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AMERICAN PHYSICIANS SERVICE GROUP INC  
Form 10QSB  
August 19, 2002

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10-QSB

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE PERIOD ENDED JUNE 30, 2002

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE TRANSITION PERIOD FROM

to

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COMMISSION FILE NUMBER 0-11453

AMERICAN PHYSICIANS SERVICE GROUP, INC.

(Exact name of registrant as specified in its charter)

TEXAS  
(State or other jurisdiction of  
incorporation or organization)

75-1458323  
(I.R.S. Employer  
identification No.)

1301 CAPITAL OF TEXAS HIGHWAY AUSTIN, TEXAS 78746  
(Address of principal executive offices) (Zip Code)

(512) 328-0888  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES      X              NO  
-----              -----

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

TITLE OF EACH CLASS -----	NUMBER OF SHARES OUTSTANDING AT JULY 31, 2002 -----
Common Stock, \$.10 par value	2,208,231

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PART I

FINANCIAL INFORMATION

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands)

	Three Months Ended June 30,	
	2002	2001
	-----	-----
Revenues:		
Financial services	\$3,201	\$3,700
Insurance services	2,241	1,521
Consulting	903	730
Investments and other	8	44
	-----	-----
Total revenue	6,353	5,995
Expenses:		
Financial services	2,826	3,277
Insurance services	1,720	1,223
Consulting	730	636
General and administrative	334	323
Gain on sale of assets	(61)	--
	-----	-----
Total expenses	5,549	5,459
Operating income	804	536
Gain (loss) on sale of investments (Note 4)	(10)	--
Equity in earnings (loss) of unconsolidated affiliates (Note 5)	--	41
	-----	-----
Earnings from continuing operations before interest, income taxes and minority interest	794	577
Interest expense	4	129
Income tax expense	283	163
Minority interests	(58)	(34)
	-----	-----

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Earnings from continuing operations	449	251
Discontinued operations:		
Earnings from discontinued operations net of income tax expense of \$17 and \$38 for the three and six months in 2001, respectively	--	34
	-----	-----
Net earnings	\$449	\$285
	=====	=====

See accompanying notes to consolidated financial statements.

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
CONSOLIDATED STATEMENT OF EARNINGS PER SHARE (UNAUDITED)

(In thousands, except per share amounts)

	Three Months Ended June 30,	
	2002	2001
	-----	-----
Earnings per common share		
Basic:		
Earnings from continuing operations	\$0.20	\$0.11
Discontinued operations	--	0.01
	-----	-----
Net earnings	\$0.20	\$0.12
	=====	=====
Diluted:		
Earnings from continuing operations	\$0.19	\$0.09
Discontinued operations	--	0.01
	-----	-----
Net earnings	\$0.19	\$0.10
	=====	=====
Basic weighted average shares outstanding	2,254	2,343
	=====	=====
Diluted weighted average shares outstanding	2,402	2,758
	=====	=====

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See accompanying notes to consolidated financial statements.

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	June 30, 2002	December 31, 2001
	----- (Unaudited)	-----
ASSETS		
Current Assets:		
Cash and cash equivalents	\$10,521	\$3,851
Trading account securities	97	149
Notes receivable - current	594	573
Trade receivables, net	760	603
Management fees and other receivables	700	484
Deposit with clearing organization	499	499
Receivable from clearing organization	70	69
Net deferred income tax asset	--	282
Income tax receivable	--	167
Prepaid expenses and other	374	1,147
	-----	-----
Total current assets	13,615	7,824
Notes receivable, less current portion	729	999
Property and equipment	401	415
Investment in available for sale equity securities (Note 5)	8,875	--
Investment in available for sale fixed income securities	1,382	--
Investment in affiliate (Note 5)	--	10,700
Other investments	68	68
Net deferred income tax asset - non-current	3,127	1,453
Other assets	201	201
	-----	-----
Total Assets	\$28,398	\$21,660
	=====	=====

See accompanying notes to consolidated financial statements.

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS, continued

(In thousands, except share data)

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	June 30, 2002
	----- (Unaudited)
LIABILITIES AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Accounts payable - trade	\$1,037
Payable to clearing broker	172
Accrued incentive compensation	673
Accrued expenses and other liabilities (Note 6)	402
Income tax payable	2,857
Deferred gain - current	488
Deferred tax liability - current	1,653
	-----
Total current liabilities	7,282
Payable under loan participation agreements	259
Deferred gain - non-current	1,959
Notes payable - long term	--
	-----
Total liabilities	9,500
Minority interests	239
Shareholders' Equity:	
Preferred stock, \$1.00 par value, 1,000,000 shares authorized, none issued or outstanding	--
Common stock, \$0.10 par value, shares authorized 20,000,000; 2,220,931 issued at 6/30/02 and 2,745,231 at 12/31/01 2,218,931 outstanding at 6/30/02 and 2,359,231 at 12/31/01	222
Additional paid-in capital	5,578
Retained earnings	9,504
Accumulated other comprehensive income (loss)	3,363
Treasury stock, at cost, 2,000 shares at 6/30/02 and 386,000 shares at 12/31/01	(8)
	-----
Total shareholders' equity	18,659
	-----
Total Liabilities and Shareholders' Equity	\$28,398
	=====

See accompanying notes to consolidated financial statements.

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)

Six Months Ended

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	June 30,	
	2002	2001
	-----	-----
Cash flows from operating activities:		
Cash received from customers	\$11,862	\$11,791
Cash paid to suppliers and employees	(11,430)	(10,847)
Change in trading account securities	52	30
Change in receivable from clearing organization	(83)	48
Interest paid	(21)	(273)
Income tax paid	(70)	(45)
Interest, dividends and other investment proceeds	48	53
	-----	-----
Net cash provided by operating activities	358	757
Cash flows from investing activities:		
Capital expenditures	(84)	(95)
Proceeds from the sale of an investment	10,600	--
Purchase of bonds	(1,382)	--
Investments in and advances to affiliate	(230)	--
Funds loaned to others	(150)	(1,898)
Collection of notes receivable	317	1,229
Other	--	69
	-----	-----
Net cash provided by (used in) investing activities	9,071	(695)
Cash flows from financing activities:		
Proceeds from borrowings	--	1,165
Payment of long term debt	(2,275)	(56)
Purchase of treasury stock	(501)	--
Exercise of stock options	17	--
Distribution to minority interest	--	(80)
	-----	-----
Net cash provided by (used in) financing activities	(2,759)	1,029
	-----	-----
Net change in cash and cash equivalents	\$6,670	\$1,091
Cash and cash equivalents at beginning of period	3,851	2,988
	-----	-----
Cash and cash equivalents at end of period	\$10,521	\$4,079
	=====	=====

See accompanying notes to consolidated financial statements.

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED), continued

(In thousands)

Six Months Ended

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	June 30,	
	2002	2001
	-----	-----
Reconciliation of net earnings to net cash provided by operating activities:		
Net earnings	\$3,051	\$410
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	87	151
Forgiveness of debt and other	105	126
Minority interest in consolidated earnings	115	63
Undistributed loss of affiliates	44	96
Gain on sale of assets	(756)	--
Gain on sale of investment	(2,791)	--
Change in income tax receivable	3,024	229
Provision for deferred taxes	(1,375)	--
Provision for bad debt	54	9
Change in trading account securities	7	30
Change in receivable from clearing organization	(83)	48
Change in management fees & other receivables	(166)	(80)
Change in trade receivables	(216)	(35)
Change in prepaid expenses & other assets	773	(39)
Change in trade accounts payable	(7)	350
Change in accrued expenses & other liabilities	(1,508)	(601)
	-----	-----
Net cash provided by operating activities	\$358	\$757
	=====	=====

See accompanying notes to consolidated financial statements.

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)  
For the six months ended June 30, 2001 and 2002

(In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Comprehensive Income (loss)	Compre Income
	-----	-----	-----	-----	-----
Balance December 31, 2000 (audited)	\$ 275	\$ 5,539	\$ 8,888		\$
Comprehensive income:					
Net income	--	--	410	410	
Other comprehensive loss					

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Unrealized loss on securities, net of tax of \$2	--	--	--	(7)
Comprehensive income	--	--	--	403
Balance June 30, 2001 (unaudited)	\$ 275	\$ 5,539	\$ 9,298	\$
Balance December 31, 2001 (audited)	\$ 275	\$ 5,539	\$ 8,310	\$
Comprehensive income:				
Net income	--	--	3,051	\$ 3,051
Other comprehensive income				
Unrealized gain on securities, net of taxes of \$1,843	--	--	--	3,402
Comprehensive income	--	--	--	\$ 6,453
Treasury stock purchases	--	--	--	
Cancelled treasury stock	(54)		(1,856)	
Stock options exercised	1	16	--	
Stock Options Expensed	--	24	--	
Balance June 30, 2002 (unaudited)	\$222	\$5,578	\$9,504	\$

See accompanying notes to consolidated financial statements.

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AMERICAN PHYSICIANS SERVICE GROUP, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
June 30, 2002  
(Unaudited)

1. GENERAL

The accompanying unaudited consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and 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 generally accepted accounting principles in the United States of America have been condensed or omitted pursuant to such rules and regulations. The consolidated financial statements for the three and six months ended June 30, 2002 and 2001 reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. Such adjustments consist of only items of a normal recurring nature. These consolidated financial statements have not been audited by our independent certified public accountants. The operating results for the interim periods are not necessarily indicative of results for the full fiscal year.

The notes to consolidated financial statements appearing in our Annual Report on



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Form 10-KSB for the year ended December 31, 2001 filed with the Securities Exchange Commission should be read in conjunction with this Quarterly Report on Form 10-QSB. There have been no significant changes in the information reported in those notes other than from normal business activities.

Certain reclassifications have been made to amounts in prior periods to be consistent with the 2002 presentation.

### 2. ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### 3 CONTINGENCIES

Under agreements with former doctor shareholders of Syntera, our practice management company that was merged with FemPartners in 1999, we agreed to exchange their shares in Syntera for the common stock of American Physicians, or cash, if the Syntera shares did not become publicly traded. Through March 31, 2002 we paid approximately \$2,956,000 in cash related to these agreements, thus satisfying all liabilities related to these agreements.

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### 3 CONTINGENCIES, continued

We have extended various lines of credit to Uncommon Care totaling \$4.69 million with interest rates between 10% and 12%. During 2001 we agreed to modify the terms of the foregoing notes. For the period July 1, 2001 through June 30, 2002 the interest rate was 4% and payments were paid in-kind (PIK) in the form of Uncommon Care common stock at \$0.57 per share. Additionally, the PIK stock may be repurchased by Uncommon Care through June 30, 2004 at a price of \$.64 per share. We agreed to these modified terms to improve Uncommon Care's liquidity and to assist it in complying with the terms of its bank covenants. PIK payments during 2002 increased our ownership in Uncommon Care preferred and common stock from 38% to 42% on a fully converted basis.

We guaranteed a loan in the maximum amount of \$110,000 for a director, William Searles. The guarantee is collateralized by Mr. Searles' options to purchase American Physicians and Prime Medical shares as well as Mr. Searles' common stock interest in Uncommon Care. The loan had a balance of \$7,500 at June 30, 2002.

We are involved in various claims and legal actions that have arisen in the ordinary course of business. Management believes that any liabilities arising from these actions will not have a significant adverse effect on our financial condition or results of operations.

### 4. GAIN RECOGNITION

During the first six months of 2002, we sold 1,580,000 shares of the common stock of Prime Medical reducing our interest to less than 5%. In connection with these sales we received proceeds of approximately \$10,600,000 and recognized a gain of \$2,791,000.

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In connection with these sales, we recognized an additional \$512,000 gain related to the sale of real estate to Prime in November 2001. At the time of the sale, we deferred a portion of the total gain to reflect our interest in the purchaser. During the first six months of 2002, we have recognized these deferred gains proportionately as our interest in Prime has been reduced.

### 5. EQUITY IN EARNINGS OF UNCONSOLIDATED AFFILIATES

At June 30, 2002 we owned slightly less than 5% (763,803 shares) of the outstanding common stock of Prime Medical. As a result of our reduced ownership interest and as a result of Board resignations mentioned in our Form 10-KSB for the year ended December 31, 2001, we ceased accounting for our investment in Prime Medical using the equity method effective March 19, 2002 and began accounting for our investment in Prime as an available for sale security in accordance with SFAS 115. Accordingly, our investment in Prime Medical is reported at fair value in our balance sheet. We recognized \$186,000 of equity earnings in 2002 prior to converting to the cost method. This change in accounting also resulted in a balance sheet reclassification for our investment in Prime Medical from "Investment in Affiliate" to "Investment in Available for Sale Equity Securities".

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### 5. EQUITY IN EARNINGS OF UNCONSOLIDATED AFFILIATES, continued

The common stock of Prime Medical is traded in the over-the-counter market under the symbol "PMSI". Prime Medical is a Delaware corporation which is required to file with the Securities and Exchange Commission annual, quarterly and other reports and documents containing financial and other information regarding Prime Medical. Such reports and documents may be examined and copies may be obtained from the offices of the Securities and Exchange Commission. A table detailing our investment in Prime Medical follows:

Fair Value June 30, 2002			Book Value at Date of Conversion*	
No. of Shares Owned	MV per Share	Fair Value	BV per Share	Book Value
763,803	\$11.62	\$8,875,000	\$5.02	\$3,837,000

\* Book Value at March 19, 2002, the date of conversion from accounting for our investment in Prime Medical common stock using the equity method to accounting for it as a marketable security.

The difference between the June 30, 2002 fair value and book value at date of conversion is represented on the consolidated balance sheet in accumulated other comprehensive income.

The condensed statements of operations for Prime Medical follows (unaudited, in thousands):

Condensed statements of operations for the six months ended  
June 30, 2002 and 2001

	2002	2001
Total revenue	\$81,007	\$71,673
Gross profit	28,292	32,382
Income from continuing operations	24,683	25,397

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Net income 5,137 4,015

At June 30, 2002 the Company owned Convertible Preferred and Common Stock of Uncommon Care, a developer and operator of dedicated Alzheimer's care facilities. We have applied the guidance of EITF 99-10, specifically the percentage of ownership method, in applying the equity method to our investment in Uncommon Care. Uncommon Care's common stock equity had been eliminated by losses prior to our investment and, accordingly, we recognized 100% of the losses of Uncommon Care based on our ownership of 100% of its preferred stock equity and subordinated debt. During 2001 our total basis in our investment and advances to Uncommon Care was reduced to zero. Until such time as Uncommon Care becomes profitable and our future equity in these profits fully offsets our prior period combined equity losses, future advances to Uncommon Care will result in a loss when advanced. Advances to Uncommon Care have totaled \$230,000 in 2002.

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### 5. EQUITY IN EARNINGS OF UNCONSOLIDATED AFFILIATES, continued

The common and preferred shares owned by the Company, together with common stock to be paid-in-kind, are convertible into approximately a 42% interest in the common equity in Uncommon Care. We continue to record our investment in and advances to Uncommon Care on the equity method.

The condensed statements of operations for Uncommon Care follows (unaudited, in thousands):

Condensed statements of operations for the six months ended  
June 30, 2002 and 2001

	2002	2001
	----	----
Total revenue	\$3,769	\$3,022
Gross profit	649	199
Income from continuing operations	(300)	(983)
Net income (loss)	(305)	(909)

### 6. ACCRUED EXPENSES AND OTHER LIABILITIES

Accrued expenses and other liabilities consists of the following:

	June 30	December 31
	2002	2001
	----	----
Taxes	\$ 57,000	\$ 61,000
Contractual/legal fees and claims	55,000	1,031,000
Vacation	140,000	140,000
Other	150,000	105,000
	-----	-----
	\$402,000	\$1,337,000
	=====	=====

### 7. EARNINGS PER SHARE

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Basic earnings per share is based on the weighted average shares outstanding without any dilutive effects considered. Diluted earnings per share reflect dilution from all contingently issuable shares, such as options and convertible debt. A reconciliation of earnings and average shares outstanding used in the calculation of basic and diluted earnings per share from continuing and discontinued operations follows:

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### 7. EARNINGS PER SHARE, continued

For the Three Months Ended June 30, 2002			
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Earnings from continuing operations	\$ 449,000		
Basic EPS			
Earnings available to common stockholders	449,000	2,254,000	\$0.20 =====
Effect of dilutive securities	--	148,000	
Diluted EPS			
Earnings available to common stockholders and assumed conversions	\$ 449,000 =====	2,402,000 =====	\$0.19 =====

For the Three Months Ended June 30, 2001			
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Earnings from continuing operations	\$ 251,000		
Discontinued operations, net of tax	34,000		
Basic EPS			
Earnings available to Common stockholders	285,000	2,343,000	\$ 0.12 =====
Effect of dilutive securities	--	415,000	
Diluted EPS			

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Earnings available to common stockholders and assumed conversions	\$ 285,000 =====	2,758,000 =====	\$ 0.10 =====
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### 7. EARNINGS PER SHARE, continued

For the Six Months Ended June 30, 2002			
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Earnings from continuing operations	\$ 3,051,000		
Basic EPS			
Earnings available to common stockholders	3,051,000	2,288,000	\$1.33 =====
Effect of dilutive securities	-- -----	124,000 -----	
Diluted EPS			
Earnings available to common stockholders and assumed conversions	\$ 3,051,000 =====	2,412,000 =====	\$1.26 =====

For the Six Months Ended June 30, 2001			
	Earnings (Numerator)	Shares (Denominator)	Per Share Amount
Earnings from continuing operations	\$ 335,000		
Discontinued operations, net of tax	75,000 -----		
Basic EPS			
Earnings available to common stockholders	410,000	2,343,000	\$0.17 =====
Effect of dilutive securities	-- -----	419,000 -----	
Diluted EPS			
Earnings available to			

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common stockholders and assumed conversions	\$ 410,000 =====	2,762,000 =====	\$0.15 =====
--	---------------------	--------------------	-----------------

Unexercised employee stock options to purchase 91,500 and 959,500 shares of the Company's common stock as of June 30, 2002 and 2001, respectively, were not included in the computations of diluted EPS because the effect would be antidilutive.

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### 8. SEGMENT INFORMATION

The Company's segments are distinct by type of service provided. Comparative financial data for the three and six month periods ended June 30, 2002 and 2001 are shown as follows:

	THREE MONTHS ENDED JUNE 30, 2002	2001
Operating Revenue:	-----	-----
Financial services	\$3,201,000	\$3,700,000
Insurance services	2,241,000	1,521,000
Consulting	903,000	730,000
Corporate	125,000	456,000
	-----	-----
	\$6,470,000	\$6,407,000
	=====	=====
Reconciliation to Consolidated Statement of Operations:		
Total segment revenues	\$6,470,000	\$6,407,000
Less: Intercompany dividends	(100,000)	(300,000)
Intercompany interest	(17,000)	(112,000)
	-----	-----
Total Revenues	\$6,353,000	\$5,995,000
	=====	=====
Operating Income (Loss)		
Financial services	\$ 375,000	\$ 423,000
Insurance services	521,000	298,000
Consulting	173,000	94,000
Corporate	(265,000)	(279,000)
	-----	-----
Total segments operating profits	804,000	536,000
Loss on sale of investments	(10,000)	--
Equity in earnings of unconsolidated affiliates	--	41,000
	-----	-----
Earnings from continuing operations before income taxes and minority interests	794,000	577,000
Interest expense	4,000	129,000
Income tax expense	283,000	163,000
Minority interests	(58,000)	(34,000)
	-----	-----
Earnings from continuing operations	\$ 449,000	\$251,000

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Net earnings from discontinued operations, net of income tax	--	34,000
	-----	-----
Net earnings	\$ 449,000	\$285,000
	=====	=====

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8. SEGMENT INFORMATION, continued

	SIX MONTHS ENDED JUNE 30, 2002	2001
	-----	-----
Operating Revenue:		
Financial services	\$ 6,298,000	\$ 7,057,000
Insurance services	4,350,000	3,154,000
Consulting	1,600,000	1,286,000
Corporate	318,000	1,068,000
	-----	-----
	\$12,566,000	\$12,565,000
Reconciliation to Consolidated Statement of Operations:		
Total segment revenues	\$12,566,000	\$12,565,000
Less: Intercompany dividends	(245,000)	(770,000)
Intercompany interest	(29,000)	(212,000)
	-----	-----
Total Revenues	\$12,292,000	\$11,583,000
	=====	=====
Operating Income (Loss)		
Financial services	\$ 827,000	\$ 950,000
Insurance services	960,000	570,000
Consulting	240,000	85,000
Corporate	91,000	(573,000)
	-----	-----
Total segments operating profits	2,118,000	1,032,000
Gain on sale of investments	2,791,000	--
Equity in loss of unconsolidated affiliates	(44,000)	(96,000)
	-----	-----
Earnings from continuing operations before income taxes and minority interests	4,865,000	936,000
Interest expense	21,000	269,000
Income tax expense	1,678,000	269,000
Minority interests	(115,000)	(63,000)
	-----	-----
Earnings from continuing operations	\$3,051,000	\$335,000
Net earnings from discontinued operations, net of income tax	--	75,000
	-----	-----
Net earnings	\$3,051,000	\$410,000

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS

FORWARD LOOKING STATEMENTS

All statements past and future, written or oral, made by the us or our officers, directors, shareholders, agents, representatives or employees, including without limitation, those statements contained in this Report on Form 10-QSB, that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, including statements regarding our expectations, hopes, intentions or strategies regarding the future. Forward-looking statements may appear in this document or other documents, reports, press releases, and written or oral presentations made by our officers to shareholders, analysts, news organizations or others. Readers should not place undue reliance on forward-looking statements. All forward-looking statements are based on information available to us and the declarant at the time the forward-looking statement is made, and we assume no obligation to update any such forward-looking statements. It is important to note that our actual results could differ materially from those described in such forward-looking statements. In addition to any risks and uncertainties specifically identified in connection with such forward-looking statements, the reader should consult our reports on previous filings under the Securities Act of 1933 and the Securities Exchange Act of 1934, for factors that could cause actual results to differ materially from those presented.

Forward-looking statements are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors and legislative, judicial and other governmental authorities and officials. Assumptions relating to the foregoing involve judgements with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond control. Any such assumptions could be inaccurate and, therefore, there can be no assurance that any forward-looking statements by us or our officers, directors, shareholders, agents, representatives or employees, including those forward-looking statements contained in this Report on Form 10-QSB, will prove to be accurate.

CRITICAL ACCOUNTING POLICIES

For our more significant judgements and estimates used in the preparation of our consolidated financial statements, we employ those critical accounting policies which are discussed in detail in our Form 10-KSB dated December 31, 2001.



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## RESULTS OF OPERATIONS

### REVENUES

Revenues from operations increased \$358,000 (6%) and \$709,000 (6%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. Revenues increased in the current three and six month periods at our insurance services and consulting segments and decreased at our financial services and administrative segments compared to the same periods in 2001.

Our financial services revenues decreased \$499,000 (13%) and \$759,000 (11%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. The decrease was due to lower commission income at APS Financial Corp., our broker/dealer division of APS Investment Services, Inc. Market conditions have become increasingly difficult this year. Investor demand for corporate bond issues has been limited due to rising credit concerns emanating from a combination of high profile corporate accounting scandals/bankruptcies and weaker industry profit forecasts. Investors have also been reluctant to put money to work in longer-term fixed income securities with yields at historically low levels. While high yield transactions declined during the period, volume in government bonds and short-term issues rose as market participants sought a safe haven from the woes in corporate America, and kept funds short term in anticipation of higher market rates over the next several quarters.

Our insurance services revenues from our premium-based insurance management segment, APS Insurance Services, increased \$720,000 (47%) and \$1,196,000 (38%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. The increase in both periods are due to greater management fees and commissions, a result of higher premiums. Premiums have increased due to rate increases at the managed insurance company.

Our consulting revenue increased \$173,000 (24%) and \$314,000 (24%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. The current year increase is due primarily to a 40% increase in revenues generated through work performed by sub-contractors involved in environmental assessment field activities. In addition, chargeable hours increased 8%, the result of an increase in the number of professional personnel employed as well as higher project demands from our largest environmental client.

### EXPENSES

Total operating expenses increased \$90,000 (2%) but decreased \$377,000 (4%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. For both the current year three and six month periods, expenses at our insurance services, consulting and administrative segments increased while expenses at our financial services segment decreased.

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Financial services expense decreased \$451,000 (14%) and \$636,000 (10%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. The primary reason for the current year decreases in both periods is a decrease in commission expense resulting from lower commission revenue at APS Financial, our broker/dealer division of APS Investment Services, Inc. For the year, commission expenses are down \$495,000 (13%) compared to the same six months in 2001. Profits at APS Financial are down 24% in 2002 which has resulted in a \$116,000 (23%) decrease in management incentive compensation. Also, legal and professional fees decreased 51% in the first six months of 2002 compared to the same period in 2001 as there were no legal fees associated with investment banking activities this year that were incurred last year.

Insurance services expenses at the insurance management subsidiary increased \$497,000 (41%) and \$806,000 (31%) for the three and six month periods June 30, 2002, respectively, compared to the same periods in 2001. The current three and six month period increase is due primarily to a \$316,000 (95%) and \$477,000 (56%) increase, respectively, in commission expense paid to third party agents arising because of the aforementioned increase in commission income. Also higher this year is payroll related expenses which rose \$105,000 (15%) and \$201,000 (15%) in the current year three and six month periods, respectively, as a result of creating two new vice-presidential positions and normal annual merit raises.

Consulting expenses increased \$94,000 (15%) and \$159,000 (13%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. The primary reason for the increase in both current year periods is an increase in work performed by sub-contractors involved in environmental assessment field activities. These direct expenses increased \$75,000 (54%) and \$88,000 (40%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001. In addition, payroll related costs increased \$47,000 (14%) and \$120,000 (18%) in the current three and six month periods, respectively, as a result of the hiring of additional professionals. Partially offsetting these increases is a decrease in professional fees of \$28,000 (77%) and \$64,000 (82%) in the current three and six month periods, respectively, as a result of litigation in 2001 that concluded before 2002.

Gain on sale of assets for the three months ended June 30, 2002 primarily represents the amortization of deferred gain attributable to the November, 2001 sale of real estate and subsequent leaseback of office space. We had deferred \$2.4 million of the \$5,000,000 gain and will recognize income monthly over the life of the five year lease. For the six month period ended June 30, 2002, amortization of deferred gains equaled \$244,000. In addition, since the sale of the real estate was to our then 15% owned affiliate, Prime Medical, we had deferred an additional \$760,000 of the \$5,000,000 gain, as required by the equity method of accounting. During 2002 we reduced our investment in Prime Medical and subsequently recognized a proportionate percentage of the deferred gain, or about \$512,000.

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Interest expense decreased \$125,000 (97%) and \$248,000 (92%) for the three and six month periods ended June 30, 2002, respectively, compared to the same

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periods in 2001. The primary cause of the current period decrease is the payoff of the Company's note payable from a balance of \$6,300,000 at June 30, 2001 to zero at June 30, 2002.

### GAIN ON SALE OF INVESTMENTS

The three month loss was caused by an adjustment related to changing the method of accounting in Prime Medical between the equity method and the cost method. The result increased our equity earnings in Prime for the six months ended June 30, 2002 but reduced our gain on sale in the three month period. The six month gain represents gains on the sale of 1,580,000 shares of Prime Medical common stock. As a result of these sales, we now own approximately 764,000 shares of Prime Medical amounting to an ownership percentage of slightly less than 5%.

### EQUITY IN EARNINGS (LOSS) OF UNCONSOLIDATED AFFILIATES

Our equity in the earnings of Prime Medical decreased \$308,000 (100%) and \$419,000 (69%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001 as we no longer account for our investment in Prime Medical using the equity method of accounting as was the case in 2001. As of March 19, 2002, we ceased accounting for our investment in Prime Medical using the equity method of accounting because (1) on January 1, 2002, Kenneth S. Shifrin, the Company's Chairman and CEO, stepped down from day-to-day operations as Executive Chairman of the Board of Prime Medical, but will continue to serve as non-executive Chairman; (2) in December 2001, Prime Medical's CEO, Brad Hummel, resigned from our board of directors; and (3) from January to March 19, 2002, we sold 1,570,000 shares of Prime Medical reducing our ownership percentage to slightly less than 5%.

Our equity in losses of Uncommon Care decreased \$267,000 (100%) and \$470,000 (67%) for the three and six month periods ended June 30, 2002, respectively, compared to the same periods in 2001 primarily as a result of our limiting our losses in Uncommon Care to our total investment and advances to Uncommon Care, which was reduced to zero during 2001. Once we reduced our total investment to zero, as required under the equity method, we ceased recording equity losses. Until such time as Uncommon Care becomes profitable and future equity in these profits fully offsets our prior period combined equity losses, future advances to Uncommon Care will result in a loss when advanced. Advances to Uncommon Care totaling \$230,000 in February 2002 accounts for the loss recorded during the first quarter 2002. No advances or repayments were booked in the second quarter of 2002.

### MINORITY INTERESTS

Minority interests represents the combination of two outside interests in subsidiaries of the Company: a twenty percent interest of Insurance Services owned by Florida Physicians Insurance Group, Inc. and a three percent interest of APS Asset Management, a subsidiary of the financial services subsidiary of the Company (APS Investment Services), owned by key individuals within APS Asset Management. Minority interests increased in the current year primarily as a result of increased profitability of our insurance services segment.

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### SHAREHOLDERS' EQUITY

Through June 30, 2002, we purchased 155,000 and cancelled 539,000 shares of treasury stock. The net effect of these purchases and cancellations was to decrease the treasury stock \$1,410,000, representing the cost of the cancelled

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shares, to decrease common stock by \$54,000, determined by multiplying the number of shares cancelled by \$0.10 par value, and to decrease retained earnings \$1,856,000.

Through June 30, 2002, we recorded other comprehensive income of \$3,402,000 which represents unrealized holding gains on securities held for sale, primarily in Prime Medical common stock, net of tax. Changes in fair value for securities categorized as "available for sale" are excluded from earnings and reported net of deferred income taxes in shareholders' equity until realized.

### LIQUIDITY AND CAPITAL RESOURCES

Current assets exceeded current liabilities by \$6,333,000 at June 30, 2002 and \$3,444,000 at December 31, 2001. Working capital rose in 2002 due to the sale of 1,580,000 shares of Prime Medical common stock which added approximately \$10,600,000 in cash. Partially offsetting this was \$2,275,000 in cash used to pay off a note payable and the purchase of \$1,382,000 in available for sale bonds.

Capital expenditures through the six month period ended June 30, 2002 were approximately \$84,000. Total capital expenditures are expected to be approximately \$150,000 in 2002.

Historically, the Company has maintained a positive working capital position and has been able to satisfy its operational and capital expenditure requirements with cash generated from its operating and investing activities. These same sources of funds have also allowed the Company to pursue investment and expansion opportunities consistent with its growth plans. Although it is uncertain if our operating activities will continue to provide positive cash flow in 2002, we believe that our current strong working capital position will enable us to meet our working capital requirements for the foreseeable future.

### ADOPTION OF ACCOUNTING PRONOUNCEMENTS

Statement of Financial Accounting Standards No. 142. Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), applies to all acquired intangible assets whether acquired singularly, as part of a group, or in a business combination. SFAS 142 supersedes APB Opinion No. 17, "Intangible Assets," and carries forward provisions in Opinion 17 related to internally developed intangible assets. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Goodwill should no longer be amortized, but instead tested for impairment at least annually at the reporting unit level. The accounting provisions are effective for fiscal years beginning after December 31, 2001. A final Statement regarding this proposal is expected to be issued in the fourth quarter of 2002. Our adoption of Statement 144 effective January 1, 2002 did not have a material effect on our financial position or results of operations.

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In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("Statement 144"), Accounting for the Impairment or Disposal of Long-Lived Assets. Statement 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. Statement 144 requires that one accounting model be used for long-lived assets to be disposed of by sale and broadens presentation of discontinued operations to include more disposals. Our adoption of Statement 144 effective January 1, 2002 did not have a material effect on our financial position or results of operations.

Statement of Financial Accounting Standards No. 145. Statement of Financial Accounting Standards No. 145, "Rescission of SFAS Statements No. 4, 44, and 64,

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Amendment of SFAS Statement No. 13, and Technical Corrections" ("SFAS 145"), updates, clarifies and simplifies existing accounting pronouncements. SFAS 145 rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt." SFAS 145 amends SFAS No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The provisions of SFAS 145 related to SFAS No. 4 and SFAS No. 13 are effective for fiscal years beginning and transactions occurring after May 15, 2002, respectively. It is anticipated that the financial impact of SFAS 145 will not have a material effect on our financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", which addresses accounting for restructuring and similar costs. SFAS No. 146 supersedes previous accounting guidance, principally Emerging Issues Task Force (EITF) Issue No. 94-3. PGE NEG will adopt the provisions of SFAS No. 146 for restructuring activities initiated after December 31, 2002. SFAS No. 146 requires that the liability for costs associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF No. 94-3, a liability for an exit cost was recognized at the date of a companys commitment to an exit plan. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. Accordingly, SFAS No. 146 may affect the timing of recognizing future restructuring costs as well as the amount recognized. It is anticipated that the financial impact of SFAS 146 will not have a material effect on our financial position or results of operations.

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### PART II

#### OTHER INFORMATION

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#### 1. LEGAL PROCEEDINGS

We are involved in various claims and legal actions that have arisen in the ordinary course of business. We believe that the liability provision in our consolidated financial statements is sufficient to cover any unfavorable outcome related to lawsuits in which we are currently named. Management believes that liabilities, if any, arising from these actions will not have a significant adverse effect on our financial condition or results of operations. However, due to the uncertain nature of legal proceedings, the actual outcome of these lawsuits may differ from the liability provision recorded in our consolidated financial statements.

#### Item 4. RESULTS OF VOTES OF SECURITY HOLDERS

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On June 12, 2002 the annual meeting of shareholders of American Physicians Service Group, Inc. was held in Austin, Texas. Shareholders voted and approved the following motions:

### ELECTION OF DIRECTORS

The names of the directors elected at the meeting along with numbers of votes for and withheld are as follows:

Name	For	Withheld
Robert L. Myer	1,947,474	40,095
William A. Searles	1,947,470	40,099
Kenneth S. Shifrin	1,947,470	40,099
Marc. R. Still	1,947,475	40,094

### AMENDMENT TO STOCK OPTION PLAN

Approval of amendment to the Company's 1995 Incentive and Non-qualified Stock Option Plan. The votes for, against, and abstain are as follows:

For:	945,425
Against	375,842
Abstain	2,109

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### Item 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) EXHIBITS

99.1 Certification of Chief Executive Officer  
99.2 Certification of Chief Financial Officer

#### (b) CURRENT REPORTS ON FORM 8-K.

Report filed March 6, 2002 concerning the February 25, 2002 sale by American Physicians Service Group, Inc. of 500,000 shares of common stock of Prime Medical Services, Inc.

Report filed April 2, 2002 concerning the March 19, 2002 sale by American Physicians Service Group, Inc. of 1,070,000 shares of common stock of Prime Medical Services, Inc.

Report filed July 25, 2002 concerning the change in certifying accountants from KPMG LLP to BDO Seidman LLP.

