COTTON STATES LIFE INSURANCE CO /
Form 10-Q
August 13, 2003

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Quarterly Report Under Section 13 or 15(d) of
The Securities Exchange Act of 1934

For the three months and six months ended June 30, 2003

Commission File Number 2-39729

COTTON STATES LIFE INSURANCE COMPANY

(Exact name of registrant as specified in its charter)

GEORGIA	**58-0830929**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
244 Perimeter Center Parkway, N.E., Atlanta, Georgia	**30346**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (770) 391-8600

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to the filing requirements for at least the past 90 days.

YES x NO o

Indicate by check mark whether the registrant is an accelerated Filer (as defined in Rule 126.2 of the Exchange Act).

YES o NO x

The Registrant as of June 30, 2003, has 6,322,737 shares of common stock outstanding.

COTTON STATES LIFE INSURANCE COMPANY

FORM 10-Q

FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2003

INDEX

INDEPENDENT ACCOUNTANTS REVIEW REPORT

To the Board of Directors and Shareholders of
Cotton States Life Insurance Company:

We have reviewed the accompanying consolidated condensed balance sheet of Cotton States Life Insurance Company and subsidiaries as of June 30, 2003, and the related consolidated condensed statements of earnings, comprehensive income and cash flows for the three-month and six-month periods ended June 30, 2003. These financial statements are the responsibility of the Company s management. The consolidated condensed statements of earnings, comprehensive income and cash flows for the three-month and six-month periods ended June 30, 2002 were reviewed by other accountants whose report (dated August 6, 2002) stated that they were not aware of any material modifications that should be made to those statements for them to be in conformity with accounting principles generally accepted in the United States.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated condensed financial statements at June 30, 2003, and for the three-month and six-month periods then ended for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Cotton States Life Insurance Company and subsidiaries as of December 31, 2002, and the related consolidated statements of earnings, comprehensive income and cash flows for the year then ended and in our report dated February 25, 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated condensed balance sheet as of December 31, 2002, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Atlanta, Georgia
August 6, 2003

COTTON STATES LIFE INSURANCE COMPANY

ITEM I. CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

The following consolidated condensed financial statements have been prepared by management. In management s opinion, all adjustments and reclassifications necessary for a fair statement of financial position at June 30, 2003 and December 31, 2002 and the results of operations for the three-months and six-months ended June 30, 2003 and 2002 have been made.

Consolidated Condensed Balance Sheets

	June 30, 2003 (unaudited)	December 31, 2002
ASSETS		
Investments:		
Fixed maturities, held for investment, at amortized cost (fair value of $4,556,377 in 2003 and $7,324,373 in 2002)	$ 4,347,914	7,048,175
Fixed maturities, available for sale, at fair value (amortized cost of $166,386,186 in 2003 and $146,159,339 in 2002)	175,171,159	152,307,406
Equity securities, at fair value (cost of $2,665,941 in 2003 and $2,984,720 in 2002)	2,779,285	2,519,895
First mortgage loans on real estate	1,218,517	1,320,330
Policy loans	10,474,348	10,425,612
Other invested assets	582,000	582,000
Total investments	194,573,223	174,203,418
Cash and cash equivalents	8,596,820	18,913,861
Accrued investment income	2,427,246	2,406,298
Amounts receivable, principally premiums	3,859,064	3,777,671
Amount due from reinsurers	4,577,467	4,263,828
Deferred policy acquisition costs	60,597,752	57,686,410
Federal income tax receivable	169,028	98,457
Other assets	645,930	460,061
	$275,446,530	261,810,004
LIABILITIES AND SHAREHOLDERS EQUITY		
Policy liabilities and accruals:		
Future policy benefits	$167,709,247	160,424,107
Policy claims and benefits payable	2,734,694	3,241,343
Total policy liabilities and accruals	170,443,941	163,665,450
Federal income taxes:		
Current		
Deferred	12,741,536	11,181,184
Other liabilities	6,087,005	5,592,961
Total liabilities	189,272,482	180,439,595
Shareholders equity:		
Common stock of $1 par value. Authorized 20,000,000 shares; issued: 6,987,331 shares in 2003 and 6,929,347 shares in 2002; outstanding: 6,322,737 shares in 2003 and 6,328,737 shares in 2002; restricted: 232,827 shares in 2003 and 174,843 shares in 2002	6,987,331	6,929,347
Additional paid-in capital	3,762,724	3,434,018

Accumulated other comprehensive income, net of tax	5,194,607	3,226,975
Retained earnings	74,658,151	72,035,550
Less:		
Unearned compensation restricted stock	(880,701)	(764,543)
Treasury stock, at cost (431,767 shares in 2003 and 425,767 shares in 2002)	(3,548,064)	(3,490,938)
Total shareholders equity	86,174,048	81,370,409
	$275,446,530	261,810,004

See accompanying notes to unaudited consolidated condensed financial statements.

COTTON STATES LIFE INSURANCE COMPANY

Unaudited Consolidated Condensed Statements of Earnings
Three Months and Six Months ending June 30, 2003 and 2002

	Three months ended June 30,		Six months ended June 30,	
	2003	2002	2003	2002
Revenue:				
Premiums	$ 8,824,057	8,007,993	17,023,006	15,674,310
Investment income	2,136,131	2,427,037	4,456,668	4,898,973
Realized investment gains (losses)	843,452	(48,821)	1,235,899	108,151
Brokerage commissions	1,119,656	1,124,817	2,197,625	2,133,103
Total revenue	12,923,296	11,511,026	24,913,198	22,814,537
Benefits and expenses:				
Benefits and claims	5,483,542	4,628,159	10,292,718	8,984,955
Interest credited	1,465,818	1,516,837	2,968,432	2,963,067
Amortization of policy acquisition costs	1,281,489	949,468	2,307,691	1,930,734
Operating expenses	2,391,136	2,132,222	4,774,556	4,422,525
Total benefits and expense	10,621,985	9,226,686	20,343,397	18,301,281
Income before income tax expense	2,301,311	2,284,340	4,569,801	4,513,256
Income tax expense	730,459	590,622	1,437,213	1,288,370
Net income	$ 1,570,852	1,693,718	3,132,588	3,224,886
Basic income per share of common stock	$ 0.25	0.27	0.50	0.51
Diluted income per share of common stock	$ 0.23	0.26	0.47	0.50
Weighted average number of shares used in computing income per share				
Basic	6,323,363	6,339,964	6,324,328	6,337,709
Diluted	6,614,624	6,501,457	6,615,016	6,498,206
Dividends paid per share	$ 0.04	0.04	0.08	0.08

See accompanying notes to unaudited consolidated condensed financial statements.

COTTON STATES LIFE INSURANCE COMPANY

Unaudited Consolidated Condensed Statements of Cash Flows
Six months ended June 30, 2003 and 2002

	Six months ended June 30, 2003	Six months ended June 30, 2002
Cash flows from operating activities:		
Net income	$ 3,132,588	3,224,886
Adjustments to reconcile net income to net cash provided from operating activities:		
Realized investment gains	(1,235,899)	(108,151)
Increase in policy liabilities and accruals	6,778,491	7,433,934
(Increase) in deferred policy acquisition costs	(2,677,528)	(3,189,458)
Increase in liability for income taxes	396,656	163,371
(Increase) decrease in amounts receivable and amounts due from reinsurers	(395,032)	561,429
Increase (decrease) in amounts due affiliate	246,230	(485,657)
Other, net	723,890	34,113
Net cash provided from operating activities	6,969,396	7,634,467
Cash flows from investing activities:		
Purchase of fixed maturities available for sale	(72,369,150)	(53,636,454)
Purchase of equity securities	(451,021)	(1,104,600)
Sale of fixed maturities held for investment		450,000
Sale of fixed maturities available for sale	37,714,114	38,777,033
Sale of equity securities	441,175	1,084,643
Proceeds from maturities of fixed maturities held for investment	2,700,000	1,000,000
Proceeds from maturity and redemption of fixed maturities held for sale	15,456,245	7,822,348
Principal collected on first mortgage loans	101,813	131,524
Net increase in policy loans	(48,736)	(284,514)
Other, net	(263,764)	73,563
Net cash used in investing activities	(16,719,324)	(5,686,457)
Cash flows from financing activities:		
Cash dividends paid	(509,987)	(509,987)
Purchase of treasury stock	(57,126)	(10,453)
Stock issued under executive compensation plans		65,232
Net cash used by financing activities	(567,113)	(455,208)
Net (decrease) increase in cash and cash equivalents:	(10,317,041)	1,492,802
Cash and cash equivalents:		
Beginning of period	18,913,861	13,187,601
End of period	$ 8,596,820	14,680,403

See accompanying notes to unaudited consolidated condensed financial statements.

COTTON STATES LIFE INSURANCE COMPANY

Unaudited Consolidated Condensed Statements of Comprehensive Income
Three Months and Six Months ended June 30, 2003 and 2002

	Three months ended June 30,		Six months ended June 30,	
	2003	**2002**	**2003**	**2002**
Net income	$1,570,852	1,693,718	3,132,588	3,224,886
Other comprehensive income (loss), before tax:				
Change in fair value of securities available for sale	3,149,407	2,073,243	4,217,159	29,446
Reclassification adjustment for realized (gains) losses included in net income	(843,452)	48,821	(1,235,899)	(108,151)
Total other comprehensive income (loss), before tax	2,305,955	2,122,064	2,981,260	(78,705)
Income tax expense related to items of other comprehensive income	784,024	838,303	1,013,628	4,100
Other comprehensive income (loss), net of tax	1,521,931	1,283,761	1,967,632	(82,805)
Total comprehensive income	$3,092,783	2,977,479	5,100,220	3,142,081

See accompanying notes to unaudited consolidated condensed financial statements.

Cotton States Life Insurance Company
Notes to Unaudited Consolidated Condensed Financial Statements
June 30, 2003

Note 1 Basis of Presentation

The accompanying consolidated condensed financial statements include the accounts of Cotton States Life Insurance Company and its wholly owned subsidiaries CSI Brokerage Services, Inc., and CS Marketing Resources, Inc. Significant intercompany transactions and balances are eliminated in the consolidation.

The consolidated condensed financial statements for the three months and six months ended June 30, 2003 are unaudited and have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. These consolidated condensed financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included in the Company s annual report on Form 10-K for the year ended December 31, 2002.

In the opinion of management, all adjustments and reclassifications necessary to present fairly the financial position and the results of operations and cash flows for the interim periods have been made. All such adjustments are of a normal and recurring nature. The results of operations for any interim period are not necessarily indicative of the results of operations that the Company may achieve for the entire year.

Certain prior year amounts in the accompanying consolidated condensed financial statements have been reclassified in order to conform with current year presentation.

Note 2 Stock-Based Compensation

In accordance with APB Opinion No. 25, $270,000 and $154,000 in compensation expense was recorded in the six months ended June 30, 2003 and 2002, respectively, for the various stock option and restricted stock awards granted. Had the Company determined compensation cost based on the fair value at the grant date for its stock options and restricted stock awards under SFAS No. 123, Accounting for Stock-Based Compensation, the Company s net income, basic net income per share, and diluted net income per share would have been reduced to the pro forma amounts indicated below:

Notes to Unaudited Condensed Consolidated Financial Statements (continued)

	Three months ended June 30,	
	2003	**2002**
Net income:		
As reported	$1,570,852	1,693,718
Pro forma	$1,555,466	1,678,332
Basic net income per share:		
As reported	$ 0.25	0.27
Pro forma	$ 0.25	0.27
Diluted net income per share:		
As reported	$ 0.23	0.26
Pro forma	$ 0.23	0.25

	Six months ended June 30,	
	2003	**2002**
Net income:		
As reported	$3,132,588	3,224,886
Pro forma	$3,101,816	3,194,114
Basic net income per share:		
As reported	$ .50	0.51
Pro forma	$ .49	0.51
Diluted net income per share:		
As reported	$ .47	0.50
Pro forma	$ .47	0.49

The per share weighted-average fair value of stock options and restricted stock granted was estimated using an option pricing model with the following weighted-average assumptions: expected life of three years for restricted stock awarded in 2003 and 2002; expected dividend yield of 1.67% for 2003 and 2002 grants; risk-free interest rate of 3.5% for 2003 and 2002; and an expected volatility of 66% for 2003 grants and 2002 grants.

Note 3   Accounting Pronouncements

The Financial Accounting Standards Board issued SFAS No. 143 Accounting for Asset Retirement Obligations, which is effective for fiscal years beginning after June 15, 2002, with early adoption encouraged. SFAS No. 143 applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. The adoption of SFAS No. 143 did not affect the Company s results of operations or financial position.

The Financial Accounting Standards Board also issued SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets which supercedes SFAS No. 121 Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and the accounting and reporting provisions of APB Opinion No. 30 Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, and is effective for fiscal years beginning after December 15, 2001. SFAS No.144 establishes a single accounting model for the disposal of long-lived assets. The adoption of SFAS No.144 did not affect the Company s results of operations or financial position.

The Financial Accounting Standards Board also issued SFAS No. 145 Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections, which is effective for financial statements issued after May 15, 2002. The adoption of SFAS No. 145 did not affect the Company s results of operations or financial position.

In July 2002, the Financial Accounting Standards Board issued SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities, which is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No. 146 did not affect the Company s results of operations or financial position.

In November 2002, the Financial Accounting Standards Board issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, for which accounting requirements are effective for guarantees issued or modified after December 15, 2002. The adoption of Interpretation No. 45 did not affect the Company s results of operations or financial position.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148 Accounting for Stock Based Compensation Transition and Disclosure, which is effective for financial statements issued after December 15, 2002. The adoption of SFAS No. 148 did not affect the Company s results of operations or financial position.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. There is no impact on the Company s financial position or results of operations for the second quarter of 2003 under FIN 46. The Company also expects no impact in future periods under FIN 46.

Note 4 Business Segments

The Company s operations include the following three major segments, differentiated primarily by their respective methods of distribution and the nature of related products: individual life insurance, guaranteed and simplified issue life insurance, and brokerage operations. The Company s operations in each segment are concentrated within its southeastern state geographic market. Individual life insurance products are distributed through the Company s multi-line exclusive agents, guaranteed and simplified issue products are distributed through independent agents as well as exclusive agents, and brokerage operations all involve third party products distributed through the Company s exclusive and independent agents.

The Company does not group items on the consolidated condensed balance sheet into segments, nor does it analyze those items by segment when making management decisions. Investment income is allocated to the individual life insurance and guaranteed and simplified issue life insurance segments based on their respective average future policy benefit reserves. Investment income for the brokerage operations segment is determined directly by each subsidiary s investment portfolio.

Total revenue and net income by business segment are as follows:

	Three months ended March 31, (Dollars in thousands)		Six months ended June 30, (Dollars in thousands)	
	2003	2002	2003	2002
Individual life insurance:				
Premiums	$ 5,306	4,922	10,060	9,571
Investment income	1,890	2,192	3,957	4,439
Realized investment (losses) gains	749	(44)	1,098	98
Total revenue	$ 7,945	7,070	15,115	14,108
Net income	$ 1,014	1,119	2,058	2,063
Guaranteed and simplified issue life insurance:				
Premiums	$ 3,518	3,086	6,963	6,103
Investment income	243	230	496	450
Realized investment (losses) gains	95	(5)	138	10
Total revenue	$ 3,856	3,311	7,597	6,563
Net income	$ 18	20	26	126
Brokerage:				
Commission income	$ 1,120	1,125	2,198	2,133
Investment income	2	5	3	10
Total revenue	$ 1,122	1,130	2,201	2,143
Net income	$ 539	555	1,049	1,036
Total revenue	$12,923	11,511	24,913	22,814
Total net income	$ 1,571	1,694	3,133	3,225

Note 5 Legal Proceedings

The Company is a defendant in various actions incidental to the conduct of its business. The Company intends to vigorously defend the litigation and while the ultimate outcome of these matters cannot be estimated with certainty, management does not believe the actions will result in any material loss to the Company.

The Company has reached partial settlement regarding $900,000 in reinsurance coverage. A lawsuit was initiated by the Company in the third quarter 2001. To date, the Company has received $475,000 and continues to seek additional recoveries against reinsurance brokers through already existing legal channels. The remaining amount outstanding is included in Amounts due from reinsurers on the consolidated condensed balance sheet.

Note 6 Income Taxes

The Company accounts for income taxes using the asset and liability method prescribed by SFAS No. 109, Accounting for Income Taxes . Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Income tax expense recognized by the Company in any one year is impacted by the extent to which the Company qualifies for the small life company deduction. The small life company deduction is 60% of life insurance company taxable income up to a maximum taxable income of $3 million. This deduction is phased out on taxable income above $3 million up to and including a maximum of $15 million. To the extent, if any, that the Company s taxable income exceeds $3 million, its effective Federal income tax rate will increase.

Note 7 Treasury Stock

During the six months ended June 30, 2003 the Company purchased 6,000 shares of its common stock, which is held in treasury. For the same period, the Company issued no shares of common stock out of treasury for its restricted stock performance award program.

There were no changes in the Company s capital structure for the six months ended June 30, 2003.

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

Forward-Looking Statements

Statements made in the following discussion that state the Company s or management s intentions, hopes, beliefs, expectations or predictions of the future are forward-looking statements. Without limiting the foregoing, forward-looking statements include statements which represent the Company s beliefs concerning future levels of sales and redemption of the Company s products, investment spreads and yields, the earnings and profitability of the Company s activities, and the sufficiency of the Company s cash flows for liquidity purposes.

Forward-looking statements are necessarily based on estimates and assumptions that are inherently subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the Company s control and many of which are subject to change. These uncertainties and contingencies could cause actual results to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company. Whether or not actual results differ materially from forward-looking statements may depend on numerous foreseeable and unforeseeable developments. Some may be national in scope, such as general economic conditions, changes in tax law and changes in interest rates. Some may be related to the insurance industry generally, such as pricing competition, regulatory developments and industry consolidation. Others may relate to the Company specifically, such as credit, volatility and other risks associated with the Company s investment portfolio. Investors are also directed to consider other risks and uncertainties discussed in Form 10-K filed by the Company with the Securities and Exchange Commission. If the Company s assumptions and estimates are incorrect or do not come to fruition, or if the Company does not achieve all of these key factors, then the Company s actual performance could differ materially from the forward-looking statements made herein. The Company disclaims any obligation to update forward-looking information.

Results of Operations

	Three months ended June 30, (Dollars in thousands)		
	2003	2002	Increase
Premiums			
Guaranteed and simplified issue life insurance	$3,518	3,086	14%
Individual life insurance:			
Traditional life	1,906	1,814	5%
Universal life	3,400	3,108	9%
Total individual life insurance	5,306	4,922	8%
Total premiums	$8,824	8,008	10%

	Six months ended June 30, (Dollars in thousands) 2003	2002	Increase
Premiums			
Guaranteed and simplified issue life insurance	$ 6,963	6,103	14%
Individual life insurance:			
Traditional life	3,495	3,367	4%
Universal life	6,565	6,204	6%
Total individual life insurance	10,060	9,571	5%
Total premiums	$17,023	15,674	9%

Guaranteed and simplified issue life insurance premiums continued to show strong growth as a result of higher production by the independent agency force which had approximately 4,500 and 4200 agents under contract at June 30, 2003 and 2002, respectively. This product is also distributed by the Company s multi-line exclusive agents and is available for purchase over the Internet at the Company s home page. (www.cottonstatesinsurance.com).

Individual life insurance products are principally sold by the Company s exclusive agent producers. Growth in individual life premiums largely reflects the popularity of universal life products. The Company had 262 exclusive agents under contract at June 30, 2003.

The rate of increases in premium growth has slowed during 2003 which the Company believes to be caused by a weakened economy, unemployment rates and the resulting alternative uses of potential customers resources.

Investment Income and Realized Gains and Losses

Investment income decreased 12% for the second quarter of fiscal 2003 as compared to a 5% decrease in the second quarter of fiscal 2002. For the first six months of 2003, investment income decreased 9% compared to a 4% decrease for the same period of fiscal 2002. This decrease was primarily a result of a decrease in the annualized average yield to 5.1% compared to 6.0% for the first six-months of 2002, which occurred as a result of continued pressure on lower interest rates.

During the first quarter of 2003 the Company realized a pre-tax investment loss of $356,000 from the write-down of the carrying value of twelve equity securities. These write-downs were the result of the Company determining that an other-than-temporary impairment had occurred.

During the second quarter of 2002 the Company realized an investment loss of $850,000 from a write-down of the carrying value on a Worldcom, Inc. debt security. This write-down was the result of the Company determining that an other-than-temporary impairment had occurred on the security.

The Company has procedures in place to monitor all debt and equity securities for possible other-than-temporary impairments. Securities are tracked comparing both unrealized losses as a percentage of original cost and length of time the security has been below a predetermined percentage of cost. Monthly discussions are held with Company s investment managers to gather information and documentation as to their outlook for future recovery of the securities making the Company s watch list . As of June 30, 2003 there were no debt or equity securities whose unrealized losses would be deemed to be other-than-temporary impairments.

Brokerage Commissions

Exclusive agents also sell products that the Cotton States Group does not underwrite (both life and property and casualty). Property and casualty business lines, principally non-standard auto, continue to show strong growth with commissions increasing 13% with one carrier for the first six-months of 2003 compared to the first six-months of 2002 and met management expectations for the quarter. This was partially offset by lower than expected override commissions on multi-peril Federal crop insurance, mobile home insurance and one other non-standard auto carrier. Brokerage commissions for the quarter were flat compared to the prior period due to lower than expected overrides from one non-standard auto carrier.

Benefits and Claims

Life benefits and claims, including reserve increases on traditional life and guaranteed and simplified issue products are as follows:

	Three months ended June 30, (Dollars in Thousands)			
	2003		2002	
	Benefits and Claims	% of Premium	Benefits and Claims	% of Premium
Benefits and Claims				
Guaranteed and simplified issue	$2,934	83%	2,356	76%
Individual life insurance				
Traditional life	1,369	72%	1,272	70%
Universal life	1,181	35%	1,000	32%
Total individual life insurance	2,550	48%	2,272	46%
Total benefits and claims	$5,484	62%	4,628	58%

	Six months ended June 30, (Dollars in Thousands) 2003		2002	
	Benefits and Claims	**% of Premium**	**Benefits and Claims**	**% of Premium**
Benefits and Claims				
Guaranteed and simplified issue	$ 5,645	81%	4,590	75%
Individual life insurance				
Traditional life	2,477	71%	2,273	68%
Universal life	2,171	33%	2,122	34%
Total individual life insurance	4,648	46%	4,395	46%
Total benefits and claims	$ 10,293	60%	8,985	57%

Benefits and claims as a percentage of premium fluctuate within a normal range reflecting volatility in mortality, changes in mix of business, and age of policyholders. Guaranteed and simplified issue experience in 2003 was slightly higher than Company expectations but due to the Company s size fluctuations can and do occur in any particular quarter. Individual life insurance claims were up for the quarter as claims greater than the Company s retention level were approximately $400,000 less than the first quarter. Year-to-date claims as a percentage of premiums were flat compared to 2002. Overall benefits and claims were within managements expectation. The Company offsets the effects of annual mortality fluctuations by routinely purchasing annual aggregate stop loss reinsurance coverage in excess of 120% of expected mortality.

Interest Credited to Policyholders

Interest credited to universal life contracts was flat for the first six months of 2003 compared to 2002 and decreased 3% for the quarter ended June 30, 2003 as compared to the same quarter in 2002. The annual interest rate credited to universal life contract accumulations was 5.75% for the first two months of 2003. Effective March 1, 2003 the annual interest rate credited to policyholders was changed to 5.64%. The annual interest rate credited was 5.6% for the six month period ended June 30, 2003 and 6.2% for the comparable period of 2002.

Amortization of Policy Acquisition Costs and Operating Expenses

The amortization of policy acquisition costs as a percentage of premiums was 14% for the six months ended June 30, 2003 compared to 12% for the same period of 2002. 2003 and 2002 results are within the Company s expected range of 12-14%. Amortization for the first six months reflects better than expected mortality in the universal life line of business and a decrease in the annual interest rate credited to policyholders. Amortization for the quarter ended June 30, 2003 was higher compared to the same period of 2002 due to higher lapses in the traditional lines of business which reflects increased term rate competition in the market place.

Operating expenses as a percentage of premiums were 27% for the second quarter of 2003 and 2002. For the six months ended June 30, 2003 and 2002 the percentage was 28%. The Company s expectations for the fiscal year 2003 are between 28-31%.

Income Tax Expense

The effective tax rate for the first six months of 2003 was 31% compared to 29% for the same period last year. The effective tax rate increased due to the effects of the estimated phase out of the small life company deduction. The effective rate reflects the Company s best estimate of the annual effective rate.

Net Income

	Three months ended June 30 (Dollars in Thousands)		
	2003	**2002**	**Increase (Decrease)**
Net Income			
Guaranteed and simplified issue	$ 18	20	(10%)
Individual life insurance:			
Traditional	292	352	(17%)
Universal life	722	767	(6%)
Total individual life insurance	1,014	1,119	9%
Brokerage operations	539	555	(3%)
Net Income	$ 1,571	1,694	(7%)

	Six months ended June 30 (Dollars in Thousands)		
	2003	**2002**	**Increase (Decrease)**
Net Income			
Guaranteed and simplified issue	$ 26	126	(79%)
Individual life insurance:			
Traditional	575	715	(20)%
Universal life	1,483	1,348	10%
Total individual life insurance	2,058	2,063	
Brokerage operations	1,049	1,036	1%
Net Income	$ 3,133	3,225	(3)%

Net income for the quarter and six months decreased compared to the prior periods primarily due to lower than expected sales believed to be caused by a continued weakened economy, and slightly lower investment income due to continued uncertainty with interest rates. These were partially offset by positive contributions by the Company s subsidiaries and benefits and claim costs that, although slightly higher were within management s expectations.

15

Critical Accounting Policies

The accounting policies described below are those the Company considers critical in preparing its consolidated financial statements. These polices include significant estimates made by management using information available at the time the estimates are made. However, as described below, these estimates could change materially if different information or assumptions were used.

Insurance Related Assets and Liabilities

The Company establishes an insurance related asset for deferred policy acquisition costs, and insurance related liabilities for future policy benefits and claims relating to its insurance policies under contract. Such assets and liabilities are developed using actuarial principles and assumptions which consider a number of factors, including: investment yields, withdrawal rates, mortality and morbidity. The Company accounts for its traditional individual life insurance policies using a net level premium method and assumptions as to the factors enumerated above. Generally, the Company s earnings in any given calendar year will not be impacted by differences in emerging experience on its traditional individual business unless such differences are severe enough to call into question the profitability of the entire block of traditional life business.

The Company does, however, experience fluctuations in its earnings as a result of current mortality experience differing from that expected in any given year. For the six months ended June 30, 2003 and 2002, the Company experienced emerged mortality of 101% and 86% of amounts expected, respectively, related to its traditional individual life insurance business. The Company routinely purchases annual aggregate stop loss reinsurance coverage which limits experience to 120% of expected mortality in any one year.

The Company accounts for its interest-sensitive and universal life insurance polices and annuities under the provisions of SFAS No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments. SFAS No. 97 requires the remeasurement of the Company s deferred acquisition costs each period in a manner that amortizes such deferred costs as a level percentage of actual emerged profit over the expected gross profits.

Each period, the Company estimates the relevant factors, based primarily on its emerging experience, and uses this information to determine the assumptions underlying its asset and liability calculations. An extensive degree of judgment is used in this estimation process.

Any adjustments required to properly state insurance assets and liabilities are charged or credited to benefit expense in the period in which the need for the adjustment becomes known.

Accounting for Income Taxes

The Company accounts for income taxes using the asset and liability method prescribed by SFAS No. 109, Accounting for Income Taxes. Under the asset and liability method of SFAS No. 109, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which these temporary differences are expected to be recovered or settled. Under SFAS No. 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Income tax expense recognized by the Company in any one year is impacted by the extent to which the Company qualifies for the small life company deduction. The small life company deduction is 60% of life insurance company taxable income up to a maximum taxable income of $3 million. This deduction is phased out on taxable income above $3 million up to and including a maximum of $15 million. To the extent, if any, that the Company s taxable income exceeds $3 million, its effective Federal income tax rate will increase.

Recent Accounting Pronouncements

The Financial Accounting Standards Board issued SFAS No. 143 Accounting for Asset Retirement Obligations, which is effective for fiscal years beginning after June 15, 2002, with early adoption encouraged. SFAS 143 applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and (or) the normal operation of a long-lived asset, except for certain obligations of lessees. The adoption of SFAS No. 143 did not affect the Company s results of operations or financial position.

The Financial Accounting Standards Board also issued SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets which supercedes SFAS No. 121 Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and the accounting and reporting provisions of APB Opinion No. 30 Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, and is effective for fiscal years beginning after December 15, 2001. SFAS No.144 establishes a single accounting model for the disposal of long-lived assets. The adoption of SFAS No.144 did not affect the Company s results of operations or financial position.

The Financial Accounting Standards Board also issued SFAS No. 145 Rescission of FASB Statements No. 4,44 and 64, Amendment of FASB Statement No.13, and Technical Corrections, which is effective for financial statements issued after May 15, 2002. The adoption of SFAS No. 145 did not affect the Company s results of operations or financial position.

In July 2002, the Financial Accounting Standards Board issued SFAS No. 146 Accounting for Costs Associated with Exit or Disposal Activities, which is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The adoption of SFAS No. 146 did not affect the Company s results of operations or financial position.

In November 2002 the Financial Accounting Standards Board issued Interpretation NO. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees for Indebtedness of Others, for which accounting requirements are effective for guarantees issued or modified after December 31, 2002 and disclosure requirements are effective for financial statements issued after December 15, 2002. The adoption of Interpretation No. 45 did not affect the Company s results of operations or financial position.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148 Accounting for Stock Based Compensation Transition and Disclosure, which is effective for financial statements issued after December 15, 2002. The adoption of SFAS No. 148 did not affect the Company s results of operations or financial position.

In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. There is no impact on the Company s financial position or results of operations for the second quarter of 2003 under FIN 46. The Company also expects no impact in future periods under FIN 46.

Liquidity and Capital Resources

Cash Flow

As of June 30, 2003 the Company s insurance operations generated positive cash flows in excess of its immediate needs. Cash flows provided by operations were $7.0 million in the first six months of 2003 compared to $7.6 million for the comparable period last year.

Operating cash flow is primarily used to purchase debt securities. The Company received proceeds of $18.2 million from investment maturities and repayments in 2003, adding to available cash flows. Such proceeds were $8.8 million in 2002. When market opportunities arise, the Company disposes of selected debt securities available for sale to improve future investment yields and/or improve duration matching of its assets and liabilities. Therefore, dispositions before maturity can vary significantly from year to year. Proceeds from sales prior to maturity were $37.7 million in 2003, and $39.2 million for the comparable period of 2002.

The Company s principal financing activity is payment of dividends to the Company s shareholders. Dividends are normally declared quarterly and must be approved by the Board of Directors. Under regulatory requirements, the maximum amount of dividends that may be paid in 2003 by the Company to its shareholders without prior regulatory approval is approximately $2.9 million.

Other than noted above, the Company does not have any debt, lease obligations, purchase obligations, lines of credit, guarantees, off-balance sheet arrangements, trading activities involving non-exchange traded contracts accounted for at fair value or relationships with persons or entities that derive benefits from a non-independent relationship with the Company or the Company s related parties.

Liquidity

Liquidity pertains to a company s ability to meet the demand for cash requirements of its business operations and financial obligations. The Company s two sources of short-term liquidity include its positive cash flow from operations and its portfolio of marketable securities as described above. The Company believes that these sources are sufficient to meet its liquidity needs for the next 12 months.

Investments

Since December 31, 2002, there has not been a material change in mix or credit quality of the Company s investment portfolio. All bond purchases have been available for sale and over 87% of the holdings at June 30, 2003 and 91% in December 31, 2002 are rated A or better by Standard & Poor s Corporation. For all fixed maturities, 13% in 2003 and 9% in 2002 are rated BBB. Ratings of BBB- and higher are considered investment grade by the rating services.

During the second quarter of 2002, the Company sold a security out of its held-to-maturity portfolio due to evidence of a significant deterioration in the issuer s credit worthiness. At the time of the sale the security had an amortized cost of $499,768. The Company realized a loss of $49,768 on the transaction.

Mortgage Loans

The Company s mortgage loan policy limits the amounts of loans to no more than 80% of the collateral value on residential loans and no more than 75% of the collateral value on commercial loans. The Company grants loans only to employees (excluding officers and directors) and agents.

The geographic distribution of the loan portfolio is:

Number of Loans			Book Value (dollars in thousands)	
June 30, 2003	December 31, 2002	State	June 30, 2003	December 31, 2002
2	2	Alabama	$ 96	100
6	6	Florida	263	283
24	25	Georgia	860	937
32	33		$ 1,219	1,320

Three loans representing $89,000 in principal are over 30 days delinquent. The loan-to-value ratio on delinquent loans is 18%.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Credit Risk

Credit risk is the risk that issuers of securities owned by the Company will default, or other parties, including reinsurers, which owe the Company money, will not pay. The Company attempts to minimize these risks by following a conservative investment strategy and by contracting with reinsuring companies that meet high standards for rating criteria and other qualifications. The Company invests principally in government, governmental agency and high quality corporate bonds having an A rating or better. The fixed maturity portfolio had an average rating of Aa- as rated by Standard & Poor s Corporation at June 30, 2003 and 2002.

Interest Rate Risk

Interest rate risk is the risk that interest rates will change and cause a decrease in the value of an insurer s investments. The Company s fixed maturity investments are subject to interest rate risk. The Company seeks to manage the impact of interest rate fluctuation through cash flow modeling, which attempts to match the maturity schedule of its assets with expected payout of its liabilities. Liabilities for interest sensitive products are carried at full account value. The fixed maturity portfolio at June 30, 2003 and June 30, 2002 had an effective duration of 4.4 years and 4.3 years, respectively.

The table below summarizes the Company s interest rate risk and shows the effect of a hypothetical 100 basis point increase/decrease in interest rates on the fair values of the fixed investment portfolio. The selection of 100 basis point increases/decrease in interest rates should not be construed as a prediction by the Company s management of future market events, but rather, to illustrate the potential impact of such events. These calculations may not fully capture the impact of the changes in the ratio of long-term rates to short-term rates.

		Estimated Value June 30, 2003	Estimated Change in Interest Rates (bp-Basis Points)	Estimated Fair Value After Hypothetical Change in Interest Rates	Hypothetical Percentage Increase (Decrease) In Shareholders' Equity
		(dollars in thousands)			
Fixed Maturities	Held for Investment	$ 4,556	100 bp decrease	4,738	N/A
			100 bp increase	4,374	N/A
Fixed Maturities	Available	$175,171	100 bp decrease	182,178	8.1%
for Sale			100 bp increase	168,164	(8.1)%

ITEM 4. CONTROLS AND PROCEDURES

The Company s Chief Executive Officer and Chief Accounting Officer evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in SEC Rule 13a-15(e)) as of June 30, 2003. Based on that evaluation, such officers have concluded that the Company s disclosure controls and procedures are effective.

During the quarter ended June 30, 2003, there was no change in the Company s control over financial reporting (as defined in SEC Rule 13a-15(f)) that has materially affected, or is 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 defendant in various actions incidental to the conduct of its business. The Company intends to vigorously defend the litigation and while the ultimate outcome of these matters cannot be estimated with certainty, management does not believe the actions will result in any material loss to the Company.

The Company has reached partial settlement of a $900,000 in reinsurance coverage. A lawsuit was initiated by the Company in the third quarter of 2001. To date, the Company has received $475,000 and continues to seek additional recoveries against the reinsurance brokers through already existing legal channels. The remaining amount outstanding is included in Amounts due from reinsurers on the consolidated condensed balance sheet.

Item 2. Changes in Securities and Use of Proceeds

NONE

Item 3. Defaults Upon Senior Securities

NONE

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

NONE

Item 5. Other Information

NONE

Item 6. Exhibits and Reports on Form 8-K

The Company furnished a report on Form 8-K on August 7, 2003 pursuant to Item 12 of Form 8-K, Disclosures of Results of Operations and Financial Condition as directed by the Securities and Exchange commission in Release No. 23-47583.

Exhibit 11 Statement re: Computation of Per Share Earnings

Exhibit 15 Letter Regarding Unaudited Interim Financial Information

Exhibit 31.1 Section 302 Certification of Chief Executive Officer

Exhibit 31.2 Section 302 Certification of Vice President of Finance

Exhibit 32 Section 906 Certification of Chief Executive Officer and Vice President of Finance

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.

COTTON STATES LIFE INSURANCE COMPANY
Registrant

Date: 08/6/03

/s/ J. Ridley Howard

J. Ridley Howard, Chairman
President and Chief Executive Officer

Date: 08/6/03

/s/ William J. Barlow

William J. Barlow
Vice President of Finance and Assistant Treasurer

21