate income taxes to segments. Transactions between reportable operating segments are accounted for under respective agreements, which provide for such transactions generally at cost.

Revenues from continuing operations, income from continuing operations before federal income taxes, and assets by operating segment are set forth in the tables below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
	(In thousands)			
Revenues from continuing operations:				
Insurance:				
Self-Employed Agency Division	$367,735	$329,106	$ 728,803	$637,716
Group Insurance Division	116,220	82,807	226,931	166,301
Life Insurance Division	16,617	15,857	32,444	31,893
Other Insurance	3,380		4,681	
Total Insurance:	503,952	427,770	992,859	835,910
Other Key Factors	8,073	3,287	13,882	6,714
Intersegment Eliminations	(45)	(309)	(65)	(693)
Total revenues from continuing operations	$511,980	$430,748	$1,006,676	$841,931

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
	(In thousands)			
Income (loss) from continuing operations before federal income taxes:				

Insurance:				
Self-Employed Agency Division	$ 69,965	$24,508	$114,582	$48,302
Group Insurance Division	(18,642)	3,023	(18,484)	8,106
Life Insurance Division	1,249	(4,727)	2,385	(2,900)
Other Insurance	305		84	
Total Insurance	52,877	22,804	98,567	53,508
Other Key Factors:				
Investment income on equity, realized gains and losses, general corporate expenses and other (including interest expense on non-student loan indebtedness)	6,013	(432)	9,333	(1,632)
Losses in Healthaxis, Inc. investment		(301)		(945)
Variable stock-based compensation (expense) benefit	(3,775)	(1,685)	(2,772)	452
	2,238	(2,418)	6,561	(2,125)
Total income from continuing operations before federal income taxes	$ 55,115	$20,386	$105,128	$51,383

	June 30, 2004	**December 31, 2003**
	(In thousands)	
Assets:		
Insurance:		
Self-Employed Agency Division	$ 824,697	$ 821,837
Group Insurance Division	162,621	251,164
Life Insurance Division	628,359	608,714
Other Insurance	5,986	1,011
Total Insurance	1,621,663	1,682,726
Other Key Factors:		
General corporate and other	508,083	444,233
Subtotal	2,129,746	2,126,959
Assets held for sale		13,291
Total assets	$2,129,746	$2,140,250

NOTE G AGENT STOCK ACCUMULATION PLANS

The Company sponsors a series of stock accumulation plans (the Agent Plans) established for the benefit of the independent insurance agents and independent sales representatives associated with its field force agencies, including UGA Association Field Services, New United Agency and Cornerstone America.

The Agent Plans generally combine an agent-contribution feature and a Company-match feature. The agent-contribution feature generally provides that eligible participants are permitted to allocate a portion (subject to prescribed limits) of their commissions or other compensation earned on a monthly basis to purchase shares of UICI common stock at the fair market value of such shares at the time of purchase. Under the Company-match feature of the Agent Plans, participants are eligible to have posted to their respective Agent Plan accounts book credits in the form of equivalent shares based on the number of shares of UICI common stock purchased by the participant under the agent-contribution feature of the Agent Plans. The matching credits vest over time (generally in prescribed increments over a ten-year period, commencing the plan year following the plan year during which contributions are first made under the agent-contribution feature), and vested matching credits in a participant s plan account in January of each year are converted from book credits to an equivalent number of shares of UICI common stock. Matching credits forfeited by participants no longer eligible to participate in the Agent Plans are reallocated each year among eligible participants and credited to eligible participants Agent Plan accounts.

The Agent Plans do not constitute qualified plans under Section 401(a) of the Internal Revenue Code of 1986 or employee benefit plans under the Employee Retirement Income Security Act of 1974 (ERISA), and the Agent Plans are not subject to the vesting, funding, nondiscrimination and other requirements imposed on such plans by the Internal Revenue Code and ERISA.

For financial reporting purposes, the Company accounts for the Company-match feature of its Agent Plans by recognizing compensation expense over the vesting period in an amount equal to the fair market value of vested shares at the date of their vesting and distribution to the participants. At each quarter-end, the Company estimates its current liability for unvested matching credits by reference to the number of unvested credits, the current market price of the Company s common stock, and the Company s estimate of the percentage of the vesting period that has elapsed up to the current quarter end. Changes in the liability from one quarter to the next are accounted for as an increase in, or decrease to, compensation expense, as the case may be. Upon vesting, the Company releases the accrued liability (equal to the market value of the vested shares at date of vesting) with a corresponding increase to paid-in capital. Unvested matching credits are considered share equivalents outstanding for purposes of the computation of earnings per share. For the six months ended June 30, 2004 and 2003, the Company recorded total compensation expense associated with these agent plans in the amount of $11.2 million and $4.6 million, respectively, of which an expense (benefit) of $2.8 million and $(452,000), respectively, represent the non-cash stock based compensation associated with the adjustment to the liability for future unvested benefits.

At December 31, 2003, the Company had recorded approximately 1.8 million unvested matching credits associated with the Agent Plans, of which approximately 700,000 vested in January 2004. At June 30, 2004, the Company had recorded approximately 1.6 million unvested matching credits.

The accounting treatment of the Company s Agent Plans will result in unpredictable stock-based compensation expense charges, dependent generally upon fluctuations in the quoted price of UICI common stock. These unpredictable fluctuations in stock based compensation charges may result in material non-cash fluctuations in the Company s results of operations. In periods of general decline in the quoted price of UICI common stock, if any, the Company will recognize less stock based compensation expense than in periods of general appreciation in the quoted price of UICI common stock. In addition, in circumstances where increases in the quoted price of UICI common stock are followed by declines in the quoted price of UICI common stock, negative compensation expense may result as the

Company adjusts the cumulative liability for unvested stock-based compensation expense.

NOTE H DISCONTINUED OPERATIONS

The Company has reflected as discontinued operations for financial reporting purposes the results of its former Academic Management Services Corp. subsidiary (which the Company sold on November 18, 2003), its former Senior Market Division and its former Special Risk Division.

Results from discontinued operations for the three months ended June 30, 2004 reflected a favorable resolution of a dispute relating to its former Special Risk Division (which resulted in pre-tax income in the amount of $10.7 million) and a tax benefit associated with the partial release of a tax reserve and the release of a portion of the valuation allowance on the capital loss carryover due to the realization of capital gains during 2004. *See* Note C. These favorable factors were offset by the recording in the second quarter of 2004 of a loss accrual with respect to multiple lawsuits that have recently been filed arising out of UICI s announcement in July 2003 of a shortfall in the type and amount of collateral supporting securitized student loan financing facilities of the Company s former Academic Management Services Corp subsidiary. *See* Note E.

Results for the six months ended June 30, 2004 also reflect a pre-tax gain recorded in the first quarter of 2004 in the amount of $7.7 million generated from the sale of the remaining uninsured student loan assets formerly held by the Company s former Academic Management Services Corp subsidiary. These assets had been retained by the Company at the November 18, 2003 sale of Academic Management Services Corp. and reflected as held-for-sale assets on the Company s consolidated balance sheet.

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

Introduction

The Company s operating segments include: (i) Insurance (which includes the businesses of the Self-Employed Agency Division, the Group Insurance Division, the Life Insurance Division and Other Insurance), and (ii) Other Key Factors (which includes investment income not allocated to the other business segments, realized gains or losses on sale of investments, the operations of the Company s AMLI Realty Co. subsidiary, certain other general expenses related to corporate operations, the Company s investment in Healthaxis, Inc. until sold on September 30, 2003, minority interest, interest expense on corporate debt and variable stock-based compensation).

Set forth in the table below is total Insurance segment premium by division for the three and six months ended June 30, 2004 and 2003:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
	(In thousands)			
Premium:				
Self-Employed Agency Division	$333,944	$293,771	$662,226	$570,650
Group Insurance Division	113,245	80,013	219,628	160,330
Life Insurance Division	9,196	8,104	17,376	15,897
Other Insurance	3,323		4,581	
Total premium	$459,708	$381,888	$903,811	$746,877

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Results of Operations

The table below sets forth certain summary information about the Company s operating results for the three and six months ended June 30, 2004 and 2003:

	Three Months Ended June 30,		Percentage Increase (Decrease)	Six Months Ended June 30,		Percentage Increase (Decrease)
	2004	2003		2004	2003	
	(Dollars in thousands)					
Revenue:						
Premiums:						
Health	$451,258	$373,421	21%	$ 886,719	$730,839	21%
Life premiums and other considerations	8,450	8,467	0%	17,092	16,038	7%
Total premium:	459,708	381,888	20%	903,811	746,877	21%
Investment income	21,195	18,926	12%	41,892	38,793	8%
Other income	27,780	29,736	(7%)	56,115	56,448	(1%)
Gains (losses) on investments	3,297	198	NM	4,858	(187)	NM
Total revenues:	511,980	430,748	19%	1,006,676	841,931	20%
Benefits and Expenses						
Benefits, claims, and settlement expenses	271,797	246,187	10%	554,564	484,183	15%
Underwriting, policy acquisition costs, and insurance expenses	165,719	143,092	16%	312,634	268,177	17%
Stock appreciation (benefit) expense	3,775	1,685	NM	2,772	(452)	NM
Other expenses	14,849	18,284	(19%)	30,086	36,233	(17%)
Interest expense	725	813	(11%)	1,492	1,462	2%
Losses in Healthaxis, Inc. investment		301	NM		945	NM
Total expenses:	456,865	410,362	11%	901,548	790,548	14%
Income from continuing operations before income taxes	55,115	20,386	170%	105,128	51,383	105%
Federal income taxes	19,168	7,093	170%	36,483	17,880	104%
Income from continuing	35,947	13,293	170%	68,645	33,503	105%

operations						
Income (loss) from discontinued operations (net of income tax expense (benefit))	6,457	(6,508)	NM	12,150	(5,615)	NM
Net income	$ 42,404	$ 6,785	NM	$ 80,795	$ 27,888	NM

NM: not meaningful

Revenues and income from continuing operations before federal income taxes (operating income) by business segment are summarized in the tables below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
	(In thousands)			
Revenues from continuing operations:				
Insurance:				
Self-Employed Agency Division	$367,735	$329,106	$ 728,803	$637,716
Group Insurance Division	116,220	82,807	226,931	166,301
Life Insurance Division	16,617	15,857	32,444	31,893
Other Insurance	3,380		4,681	
Total Insurance	503,952	427,770	992,859	835,910
Other Key Factors	8,073	3,287	13,882	6,714
Intersegment Eliminations	(45)	(309)	(65)	(693)
Total revenues from continuing operations	$511,980	$430,748	$1,006,676	$841,931

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
	(In thousands)			
Operating income(loss) from continuing operations:				
Insurance:				
Self-Employed Agency Division	$ 69,965	$24,508	$114,582	$48,302
Group Insurance Division	(18,642)	3,023	(18,484)	8,106
Life Insurance Division	1,249	(4,727)	2,385	(2,900)
Other Insurance (1)	305		84	
Total Insurance	52,877	22,804	98,567	53,508
Other Key Factors:				
Investment income on equity, realized gains and losses, general corporate expenses and other (including interest expense on non-student loan indebtedness)	6,013	(432)	9,333	(1,632)
Losses in Healthaxis, Inc. investment		(301)		(945)
Variable stock-based compensation (expense) benefit.	(3,775)	(1,685)	(2,772)	452
	2,238	(2,418)	6,561	(2,125)
Total operating income from continuing operations	$ 55,115	$20,386	$105,128	$51,383

(1) Other Insurance reflects results of a subsidiary (ZON Re USA, LLC) established in the third quarter of 2003 to underwrite, administer and issue accidental death, accidental death and dismemberment (AD&D), accident medical and accident disability insurance policies, both on a primary and on a reinsurance basis.

UICI s results of operations for the three and six months ended June 30, 2004 were particularly impacted by the following factors:

Self- Employed Agency Division

Set forth below is certain summary financial and operating data for the Company s Self-Employed Agency (SEA) Division for the three and six months ended June 30, 2004 and 2003:

Self-Employed Agency Division					
Three Months Ended June 30,		Percentage Increase	Six Months Ended June 30,		Percentage Increase

	2004	2003	(Decrease)	2004	2003	(Decrease)
			(Dollars in thousands)			
Revenue:						
Earned premium revenue	$333,944	$293,771	14%	$662,226	$570,650	16%
Investment income(1)	8,517	7,561	13%	16,937	14,982	13%
Other income	25,274	27,774	(9%)	49,640	52,084	(5%)
Total revenues	367,735	329,106	12%	728,803	637,716	14%
Expenses:						
Benefit expenses	170,422	180,130	(5%)	367,013	355,465	3%
Underwriting and policy acquisition expenses	114,297	109,284	5%	221,069	204,931	8%
Other expenses(1)	13,051	15,184	(14%)	26,139	29,018	(10%)
Total expenses	297,770	304,598	(2%)	614,221	589,414	4%
Operating income	$ 69,965	$ 24,508	NM	$114,582	$ 48,302	NM
Other operating data:						
Loss ratio(2)	51.0%	61.3%		55.4%	62.3%	
Expense ratio (3)	34.3%	37.2%		33.4%	35.9%	
Combined ratio	85.3%	98.5%		88.8%	98.2%	
Average number of writing agents in period	2,405	2,565		2,493	2,663	
Submitted annualized volume(4)	$215,169	$215,461		$460,717	$462,831	

NM: not meaningful

(1) Allocations of investment income and certain general expenses are based on a number of assumptions and estimates, and the business segments reported operating results would change if different methods were applied.

(2) Defined as total benefits expenses as a percentage of earned premium revenue.

(3) Defined as total underwriting and policy acquisition expenses as a percentage of earned premium revenue.

(4) Submitted annualized premium volume in any period is the aggregate annualized premium amount associated with health insurance applications submitted by the Company s agents in such period for underwriting by the Company.

The SEA Division reported operating income of $70.0 million and $114.6 million in the three and six-month periods ended June 30, 2004, compared to operating income of $24.5 million and $48.3 million in the corresponding 2003 periods. Operating income at the SEA Division in the six month period ended June 30, 2004, was positively impacted by an increase in earned premium revenue, reduced commission and marketing expenses as a percentage of earned premium, and a decrease in loss ratio resulting from favorable claims experience. Earned premium revenue at the SEA Division increased to $333.9 million in the second quarter of 2004 from $293.8 million in the second quarter of 2003 and to $662.2 million in the first six months of 2004 from $570.7 million in the first six months of 2003. Submitted annualized premium volume (*i.e.*, the aggregate annualized premium amount associated with health insurance applications submitted by the Company s agents for underwriting by the Company) remained relatively level in the six months ended June 30, 2004 compared to corresponding period in 2003 ($460.7 million in the 2004 six-month period and $462.8 million in the 2003 six-month period). The Company attributes the slowing of growth in submitted annualized premium volume to a reduced number of writing agents in the field and the entry of new competitors into selected markets served by the Company.

Operating income at the SEA Division as a percentage of earned premium revenue (*i.e.,* operating margin) in the three and six-month periods ended June 30, 2004 was 21.0% and 17.3%, respectively, compared to 8.3% and 8.5%, respectively, in the corresponding periods of the prior year. The significant increase in operating margin in the second quarter of 2004 was attributable primarily to a decrease in the loss ratio (from 61.3% in the second quarter of 2003 to 51.0% in the second quarter of 2004) and a decrease in the effective commission rate (due to the decrease in the amount of first year premium relative to renewal premium, which carries a lower commission rate compared to commissions on first year premium). The decrease in loss ratio was due in part to the reduction of claim reserves established in 2003 in response to a rapid pay down of an excess pending claims inventory. The actual claim payment experience in the six months ended June 30, 2004 with respect to prior periods was lower than originally estimated when the claim reserves were established in 2003. The decrease in loss ratio was also due in part to lower levels of incurred claims in the current period compared to prior periods. The Company currently anticipates that loss ratios at the SEA Division will begin over time to trend upward to historical levels.

As the Company has previously announced, in May 2004 the Company and its principal insurance subsidiaries executed a definitive agreement contemplating the full and final settlement on a nationwide class action basis of certain pending litigation challenging the nature of the relationship between the Company s insurance companies and the associations that have made available to their members the insurance companies health insurance products. The Company believes that the terms of the settlement as contemplated by the agreement will not have a material adverse effect upon the financial condition or results of operations of the Company. On July 6, 2004, the Court issued an order granting conditional certification of the nationwide settlement class, confirming appointment of class counsel, granting preliminary approval of the proposed settlement and scheduling a final approval hearing for October 5, 2004. Notice of the settlement was mailed to members of the plaintiff class and published on August 2, 2004. The settlement of the to-be-certified class action litigation remains subject to the final approval of, and granting of a final judgment by, the United States District Court for the Northern District of Texas. There can be no assurance that these conditions to effectiveness of the settlement will in fact be satisfied. Results of operations for the year ended December 31, 2003 reflected a $25.0 million charge associated with the reassessment of loss accruals established for this and all other pending association group-related litigation.

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Group Insurance Division

Set forth below is certain summary financial and operating data for the Company s Group Insurance Division (consisting of the Company s Student Insurance and Star HRG business units) for the three and six months ended June 30, 2004 and 2003:

	Group Insurance Division					
	Three Months Ended June 30,		Percentage Increase (Decrease)	Six Months Ended June 30,		Percentage Increase (Decrease)
	2004	2003		2004	2003	
	(Dollars in thousands)					
Revenue:						
Earned premium revenue	$113,245	$80,013	42%	$219,628	$160,330	37%
Investment income(1)	1,520	1,097	39%	3,535	2,687	32%
Other income	1,455	1,697	(14%)	3,768	3,284	15%
Total revenues	116,220	82,807	40%	226,931	166,301	36%
Expenses:						
Benefit expenses	93,463	58,281	60%	173,264	114,886	51%
Underwriting and acquisition expenses	41,399	21,503	93%	72,151	43,309	67%
Total expenses	134,862	79,784	69%	245,415	158,195	55%
Operating income	$ (18,642)	$ 3,023	NM	$ (18,484)	$ 8,106	NM
Other operating data:						
Loss ratio(2)	82.5%	72.8%		78.9%	71.7%	
Expense ratio (3)	36.6%	26.9%		32.8%	27.0%	
Combined ratio	119.1%	99.7%		111.7%	98.7%	

NM: not meaningful

(1) Allocations of investment income and certain general expenses are based on a number of assumptions and estimates, and the business segments reported operating results would change if different methods were applied.

(2) Defined as total benefits expenses as a percentage of earned premium revenue.

(3) Defined as total underwriting and policy acquisition expenses as a percentage of earned premium revenue.

The Company s Group Insurance Division (consisting of the Company s Student Insurance and Star HRG business units) reported operating losses of $(18.6) million and $(18.5) million in the three and six months ended June 30, 2004, compared to operating income of $3.0 million and $8.1 million in the corresponding periods of 2003.

The operating losses in the 2004 periods at the Group Insurance segment were attributable to results at the Company s Student Insurance business unit, which offers tailored health insurance programs that generally provide single school year coverage to individual students at colleges and universities. Results in the second quarter of 2004 at the Student Insurance business unit reflected, among other things, the following factors:

higher than expected claims experience in the Student Insurance business unit s college business written for the 2003-2004 school year in the amount of $(9.3) million (which in turn also resulted in a write off of deferred acquisition costs related to the 2003-2004 block of business in the amount of $(2.1) million, which otherwise would have been amortized completely in the third quarter of 2004);

an impairment charge in the amount of $(6.3) million principally associated with the abandonment of computer hardware and software assets associated with a claims processing system; and

higher than expected administrative costs attributable to inefficiencies created with its claim processing systems.

The Student Insurance business unit continues to experience a higher than normal backlog in outstanding claims, which is attributable to unforeseen difficulties in converting to a new claims processing system. The Company currently anticipates that its outstanding claims backlog will be reduced to normalized levels during the course of the third quarter of 2004. In establishing its best estimate of reserves for benefit claims that have been reported but not paid and claims that have been incurred but not reported under health insurance contracts, the Company has considered in its actuarial analyses the higher than normal backlog in outstanding claims at its Student Insurance business unit.

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The Company s Student Insurance business unit has completed its 2004-2005 school year sales efforts, with respect to which it has imposed significant rate increases. The Company currently anticipates that the impact of such rate increases will not be fully realized until 2005.

The Student Insurance business unit reported a 45.7% quarter over quarter increase in earned premium revenue, from $50.6 million in the second quarter of 2003 to $73.7 million in the second quarter of 2004.

Second quarter 2004 results at the Group Insurance Division were positively impacted by favorable operating results at the Company s Star HRG business unit. Despite quoting premium rate increases on new and renewal accounts, Star HRG reported a 34.4% quarter-over-quarter increase in earned premium revenue, from $29.5 million in the second quarter of 2003 to $39.6 million in the second quarter of 2004.

As a result of the losses experienced in the second quarter and first six months of 2004 at its Student Insurance business unit, the Company currently anticipates that overall results at its Group Insurance Division for the remaining six months ending December 31, 2004 will be near breakeven. The Company currently anticipates that the Group Insurance Division will return to profitability in 2005.

Life Insurance Division

Set forth below is certain summary financial and operating data for the Company s Life Insurance Division for the three and six months ended June 30, 2004 and 2003:

	Life Insurance Division					
	Three Months Ended June 30,		**Percentage Increase (Decrease)**	**Six Months Ended June 30,**		**Percentage Increase (Decrease)**
	2004	**2003**		**2004**	**2003**	
	(Dollars in thousands)					
Revenue:						
Earned premium revenue	$ 9,196	$ 8,104	13%	$17,376	$15,897	9%
Investment income(1)	6,673	7,589	(12%)	13,741	15,656	(12%)
Other income	748	164	NM	1,327	340	NM
Total revenues	16,617	15,857	5%	32,444	31,893	2%
Expenses:						
Benefit expenses	6,125	7,775	(21%)	11,997	13,832	(13%)
Underwriting and acquisition expenses	8,780	12,305	(29%)	17,172	19,937	(14%)
Interest expense	463	504	(8%)	890	1,024	(13%)
Total expenses	15,368	20,584	(25%)	30,059	34,793	(14%)
Operating income (loss)	$ 1,249	$ (4,727)	NM	$ 2,385	$ (2,900)	NM

NM: not meaningful

(1) Allocations of investment income and certain general expenses are based on a number of assumptions and estimates, and the business segments reported operating results would change if different methods were applied.

The Company s Life Insurance Division reported operating income in the three and six months ended June 30, 2004 of $1.2 million and $2.4 million, respectively, compared to operating losses of $(4.7) million and $(2.9) million, respectively, in the corresponding 2003 periods. The operating loss in the second quarter of 2003 was attributable to a charge associated with the final resolution of litigation arising out of the closedown in 2001 of the Company s former workers compensation business and costs associated with the closedown of the Company s College Fund Life Division operations.

During the three and six months ended June 30, 2004, the Company s Life Insurance Division generated submitted premium volume (*i.e.*, the aggregate annualized life premium amount associated with new life insurance applications submitted) associated with new life insurance business in the amount of $13.3 million and $24.0 million, respectively, representing a significant increase over submitted premium volume in 2003. The submitted premium volume for the comparable periods in 2003 was $1.3 million and $2.5 million, respectively.

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Other Key Factors

In the three and six months ended June 30, 2004, the Company s Other Key Factors segment reported operating income of $2.2 million and $6.6 million, respectively, compared to operating losses of $(2.4) million and $(2.1) million in the corresponding periods of 2003.

The increase in operating income in the Other Key Factors category in the three months ended June 30, 2004 as compared to the corresponding 2003 period was primarily attributable to a $2.0 million increase in investment income on equity, a $3.2 million increase in net realized gains (from $198,000 in the second quarter of 2003 to $3.4 million in the second quarter of 2004) and a reduction in general corporate expenses of $1.3 million. These favorable factors were offset in part by a $2.1 million quarter over quarter increase in the expense related to variable stock-based compensation associated with the various stock accumulation plans established by the Company for the benefit of its independent agents. In connection with these plans, the Company records non-cash variable stock-based compensation expense (or records a benefit) in amounts that depend and fluctuate based upon the market performance of the Company s common stock. *See* Note G of Notes to Condensed Consolidated Financial Statements.

The increase in operating income in the Other Key Factors category in the six months ended June 30, 2004 as compared to the corresponding 2003 period was primarily attributable to a $2.4 million increase in investment income on equity, a reduction of general corporate expenses of $2.7 million and a $6.0 million increase in net realized gains (from $(187,000) in net realized losses in the first six months of 2003 to $5.8 million of realized gains in the first six months of 2004). These favorable factors were offset in part by a $3.2 million period-over-period increase (from a benefit of $452,000 in the first six months of 2003 to an expense of $(2.8) million in the first six months of 2004) in the expense related to variable stock-based compensation associated with the various stock accumulation plans established by the Company for the benefit of its independent agents.

Discontinued Operations

The Company has reflected as discontinued operations for financial reporting purposes the results of its former Academic Management Services Corp. subsidiary (which the Company sold on November 18, 2003), its former Senior Market Division and its former Special Risk Division.

In the three and six months ended June 30, 2004, the Company recorded income from discontinued operations in the amount of $6.5 million, net of tax ($0.13 per diluted share) and $12.2 million, net of tax ($0.25 per diluted share), respectively, compared to losses from discontinued operations in the amount of $(6.5) million, net of tax ($(0.14) per diluted share) and $(5.6) million, net of tax ($(0.12) per diluted share), respectively, recorded in the three and six months ended June 30, 2003.

Results from discontinued operations for the three months ended June 30, 2004 reflected a favorable resolution of a dispute relating to its former Special Risk Division (which resulted in pre-tax income in the amount of $10.7 million) and a tax benefit associated with the partial release of a tax reserve and the release of a portion of the valuation allowance on the capital loss carryover due to the realization of capital gains during 2004. *See* Note C of Notes to Condensed Consolidated Financial Statements. These favorable factors were offset by the recording in the second quarter of 2004 of a loss accrual with respect to multiple lawsuits that have recently been filed arising out of UICI s announcement in July 2003 of a shortfall in the type and amount of collateral supporting securitized student loan financing facilities of the Company s former Academic Management Services Corp subsidiary. *See* Note E of Notes to Condensed Consolidated Financial Statements.

Results for the six months ended June 30, 2004 also reflect a pre-tax gain recorded in the first quarter of 2004 in the amount of $7.7 million generated from the sale of the remaining uninsured student loan assets formerly held by the

Company s former Academic Management Services Corp subsidiary. These assets had been retained by the Company at the November 18, 2003 sale of Academic Management Services Corp. and reflected as held-for-sale assets on the Company s consolidated balance sheet.

Liquidity and Capital Resources

Historically, the Company s primary sources of cash on a consolidated basis have been premium revenues from policies issued, investment income, fees and other income, and borrowings under a secured student loan credit

facility. The primary uses of cash have been payments for benefits, claims and commissions under those policies, operating expenses and the funding of student loans generated under the Company s College First Alternative Loan program. In the six months ended June 30, 2004, net cash provided by operations totaled approximately $97.7 million, compared to net cash provided by operations of $87.6 million in the corresponding period of 2003.

UICI is a holding company, the principal assets of which are its investments in its separate operating subsidiaries, including its regulated insurance subsidiaries. The holding company s ability to fund its cash requirements is largely dependent upon its ability to access cash, by means of dividends or other means, from its subsidiaries. The laws governing the Company s insurance subsidiaries restrict dividends paid by the Company s domestic insurance subsidiaries in any year. Inability to access cash from its subsidiaries could have a material adverse effect upon the Company s liquidity and capital resources.

At December 31, 2003 and June 30, 2004, UICI at the holding company level held cash and cash equivalents in the amount of $37.8 million and $44.3 million, respectively. The Company currently estimates that through December 31, 2004, the holding company will have sufficient cash to meet its scheduled cash requirements. There can be no assurance that the cash requirements at the holding company level will not exceed current estimates, or that the holding company will be able to raise sufficient cash to fund cash requirements on a timely basis.

Prior approval by insurance regulatory authorities is required for the payment by a domestic insurance company of dividends that exceed certain limitations based on statutory surplus and net income. During 2004, the Company s domestic insurance companies could pay, without prior approval of the regulatory authorities, aggregate dividends in the ordinary course of business to the parent company of approximately $49.2 million. However, as it has done in the past, the Company will assess the results of operations of the regulated domestic insurance companies to determine the prudent dividend capability of the subsidiaries, consistent with UICI s practice of maintaining risk-based capital ratios at each of the Company s domestic insurance subsidiaries significantly in excess of minimum requirements.

At June 30, 2004 and December 31, 2003, the Company at the holding company level had outstanding consolidated short and long-term indebtedness (exclusive of indebtedness incurred to fund student loans) in the amount of $15.5 million and $19.0 million, respectively. *See* Note B of Notes to Condensed Consolidated Financial Statements.

The Company has entered into a bank credit facility with Bank of America, NA and JP Morgan Chase Bank maturing in January 2005. Under the facility, the Company may borrow from time to time up to $30.0 million on a revolving, unsecured basis. Loans outstanding under the facility will bear interest at the option of the Company at prime plus 1% or LIBOR plus 1%. The Company intends to utilize the proceeds of the facility for general working capital purposes. The Company has not to date borrowed any funds under the facility.

On April 29, 2004, the Company through a newly formed Delaware statutory business trust completed the private placement of $15.0 million aggregate issuance amount of floating rate trust preferred securities with an aggregate liquidation value of $15.0 million. *See* Note B of Notes to Condensed Consolidated Financial Statements.

On March 31, 2004, the Company completed the sale of all of the remaining uninsured student loan assets formerly held by the Company s former Academic Management Services Corp subsidiary. These assets had been retained by the Company at the November 18, 2003 sale of Academic Management Services Corp and reflected as held-for-sale assets on the Company s consolidated balance sheet. The sale of the uninsured student loans generated to the Company gross cash proceeds in the amount of approximately $25.0 million.

On April 19, 2004, the Company paid in full its outstanding 6% convertible subordinated notes in the aggregate amount of $15.0 million and accrued interest thereon to the date of prepayment. The notes had been issued by the Company in November 2003 in full payment of all contingent consideration payable in connection with UICI s

February 2002 acquisition of Star HRG.

Stock Repurchase Plan

At its April 28, 2004 quarterly meeting, the UICI Board of Directors reconfirmed the Company s 1998 share repurchase program, in which it initially authorized the repurchase of up to 4,500,000 shares of UICI common stock from time to time in open market or private transactions, and granted management authority to repurchase up to an additional 1,000,000 shares. Through July 28, 2004, the Company had purchased an aggregate of 4,571,000 shares

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(at an aggregate cost of $64.1 million; average cost per share of $14.03) under the program, of which 1,043,400 shares (at an aggregate cost of $16.3 million; average cost per share of $15.67) have been purchased during 2004. The Company now has remaining authority pursuant to the program as reauthorized to repurchase up to an additional 929,000 shares. The timing and extent of additional repurchases, if any, will depend on market conditions and the Company s evaluation of its financial resources at the time of purchase.

Critical Accounting Policies and Estimates

The Company s discussion and analysis of its financial condition and results of operations are based upon the Company s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to health and life insurance claims and reserves, deferred acquisition costs, bad debts, impairment of investments, intangible assets, income taxes, financing operations and contingencies and litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Privacy Initiatives

Recently-adopted legislation and regulations governing the use and security of individuals nonpublic personal data by financial institutions, including insurance companies, may have a significant impact on the Company s business and future results of operations.

Gramm-Leach-Bliley Act and State Insurance Laws and Regulations

The business of insurance is primarily regulated by the states and is also affected by a range of legislative developments at the state and federal levels. The Financial Services Modernization Act of 1999 (the so-called Gramm-Leach-Bliley Act, or GLBA) includes several privacy provisions and introduces new controls over the transfer and use of individuals nonpublic personal data by financial institutions, including insurance companies, insurance agents and brokers and certain other entities licensed by state insurance regulatory authorities. Additional federal legislation aimed at protecting the privacy of nonpublic personal financial and health information is proposed and over 400 state privacy bills are pending.

GLBA provides that there is no federal preemption of a state s insurance related privacy laws if the state law is more stringent than the privacy rules imposed under GLBA. Accordingly, state insurance regulators or state legislatures will likely adopt rules that will limit the ability of insurance companies, insurance agents and brokers and certain other entities licensed by state insurance regulatory authorities to disclose and use nonpublic information about consumers to third parties. These limitations will require the disclosure by these entities of their privacy policies to consumers and, in some circumstances, will allow consumers to prevent the disclosure or use of certain personal information to an unaffiliated third party. Pursuant to the authority granted under GLBA to state insurance regulatory authorities to regulate the privacy of nonpublic personal information provided to consumers and customers of insurance companies, insurance agents and brokers and certain other entities licensed by state insurance regulatory authorities, the National Association of Insurance Commissioners promulgated a new model regulation called Privacy of Consumer Financial and Health Information Regulation. Some states issued this model regulation before July 1, 2001, while other states must pass certain legislative reforms to implement new state privacy rules pursuant to GLBA. In addition, GLBA requires state insurance regulators to establish standards for administrative, technical and physical

safeguards pertaining to customer records and information to (a) ensure their security and confidentiality, (b) protect against anticipated threats and hazards to their security and integrity, and (c) protect against unauthorized access to and use of these records and information. The privacy and security provisions of GLBA will significantly affect how a consumer s nonpublic personal information is transmitted through and used by diversified financial services companies and conveyed to and used by outside vendors and other unaffiliated third parties.

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Health Insurance Portability and Accountability Act of 1996

The federal Health Insurance Portability and Accountability Act of 1996 (HIPAA) contains provisions requiring mandatory standardization of certain communications between health plans (including health insurance companies), electronic clearinghouses and health care providers who transmit certain health information electronically. HIPAA requires health plans to use specific data-content standards, mandates the use of specific identifiers (i.e., national provider identifiers and national employer identifiers) and requires specific privacy and security procedures. HIPAA authorized the Secretary of the federal Department of Health and Human Services (HHS) to issue standards for the privacy and security of medical records and other individually identifiable patient data.

In December 2000, HHS issued final regulations regarding the privacy of individually-identifiable health information. This final rule on privacy applies to both electronic and paper records and imposes extensive requirements on the way in which health care providers, health plan sponsors, health insurance companies and their business associates use and disclose protected information. Under the new HIPAA privacy rules, the Company is required to (a) comply with a variety of requirements concerning its use and disclosure of individuals protected health information, (b) establish rigorous internal procedures to protect health information and (c) enter into business associate contracts with other companies that use similar privacy protection procedures. The final rules do not provide for complete federal preemption of state laws, but, rather, preempt all contrary state laws unless the state law is more stringent. The Company believes that it was in material compliance with the privacy requirements imposed by HIPAA and the rules thereunder as of April 14, 2003, the date the rules became effective.

Sanctions for failing to comply with standards issued pursuant to HIPAA include criminal penalties of up to $250,000 per violation and civil sanctions of up to $25,000 per violation. Due to the complex and controversial nature of the privacy regulations, they may be subject to court challenge, as well as further legislative and regulatory actions that could alter their effect.

In February 2003 HHS issued final rules related to the security of electronic health data, including individual health information and medical records, for health plans, health care providers, and health care clearinghouses that maintain or transmit health information electronically. The rules will require these businesses to establish and maintain responsible and appropriate safeguards to ensure the integrity and confidentiality of this information. The standards embraced by these rules include the implementation of technical and organization policies, practices and procedures for security and confidentiality of health information and protecting its integrity, education and training programs, authentication of individuals who access this information, system controls, physical security and disaster recovery systems, protection of external communications and use of electronic signatures. The compliance date for HIPAA covered entities (including the Company) is April 21, 2005.

UICI is currently reviewing the potential impact of the HIPAA privacy and security regulations on its operations, including its information technology and security systems. The Company cannot at this time predict with specificity what impact the recently adopted final HIPAA rules governing the privacy and security of individually-identifiable health information may have on the business or results of operations of the Company. However, these new rules will likely increase the Company s burden of regulatory compliance with respect to its life and health insurance products and other information-based products, and may reduce the amount of information the Company may disclose and use if the Company s customers do not consent to such disclosure and use. There can be no assurance that the restrictions and duties imposed by the recently adopted final rules on the privacy and security of individually-identifiable health information will not have a material adverse effect on UICI s business and future results of operations.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

Certain statements set forth herein or incorporated by reference herein from the Company s filings that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act. Actual results may differ materially from those included in the forward-looking statements. These forward-looking statements involve risks and uncertainties including, but not limited to, the following: changes in general economic conditions, including the performance of financial markets, and interest rates; competitive, regulatory or tax changes that affect the cost of or demand for the Company s products; health care reform; the ability to predict and effectively manage claims related to health care costs; and reliance on key management and adequacy of claim liabilities.

The Company s future results will depend in large part on accurately predicting health care costs incurred on existing business and upon the Company s ability to control future health care costs through product and benefit design, underwriting criteria, utilization management and negotiation of favorable provider contracts. Changes in mandated benefits, utilization rates, demographic characteristics, health care practices, provider consolidation, inflation, new pharmaceuticals/technologies, clusters of high-cost cases, the regulatory environment and numerous other factors are beyond the control of any health plan provider and may adversely affect the Company s ability to predict and control health care costs and claims, as well as the Company s financial condition, results of operations or cash flows. Periodic renegotiations of hospital and other provider contracts coupled with continued consolidation of physician, hospital and other provider groups may result in increased health care costs and limit the Company s ability to negotiate favorable rates. In addition, the Company faces competitive and regulatory pressure to contain premium prices. Fiscal concerns regarding the continued viability of government-sponsored programs such as Medicare and Medicaid may cause decreasing reimbursement rates for these programs. Any limitation on the Company s ability to increase or maintain its premium levels, design products, implement underwriting criteria or negotiate competitive provider contracts may adversely affect the Company s financial condition or results of operations.

The Company s insurance subsidiaries are subject to extensive regulation in their states of domicile and the other states in which they do business under statutes that typically delegate broad regulatory, supervisory and administrative powers to state insurance departments and agencies. State insurance departments have also periodically conducted and continue to conduct financial and market conduct examinations and other inquiries of UICI s insurance subsidiaries. State insurance regulatory agencies have authority to levy monetary fines and penalties resulting from findings made during the course of such examinations and inquiries. Historically, the Company s insurance subsidiaries have from time to time been subject to such regulatory fines and penalties. While none of such fines or penalties individually or in the aggregate have to date had a material adverse effect on the results of operations or financial condition of the Company, the Company could be adversely affected by increases in regulatory fines or penalties and/or changes in the scope, nature and/or intensity of regulatory scrutiny and review.

The Company provides health insurance products to consumers in the self-employed market in 44 states. A substantial portion of such products is issued to members of various membership associations that act as the master policyholder for such products. The two principal membership associations in the self-employed market for which the Company underwrites insurance are the National Association for the Self-Employed (NASE) and the Alliance for Affordable Services (AAS). The associations provide their membership with a number of benefits and products, including health insurance underwritten by the Company. Subject to applicable state law, individuals generally may not obtain insurance under an association s master policy unless they are also members of the associations. UGA agents and Cornerstone agents also act as enrollers of new members for the associations, for which the agents receive compensation. Specialized Association Services, Inc. (a company controlled by the adult children of Ronald L. Jensen. the Chairman of the Company) provides administrative and benefit procurement services to the associations. A subsidiary of the Company generates new membership sales prospect leads for both UGA and Cornerstone for use by the enrollers (agents) and provides video and print services to the associations and to Specialized Association Services, Inc. In addition to health insurance premiums derived from the sale of health insurance, the Company receives fee income from the associations, including fees associated with the enrollment of new members, fees for association membership marketing and administrative services and fees for certain association member benefits. The agreements with these associations requiring the associations to continue as the master policyholder and to make available to their respective members the Company s insurance products to their respective members are terminable by the Company and the associations upon not less than one year s advance notice to the other party.

The Company is aware that selected states are reviewing the laws and regulations under which association group policies are issued. The Company and its insurance company subsidiaries are also parties to several lawsuits challenging the nature of the relationship between the insurance companies and the membership associations that make available to their members the insurance companies health insurance products. *See* Note E of Notes to

Consolidated Condensed Financial Statements. While the Company believes that its insurance company subsidiaries are providing association group coverage in full compliance with applicable law, changes in the Company s relationship with the membership associations and/or changes in the laws and regulations governing so-called association group insurance (particularly changes that would subject the issuance of policies to prior premium rate approval and/or require the issuance of policies on a guaranteed issue basis) could have a material adverse impact on the financial condition, results of operations and/or business of the Company.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the risk of loss arising from adverse changes in market rates and prices, such as interest rates, foreign currency exchange rates, and other relevant market rate or price changes. Market risk is directly influenced by the volatility and liquidity in the markets in which the related underlying assets are traded.

The primary market risk to the Company s investment portfolio is interest rate risk associated with investments and the amount of interest that policyholders expect to have credited to their policies. The interest rate risk taken in the investment portfolio is managed relative to the duration of the policy liabilities. The Company s investment portfolio consists mainly of high quality, liquid securities that provide current investment returns. The Company believes that the annuity and universal life-type policies are generally competitive with those offered by other insurance companies of similar size. The Company does not anticipate significant changes in the primary market risk exposures or in how those exposures are managed in the future reporting periods based upon what is known or expected to be in effect in future reporting periods.

The Company has not experienced significant changes related to its market risk exposures during the six months ended June 30, 2004.

ITEM 4 CONTROLS AND PROCEDURES

As of June 30, 2004, the Company s management, including William J. Gedwed (the Chief Executive Officer) and Mark D. Hauptman (the Principal Financial Officer), evaluated the effectiveness of the Company s disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (Disclosure Controls).

The Company s management, including the CEO and CFO, does not expect that its Disclosure Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based upon the Company s controls evaluation, the CEO and CFO have concluded that the Company s Disclosure Controls provide reasonable assurance that the information required to be disclosed by the Company in its periodic Securities and Exchange Commission filings is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms.

There have been no significant changes in the Company s internal control over financial reporting that occurred that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

The Company is a party to various material legal proceedings, all of which are described in Note E of Notes to the Consolidated Condensed Financial Statements included herein and in the Company s Annual Report on Form 10-K filed for the year ended December 31, 2003 under the caption Item 3 Legal Proceedings. The Company and its subsidiaries are parties to various other pending legal proceedings arising in the ordinary course of business, including some asserting significant damages arising from claims under insurance policies, disputes with agents and other matters. Based in part upon the opinion of counsel as to the ultimate disposition of such lawsuits and claims, management believes that the liability, if any, resulting from the disposition of such proceedings will not be material to the Company s financial condition or results of operations.

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ITEM 2 CHANGES IN SECURITIES AND USE OF PROCEEDS

During the six months ended June 30, 2004, the Company issued 16,000 shares of unregistered common stock pursuant to its 2001 Restricted Stock Plan.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company s Annual Meeting of Stockholders was held on May 19, 2004. The following members were elected to the Company s Board of Directors to hold office for the ensuing year.

Nominee	In Favor	Withheld
Ronald L. Jensen	40,590,197	1,190,145
William J. Gedwed	40,653,247	1,127,095
Glenn W. Reed	40,786,101	994,241
Richard T. Mockler	41,002,224	778,118
Mural R. Josephson	40,433,655	1,346,687
R. H. Mick Thompson	40,544,145	1,236,197
Dennis C. McCuistion	40,537,345	1,242,997

The results of the voting for the proposal to approve the UICI Agency Matching Total Ownership Plan II were as follows:

For	Against	Abstain
32,188,022	4,321,468	64,370

The results of the voting for the proposal to approve the UICI Matching Agency Contribution Plan I were as follows:

For	Against	Abstain
32,905,720	3,570,983	197,157

The results of the voting on the appointment of auditors were as follows:

Ratification of Appointment of KPMG LLP as the Company s independent auditors for the fiscal year ending December 31, 2004.

The voters of the stockholders on this item were as follows:

In Favor	Against	Abstain
41,064,959	569,939	145,444

ITEM 6 EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

31.1	Rule 13a-14(a)/15d-14(a) Certification, executed by William J. Gedwed, Chief Executive Officer of UICI
31.2	Rule 13a-14(a)/15d-14(a) Certification, executed by Mark D. Hauptman, Chief Financial Officer of UICI
32	Certifications required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350), executed by William J. Gedwed, Chief Executive Officer of UICI and by Mark D. Hauptman, Chief Financial Officer of UICI

(b) Reports on Form 8-K.

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1. Current Report on Form 8-K dated April 28, 2004 and filed April 29, 2004
2. Current Report on Form 8-K dated and filed May 14, 2004
3. Current Report on Form 8-K dated and filed May 28, 2004
4. Current Report on Form 8-K dated and filed June 9, 2004
5. Current Report on Form 8-K dated July 28, 2004 and filed July 29, 2004

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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.

	UICI (Registrant)
Date: August 6, 2004	/s/ William J. Gedwed
	William J. Gedwed, President, Chief Executive Officer and Director
Date: August 6, 2004	/s/ Mark D. Hauptman
	Mark D. Hauptman, Vice President, Chief Accounting Officer and Chief Financial Officer

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