SEIBELS BRUCE GROUP INC
Form 10-Q
November 13, 2001

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For Quarter Ended September 30, 2001

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______

Commission file number 0 8804

THE SEIBELS BRUCE GROUP, INC.

(Exact name of registrant as specified in its charter)

South Carolina	**57 0672136**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1501 Lady Street (PO Box 1), Columbia, SC	**29201(2)**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code **(803) 748 2000**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date: 7,831,690 shares of Common Stock, $1 par value, at November 9, 2001.

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE SEIBELS BRUCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts shown in thousands, except share data)

	(Unaudited) September 30, 2001	December 31, 2000
ASSETS		
Investments:		
Debt securities, available for sale, at market (cost of $35,057 in 2001 and $31,596 in 2000)	$ 36,540	$ 31,990
Equity securities, at market (cost of $5,825 in 2001 and $6,344 in 2000)	5,907	6,307
Cash and short term investments	5,953	10,410
Total cash and investments	48,400	48,707
Accrued investment income	564	749
Premiums and agents' balances receivable, net of allowance for doubtful accounts of $3,055 in 2001 and $4,780 in 2000	1,452	1,637
Premium notes receivable, net of allowance for doubtful accounts of $99 in 2001 and $400 in 2000	7,459	5,260
Reinsurance recoverable on paid losses and loss adjustment expenses	11,745	14,031
Reinsurance recoverable on unpaid losses and loss adjustment expenses	44,549	50,012
Property and equipment, net	470	917
Prepaid reinsurance premiums ceded business	38,610	40,997
Deferred policy acquisition costs	400	400
Goodwill	4,544	4,638
Other assets	3,111	3,318
Total assets	$ 161,304	$ 170,666
LIABILITIES		
Losses and loss adjustment expenses:		
Reported and estimated losses and claims retained business	$ 23,052	$ 30,574
ceded business	42,119	46,612
Adjustment expenses retained business	5,274	5,247
ceded business	2,430	3,400
Unearned premiums:		

Property and casualty retained business		6,439		5,056
ceded business		38,610		40,997
Balances due other insurance companies		3,941		4,592
Debt		8,330		10,159
Restructuring accrual		0		276
Other liabilities and deferred items		12,185		9,061
Total liabilities		142,380		155,974
COMMITMENTS AND CONTINGENCIES				
SPECIAL STOCK, no par value, authorized 5,000,000 shares				
Issued and outstanding 209,000 and 220,000 shares in 2001 and 2000, respectively, of cumulative $0.62, convertible, redeemable, nonvoting, special preferred stock, redemption value $2,090		2,090		2,200
Issued and outstanding 50,000 shares of cumulative $0.625 convertible, redeemable nonvoting, special preferred stock, redemption value $500		500		500
Total special stock		2,590		2,700
SHAREHOLDERS' EQUITY				
Common stock, $1 par value, authorized 17,500,000 shares, issued and outstanding 7,831,690 shares in 2001 and 2000		7,832		7,832
Additional paid in capital		61,989		61,989
Accumulated other comprehensive income		1,565		357
Accumulated deficit		(55,052)		(58,186)
Total shareholders' equity		16,334		11,992
Total liabilities and shareholders' equity	$	161,304	$	170,666

THE SEIBELS BRUCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts shown in thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Commission and service income	$ 9,461	$ 9,740	$ 28,069	$ 28,085
Premiums earned	3,288	9,956	11,016	18,719
Net investment income	600	611	1,899	1,968
Other interest income, net	309	314	919	875
Net realized gain (loss)	51	0	(167)	(227)
Policy fees and other income	579	1,251	2,308	3,863
Total revenue	14,288	21,872	44,044	53,283
Expenses:				
Losses and loss adjustment expenses	1,260	8,133	6,286	18,945
Policy acquisition costs	5,816	5,648	17,448	20,067
Interest expense	168	504	597	1,144
Other operating costs and expenses	5,984	7,359	16,584	20,976
Special items	(156)	0	(156)	16,421
Total expenses	13,072	21,644	40,759	77,553
Income (loss) from operations, before provision for income taxes	1,216	228	3,285	(24,270)
Provision for income taxes	30	0	30	0
Net income (loss)	1,186	228	3,255	(24,270)
Other comprehensive income:				
Change in value of marketable securities, less reclassification adjustments of $51 and $0 for gains included in net income for the three months ended September 30, 2001 and 2000, respectively, and $51 and $(236) for gains (losses) included in net income (loss) for the nine months ended September 30, 2001	750	329	1,208	375

and 2000, respectively								
Comprehensive net income (loss)	$	1,936	$	557	$	4,463	$	(23,895)
Basic earnings (loss) per share:								
Net income (loss)	$	0.15	$	0.02	$	0.40	$	(3.12)
Weighted average shares outstanding		7,832		7,832		7,832		7,832
Diluted earnings (loss) per share:								
Net income (loss)	$	0.14	$	0.02	$	0.40	$	(3.12)
Weighted average shares outstanding		8,233		7,832		8,204		7,832

THE SEIBELS BRUCE GROUP, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Nine Months Ended September 30,

(Amounts shown in thousands)

(Unaudited)

	2001	2000
Cash flows from operating activities:		
Net income (loss)	$ 3,255	$ (24,270)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Equity in loss (earnings) of unconsolidated subsidiaries	519	(115)
(Recovery of) provision for losses on premium notes and premiums and agents balances receivable, net	(1,112)	1,562
Special items	0	16,421
Amortization of deferred policy acquisition costs	17,448	20,066
Depreciation and amortization	378	1,412
Realized (gain) loss on sale of investments, net	(51)	236
Realized loss (gain) on sale of property and equipment, net	218	(9)
Change in assets and liabilities:		
Accrued investment income	185	257
Premiums and agents' balances receivable, net	886	3,502
Premium notes receivable, net	(1,898)	(1,332)
Reinsurance recoverable on losses and loss adjustment expenses	7,749	20,698
Prepaid reinsurance premiums ceded business	2,387	13,105
Deferred policy acquisition costs	(17,448)	(19,093)
Unpaid losses and loss adjustment expenses	(12,958)	(23,628)
Unearned premiums	(1,004)	(9,302)
Balances due other insurance companies	(651)	(9,059)
Accrued restructuring charges	(276)	(289)
Other, net	3,304	(4,394)
Net cash provided by (used in) operating activities	931	(14,232)
Cash flows from investing activities:		
Proceeds from investments sold or matured	7,083	10,311
Cost of investments acquired	(10,445)	(13,872)

Proceeds from property and equipment sold, net		2		9
Purchases of property and equipment		(78)		(212)
Net cash used in investing activities		(3,438)		(3,764)
Cash flows from financing activities:				
Issuance of capital stock		0		2
Repayment of debt		(1,829)		(1,220)
Dividends paid		(121)		(127)
Net cash used in financing activities		(1,950)		(1,345)
Net decrease in cash and short term investments		(4,457)		(19,341)
Cash and short term investments, January 1		10,410		26,722
Cash and short term investments, September 30	$	5,953	$	7,381
Supplemental cash flow information:				
Interest paid	$	597	$	763
Income taxes paid		30		0

THE SEIBELS BRUCE GROUP, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars shown in thousands except per share amounts)
(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

The accompanying consolidated financial statements include the accounts of The Seibels Bruce Group, Inc. (the Company) and its wholly owned subsidiaries and have been prepared, without audit, in conformity with accounting principles generally accepted in the United States (GAAP) pursuant to the rules and regulations of the Securities and Exchange Commission. All significant intercompany balances and transactions have been eliminated in consolidation and, in the opinion of management, all adjustments necessary for the fair presentation of the Company's unaudited interim financial position, results of operations and cash flows have been recorded. These financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's annual report on Form 10 K for the year ended December 31, 2000 filed with the Securities and Exchange Commission. The results of operations for the interim periods are not necessarily indicative of the results for a full year. Certain prior period amounts have been reclassified to conform to the current period presentation.

Description of the Business

The Company is a provider of a wide range of services to the insurance industry, as well as a provider of automobile, flood and other property and casualty insurance products, to customers located primarily in the southeastern United States. A significant source of revenue for the Company includes premiums earned from its risk-bearing property and casualty insurance operations, which consists of its North Carolina nonstandard automobile operations, its commercial lines operations and its runoff South Carolina nonstandard automobile operations. During 2000, however, the Company shifted its emphasis of operations away from its risk-bearing property and casualty insurance operations towards its fee-based products and services, which include the following:

South Carolina Reinsurance Facility (SC Facility)

One of the Company s insurance subsidiaries, Catawba Insurance Company (Catawba), is one of three servicing carriers for the SC Facility, a state-sponsored plan for insuring South Carolina drivers outside of the voluntary market. In its capacity as a servicing carrier, Catawba receives commission and service income from the SC Facility but retains no underwriting risk. The SC Facility began its planned runoff effective March 1, 1999, at which time no new business was accepted into the SC Facility. Effective October 1, 1999, voluntary renewals were no longer accepted by the SC Facility. However, servicing carriers can still cede renewal business to the SC Facility until March 1, 2002, at which time final runoff of the SC Facility will commence. The South Carolina Associated Auto Insurers Plan (SCAAIP) became effective in March 1999 and will survive the SC Facility. The SCAAIP offers the Company access to additional fee-based revenue with no underwriting risk. However, thus far into the runoff of the SC Facility, the Company has not experienced significant activity in the SCAAIP.

North Carolina Reinsurance Facility (NC Facility)

The NC Facility is a state-sponsored plan for insuring North Carolina drivers outside of the voluntary market. Two of the Company s insurance subsidiaries, South Carolina Insurance Company (SCIC) and Universal Insurance Company (UIC) derive commission and service income from business they cede to the NC Facility, but retain no underwriting risk.

National Flood Insurance Program (NFIP)

Through its subsidiaries, SCIC and Catawba, the Company continues to be a leading provider, and is an original participant, in the NFIP, a flood insurance program administered by the federal government. In this capacity, the Company receives commissions and fees from the NFIP, but retains no underwriting risk.

Claims Adjusting and Management Services

The Company receives fee-based income from its catastrophe, property and casualty and automobile claims adjusting services and liability runoff management services. The Company's premium concentration in the catastrophe-heavy Southeast led to the creation of a catastrophe adjusting business, Insurance Network Services, Inc. (INS), to manage the Company's internal claims volume. INS has since extended its services to over 50 third party affiliated and unaffiliated customers and currently offers three services: catastrophe claims handling for hurricanes, tornadoes, hailstorms, earthquakes and floods; catastrophe claims supervision; and ordinary claims adjusting.

Flood Zone Determinations and Compliance Tracking Services

Through its subsidiary, America's Flood Services, Inc. (AFS), located in Rancho Cordova, California, the Company offers fee-based flood zone determinations and compliance tracking services to a variety of customers and institutions located throughout the United States.

Fair Value of Financial Instruments

Investments in debt and equity securities are classified as either held-to-maturity, available-for-sale or trading. The Company currently holds all securities as available-for-sale, and reports them at fair value, with subsequent changes in value reflected as unrealized investment gains and losses credited or charged directly to accumulated other comprehensive income included in shareholders' equity. The fair values of debt securities and equity securities were determined from nationally quoted market rates. The fair market value of certain municipal bonds is assumed to be equal to amortized cost where no market quotations exist.

The fair values of the Company's cash and short-term investments approximate carrying values due to the short-term nature of those instruments.

Premiums and agents balances receivable and premium notes receivable are carried at historical cost which approximates fair value as a result of timely collections and evaluations of recoverability with a provision for uncollectable amounts. Premium notes receivable are generally short-term in nature, with a duration of approximately six months.

The Company s debt is carried at its outstanding balance, which approximates fair value as a result of its variable market rate of interest.

Cash and Short-term Investments

Cash and short-term investments consists of cash on hand, time deposits and commercial paper. Short-term investments have an original maturity of six months or less and are considered to be cash equivalents.

Premium Notes Receivable

The Company offers premium financing arrangements that require a down payment and payment of the remaining balance in equal installments over the policy term.

Allowance for Uncollectable Accounts

The Company routinely evaluates the collectability of receivables and has established an allowance for uncollectable accounts for agents balances and direct billed balances receivable and premium notes receivable in the amount of approximately $3,154 and $5,180 at September 30, 2001 and December 31, 2000, respectively.

Property and Equipment

Property and equipment is stated at cost and, for financial reporting purposes, depreciated on a straight-line basis over the estimated useful lives of the assets. For income tax purposes, accelerated depreciation methods are used. Maintenance and repairs costs are charged to expense as incurred.

Property and Casualty Unpaid Loss and Loss Adjustment Expenses

The liability for property and casualty unpaid losses and loss adjustment expenses (LAE) includes:

An accumulation of case estimates for losses reported prior to the close of the accounting period.

Estimates of incurred-but-not-reported losses based upon past experience and current circumstances.

Estimates of allocated, as well as unallocated, LAE liabilities determined by applying percentage factors to the unpaid loss reserves, with such factors determined on a by-line basis based on past results of paid loss expenses to paid losses.

The deduction of estimated amounts recoverable from salvage, subrogation, and second injury funds.

Estimated losses for reinsurance ceded and assumed.

Management performs a complete review of the above components of the Company's loss reserves to evaluate the adequacy of such reserves. Management believes the reserves are sufficient to prevent prior years' losses from adversely affecting future periods; however, establishing reserves is an estimation process and adverse developments in future years may occur and would be recorded in the year so determined.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. This method also requires the recognition of future tax benefits such as net operating loss carryforwards to the extent that realization of such benefits is more likely than not. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

As of December 31, 2000, the Company has unused tax operating loss carryforwards and capital loss carryforwards of $104,857 for income tax purposes. However, due to "change in ownership" events that occurred in June 1998, January 1997, and January 1995, the Company's use of the net operating loss carryforwards are subject to maximum limitations in future years of approximately $2,200 per year. Net operating loss carryforwards available for use in 2001 are approximately $10,900 due to losses incurred in 1998, 1999 and 2000 after the change in ownership event occurred and carryover of previous years' unused limitations. The provision for income taxes recorded for the nine months ended September 30, 2001 results from estimated Alternative Minimum Tax arising from limitations on the use of net operating loss carryovers.

The Company has determined, based on its recent earnings history, that a valuation allowance should be maintained against the deferred tax asset at September 30, 2001 and December 31, 2000.

Commission and Service Income and Policy Fees

Commission and service income is predominately derived from the Company s servicing carrier and claims adjusting and management services activities. The commission income related to producing and underwriting the business is recognized in the period in which the business is written. Service income related to claims processing and policy fees are recognized on an accrual basis as earned.

Property and Casualty Premiums

Property and casualty premiums are reflected in income when earned as computed on a monthly pro-rata basis. Written premiums and earned premiums have been reduced by reinsurance placed with other companies, including amounts related to business produced as a servicing carrier.

Other Interest Income

Other interest income includes interest received on reinsurance balances withheld, agents' balances receivable, balances due from the SC Facility and the SCAAIP, and financing of premium notes receivable. Other interest income is recognized on an accrual basis as earned.

Policy Acquisition Costs

Policy acquisition costs attributable to property and casualty operations represent that portion of the cost of writing business that varies with, and is primarily related to, the production of business. Such costs are deferred and charged against income as the premiums are earned. The deferral of policy acquisition costs is subject to the application of recoverability tests to each primary line or source of business based on past and anticipated underwriting results. The deferred policy acquisition costs that are not recoverable from future policy revenues, if any, are expensed. The Company considers anticipated investment income in determining whether premium deficiencies exist.

Management Compensation Program

The Company has an incentive compensation plan covering certain members of its management team. Awards under the plan are payable each March and are based upon the Company s performance during the prior year ending December 31. The provisions of the plan require recipients to use a portion of their individual award to purchase stock of the Company. The Company has accrued for its estimated obligations under the plan as of September 30, 2001.

Comprehensive Income

Comprehensive income is a measure of all non-owner changes in equity of an entity and includes net income (loss) plus changes in certain assets and liabilities that are reported directly through equity.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates, although, in the opinion of management, such differences would not be significant.

Recent Accounting Pronouncements

In June 2001, the Financial Accounting Standards Board issued SFAS No. 142, Goodwill and Other Intangible Assets. This statement established accounting and reporting standards for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, Intangible Assets. It requires an entity to separate its goodwill, intangible assets with definite useful lives and intangible assets with indefinite useful lives. Goodwill and intangible assets with indefinite useful lives are no longer subject to periodic amortization. Rather they are subject to impairment tests that are required to be performed on at least an annual basis. At September 30, 2001, the Company had unamortized goodwill totaling $4,544 associated with its November 1997 and March 1998 purchases of The Innovative Company (former 100% owner of Universal Insurance Company and Premium Budget Plan, Inc.) and Americas Flood Services, Inc., respectively. Annual amortization of goodwill which will cease to be recorded effective January 1, 2002 upon the adoption of SFAS No. 142 is $125. The Company currently does not expect that it will incur impairment to either component of the goodwill as a result of adopting SFAS No. 142 and the Company has no other material intangible assets falling under the scope of the statement.

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This statement established accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. This statement could increase volatility in earnings and other comprehensive income. The effective date of this statement was amended by SFAS Nos. 137 and 138 and, as amended, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The Company adopted SFAS No. 133 effective January 1, 2001 and the statement had no material impact on its financial position or results of operations.

NOTE 2. INVESTMENTS

The Company s investments in debt securities are considered available-for-sale securities and carried at market value at September 30, 2001 and December 31, 2000. Unrealized gains and losses on debt securities are credited or charged directly to accumulated other comprehensive income and included in shareholders' equity.

The Company s equity securities consist of its investments in Sunshine State Holding Corporation (Sunshine) and QualSure Holding Corporation (QualSure). During the fourth quarter of 1997, the Company invested $854 in Sunshine for an ownership interest of 21.49%. Sunshine owns 100% of the issued and outstanding stock of Sunshine State Insurance Company, a Florida-based writer of homeowners insurance. Effective January 21, 2000, three of the Company's insurance subsidiaries collectively acquired a 30.625% equity ownership interest in QualSure for $4,900. QualSure is the holding company parent of QualSure Insurance Corporation, a homeowners take out insurance company domiciled in the state of Florida. In connection with this investment, the Company's claims adjusting and management services subsidiary, INS, entered into a Claims Administration Services Agreement with QualSure Insurance Corporation to adjudicate all of its claims for a fee based upon subject earned premium. As each of these investments exceeds 20% of the equity of each respective company, the Company's equity in the undistributed earnings of the unconsolidated affiliates are included in current earnings.

Short-term investments are carried at cost, which approximates market value.

NOTE 3. REINSURANCE ARRANGEMENTS

The Company s risk-bearing property and casualty insurance operations include the active nonstandard automobile operations of UIC, the runoff nonstandard automobile operations of SCIC, and the active commercial lines operations of SCIC. Since December 31, 1999, UIC has operated under a 75% quota share reinsurance agreement for its risk-bearing nonstandard automobile operations. Effective June 30, 1999 and continuing through June 30, 2000, SCIC operated under a 90% quota share reinsurance agreement for its risk-bearing commercial lines operations. This agreement was amended to become a 70% quota share reinsurance agreement effective April 1, 2000, and the amended agreement was terminated at the Company s request effective April 1, 2001. The Company s commercial lines business is now reinsured through facultative, excess of loss, catastrophe and umbrella reinsurance.

Reinsurance contracts do not relieve the Company of its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvency.

The Company issues a substantial number of automobile and flood insurance policies for, and fully reinsures those risks with, the SC Facility, the NC Facility and the NFIP. While the amount of reinsurance recoverable under these arrangements is significant, the Company believes the balances due from the SC Facility, the NC Facility and the NFIP are fully collectable due to the governmental agency's ability to assess policyholders and member companies for deficiencies.

NOTE 4. DEFERRED POLICY ACQUISITION COSTS

Policy acquisition costs incurred and amortized to income on property and casualty business for the nine months ended September 30, 2001 and 2000 were as follows:

	2001	2000
Deferred at the beginning of the period	$ 400	$ 1,373
Costs incurred and deferred during year:		
Commissions and brokerage	13,086	14,320
Taxes, licenses and fees	2,617	2,864
Other	1,745	1,909
Total	17,448	19,093
Amortization charged to income during the period	(17,448)	(20,066)
Deferred at the end of the period	$ 400	$ 400

NOTE 5. PROPERTY AND CASUALTY UNPAID LOSSES AND LOSS ADJUSTMENT EXPENSE

Activity in the liability for unpaid losses and LAE for the nine months ended September 30, 2001 and 2000 is summarized as follows:

	2001	2000
Liability at the beginning of the period:		
Gross liability per balance sheet	$ 85,833	$ 113,850
Ceded reinsurance recoverable, classified as an asset	(50,012)	(74,017)
Net liability	35,821	39,833
Provision for claims occurring in the current year	6,477	17,455
(Decrease) increase in estimated losses and LAE for claims occurring in prior years	(191)	1,490
	6,286	18,945
Losses and LAE payments for claims occurring during:		
Current year	3,974	7,963
Prior years	9,807	13,878
	13,781	21,841
Liability for losses and LAE at the end of the year:		
Net liability	28,326	36,937
Ceded reinsurance recoverable, classified as an asset	44,549	53,285
Gross liability per balance sheet	$ 72,875	$ 90,222

NOTE 6. DEBT

On March 31, 1998, the Company entered into a $15,000 Credit Facility with a major lending institution for the purpose of financing its acquisition activity and other general corporate purposes. Quarterly principal payments began in March 1999 and the final payment of all remaining principal and accrued interest is due in June 2004. Accrued interest is payable monthly on the outstanding balance under the Credit Facility and is calculated, at the Company's discretion, using a pre determined spread over LIBOR or the prime interest rate of the lending institution. The effective interest rate as of September 30, 2001, December 31, 2000 and September 30, 2000 was 6.19%, 9.44% and 9.38%, respectively. The Credit Facility is secured by a lien on the assets of the Company. As of September 30, 2001 and December 31, 2000, the outstanding balance under the Credit Facility was $8,330 and $10,159, respectively. The underlying Credit Agreement stipulates that the Company demonstrate compliance with a number of affirmative and negative covenants on a quarterly basis. Significant financial covenants include minimum statutory surplus levels, ratios of debt to total capitalization and cash flow coverage. As of September 30, 2001, the Company was in compliance with all amended covenants. The underlying Credit Agreement further stipulates that the Company may not redeem any of its Cumulative, Convertible, Redeemable, Nonvoting Special Preferred Stock (see Note 7) until the Credit Facility has been repaid in its entirety.

NOTE 7. SPECIAL STOCK

On December 1, 1997, the Company issued 220,000 shares of Cumulative, Convertible, Redeemable, Nonvoting Special Preferred Stock (the Special Stock) in connection with an acquisition. The Company determined the value of the Special Stock at the issuance date to be $2,200. In January 2001, the holders of the Special Stock surrendered, and the Company cancelled, 11,000 shares of the Special Stock to settle a dispute between the Company and the holders. The Special Stock pays quarterly dividends at an annual rate of $0.62 per share. The Company paid $97 and $103 in special stock dividends for the nine months ended September 30, 2001 and 2000, respectively. Prior to August 15, 2002, the Company, at its option, may redeem in whole or in part the Special Stock at a price of $15.00 per share. On August 15, 2002, the Company must redeem any remaining shares at a rate of $10.00 per share. Prior to August 15, 2002, holders of the shares have the right to convert each share of the Special Stock into 1.25 shares of the Company's common stock.

On March 31, 1998, the Company issued 50,000 shares of Cumulative, Convertible, Redeemable, Nonvoting Special Preferred Stock (the AFS Special Stock) in connection with its acquisition of AFS. The Company determined the value of the AFS Special Stock at the issuance date to be $500. The AFS Special Stock pays quarterly dividends at an annual rate of $0.625 per share. The Company paid $24 in special stock dividends for the nine months ended September 30, 2001 and 2000. Prior to August 15, 2002, the Company, at its option, may redeem in whole or in part the AFS Special Stock at a price of $15.00 per share. On August 15, 2002, the Company must redeem any remaining shares at a rate of $10.00 per share. Prior to August 15, 2002, holders of the shares have the right to convert each share of the AFS Special Stock into 1.25 shares of the Company's common stock.

NOTE 8. EARNINGS PER SHARE

In accordance with SFAS 128, Earnings Per Share, the Company measures earnings per share at two levels: basic earnings per share and diluted earnings per share. Basic earnings per share is calculated by dividing income (loss) available to common stockholders by the weighted average number of shares outstanding during the reporting period. Diluted earnings per share is calculated by dividing income (loss) available to common stockholders by the weighted average number of shares outstanding during the reporting period, as adjusted for the dilutive effect of stock options, warrants and convertible preferred stock. The following table shows the computation of earnings per share for the nine months ended September 30, 2001 and 2000:

	Income (Numerator)	Shares (Denominator)	Share Amount
For the nine months ended September 30, 2001:			
Net income	$ 3,255		
Less: Preferred stock dividends	(121)		
Basic earnings per share	3,134	7,832	$ 0.40
Effect of dilutive securities:			
Convertible preferred stock	121	324	
Stock options and warrants	0	48	
Diluted earnings per share	$ 3,255	8,204	$ 0.40