ATLANTIC AMERICAN CORP
Form 10-Q
August 11, 2006

---

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

**FORM 10-Q**

|X| Quarterly report pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

**For the quarterly period ended June 30, 2006**

OR

|_| Transition report pursuant to Section 13 or 15(d) of
the Securities Exchange Act of 1934

Commission File Number 0-3722

**ATLANTIC AMERICAN CORPORATION**
Incorporated pursuant to the laws of the State of Georgia

Internal Revenue Service-- Employer Identification No.
58-1027114

Address of Principal Executive Offices:
4370 Peachtree Road, N.E., Atlanta, Georgia 30319
(404) 266-5500

Indicate by check mark whether 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 by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large Accelerated Filer |_| Accelerated Filer |_| Non-Accelerated Filer |X|

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes |_| No |X|

The total number of shares of the registrant s Common Stock, $1 par value, outstanding on August 9, 2006 was 21,462,077.

---

**ATLANTIC AMERICAN CORPORATION**

**TABLE OF CONTENTS**

**TABLE OF CONTENTS**

**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

**ATLANTIC AMERICAN CORPORATION**
**CONSOLIDATED BALANCE SHEETS**
*(In thousands, except share data)*

**ASSETS**

| | *Unaudited* June 30, 2006 | December 31, 2005 |
|---|---|---|
| Cash and cash equivalents, including short-term investments of $0 and $27,726 | $ 4,003 | $ 41,776 |
| Investments: | | |
| Fixed maturities (cost: $264,790 and $232,564) | 260,390 | 231,907 |
| Common and non-redeemable preferred stocks (cost: $14,269 and $15,398) | 31,997 | 36,108 |
| Other invested assets (cost: $3,586 and $3,659) | 3,558 | 3,660 |
| Mortgage loans | 1,808 | 1,941 |
| Policy and student loans | 1,997 | 2,076 |
| Real estate | 38 | 38 |
| Investment in unconsolidated trusts | 1,238 | 1,238 |
| Total investments | 301,026 | 276,968 |
| Receivables: | | |
| Reinsurance | 50,584 | 57,406 |
| Other (net of allowance for doubtful accounts: $1,537 and $1,501) | 31,113 | 37,643 |
| Deferred income taxes, net | 7,836 | 7,099 |
| Deferred acquisition costs | 25,723 | 27,835 |
| Other assets | 7,791 | 8,682 |
| Goodwill | 3,008 | 3,008 |
| Total assets | $ 431,084 | $ 460,417 |

**LIABILITIES AND SHAREHOLDERS' EQUITY**

| | | |
|---|---|---|
| Insurance reserves and policy funds: | | |
| Future policy benefits | $ 51,494 | $ 51,356 |
| Unearned premiums | 50,820 | 60,879 |
| Losses and claims | 160,507 | 168,617 |
| Other policy liabilities | 5,370 | 5,499 |
| Total policy liabilities | 268,191 | 286,351 |
| Accounts payable and accrued expenses | 29,861 | 35,125 |
| Payable for securities | - | 7,000 |
| Bank debt payable | 12,750 | 10,250 |
| Junior subordinated debenture obligations | 41,238 | 41,238 |
| Total liabilities | 352,040 | 379,964 |

| | | |
|---|---|---|
| Commitments and contingencies (Note 10) | | |
| Shareholders' equity: | | |
| Preferred stock, $1 par, 4,000,000 shares authorized: | | |
| Series B preferred, 134,000 shares issued and outstanding; | | |
| $13,400 redemption value | 134 | 134 |
| Common stock, $1 par; shares authorized: 50,000,000; | | |
| shares issued: 21,455,686 and 21,412,138; | | |
| shares outstanding: 21,455,686 and 21,383,255 | 21,456 | 21,412 |
| Additional paid-in capital | 48,820 | 48,925 |
| Retained earnings (accumulated deficit) | - | (2,780) |
| Accumulated other comprehensive income | 8,634 | 12,846 |
| Treasury stock, at cost; 0 and 28,883 shares | - | (84) |
| Total shareholders' equity | 79,044 | 80,453 |
| Total liabilities and shareholders' equity | $ 431,084 | $ 460,417 |

The accompanying notes are an integral part of these consolidated financial statements.

**TABLE OF CONTENTS**

**ATLANTIC AMERICAN CORPORATION**
**CONSOLIDATED STATEMENTS OF OPERATIONS**
*(Unaudited; In thousands, except per share data)*

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Revenue: | | | | |
| Insurance premiums | $ 38,660 | $ 45,312 | $ 78,994 | $ 91,606 |
| Investment income | 4,795 | 4,272 | 9,258 | 8,308 |
| Realized investment gains, net | 2 | 474 | 3,970 | 34 |
| Other income | 121 | 130 | 441 | 513 |
| Total revenue | 43,578 | 50,188 | 92,663 | 100,461 |
| Benefits and expenses: | | | | |
| Insurance benefits and losses incurred | 22,017 | 29,584 | 47,435 | 62,508 |
| Commissions and underwriting expenses | 16,846 | 14,636 | 30,512 | 29,133 |
| Interest expense | 1,146 | 881 | 2,191 | 1,673 |
| Other | 3,821 | 3,669 | 7,725 | 7,361 |
| Total benefits and expenses | 43,830 | 48,770 | 87,863 | 100,675 |
| Income (loss) before income tax expense (benefit) | (252) | 1,418 | 4,800 | (214) |
| Income tax expense (benefit) | 7 | 176 | 1,565 | (624) |
| Net income (loss) | (259) | 1,242 | 3,235 | 410 |
| Preferred stock dividends | (302) | (301) | (603) | (603) |
| Net income (loss) applicable to common stock | $ (561) | $ 941 | $ 2,632 | $ (193) |
| Net income (loss) per common share (basic and diluted) | $ (.03) | $ .04 | $ .12 | $ (.01) |

The accompanying notes are an integral part of these consolidated financial statements.

**TABLE OF CONTENTS**

**ATLANTIC AMERICAN CORPORATION**
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**
*(Unaudited; In thousands)*

| Six Months Ended June 30, 2006 | Preferred Stock | Common Stock | Additional Paid-in Capital | Retained Earnings (Accumulated Deficit) | Accumulated Other Comprehensive Income | Treasury Stock | Total |
|---|---|---|---|---|---|---|---|
| Balance, December 31, 2005 | $ 134 | $ 21,412 | $ 48,925 | $ (2,780) | $ 12,846 | $ (84) | $ 80,453 |
| Comprehensive income (loss): | | | | | | | |
| Net income | | | | 3,235 | | | 3,235 |
| Decrease in unrealized investment gains | | | | | (6,754) | | (6,754) |
| Fair value adjustment to derivative financial instrument | | | | | 275 | | 275 |
| Deferred income tax attributable to other comprehensive income (loss) | | | | | 2,267 | | 2,267 |
| Total comprehensive loss | | | | | | | (977) |
| Dividends accrued on preferred stock | | | (155) | (448) | | | (603) |
| Deferred share compensation expense | | | 2 | | | | 2 |
| Restricted stock grants | | 22 | (22) | | | | - |
| Amortization of unearned compensation | | | 33 | | | | 33 |
| Purchase of shares for treasury | | | | | | (16) | (16) |
| Issuance of shares for employee benefit plans and stock options | | 22 | 37 | (7) | | 100 | 152 |
| Balance, June 30, 2006 | $ 134 | $ 21,456 | $ 48,820 | $ - | $ 8,634 | $ - | $ 79,044 |
| Six Months Ended June 30, 2005 | | | | | | | |
| Balance, December 31, 2004 | $ 134 | $ 21,412 | $ 50,347 | $ 462 | $ 17,207 | $ (602) | $ 88,960 |
| Comprehensive income (loss): | | | | | | | |
| Net income | | | | 410 | | | 410 |
| Decrease in unrealized investment gains | | | | | (9,045) | | (9,045) |
| Deferred income tax attributable to other comprehensive income (loss) | | | | | 3,166 | | 3,166 |
| Total comprehensive loss | | | | | | | (5,469) |
| Dividends accrued on preferred stock | | | | (603) | | | (603) |
| Deferred share compensation expense | | | (203) | (40) | | 240 | (3) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Restricted stock grants | | | (66) | | | 66 | - |
| Amortization of unearned compensation | | | 33 | | | | 33 |
| Purchase of shares for treasury | | | | | | (79) | (79) |
| Issuance of shares for employee benefit plans and stock options | | | 1 | (27) | | 207 | 181 |
| Balance, June 30, 2005 | $ 134 | $ 21,412 | $ 50,112 | $ 202 | $ 11,328 | $ (168) | $ 83,020 |

The accompanying notes are an integral part of these consolidated financial statements

TABLE OF CONTENTS

**ATLANTIC AMERICAN CORPORATION**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
*(Unaudited; In thousands)*

| | Six Months Ended June 30, | |
|---|---|---|
| | 2006 | 2005 |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | |
| Net income | $ 3,235 | $ 410 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Amortization of deferred acquisition costs | 11,985 | 13,054 |
| Acquisition costs deferred | (9,873) | (11,862) |
| Realized investment gains | (3,970) | (34) |
| (Decrease) increase in insurance reserves | (18,160) | 17 |
| Compensation expense related to share awards | 35 | 30 |
| Depreciation and amortization | 510 | 516 |
| Deferred income tax expense (benefit) | 1,530 | (806) |
| Decrease in receivables, net | 13,627 | 2,116 |
| Decrease in other liabilities | (5,867) | (6,296) |
| Other, net | 440 | (2,106) |
| Net cash used in operating activities | (6,508) | (4,961) |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | |
| Proceeds from investments sold, called, or matured | 23,904 | 55,009 |
| Investments purchased | (57,564) | (52,709) |
| Additions to property and equipment | (103) | (154) |
| Net cash (used in) provided by investing activities | (33,763) | 2,146 |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | |
| Proceeds from bank financing | 3,000 | - |
| Repayment of debt | (500) | (500) |
| Proceeds from the exercise of stock options | 14 | 34 |
| Purchase of treasury shares | (16) | (79) |
| Net cash provided by (used in) financing activities | 2,498 | (545) |
| Net decrease in cash and cash equivalents | (37,773) | (3,360) |
| Cash and cash equivalents at beginning of period | 41,776 | 40,958 |
| Cash and cash equivalents at end of period | $ 4,003 | $ 37,598 |
| **SUPPLEMENTAL CASH FLOW INFORMATION:** | | |
| Cash paid for interest | $ 2,120 | $ 1,600 |
| Cash (received) paid for income taxes | $ (367) | $ 317 |

The accompanying notes are an integral part of these consolidated financial statements.

**TABLE OF CONTENTS**

**ATLANTIC AMERICAN CORPORATION**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**June 30, 2006**
*(Unaudited; In thousands, except per share amounts)*

**Note 1.** Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Atlantic American Corporation (the Parent ) and its subsidiaries (collectively, the Company ). All significant intercompany accounts and transactions have been eliminated in consolidation. The accompanying statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The unaudited condensed consolidated financial statements and the related notes thereto included herein should be read in conjunction with the Company s consolidated financial statements, and the notes thereto, that are included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005. Operating results for the three and six month periods ended June 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006.

**Note 2.** Impact of Recently Issued Accounting Standards

In July 2006, the Financial Accounting Standards Board ( FASB ) issued Interpretation ( FIN ) No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109". FIN No. 48 clarifies the accounting for uncertainty in income taxes by establishing minimum standards for the recognition and measurement of income tax positions taken, or expected to be taken, in an income tax return. FIN No. 48 represents a significant change in accounting for income taxes, and for disclosures related to income taxes, and becomes effective for the Company in 2007. The Company is currently evaluating FIN 48 and has not yet determined the impact, if any, the adoption of this Interpretation will have on our consolidated financial position or results of operations.

In March 2005, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin No. 107 ( SAB No. 107 ), Share-Based Payment , providing guidance on stock option valuation methods, the accounting for income tax effects of share-based payment arrangements upon adoption of Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), Share-Based Payment ( SFAS No. 123R ), and the disclosures in the management s discussion and analysis of financial condition and results of operations section of reports or registration statements subsequent to such adoption. The Company adopted SAB No. 107 on January 1, 2006. Adoption of this statement did not have a material impact on the Company s financial condition or results of operations.

In December 2004, the FASB issued SFAS No. 123R, which replaces SFAS No. 123, Accounting for Stock-Based Compensation ( SFAS No. 123 ) and supersedes Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees . SFAS No. 123R requires all companies to recognize compensation costs for share-based payments to employees based on the grant-date fair value of the award for financial statements. The pro forma disclosures previously permitted under SFAS No. 123 are no longer an alternative to financial statement recognition. The transition method included a prospective or retrospective adoption option. The Company adopted SFAS No. 123R during the first quarter of 2006 using the prospective method. Adoption of this statement did not have a material impact on the Company s financial condition or results of operations (See Note 8).

**Note 3.** Segment Information

The Company has four principal insurance subsidiaries, each focusing on a specific geographic region and/or specific products. Each operating company is managed independently and is evaluated on its individual performance. The following summary sets forth each principal operating company s revenue and pre-tax income (loss) for the three and six month periods ended June 30, 2006 and 2005.

**TABLE OF CONTENTS**

| **Revenues** | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| American Southern | $ 14,330 | $ 13,916 | $ 28,880 | $ 28,034 |
| Association Casualty | 6,234 | 6,589 | 11,359 | 12,704 |
| Georgia Casualty | 6,553 | 11,284 | 17,578 | 22,745 |
| Bankers Fidelity | 16,314 | 18,235 | 34,148 | 36,482 |
| Corporate and Other | 6,291 | 3,364 | 10,839 | 6,641 |
| Adjustments and Eliminations | (6,144) | (3,200) | (10,141) | (6,145) |
| Total Revenue | $ 43,578 | $ 50,188 | $ 92,663 | $ 100,461 |

| **Income (loss) before income taxes** | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| American Southern | $ 2,659 | $ 2,455 | $ 5,316 | $ 3,982 |
| Association Casualty | 763 | 31 | 1,413 | 979 |
| Georgia Casualty | (2,720) | (127) | (970) | (3,459) |
| Bankers Fidelity | 920 | 876 | 2,417 | 1,759 |
| Corporate and Other | (1,874) | (1,817) | (3,376) | (3,475) |
| Consolidated Results | $ (252) | $ 1,418 | $ 4,800 | $ (214) |

**Note 4.** Credit Arrangements

***Bank Debt***

At June 30, 2006, the Company s $12,750 of bank debt with Wachovia Bank, N.A. ( Wachovia ) consisted of a $9,750 term loan (the Term Loan ) as well as a second $3,000 term loan (the Second Term Loan ) that the Company entered into on February 28, 2006. The Term Loan requires the Company to repay $500 in principal on June 30 and $1,250 in principal on December 31 in each of 2006 and 2007, with one final payment of $6,750 at maturity on June 30, 2008. The Second Term Loan requires the Company to repay $3,000 in principal at maturity on April 1, 2007. Both term loans have the same interest rate, covenants, and collateral. The interest rate is the London Interbank Offered Rate ( LIBOR ) plus a margin ranging between 1.75% and 2.50%. As of June 30, 2006 the contractual interest rate on the bank debt was LIBOR plus 2.00%, or 7.50%. The applicable margin is determined based on the ratio of funded debt to consolidated total capitalization, each as defined. The term loans require the Company to comply with certain covenants including, among others, ratios that relate funded debt to capitalization and interest coverage, as well as the maintenance of minimum levels of tangible net worth. The Company also must comply with limitations on capital expenditures, additional debt obligations, equity repurchases and redemptions, as well as minimum risk-based capital levels. On June 30, 2006, in accordance with the Term Loan agreement, the Company repaid $500 in principal to Wachovia, reducing the outstanding amount of the Term Loan to $9,750.

***Junior Subordinated Debentures***

The Company has two unconsolidated Connecticut statutory business trusts, which exist for the exclusive purposes of: (i) issuing trust preferred securities ( Trust Preferred Securities ) representing undivided beneficial interests in the assets of the trusts; (ii) investing the gross proceeds of the Trust Preferred Securities in junior subordinated deferrable interest debentures ( Junior Subordinated Debentures ) of Atlantic American; and (iii) engaging in only those activities necessary or incidental thereto.

**TABLE OF CONTENTS**

At June 30, 2006, the financial structure of each of Atlantic American Statutory Trust I and II were as follows:

| | Atlantic American Statutory Trust I | Atlantic American Statutory Trust II |
|---|---|---|
| JUNIOR SUBORDINATED DEBENTURES [1] [2] | | |
| Principal amount owed | $ 18,042 | $ 23,196 |
| Balance June 30, 2006 | 18,042 | 23,196 |
| Balance December 31, 2005 | 18,042 | 23,196 |
| Coupon rate | LIBOR + 4.00% | LIBOR + 4.10% |
| Interest payable | Quarterly | Quarterly |
| Maturity date | December 4, 2032 | May 15, 2033 |
| Redeemable by issuer on or after | December 4, 2007 | May 15, 2008 |
| TRUST PREFERRED SECURITIES | | |
| Issuance date | December 4, 2002 | May 15, 2003 |
| Securities issued | 17,500 | 22,500 |
| Liquidation preference per security | $ 1 | $ 1 |
| Liquidation value | 17,500 | 22,500 |
| Coupon rate | LIBOR + 4.00% | LIBOR + 4.10% |
| Distribution payable | Quarterly | Quarterly |
| Distribution guaranteed by[3] | Atlantic American Corporation | Atlantic American Corporation |

(1) For each of the respective debentures, the Company has the right at any time, and from time to time, to defer payments of interest on the Junior Subordinated Debentures for a period not exceeding 20 consecutive quarters up to the debentures' respective maturity dates. During any such period, interest will continue to accrue and the Company may not declare or pay any cash dividends or distributions on, or purchase, the Company's common stock nor make any principal, interest or premium payments on or repurchase any debt securities that rank equally with or junior to the Junior Subordinated Debentures. The Company has the right at any time to dissolve each of the trusts and cause the Junior Subordinated Debentures to be distributed to the holders of the Trust Preferred Securities.

(2) The Junior Subordinated Debentures are unsecured and rank junior and subordinate in right of payment to all senior debt of the Parent and are effectively subordinated to all existing and future liabilities of its subsidiaries.

(3) The Parent has guaranteed, on a subordinated basis, all of the obligations under the Trust Preferred Securities, including payment of the redemption price and any accumulated and unpaid distributions to the extent of available funds and upon dissolution, winding up or liquidation.

**Note 5.** Derivative Financial Instruments

On February 21, 2006, the Company entered into a zero cost rate collar with Wachovia to hedge future interest payments on a portion of the Junior Subordinated Debentures. The notional amount of the collar was $18,042 with an effective date of March 6, 2006. The collar has a LIBOR floor rate of 4.77% and a LIBOR cap rate of 5.85% and adjusts quarterly on the 4th of each March, June, September and December through termination on March 4, 2013.

**Note 6.** Reconciliation of Other Comprehensive Income

| | Three Months Ended, June 30, | | Six Months Ended, June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Gain on sale of investments included in net income (loss) | $ 2 | $ 474 | $ 3,970 | $ 34 |
| Other components of comprehensive income (loss): | | | | |
| Net pre-tax unrealized gain (loss) arising during period | $ (3,355) | $ 821 | $ (2,784) | $ (9,011) |
| Reclassification adjustment | (2) | (474) | (3,970) | (34) |
| Net pre-tax unrealized gain (loss) recognized in other comprehensive income (loss) | (3,357) | 347 | (6,754) | (9,045) |
| Fair value adjustment to derivative financial instrument | 143 | - | 275 | - |
| Deferred income tax attributable to other comprehensive income (loss) | 1,124 | (121) | 2,267 | 3,166 |
| Change in accumulated other comprehensive income | (2,090) | 226 | (4,212) | (5,879) |
| Accumulated other comprehensive income beginning of period | 10,724 | 11,102 | 12,846 | 17,207 |
| Accumulated other comprehensive income end of period | $ 8,634 | $ 11,328 | $ 8,634 | $ 11,328 |

**Note 7.** Earnings Per Common Share

A reconciliation of the numerator and denominator of the earnings per common share calculations are as follows:

| | Three Months Ended June 30, 2006 | | |
|---|---|---|---|
| | Income | Shares | Per Share Amount |
| *Basic and Diluted Loss Per Common Share:* | | | |
| Net loss | $ (259) | 21,410 | |
| Less preferred stock dividends | (302) | | |
| Net loss applicable to common shareholders | $ (561) | 21,410 | $ (.03) |

| | Three Months Ended June 30, 2005 | | |
|---|---|---|---|
| | Income | Shares | Per Share Amount |
| *Basic Earnings Per Common Share:* | | | |
| Net Income | $ 1,242 | 21,300 | |
| Less preferred stock dividends | (301) | | |
| Net income applicable to common shareholders | $ 941 | 21,300 | $ .04 |
| *Diluted Earnings Per Common Share:* | | | |
| Effect of dilutive stock options | | 350 | |
| Net income applicable to common shareholders | $ 941 | 21,650 | $ .04 |

| | Six Months Ended June 30, 2006 | | |
|---|---|---|---|
| | Income | Shares | Per Share Amount |
| *Basic Earnings Per Common Share:* | | | |
| Net Income | $ 3,235 | 21,388 | |
| Less preferred stock dividends | (603) | | |
| Net income applicable to common shareholders | $ 2,632 | 21,388 | $ .12 |
| *Diluted Earnings Per Common Share:* | | | |
| Effect of dilutive stock options | | 168 | |
| Net income applicable to common shareholders | $ 2,632 | 21,556 | $ .12 |

| | Six Months Ended June 30, 2005 | | |
|---|---|---|---|
| | Income | Shares | Per Share Amount |
| *Basic and Diluted Loss Per Common Share:* | | | |
| Net income | $ 410 | 21,256 | |
| Less preferred stock dividends | (603) | | |
| Net loss applicable to common shareholders | $ (193) | 21,256 | $ (.01) |

All outstanding stock options for the three months ended June 30, 2006 and the six months ended June 30, 2005 were excluded from the earnings per common share calculation since their impact was antidilutive. The assumed conversion of the Series B Preferred Stock was excluded from the earnings per common share calculation for all periods presented since its impact was antidilutive.

**TABLE OF CONTENTS**

**Note 8.** Stock Options

On January 1, 2006, the Company adopted SFAS 123R using the modified prospective transition method. Under this transition method, compensation cost to be recognized beginning in the first quarter of 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006 and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006. The adoption of SFAS 123R did not have a material impact on the Company s consolidated statements of income or net income per share as there were no outstanding unvested options at January 1, 2006.

Prior to January 1, 2006, stock options were reported under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees instead of the fair value approach recommended in SFAS No. 123 Accounting for Stock-Based Compensation, as amended by SFAS 148, Accounting for Stock-Based Compensation-Transition and Disclosure. Accordingly, no stock-based employee compensation cost attributable to stock options was reflected in net income, as all stock options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. The following pro forma net income and net income (loss) per common share were determined as if SFAS 123R had been in effect for the three month and six month periods ended June 30, 2005. The fair value of these options was estimated using an options pricing model, which requires the input of subjective assumptions, including the volatility of the stock price. If the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation during the three month and six month periods ended June 30, 2005, the Company s net income and net income (loss) per share would have been as follows:

| | Three Months Ended June 30, | Six Months Ended June 30, |
|---|---|---|
| | 2005 | 2005 |
| Net income, as reported | $ 1,242 | $ 410 |
| Stock-based employee compensation expense determined under fair value basis, net of tax | (19) | (38) |
| Pro forma net income | $ 1,223 | $ 372 |
| Net income (loss) per common share: | | |
| Basic - as reported | $ .04 | $ (.01) |
| Basic - pro forma | $ .04 | $ (.01) |
| Diluted - as reported | $ .04 | $ (.01) |
| Diluted - pro forma | $ .04 | $ (.01) |

Due to a variety of factors, including the timing and number of awards, the above pro forma results may not be indicative of the future effect of stock option expensing on the Company s results of operations.

**Note 9.** Employee Retirement Plans

The following table provides the components for the net periodic benefit cost for all defined benefit pension plans:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Service cost | $ 50 | $ 45 | $ 100 | $ 89 |
| Interest cost | 77 | 75 | 155 | 150 |
| Expected return on plan assets | (48) | (47) | (96) | (93) |
| Net amortization | 34 | 35 | 69 | 71 |

| | | | | |
|---|---|---|---|---|
| Net periodic benefit cost | $ 113 | $ 108 | $ 228 | $ 217 |

**TABLE OF CONTENTS**

The weighted-average assumptions used to determine the net periodic benefit cost were as follows:

| | Six Months Ended June 30, | |
|---|---|---|
| | 2006 | 2005 |
| Discount rate | 5.50% | 5.75% |
| Expected return on plan assets | 7.00% | 7.00% |
| Projected annual salary increases | 4.50% | 4.50% |

The Company expects to contribute $184 for all defined benefit pension plans in 2006. During the three month and six month periods ended June 30, 2006, the Company made payments of $32 and $63, respectively, to the pension plans.

**Note 10.** Commitments and Contingencies

From time to time, the Company is involved in various claims and lawsuits incidental to and in the ordinary course of its businesses. In the opinion of management, any such claims are not expected to have a material effect on the business or financial condition of the Company.

TABLE OF CONTENTS

Item 2.

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

The following is management s discussion and analysis of the financial condition and results of operations of Atlantic American Corporation ( Atlantic American or the Parent ) and its subsidiaries (collectively, the Company ) for the three month and six month periods ended June 30, 2006. This discussion should be read in conjunction with the consolidated financial statements and notes thereto included elsewhere herein, as well as with the consolidated financial statements and notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

Atlantic American is an insurance holding company whose operations are conducted through a group of regional insurance companies: American Southern Insurance Company and American Safety Insurance Company (together known as American Southern ); Association Casualty Insurance Company and Association Risk Management General Agency, Inc. (together known as Association Casualty ); Georgia Casualty & Surety Company ( Georgia Casualty ); and Bankers Fidelity Life Insurance Company ( Bankers Fidelity ). Each operating company is managed separately based upon the geographic location or the type of products offered and is evaluated on its individual performance. Management is in the process of conforming information systems, policies and procedures, products, marketing and other functions between Association Casualty and Georgia Casualty to create a southern regional property and casualty operation and increase efficiencies.

### Critical Accounting Policies

The accounting and reporting policies of Atlantic American and its subsidiaries are in accordance with accounting principles generally accepted in the United States of America and, in management s belief, conform to general practices within the insurance industry. The following is an explanation of the Company s accounting policies and the resultant estimates considered most significant by management. These accounting policies inherently require significant judgment and assumptions and actual operating results could differ from management s initial estimates determined using these policies. Atlantic American does not expect that changes in the estimates determined using these policies will have a material effect on the Company s financial condition or liquidity, although changes could have a material effect on its consolidated results of operations.

*Unpaid loss and loss adjustment expenses* comprised 46% of the Company s liabilities at June 30, 2006. This obligation includes estimates for: 1) unpaid losses on claims reported prior to June 30, 2006, 2) development on those reported claims, 3) unpaid ultimate losses on claims incurred prior to June 30, 2006 but not yet reported and 4) unpaid loss adjustment expenses for reported and unreported claims incurred prior to June 30, 2006. Quantification of loss estimates for each of these components involves a significant degree of judgment and estimates may vary, materially, from period to period. Estimated unpaid losses on reported claims are developed based on historical experience with similar claims by the Company. Development on reported claims, estimates of unpaid ultimate losses on claims incurred prior to June 30, 2006 but not yet reported, and estimates of unpaid loss adjustment expenses are developed based on the Company s historical experience, using actuarial methods to assist in the analysis. The Company s actuarial staff develops ranges of estimated development on reported and unreported claims as well as loss adjustment expenses using various methods including the paid-loss development method, the reported-loss development method, the paid Bornhuetter-Ferguson method, the reported Bornhuetter-Ferguson method, the Berquist-Sherman method and a frequency-severity method. Any single method used to estimate ultimate losses has inherent advantages and disadvantages due to the trends and changes affecting the business environment and the Company s administrative policies. Further, a variety of external factors, such as legislative changes, medical inflation, and others may directly or indirectly impact the relative adequacy of liabilities for unpaid losses and loss adjustment expenses. The Company s approach is to select an estimate of ultimate losses based on comparing results of a variety of reserving methods, as opposed to total reliance on any single method. Unpaid loss and loss adjustment expenses are reviewed periodically for significant lines of business, and when current results differ from the original assumptions used to develop such estimates, the amount of the Company s recorded liability for unpaid loss and loss adjustment expenses is adjusted. In the event the Company s actual reported losses in any period are materially in excess of the previous estimated amounts, such losses, to the extent reinsurance coverage does not exist, would have a material adverse effect on the Company s results of operations.

*Future policy benefits* comprised 15% of the Company s total liabilities at June 30, 2006. These liabilities relate primarily to life insurance products and are based upon assumed future investment yields, mortality rates, and withdrawal rates after giving effect to possible risks of adverse deviation. The assumed mortality and withdrawal rates are based upon the Company s experience. If actual results differ from the initial assumptions, the amount of the Company s recorded liability could require adjustment.

*Deferred acquisition costs* comprised 6% of the Company s total assets at June 30, 2006. Deferred acquisition costs are commissions, premium taxes, and other costs that vary with and are primarily related to the acquisition of new and renewal business and are generally deferred and amortized. The deferred amounts are recorded as an asset on the balance sheet and amortized to expense in a systematic manner. Traditional life insurance and long-duration health insurance deferred policy acquisition costs are amortized over the estimated premium-paying period of the related policies using assumptions consistent with those used in computing the related liability for policy benefit reserves. The deferred acquisition costs for property and casualty insurance and short-duration health insurance are amortized over the effective period of the related insurance policies. Deferred policy acquisition costs are expensed when such costs are deemed not to be recoverable from future premiums (for traditional life and long-duration health insurance) and from the related unearned premiums and investment income (for property and casualty and short-duration health insurance). Assessments of recoverability for property and casualty and short-duration health insurance are extremely sensitive to the estimates of a subsequent year s projected losses related to the unearned premiums. Projected loss estimates for a current block of business for which unearned premiums remain to be earned may vary significantly from the indicated losses incurred in any given previous calendar year.

*Receivables* are amounts due from reinsurers, insureds and agents and comprised 19% of the Company s total assets at June 30, 2006. Insured and agent balances are evaluated periodically for collectibility. Annually, the Company performs an analysis of the credit worthiness of the Company s reinsurers using various data sources. Failure of reinsurers to meet their obligations due to insolvencies or disputes could result in uncollectible amounts and losses to the Company. Allowances for uncollectible amounts are established, as and when a loss has been determined probable, against the related receivable. Losses are recognized when determined on a specific account basis and a general provision for loss is made based on the Company s historical experience.

*Cash and investments* comprised 71% of the Company s total assets at June 30, 2006. Substantially all investments are in bonds and common and preferred stocks, which are subject to significant market fluctuations. The Company carries all investments as available for sale and, accordingly, at their estimated fair values. The Company owns certain non-redeemable preferred stocks that do not have quoted values and are carried at estimated fair values as de