FORM 10-K405

Annual report pursuant to section 13 and 15(d), Regulation S-K Item 405

Filing Date: **1999-03-26** | Period of Report: **1998-12-31**
SEC Accession No. 0000950144-99-003252

FILER

AMERICA SERVICE GROUP INC /DE

CIK:**877476**| IRS No.: **510332317** | State of Incorp.:**DE** | Fiscal Year End: **1231**
Type: **10-K405** | Act: **34** | File No.: **000-19673** | Film No.: **99574288**
SIC: **8090** Misc health & allied services, nec

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

<TABLE>
<C> <S>

(MARK ONE)	
[X]	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 1998
	OR
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ____________ TO ____________

</TABLE>

Commission File Number: 0-23340

America Service Group Inc.
(Exact name of registrant as specified in its charter)

<TABLE>
<S> <C>

DELAWARE (State or other jurisdiction of incorporation or organization)	51-0332317 (I.R.S. Employer Identification No.)
105 WESTPARK DRIVE, SUITE 300 BRENTWOOD, TENNESSEE (Address of principal executive offices)	37027 (Zip Code)

</TABLE>

Registrant's telephone number, including area code: (615) 373-3100

Securities Registered Pursuant to Section 12(b) of the Act:

NONE

Securities Registered Pursuant to Section 12(g) of the Act:

COMMON STOCK, PAR VALUE $.01 PER SHARE

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 by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the Common Stock held by non-affiliates of the registrant as of March 23, 1999 (based on the last reported closing price per share of Common Stock as reported on The Nasdaq National Market on such date) was approximately $43,927,182. As of March 23, 1999, the registrant had 3,576,163 shares of Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Not applicable.

PART I

ITEM 1. BUSINESS

This Form 10-K contains statements which may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Those statements include statements regarding the intent, belief or current expectations of America Service Group Inc. and members of its management team. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risks and uncertainties, and that actual results may differ materially from those contemplated by such forward-looking statements. Important factors currently known to management that could cause actual results to differ materially from those in forward-looking statements are set forth below under the caption "Cautionary Statements." America Service Group Inc. undertakes no obligation to update or revise forward-looking statements to reflect changed assumptions, the occurrence of unanticipated events or changes to future operating results over time.

GENERAL

America Service Group Inc. ("ASG" or the "Company"), through its subsidiary Prison Health Services, Inc. ("PHS") and indirect subsidiaries EMSA Correctional Care, Inc. ("EMSA Correctional") and EMSA Military, Inc. ("EMSA Military"), contracts to provide managed healthcare services to correctional facilities and military installations throughout the United States. ASG was incorporated in 1990 as a holding company for PHS. Unless the context otherwise requires, the term "Company" refers to ASG and its direct and indirect subsidiaries. ASG's executive offices are located at 105 Westpark Drive, Suite 300 Brentwood, Tennessee 37027. Its telephone number is (615) 373-3100.

RECENT DEVELOPMENTS

On January 26, 1999, the Company purchased all of the outstanding stock of EMSA Government Services, Inc. ("EMSA") from InPhyNet Administrative Services, Inc. ("InPhyNet") for $67.0 million in cash pursuant to a Stock Purchase Agreement, dated as of December 18, 1998 (the "Stock Purchase Agreement"), as amended by the First Amendment to Stock Purchase Agreement, dated as of January 26, 1999 (the "First Amendment"), between the Company and InPhyNet. InPhyNet is a wholly-owned subsidiary of MedPartners, Inc. ("MedPartners").

EMSA conducts its operations through two wholly-owned subsidiaries, EMSA Correctional and EMSA Military Services, each of which became indirect subsidiaries of the Company as a result of its acquisition of EMSA. EMSA Correctional provides comprehensive managed healthcare solutions to state and local correctional facilities, managing healthcare for approximately 70,000 inmates. Following the EMSA acquisition, the Company, through EMSA Correctional and PHS, manages healthcare for approximately 133,000 inmates in 25 states. EMSA Military contracts with the U.S. Department of Defense (the "DOD") and the Veterans Administration (the "VA") to provide emergency medicine and primary healthcare services to active and retired military personnel and their dependents at medical facilities operated by the DOD and the VA. EMSA Military currently provides such services for military personnel and their dependants at 10 DOD and VA medical facilities.

The purchase price paid to InPhyNet was subject to increase or decrease on a dollar-for-dollar basis by an amount equal to the amount by which EMSA's working capital (as defined in the Stock Purchase Agreement), as reflected on its balance sheet as of January 25, 1999 (the "Closing Date Balance Sheet"),was in excess of or was less than $27.6 million. The Closing Date Balance Sheet reflected working capital of $24.0 million. Accordingly, InPhyNet repaid $3.6 million of the purchase price. The Company will account for the EMSA acquisition using the purchase method of accounting.

In connection with the EMSA acquisition: (i) the Company and all of its subsidiaries, including EMSA, EMSA Military and EMSA Correctional, entered into an Amended and Restated Credit Agreement, dated as

of January 26, 1999 (the "Credit Agreement"), with NationsBank, N.A., as Administrative Agent and Issuing Bank ("NationsBank"), which provides for a revolving credit facility of up to $52.0 million (the "Credit Facility") and (ii) the Company entered into a Securities Purchase Agreement, dated as of January 26, 1999 (the "Securities Purchase Agreement"), with Health Care Capital Partners L.P. ("Capital Partners") and Health Care Executive Partners L.P. ("Executive Partners"), private equity funds managed by Ferrer Freeman Thompson & Co. ("FFT"). On January 26, 1999, pursuant to the Securities Purchase Agreement, the Company issued to Capital Partners and Executive Partners (i) $15.0 million aggregate principal amount of the Company's 12% Subordinated Convertible Bridge Notes due January 26, 2000 (the "Notes") with detachable warrants (the "Warrants") to purchase an aggregate 135,000 shares of the Company's common stock, par value $0.01 per share (the "Common Stock"), and (ii) 50,000 shares of the Company's Series A Convertible Preferred Stock, par value

$0.01 per share (the "Preferred Stock"). ASG received aggregate consideration of $20.0 million for the Notes, Warrants and Preferred Stock. The Notes, Warrants and Preferred Stock are referred to collectively as the "Convertible Securities."

The following table sets forth the sources and uses of funds for the EMSA acquisition (in millions):

<TABLE>

SOURCES:	
Cash	$ 2.1
Borrowings under the Credit Facility	47.0
Proceeds from sale of the Notes	15.0
Proceeds from sale of the Preferred Stock	5.0
Total Sources	$69.1
USES:	
Cash Consideration for EMSA ("Purchase Price")	$67.0
Transaction costs	2.1
Total Uses	$69.1

</TABLE>

At the option of either the Company or the holders of the Notes, the Notes are convertible, subject to certain conditions, into shares of Preferred Stock at a conversion ratio of one share of Preferred Stock for each $100 of outstanding principal amount of Notes. The Warrants entitle the holder thereof to purchase 135,000 shares of Common Stock at the lower of $9.45 and the average closing sale price of the Common Stock for the thirty consecutive trading days prior to the Stockholder Meeting (as defined), provided that such price shall in no event be less than $5.50 per share (subject to adjustment) (the "Warrant Exercise Price"). Subject to certain adjustments, each share of Preferred Stock is convertible, at the option of the holder thereof, into the number of shares of Common Stock determined by dividing the face value of such share of Preferred Stock by the lower of $9.45 and the average closing sale price of the Common Stock for the thirty consecutive trading days prior to the Stockholder Meeting, provided that such price shall in no event be less than $5.50 per share (subject to adjustment).

The conversion of the Notes into shares of Preferred Stock is conditioned upon, among other things, the Company's stockholders approving the issuance of: (i) the shares of Preferred Stock issued to Capital Partners and Executive Partners on January 26, 1999, (ii) the shares of Preferred Stock issuable upon conversion of the Notes and (iii) the shares of Common Stock issuable upon conversion or exercise, as applicable, of the Convertible Securities, to the extent that the number of shares of Common Stock to be issued will be in excess of 20% of the number of shares of Common Stock outstanding, without regard to the shares of Common Stock issuable upon conversion of the Convertible Securities (the "Stock Issuance"). The Securities Purchase Agreement obligates the Company to convene a meeting of its stockholders (the "Stockholder Meeting") to consider and vote upon the approval of the Stock Issuance (the "Stockholder Approval") as soon as practicable following the closing of the Securities Purchase Agreement and no later than July 26, 1999.

If the Company fails to convene the Stockholder Meeting on or before July 26, 1999, the interest on the Notes will increase by 0.05% on July 27, 1999 and will further increase by 0.05% per month to a maximum monthly interest rate of 1.5% (which represents an annual interest rate of 18%) until the Company convenes the Stockholder Meeting. In addition, if the Company fails to convene the Stockholder Meeting on or before

July 26, 1999, fails to take other actions in connection with obtaining Stockholder Approval or fails to take certain other actions required by the terms of the Warrants, the Warrant Exercise Price will be reduced to $.01 per share. The interest on the Notes will not be increased as described above and the Warrant Exercise Price will not be reduced as described above until the maturity of the Notes, in each case, if the sole reason the Company fails to obtain Stockholder Approval is the failure of the holders of the Common Stock to approve the Stock Issuance at a meeting duly called and convened in accordance with the Securities Purchase Agreement.

The Company entered into a Registration Rights Agreement, dated as of January 26, 1999 (the "Registration Rights Agreement"), with Capital Partners and Executive Partners pursuant to which it agreed to register the Common Stock issuable upon conversion of the Preferred Stock issued or issuable to Capital

Partners and Executive Partners pursuant to the Securities Purchase Agreement and exercise of the Warrants for resale by the holders thereof.

The summaries contained herein of certain provisions of the Credit Agreement, the Securities Purchase Agreement, the Notes, the Warrants, the Certificate of Designation of the Preferred Stock, the Registration Rights Agreement, the Stock Purchase Agreement and the First Amendment are qualified in their entirety by reference to all the provisions of such documents, including the definitions therein of certain terms which are not otherwise defined herein. Copies of all such documents except the Stock Purchase Agreement, which was filed as an exhibit to the Company's Current Report on Form 8-K filed with the Securities and Exchange Commission (the "Commission") on January 5, 1999, were filed as exhibits to the Company's Current Report on Form 8-K filed with the Commission on February 10, 1999.

CORRECTIONAL HEALTHCARE SERVICES

Generally. ASG, through PHS and EMSA Correctional, contracts with state, county and local governmental agencies to provide comprehensive healthcare services to inmates of prisons and jails, with a focus on those facilities that maintain an average daily population of over 300 inmates.

ASG generally enters into fixed fee contracts to provide comprehensive healthcare to inmates from their admission to the facility through their release. All of ASG's revenues from correctional healthcare services are generated by payments from governmental agencies, none of which are dependent on third party payment sources. Services provided by ASG include a wide range of on-site healthcare programs, as well as off-site hospitalization and specialty outpatient care. See "-- Services Provided." Hospitalization and most outpatient care is performed through subcontract arrangements with independent doctors and local hospitals.

The following table sets forth information regarding ASG's correctional contracts.

<TABLE>
<CAPTION>

	PRO FORMA (1)	HISTORICAL				
		DECEMBER 31,				
	1998	1998	1997	1996	1995	1994
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Number of correctional contracts(2)..........	96	35	32	34	35	35
Average number of inmates in all facilities covered by correctional contracts(3).......	132,991	63,783	54,364	83,288	82,310	51,939

</TABLE>

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(1) Indicates the combined number of contracts or inmates, as the case may be, for PHS and EMSA Correctional as of December 31, 1998.
(2) Indicates the number of contracts in force at the end of the period specified.
(3) Based on an average number of inmates during the last month of each period specified.

ASG's target correctional market consists of state prisons and county and local jails. A prison is a facility in which an inmate is incarcerated for an extended period of time (typically one year or longer). A jail is a facility in which the inmate is held for a shorter period of time, often while awaiting trial or sentencing. The higher inmate turnover in jails requires that healthcare be provided to a much larger number of individual inmates over time. Conversely, the costs of long-term healthcare requirements are greater with respect to state

prison contracts. State prison contracts often cover a larger number of facilities and often have longer terms than jail contracts.

Services Provided. Generally, ASG's obligation to provide services to a particular inmate begins upon the inmate's admission into the correctional facility and ends upon the inmate's release. Emphasis is placed upon early identification of serious injuries or illnesses so that prompt and cost-effective treatment is commenced.

Medical services provided on-site include physical and mental health screening upon intake. Screening includes the compilation of the inmate's health history and the identification of any current, chronic or acute healthcare needs. After initial screening, services provided may include regular physical and dental screening and care, psychiatric care, OB-GYN screening and care and diagnostic testing. Sick call is held on a regular basis and infirmary bed care is provided in some facilities. Nursing rounds are regularly conducted and physicians, nurse practitioners, physicians' assistants and others are also involved in the delivery of care on a regular basis. Appropriate medications are administered by nursing staff, as needed.

Medical services provided off-site include specialty out-patient diagnostic testing and care, emergency room care, surgery and hospitalization. In addition, ASG provides administrative support services both on-site and at ASG's headquarters and regional offices. Administrative programs include on-site medical records and management and employee education and licensing. Central and regional offices provide quality assurance, medical audits, credentialing, continuing education and clinical program development activities. ASG maintains a utilization review system to monitor the extent and duration of most healthcare services required by inmates on an inpatient and outpatient basis. See "-- Administrative Systems."

Most of the Company's correctional contracts require it to staff the facilities it serves with nurses 24 hours a day. Doctors at the facilities have regular hours and are generally available on call. In addition, dentists, psychiatrists and other specialists are often available on a routine basis. ASG enters into contractual arrangements with independent doctors and local hospitals with respect to more significant off-site procedures and hospitalization. ASG is responsible for all of the costs of such arrangements, unless the relevant contract contains a limit on ASG's obligations in connection with the treatment costs. See "-- Contract Provisions."

The National Commission on Correctional Health Care (the "NCCHC") sets standards for the correctional healthcare industry and offers accreditation to facilities that meet its standards. These standards provide specific guidance related to a service provider's operations including administration, personnel, support services such as hospital care, regular services such as sick call, records management and medical and legal issues. Although accreditation is voluntary, many contracts require compliance with NCCHC standards.

Contract Provisions. ASG's correctional contracts generally provide for a fixed fee, payable monthly, often in advance. In addition to the fixed annual fee, some of ASG's contracts provide for per diem price adjustments based upon fluctuations in the size of inmate populations beyond a specified range. Most contracts also provide for annual increases in the fixed fee based upon the regional medical care component of the Consumer Price Index. In all other contracts that extend beyond one year, ASG utilizes a projection of the future inflation rate when bidding and negotiating the fixed fee for future years. ASG bears the risk of increased or unexpected costs, which could reduce its profits or cause it to sustain losses, and benefits when costs are lower than projected. Certain contracts also contain financial penalties when performance criteria are not achieved.

Contracts accounting for approximately 76% of revenues for the year ended December 31, 1998, and 63% on a pro forma basis after giving effect to the EMSA acquisition, including ASG's contracts with the Indiana Department of Correction (the "Indiana Contract"), Delaware Department of Corrections, Kansas Department of Corrections, and Alameda County, California, contain no limits on ASG's exposure for treatment costs related to catastrophic illnesses or injuries to inmates. Although the specific terms of the limits vary, typically a dollar limit is placed on ASG's responsibility for costs related to illness of or injury to an individual inmate, injuries to more than one inmate resulting from an accident or contagious illnesses affecting more than one inmate. When preparing bid proposals, ASG estimates the extent of its exposure to cost increases, severe individual cases and catastrophic events and attempts to compensate for its exposure in the pricing of its bids.

ASG's management has experience in evaluating these risks for bidding purposes and maintains an extensive database of historical experience. Nonetheless, increased or unexpected costs against which ASG is not protected could render a contract unprofitable. In an effort to manage risk of catastrophic illness or injury of inmates under contracts that do not limit ASG's exposure to such risk, ASG maintains stop loss insurance from an unaffiliated insurer covering hospitalization for amounts in excess of $200,000 per inmate for PHS contracts and $170,000 per inmate for EMSA Correctional contracts. Such stop loss insurance covers 80% of ASG's exposure for such treatment costs. ASG believes this insurance mitigates its exposure to unanticipated expenses of catastrophic hospitalization. See "-- Risk Management."

In general, contracts may be terminated by the governmental agency, and often by ASG as well, without cause at any time upon proper notice (typically between 30 and 180 days). Governmental agencies may be subject to political influences that could lead to termination of a contract with no fault of the contractor. As with other governmental contracts, ASG's contracts are subject to adequate budgeting and appropriation of funds by the governing legislature or administrative body.

The Indiana Contract provides for fixed payment on a per inmate, per day basis. The City of Philadelphia Contract provides for a fixed payment on a fixed dollar basis with a per diem price adjustment based on any increase in the size of the inmate population above a set number. The remainder of ASG's largest existing contracts for the year ended December 31, 1998 -- contracts with the Kansas Department of Corrections, the Delaware Department of Corrections and Alameda County, California -- provide for per diem price adjustments based upon fluctuations in the size of inmate populations beyond a specified range. The fixed fees under all five contracts take into account projected levels of inflation. See "-- Major Contracts."

Administrative Systems. ASG has centralized its administrative systems in order to enhance economies of scale and to provide management with accurate, up-to-date field data for forecasting purposes. These systems also enable ASG to refine its bids and help ASG reduce the costs associated with the delivery of consistent healthcare.

ASG maintains a utilization review system to monitor the extent and duration of most healthcare services required by inmates on an inpatient and outpatient basis. The current automated utilization review program is an integral part of the services provided at each facility. The system is designed to ensure that the medical care rendered is medically necessary and is provided safely in a clinically appropriate setting while maintaining traditional standards of quality of care. The program provides for determinations of medical necessity by medical professionals through a process of pre-authorization and concurrent review of the appropriateness of any hospital stay. The program seeks to identify the maximum capability of on-site healthcare units so as to allow for a more timely discharge from the hospital back to the correctional facility. The utilization review staff consists of nurses who are supported by a medical director at the corporate level and a panel of medical specialists who are consultants to ASG.

ASG has developed a variety of customized databases to facilitate and improve operational review including (i) a claims management tracking system that monitors current incidents, claims and litigation against ASG, (ii) a comprehensive cost review system that analyzes ASG's average costs per inmate at each facility and (iii) a daily operating report to control staffing and off-site utilization.

Bid Process. Contracts with governmental agencies are obtained primarily through a competitive bidding process, which is governed by applicable state and local statutes and ordinances. Although practices vary, typically a formal request for proposal ("RFP") is issued stating the scope of work to be performed, length of contract, performance bonding requirements, minimum qualifications of bidders, selection criteria and the format to be followed in the bid or proposal. Usually, a committee appointed by the governmental agency reviews bids and makes an award determination. The committee may award the contract to a particular bidder or decide not to award the contract to the private sector. The award of a contract may be subject to formal or informal protest, through a governmental appeals process, by unsuccessful bidders.

Many RFPs for significant contracts require the bidder to post a bid bond. Performance bonding requirements are for the length of the contract and at December 31, 1998, generally ranged between 4% and 60% (and in one case, 100%) of the 1998 contract fee.

A successful bidder must often agree to comply with numerous additional requirements regarding record-keeping and accounting, non-discrimination in the hiring of personnel, safety, safeguarding classified information, management qualifications, professional licensing requirements, emergency healthcare needs of corrections employees and other matters. Upon a violation of the terms of an applicable contractual or statutory provision, a contractor may be debarred or suspended from obtaining future contracts for specified periods of time in the applicable location. ASG has never been debarred or suspended in any jurisdiction.

Marketing. ASG gathers and analyzes information on prisons and jails around the country in order to identify the ones that best meet its marketing criteria. Relevant factors include the quality and costs of healthcare in the region, the management and operations of the correctional facility, the financial stability of the governmental agency and the composition of the inmate population. ASG then devotes a substantial portion of its marketing resources to such potential customers. State prison systems, because of their more stable inmate populations and, in many cases, larger number of facilities and longer contract terms, are an important focal point of ASG's marketing plans. Also, ASG will continue to identify those county and local jails that fit its market profile and will pursue contracts with those facilities.

ASG maintains a staff of sales and marketing representatives assigned to specific geographic areas of the United States. In addition, ASG uses consultants to help identify marketing opportunities, to determine the needs of specific potential customers and to engage customers on ASG's behalf. ASG uses paid advertising and promotion to reach prospective clients as well as to reinforce its image with existing clients.

Risk Management. Prior to December 1, 1997, Harbour Insurance, Inc. ("Harbour"), a wholly owned subsidiary of PHS and a captive insurance company, provided insurance covering PHS's medical professional and general liability arising out of its provision of healthcare services. Since December 1, 1997, the Company has maintained professional and general liability insurance through an unaffiliated insurer. ASG was able to substantially fix its insurance costs for medical malpractice liability exposure over the next two years through such unaffiliated insurer. In October 1998, ASG liquidated Harbour and entered into a novation agreement pursuant to which an unaffiliated insurer assumed substantially all of the liabilities of Harbour for outstanding claims as of August 31, 1998.

Prior to October 1998, for contracts where ASG's exposure to the risk of inmates' catastrophic illness or injury was not limited, the Company maintained stop loss insurance for an unaffiliated insurer with respect to hospitalization for amounts in excess of $125,000 per inmate. This stop loss insurance covered 70% of the Company's exposure for such treatment costs. Since October 1998, for contracts where ASG's exposure to the risk of inmates' catastrophic illness or injury is not limited, ASG has maintained stop loss insurance to cover 80% of ASG's exposure with respect to hospitalization for amounts in excess of $200,000 per inmate for PHS contracts and $170,000 per inmate for EMSA Correctional contracts. ASG believes this insurance mitigates its exposure to unanticipated expenses of catastrophic hospitalization.

There can be no assurance that third-party commercial insurance will continue to be available in the future or will be available at reasonable prices. ASG believes its insurance coverage is maintained at reasonable levels, but there can be no assurance that it will cover all claims that may be asserted against ASG and its employees and agents.

MILITARY SERVICES

EMSA Military provides a broad range of emergency medicine and primary healthcare services to active and retired military personnel and their dependents in medical facilities operated by the DOD and the VA. EMSA Military began providing healthcare services to DOD clients in 1988 and has provided in excess of 3.5 million patient visits. During the fiscal year ended December 31, 1998, EMSA Military provided services under 10 contracts.

Most military contracts are for a period of five years, with an initial one year base period and four one year options. EMSA Military's bidding strategy is to seek contract opportunities that will be awarded on a best value, rather than a low cost basis. This allows EMSA to highlight the Company's operational expertise and the overall quality of its provider staff. Margins are determined by the size and risk associated with a specific

contract. The current target markets include VA emergency departments ($1.4 to $2.4 million per site per year in annual revenue) and multi-level facilities operated by TRICARE Prime, a healthcare provider for military personnel and their dependents ($8 to $10 million per site per year in annual revenue).

EMPLOYEES AND INDEPENDENT CONTRACTORS

The services provided by ASG require an experienced staff of healthcare professionals and facilities administrators. In particular, a nursing staff with experience in correctional healthcare and specialized skills in all necessary areas contributes significantly to ASG's ability to provide efficient service. In addition to nurses, ASG's staff of employees or independent contractors includes physicians, dentists, psychologists and other healthcare professionals.

As of December 31, 1998, on a pro forma basis after giving effect to the EMSA acquisition, ASG had approximately 2,950 full-time equivalent employees, including 2,050 medical personnel. ASG also had, on such pro forma basis, under contract 375 independent contractors, most of whom are part-time, including physicians, dentists, psychiatrists and psychologists. ASG's employees at its Alameda County, California, City of Philadelphia and Delaware facilities are represented by labor unions. ASG believes that its employee relations are good.

COMPETITION

The business of providing correctional healthcare services to governmental agencies is highly competitive. ASG is in direct competition with local, regional and national correctional healthcare providers. ASG believes that some of its competitors may have larger staffs and greater resources than ASG. As the private market for providing correctional healthcare matures, ASG's competitors may gain additional experience in bidding and administering correctional healthcare contracts. In addition, new competitors, some of whom may have extensive experience in related fields or greater financial resources than ASG, may enter the market.

MAJOR CONTRACTS

ASG's operating revenue with respect to its correctional healthcare operations is derived exclusively from contracts with state, county and local governmental agencies. ASG's contracts with the States of Indiana and Kansas, the City of Philadelphia and Alameda County, California, accounted for approximately 21%, 17% 16% and 11%, respectively, of revenues during the year ended December 31, 1998. Generally, contracts may be terminated by the governmental agency at will and without cause upon proper notice (typically between 30 and 180 days). Governmental agencies may be subject to political influences that could lead to termination of a contract through no fault of the contractor. Although ASG generally attempts to renew or renegotiate contracts at or prior to their termination, contracts that are put out for bid are subject to intense competition. The loss of one or more of the major contracts could have a material adverse effect on ASG's business.

CAUTIONARY STATEMENTS

All statements made by ASG that are not historical facts are based on current expectations. These statements are forward looking in nature and involve a number of risks and uncertainties. Actual results may differ materially. Among the factors that could cause actual results to differ materially are the following: dependence on major contracts; price competition in the prison healthcare industry; ASG's ability to provide adequate staffing to meet its contractual commitments; changes in performance bonding requirements; substantial damage awards against ASG in connection with medical malpractice claims; changes in laws or regulations or the application thereof; general business and economic conditions; ASG's ability to integrate EMSA's operations successfully into its existing operations; and the other risk factors described in ASG's reports filed from time to time with the Securities and Exchange Commission.

Dependence on Major Contracts. ASG's operating revenue is derived exclusively from contracts with federal, state, county and local governmental agencies. Generally, contracts may be terminated by the governmental agency at will and without cause upon proper notice (typically between 30 and 180 days). Governmental agencies may be subject to political influences that could lead to termination of a contract

through no fault of the contractor. Although ASG generally attempts to renew or renegotiate contracts at or prior to their termination, contracts that are put out for bid are subject to intense competition. The loss of one or more of the major contracts could have a material adverse effect on ASG's business.

Contracts with government agencies are generally complex in nature and subject contractors to extensive regulation under federal, state, county and local law. Under certain circumstances, a government contractor may be debarred or suspended from obtaining future contracts. While ASG considers the possibility remote, such debarment or suspension could have a material adverse effect on ASG.

Privatization of Government Services, Competition and Correctional Population. ASG's future financial performance will depend in part on continued privatization by state, county and local governmental agencies of healthcare services for correctional facilities. There can be no assurance that this market will continue to grow or that existing contracts will continue to be made available to the private sector. The business of providing correctional healthcare services to governmental agencies is highly competitive. ASG is in direct competition with local, regional and national correctional healthcare providers. ASG believes that some of its competitors may have larger staffs and greater resources than ASG. As the private market for providing correctional healthcare matures, ASG's competitors may gain additional experience in bidding and administering correctional healthcare contracts. In addition, new competitors, some of whom may have extensive experience in related fields or greater financial resources than ASG, may enter the market. ASG's business could also be adversely affected by material decreases in the inmate population of correctional facilities.

Acquisitions. ASG's expansion strategy involves both internal growth and, as attractive opportunities become available, acquisitions. The Company took a significant step toward implementing this strategy with the EMSA acquisition. ASG has limited experience acquiring businesses and integrating them into its operations. There can be no assurances that ASG will be able to integrate EMSA or any additional acquired business successfully into its existing operations. Furthermore, there can be no assurance that ASG will be able to operate EMSA or any additional acquired business in a profitable manner.

Catastrophic Limits. Contracts accounting for 76% of revenues for the year ended December 31, 1998, and 63% on a pro forma basis after giving effect to the EMSA acquisition, contain no limits on ASG's exposure for treatment costs related to catastrophic illnesses or injuries to inmates. For those contracts that contain no catastrophic limits, ASG maintains stop loss insurance for 80% of its exposure with respect to catastrophic illnesses or injuries for amounts in excess of $200,000 per inmate for such PHS contracts and $170,000 per inmate for such EMSA Correctional contracts. ASG attempts to compensate for the increased financial risk when pricing contracts that do not contain catastrophic limits. Although, the occurrence of severe individual cases without such limits could render the contract unprofitable and could have a material adverse effect, ASG believes the potential impact of any such occurrences is mitigated by such insurance.

Dependence on Key Personnel. The success of ASG depends in large part on the ability and experience of its senior management. The loss of services of one or more key employees could adversely affect ASG's operations. ASG has employment contracts with Michael Catalano, President and Chief Executive Officer, Gerard F. Boyle, Executive Vice President and Chief Operating Officer of the Company, Bruce A. Teal, Senior Vice President and Chief Financial Officer, and Jean L. Byassee, Senior Vice President, General Counsel and Secretary.

Dependence on Healthcare Personnel. ASG's success depends on its ability to attract and retain highly skilled healthcare personnel. A shortage of trained and competent employees and/or independent contractors may result in overtime costs or the need to hire less efficient temporary staff. Attracting qualified nurses at a reasonable cost has been and continues to be of concern to ASG. There can be no assurance that ASG will be successful in attracting and retaining a sufficient number of qualified healthcare personnel in the future.

Corporate Exposure to Professional Liability. ASG periodically becomes involved in medical malpractice claims with the attendant risk of substantial damage awards. The most significant source of potential liability in this regard is the risk of suits brought by inmates alleging lack of timely or adequate healthcare services. ASG may be liable, as employer, for the negligence of healthcare professionals who are employees of ASG. ASG may also have potential liability for the negligence of healthcare professionals engaged by ASG as

independent contractors. ASG's contracts generally provide for ASG to indemnify the governmental agency for losses incurred related to healthcare provided by ASG and its agents. ASG maintains professional liability insurance and requires its independent contractors to maintain professional liability insurance in amounts deemed appropriate by management based upon ASG's claims history and the nature and risks of its business. There can be no assurance that a future claim or claims will not exceed the limits of available insurance coverage or that such coverage will continue to be available at a reasonable cost.

ITEM 2. PROPERTIES

The Company occupies approximately 12,500 square feet of leased office space in Brentwood, Tennessee, where it maintains its corporate headquarters. The Company's lease on its current headquarters expires in October 2003. The Company leases additional office facilities in Newark, Delaware; Indianapolis, Indiana; Alameda, California; Topeka, Kansas, Fort Lauderdale, Florida and Concordeville and Pittsburgh, Pennsylvania. While the Company may open additional offices to meet the local needs of future contracts awarded in new areas, management believes that its current facilities are adequate for its existing contracts for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

The Company is subject to claims and suits in the ordinary course of business. In management's opinion, such currently pending legal proceedings and claims against the Company will not, in the aggregate, have a material adverse effect on the Company.

ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

The Common Stock is traded on The Nasdaq Stock Market's National Market System under the symbol "ASGR." As of March 25, 1999, there were approximately 187 holders of record of the Common Stock. The high and low prices of the Common Stock as reported on The Nasdaq Stock Market during each quarter from January 1, 1997 through December 31, 1998 are shown below:

QUARTER ENDED	HIGH	LOW
March 31, 1997	$13.63	$ 9.25
June 30, 1997	14.75	9.25
September 30, 1997	15.75	14.00
December 31, 1997	19.13	13.38
March 31, 1998	$15.00	$ 7.44
June 30, 1998	14.50	12.00
September 30, 1998	13.00	7.63
December 31, 1998	14.00	8.63

ITEM 6. SELECTED FINANCIAL DATA

	FOR THE YEAR ENDED DECEMBER 31,				
	1998	1997	1996	1995	1994
	(IN THOUSANDS, EXCEPT PER SHARE DATA)				
STATEMENT OF OPERATIONS DATA:					
Healthcare revenues	$113,287	$129,211	$152,282	$115,238	$109,983
Income (loss) before income taxes (benefits)	5,099	1,786	(9,933)	1,146	1,646
Net income (loss)	5,724	1,685	(8,686)	687	996
Net income (loss) attributable to common shares	5,724	1,742	(8,912)	687	996
Net income (loss) per common shares -- basic	1.61	0.50	(2.81)	0.23	0.33
Net income (loss) per common shares -- diluted	1.57	0.48	(2.81)	0.21	0.32
Weighted average common shares outstanding	3,554	3,480	3,171	3,027	2,994
Weighted average common shares outstanding and common equivalent shares outstanding	3,653	3,657	3,171	3,221	3,126

	AS OF DECEMBER 31,				
	1998	1997	1996	1995	1994
BALANCE SHEET DATA:					
Working capital (deficit)	$ 10,515	$ 257	$ (2,434)	$ 2,692	$ 2,302
Total assets	28,375	27,754	42,709	42,501	32,108
Redeemable common stock, common stock, additional paid-in-capital, retained earnings (deficit) and treasury stock	12,791	6,641	4,384	8,667	8,188

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS

OF OPERATIONS

RESULTS OF OPERATIONS

The following table sets forth, for the years indicated, the percentage relationship to total revenue of certain items in the Consolidated Statements of Operations.

PERCENTAGE OF TOTAL REVENUES	YEAR ENDED DECEMBER 31, 1998	1997	1996
Healthcare revenue	99.5%	99.5%	99.5%
Interest income	.5	.5	.5
Total revenue	100.0	100.0	100.0
Healthcare expenses	88.3	91.3	95.2
Gross margin	11.7	8.7	4.8
Selling, general and administrative expenses	8.3	7.3	7.2
Nonrecurring (gain) loss	(1.1)	--	4.1
Income (loss) from operations	4.5	1.4	(6.5)
Provision for income taxes (benefits)	(.5)	.1	(.8)
Net income (loss)	5.0	1.3	(5.7)
Change in redeemable common stock	--	--	.1
Net income (loss) attributable to common stock	5.0%	1.3%	(5.8%)

1998 Compared to 1997

Healthcare revenues decreased $15.9 million from $129.2 million in 1997 to $113.3 million in 1998, representing a 12% decrease. The decline in revenues resulted from the termination of the Georgia Department of Corrections Contract (the "Georgia Contract") which expired in June 1997, and provided revenue of $31.3 million in the year ended December 31, 1997. The Company added three new contracts in 1998, which generated $0.8 million in new revenues, and experienced $14.6 million of revenue growth from

existing contracts through population increases, contract renegotiations, automatic price adjustments and from being in effect a full year. The Company did not lose any contracts in 1998.

Interest income of $0.6 million in 1998 declined from $0.7 million in 1997 due to the dissolution of Harbour and the subsequent liquidation of its long-term restricted investments.

The cost of healthcare decreased $18.0 million or 15% to $100.6 million in 1998. Healthcare expenses as a percentage of revenues were 88% in 1998 versus 91% in 1997. The medical loss ratio was favorably impacted by certain healthcare expenses and lease costs being reimbursed by MedPartners pursuant to a settlement agreement entered into upon the termination during the first quarter of 1998 of MedPartners' agreement to acquire the Company (the "Settlement Agreement"). These costs were approximately $1.5 million or 1% of total revenue. Healthcare expenses exclusive of the Georgia Contract were 89% in 1997. Personnel costs and fringe benefits related to inmate care were 45% of revenues in 1998 versus 57% of revenues in 1997. The significant decline is attributable to the existing contracts generally being more full service versus staffing only and the Indiana Contract, where PHS is not responsible for nursing coverage. Costs related to outside services (defined as hospitalization, emergency room and ambulance and outpatient surgeries and visits) were 15% of revenues in 1998 and 17% of revenues in 1997. The decline is due to the Company's continued emphases on network development and case management.

Selling general and administrative expenses were $9.4 million in 1998 compared to $9.5 million in 1997. The decrease is due to the Company's continued attempt to streamline the corporate support functions.

The Company recorded a nonrecurring gain of $1.2 million which is directly related to the Settlement Agreement.

The income tax benefit was $0.6 million in 1998 compared to $0.1 million expense in 1997. The benefit relates to the elimination of valuation allowances on the Company's deferred tax assets in 1998. As of December 31, 1998, the Company had approximately $5.7 million in net operating loss carry forwards.

1997 Compared to 1996

Healthcare revenues decreased $23.1 million from $152.3 million in 1996 to $129.2 million in 1997, representing a 15% decrease. The decline in revenues resulted primarily from the expiration in June 1997 of the Georgia Contract. The Georgia Contract generated $31.3 million in the year ended December 31, 1997, compared to $56.7 million in 1996. The Company added five new contracts in 1997, which generated $9.9 million in new revenues, and experienced $13.0 million of revenue growth from existing contracts through contract renegotiations, automatic price adjustments and from contracts being in effect a full year. Revenues were negatively impacted by the loss of eight contracts during 1997, which generated $40.2 million of revenues in 1997, compared to $77.5 million of revenues in 1996. Contract revenues for 1996 include $9.1 million of revenues from contracts that were terminated in that year.

Interest income of $.7 million in 1997 declined from $.8 million in 1996 due to the cash expenditure involved with the expiration of the Georgia Contract.

The cost of healthcare decreased $27.0 million or 19% to $118.6 million in 1997. Healthcare expenses as a percentage of revenues were 91% in 1997 versus 95% in 1996. Healthcare expenses exclusive of the Georgia Contract were 89% and 91% in 1997 and 1996, respectively. Personnel costs and fringe benefits related to inmate care were 57% of revenues in 1997 versus 64% of revenues in 1996. The significant decline is attributable to the existing contracts generally being more full service versus staffing only. Costs related to outside services (defined as hospitalization, emergency room and ambulance and outpatient surgeries and visits) were 17% of revenues in 1997 and 1996.

At December 31, 1996, the Company had reserved $2.8 million in anticipated losses relating to the Georgia Contract. During 1997, the Company recorded an additional $1.4 million in healthcare expenses relating to the further deterioration of the contract's operating performance. Due to continued enhancements in the clinical and risk management areas, healthcare expenses were positively impacted by $1.4 million in adjustments to Harbour's estimates of medical malpractice claims.

Selling, general and administrative expenses were $9.5 million in 1997 compared to $11.1 million in 1996. The decrease was attributable to the corporate reengineering and downsizing implemented throughout 1997.

The provision for income taxes was $0.1 million of expense in 1997 compared to $1.2 million of benefit in 1996. Income taxes for 1997 relate to various state income taxes. The Company did not incur any federal income taxes due to the utilization of net operating loss carryforwards.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash and cash equivalents and short-term investments as of December 31, 1998 were $7.2 million compared to $5.0 million as of December 31, 1997. The increase is attributable to the dissolution of Harbour, which provided approximately $4.6 million in cash offset by funding the increase in accounts receivable. Accounts receivable increased due to the timing of payment on two major contracts' base fees. Payments were received subsequent to December 31, 1998 for both contracts' base fees. During 1998, the Company received $0.3 million in cash from the exercise of stock options.

Accrued expenses of the Company decreased $3.4 million from $16.5 million at December 31, 1997 to $13.1 million at December 31, 1998. The reduction is attributable to the portfolio transfer of all outstanding medical malpractice claims covered by Harbour and the Company's reduction in average days outstanding of medical claims under at-risk contracts.

As part of the EMSA acquisition, the Company increased its $20 million line of credit facility to a $52 million Credit Facility. Under the Credit Facility, the Company has available a $10 million line of credit for general corporate purposes, including working capital and the funding of acquisitions. The interest rate is based upon LIBOR or prime rate, subject to the quarterly operating performance of the Company and other funding criteria, as defined in the Credit Facility. The Credit Facility is subject to certain quarterly covenants.

Management believes that the current levels of cash, cash equivalents and investments, when coupled with the internally generated funds and available credit, are sufficient to meet the Company's immediate foreseeable future cash needs and anticipated contract renewal activity.

INFLATION

The increase in the healthcare costs in 1998 over 1997 was 3.2%, compared to an overall increase in the Consumer Price Index of 1.6% for all costs for the same period.

Some of the Company's contracts provide for annual increases in the fixed base fee upon changes in the regional medical care component of the Consumer Price Index. In all other contracts that extend beyond one year, the Company utilizes a projection of the future inflation rate when bidding and negotiating the fixed fee for future years. If the rate of inflation exceeds the levels projected, such excess will be absorbed by the Company. Conversely, the Company will benefit should the actual rate of inflation fall below the estimated used in the bidding and negotiation process.

IMPACT OF YEAR 2000

The Year 2000 problem is the result of two potential malfunctions that could have an impact on the Company's operations. The first is computer systems and software being programmed to use two rather than four digits to define the applicable year. The second is the use of embedded chips that have been designed using two rather than four digits to define the applicable year. These chips are often used in medical equipment used in certain Company sites.

The Company has completed the evaluation of all computer systems and software it currently utilizes and has determined that 85% of all computer systems and software will be in compliance without modification. The Company is currently in the process of modifying or replacing the remaining 15% of its computer systems and software. The general ledger, accounts payable and accounts receivable systems have been tested and upgraded, as needed. Timekeeping software is currently being upgraded and this process is 87% complete. The timekeeping upgrades will be completed by April 30, 1999. The Company's most significant outsourcing

contract is for medical claims processing and payment and that vendor has certified that all Year 2000 modifications will be completed by December 31, 1999.

The Company has undertaken a program to inventory, assess and correct or replace the equipment that contains embedded chips. The Company has a plan to inventory its sites, contact vendors, analyze information provided and replace or modify devices or equipment that will have a direct impact on patient safety and health. The Company anticipates completion in all material respects of this portion of its Year 2000 assessment program by July 1999.

The Company is relying on information that is being provided by equipment and medical device manufacturers regarding the Year 2000 compliance status of their products. While the Company is attempting to evaluate information provided by its present vendors, there can be no assurances that in all instances accurate information is being provided. The Company also cannot in all instances guarantee that the repair, replacement or upgrade of all items of equipment and medical device systems will occur on a timely basis. Contingency planning will be established and implemented in an effort to minimize any impact from Year 2000 related failures of such equipment. The Company anticipates its contingency planning for this aspect of its Year 2000 assessment to be completed by July 31, 1999. Costs as a result of these types of occurrences are in the process of being determined.

The Company has also initiated communications with suppliers and vendors whose supplies are essential for day-to-day operations regarding their state of Year 2000 readiness. The Company is continuing its effort to obtain such information from all critical suppliers and vendors and feels that it will be able to determine its vendors' status by April 30, 1999. Failure of certain suppliers and vendors to remain in business without interruptions following December 31, 1999 could have a material impact on operations or the Company's ability to provide healthcare services. Contingency plans may include stockpiling medical supplies and materials, increasing inventory levels and securing alternate sources of supply. The Company anticipates its contingency planning for this aspect of its Year 2000 assessment to be completed by July 31, 1999. Costs as a result of these types of occurrences are in the process of being determined.

Because the Company's physical sites are located within facilities owned and operated by other entities whose Year 2000 readiness efforts it does not control, there will be issues that arise which are dependent on these clients' efforts. The Company has communicated with many of its clients on these matters. The Company anticipates its contingency planning for this aspect of its Year 2000 assessment to be completed by July 31, 1999 and feels costs related to this phase will be immaterial.

The Company expects to expend approximately $110,000 in connection with evaluating, modifying and replacing its computer systems and software and expects to fund such expenditures through operating cash flows. However, there can be no guarantees that these estimates will be achieved and actual results could differ materially from those anticipated.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The Company's Consolidated Financial Statements, together with the report thereon of Ernst & Young LLP, dated February 12, 1999, begin on page F-1 of this Report.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There are no disagreements with accountants on accounting and financial disclosure required to be reported in this annual report pursuant to Item 304 of Regulation S-K.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The following table sets forth certain information, including ownership of the Common Stock, as of March 23, 1999, with respect to: (i) each continuing director or nominee; (ii) each executive officer; and (iii) all continuing directors and executive officers as a group. Except as disclosed under Item 12, "Security Ownership of Certain Beneficial Owners and Management -- Preferred Stock" with respect to David A. Freeman, none of such persons owned any shares of Preferred Stock.

<TABLE>
<CAPTION>

NAME AND AGE	PRINCIPAL OCCUPATION OR EMPLOYMENT (BY THE COMPANY UNLESS OTHERWISE INDICATED)	DIRECTOR SINCE	NUMBER OF SHARES OF COMMON STOCK OWNED (1)	PERCENTAGE
<S>	<C>	<C>	<C>	<C>
Michael Catalano, 47	President and Chief Executive Officer since September 1, 1998; Executive Vice President of Development, General Counsel and Secretary of the Company from July 1996 to September 1, 1998; Senior Vice President Planning and Development and Chief Legal Counsel of Magellan Health Services, Inc. (formerly Charter Medical Corporation) from 1989 through February 1996.	1998	50,666	1.4%
William D. Eberle, 75(2)	Chairman of the Executive Committee of the Board of Directors since September 1, 1998; Chairman of the Board of Directors from March 1995 to September 1, 1998; Chairman, Manchester Associates, Ltd., an international consulting company, since 1995; Of Counsel to Kaye Scholer, Fierman, Hays & Handler, a law firm, since 1993.	1991	49,000(3)	1.4%
David A. Freeman, 37	Member of Ferrer Freeman Thompson & Co., General Partner of Health Care Capital	1999(3)	664,100(4)	15.7%

	Partners L.P. and Health Care Executive Partners L.P., each of which is an investment management company, since October 1995; Managing Director of J.P. Morgan & Co., Inc., an investment banking firm, from September 1983 through September 1995.			
John W. Gildea, 55(5)	Managing Director, Gildea Management Co., an investment management company.	1986	39,115	1.1%
Carol R. Goldberg, 68(6)	President, AVCAR Group, Ltd., a management consulting firm.	1991	23,000	*

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<TABLE>
<CAPTION>

NAME AND AGE	PRINCIPAL OCCUPATION OR EMPLOYMENT (BY THE COMPANY UNLESS OTHERWISE INDICATED)	DIRECTOR SINCE	NUMBER OF SHARES OF COMMON STOCK OWNED (1)	PERCENTAGE
<S>	<C>	<C>	<C>	<C>
Jeffrey L. McWaters, 42	Chairman, President and Chief Executive Officer of Amerigroup Corporation (formerly Americaid, Inc.), a managed health care company, since October 1994; President and Chief Executive Officer of Options Mental Health, a managed mental health care company and a subsidiary of First Hospital Corporation, from 1991 through September 1994.	N/A	0	--
Richard M. Mastaler, 53	Chairman and Chief Executive Officer of CCN Managed Care, Inc., a managed health care company, since August 1997; Executive Vice President -- Mergers and Acquisitions and Product Development of Magellan Health Services, Inc., a managed behavioral health care company, from September 1996 through August 1997; President and Chief Executive Officer of Unilab Corporation, a clinical and pathological laboratory, from April 1994 through March 1996.	N/A	0	--
Scott L. Mercy, 37	Chairman and Chief Executive Officer of LifePoint Hospitals, a group of rural hospitals to be spun out of Columbia/HCA Healthcare Corp. during the second quarter of 1999, since September 1998; Chairman of the Board of Directors since September 1, 1998; President and Chief Executive Officer of the Company from April 1, 1996 through September 1, 1998; Senior Vice President -- Financial Operations of Columbia/HCA Healthcare Corporation from 1994 through 1995; Vice President -- Financial Operations and Director -- Financial Operations Support of Hospital Corporation of	1996	361,000(7)	9.6%

	America from 1987 through 1994.			
Richard D. Wright, 53	Chairman, President and Chief Executive Officer of Covation LLC, a provider of software inte-	N/A	0	*

</TABLE>

<TABLE>
<CAPTION>

NAME AND AGE	PRINCIPAL OCCUPATION OR EMPLOYMENT (BY THE COMPANY UNLESS OTHERWISE INDICATED)	DIRECTOR SINCE	NUMBER OF SHARES OF COMMON STOCK OWNED (1)	PERCENTAGE
<S>	<C>	<C>	<C>	<C>
	gration and data management services for health care providers and organizations, since December 1998; Co-Founder and Executive Vice President, Corporate Services of PhyCor, Inc., a physician practice management company, from 1997 through December 1998; Executive Vice President of Operations from 1988 through 1997.			
OTHER EXECUTIVE OFFICERS				
Gerard F. Boyle, 44	Executive Vice President of the Company since February 1998; President and Chief Executive Officer of Prison Health Services, Inc., a wholly owned subsidiary of the Company ("PHS"), since March 1998; Vice President of Operations of EMSA Correctional Care, Inc., from September 1996 through February 1998; Vice President and Administrator of Sales for EMSA Correctional Care, Inc. from July 1994 through August 1996; Regional Administrator for Operations (Southeast Virginia) for EMSA Correctional Care, Inc. from January 1993 through July 1994.	--	25,671	*
Bruce A. Teal, 37	Senior Vice President and Chief Financial Officer of the Company since February 1998; Vice President, Controller and Treasurer of the Company from December 1996 through February 1998; Vice President of Financial Operations of Vendell Healthcare from October 1992 through November 1996.	--	23,807	*
All continuing Directors and executive officers as a group (10 persons)			1,236,359	27.6%

</TABLE>

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* Less than 1%

(1) Includes the following shares subject to options exercisable presently or within 60 days: Mr. Catalano, 44,000 shares; Mr. Eberle, 48,000 shares; Mr. Gildea, 38,000 shares; Ms. Goldberg, 23,000 shares; Mr. Mercy, 175,000 shares; Mr. Boyle, 25,000 shares; Mr. Teal, 22,110 shares; and all continuing directors and executive officers as a group, 375,110 shares.

(2) Mr. Eberle also serves on the Boards of Directors of Ampco-Pittsburgh Corporation, Mitchell Energy & Development Corporation, Konover Property Trust and Showscan Entertainment, Inc.
(3) Mr. Freeman was appointed to the Board of Directors on January 26, 1999 pursuant to the terms of the Securities Purchase Agreement (as defined below). See "Certain Transactions."
(4) Mr. Freeman is deemed to beneficially own the shares of Common Stock which are issuable upon the exercise of the Warrants and Preferred Stock issued to Health Care Capital Partners L.P. and Health Care Executive Partners L.P. See Item 13, "Certain Relationships and Related Transactions."
(5) Mr. Gildea also serves on the Boards of Directors of General Chemical Group Inc. and Konover Property Trust.
(6) Ms. Goldberg also serves on the Board of Directors of The Gillette Company and Selfcare, Inc.
(7) Includes 146,000 shares of Common Stock purchased by Mr. Mercy from the Company, 40,000 shares of Common Stock issued under the Old Mercy Agreement (as defined), (which are presently held in the name of his spouse and beneficial ownership of which he disclaims), and options to purchase 175,000 shares of Common Stock. The shares of Common Stock purchased by Mr. Mercy and the shares of Common Stock issued under the Old Mercy Employment Agreement are subject to certain repurchase rights in favor of the Company and Mr. Mercy. See Item 11, "Executive Compensation -- Employment Agreements."

ITEM 11. EXECUTIVE COMPENSATION

SUMMARY COMPENSATION TABLE

The following table sets forth information concerning the compensation of the Company's Chief Executive Officer and the two most highly compensated executive officers other than the CEO (the "Named Executives") for each of the years 1996 through 1998. The Company has no other executive officers other than the individuals named below.

<TABLE>
<CAPTION>

		ANNUAL COMPENSATION			LONG-TERM COMPENSATION		
NAME AND PRINCIPAL POSITION	YEAR	SALARY	BONUS	OTHER ANNUAL COMPENSATION	RESTRICTED STOCK ($)	STOCK OPTIONS(#)	ALL OTHER COMPENSATION (1)
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Scott L. Mercy (2)..........	1998	$155,000	$175,375	$ --	$ --	--	$ --
	1997	190,000	--	--	--	--	16,533
	1996	138,846	--	--	350,000	175,000	9,223
Michael Catalano (3)........	1998	$186,862	$187,832	$ --	$ --	--	$ 3,454
President and Chief	1997	165,500	--	56,000(4)	--	--	13,384
Executive Officer	1996	83,077	--	--	--	60,000	4,452
Gerard F. Boyle (5).........	1998	$162,413	$ 71,445	$29,068(3)	$ --	85,000	$ 2,500
Executive Vice	1997	--	--	--	--	--	--
President and Chief	1996	--	--	--	--	--	--
Operating Officer							
Bruce A. Teal (6)..........	1998	$159,259	$160,643	$ --	$ --	33,000	$ 2,500
Senior Vice	1997	115,000	--	--	--	--	102
President and Chief	1996	4,423	--	--	--	17,000	9
Financial Officer							

</TABLE>

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(1) Includes matching contributions by the Company to its 401(k) Profit Sharing Plan and life and health insurance premiums paid by the Company on behalf of the Named Executives.
(2) Mr. Mercy became President and Chief Executive Officer of the Company on April 1, 1996. Mr. Mercy resigned his position as President and Chief Executive Officer on September 1 , 1998.
(3) Mr. Catalano served as Executive Vice President of Development, General Counsel and Secretary of the Company from July 12, 1996 through September 1, 1998. Mr. Catalano became President and Chief Executive Officer of the Company on September 1, 1998.
(4) Represents reimbursement for relocation costs.

(5) Mr. Boyle became Executive Vice President and Chief Operating Officer of the Company on February 12, 1998.
(6) Mr. Teal served as Vice President, Controller and Treasurer of the Company from December 10, 1996 through February 20, 1998. Mr. Teal became Senior Vice President and Chief Financial Officer of the Company on February 20, 1998.

STOCK OPTION GRANTS AND VALUES

The following table sets forth certain information with respect to stock options granted to the Named Executives during 1998 and the potential realizable value of such options.

<TABLE>
<CAPTION>

NAME	NUMBER OF SECURITIES UNDERLYING OPTIONS/ SARS GRANTED (#)	% OF TOTAL OPTIONS/SARS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE OR BASE PRICE ($/SH)	EXPIRATION DATE	POTENTIAL REALIZABLE VALUE AT ASSUMED ANNUAL RATES OF STOCK PRICE APPRECIATION FOR OPTION TERM 5% ($)	10% ($)
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Michael Catalano						
Feb. 20, 1998..........................	12,000	3.7	9.69	Feb. 20, 2008	73,080	185,280
Sept. 1, 1998..........................	50,000	15.8	8.69	Sept. 1, 2008	273,000	692,000
Gerald Boyle						
Feb. 12, 1998..........................	75,000	23.4	9.37	Feb. 12, 2008	442,500	1,120,500
Sept. 1, 1998..........................	10,000	3.1	8.69	Sept. 1, 2008	54,600	138,400
Bruce Teal						
Feb. 20, 1998..........................	33,000	10.3	9.69	Feb. 20, 2008	200,970	509,520

</TABLE>

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR-END OPTION VALUE TABLE

The following table sets forth certain information with respect to option exercises by the Named Executives during 1998 and the value of options owned by the Named Executives at December 31, 1998.

<TABLE>
<CAPTION>

NAME	SHARES ACQUIRED ON EXERCISE(#)	VALUE REALIZED($)	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS AT FY-END(#) EXERCISABLE/ UNEXERCISABLE	VALUE OF UNEXERCISED IN-THE-MONEY OPTIONS AT FY-END($)(1) EXERCISABLE/ UNEXERCISABLE
<S>	<C>	<C>	<C>	<C>
Scott L. Mercy..............	--	$--	175,000/0	$ 743,750/-
Michael Catalano............	--	--	40,000/82,000	-/225,406
Gerard F. Boyle.............	--	--	0/85,000	-/315,380
Bruce A. Teal...............	--	--	11,220/38,780	41,374/130,643

</TABLE>

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(1) Based on the closing price of the Common Stock on the Nasdaq National Market System on December 31, 1998 of $13.00 per share.

EMPLOYMENT AGREEMENTS

Scott L. Mercy was employed as President and Chief Executive Officer of the Company from April 1, 1996 through September 1, 1998 pursuant to an employment agreement, which was amended on June 30, 1997 (the "Old Mercy Agreement"). The Old Mercy Agreement provided for a minimum annual base salary of $190,000, an annual bonus based upon performance objectives, and such additional compensation as determined by the Compensation Committee from time to time. On September 1, 1998, Mr. Mercy and the Company amended and restated the Old Mercy Agreement (the "New Mercy Agreement") pursuant to which Mr. Mercy was appointed Chairman of the Board of Directors. Pursuant to the New Mercy Agreement, Mr. Mercy was paid a base salary of $60,000 for his service as Chairman of the Board during 1998. For years after 1998, the New Mercy Agreement establishes a minimum annual base salary of $24,000 and such additional compensation as may be determined by the Compensation Committee from time to time. Pursuant

to the Old Mercy Agreement, Mr. Mercy purchased 146,000 shares of Common Stock from the Company at $8.75 per share, the mean between the high and low sale prices for the Common Stock on April 1, 1996, received 40,000 shares as a restricted stock award under the Company's Incentive Stock Plan, and was awarded options to purchase 175,000 additional shares of Common Stock, at $8.75 per share. Pursuant to the Old Mercy Agreement the restricted stock and stock options were to vest in installments over four years, or earlier in one-third installments when the closing price of the Common Stock reached $12, $14 and $16, respectively. Mr. Mercy's restricted stock and stock options vested in 1996 when the closing price of the Common Stock exceeded $16 per share. Pursuant to the New Mercy Agreement, Mr. Mercy has the right to require the Company to purchase (and the Company has the right to require Mr. Mercy to sell), at a price not less than $9.90 per share, the purchased shares and the award shares, but not the option shares, upon Mr. Mercy's termination of employment. Mr. Mercy is subject to certain non-competition and confidentiality agreements following termination. The New Mercy Agreement provides for perpetual employment until terminated by 30 days written notice by either party. The New Mercy Agreement also provides that the Board of Directors shall take all necessary actions to ensure that Mr. Mercy is slated as a management nominee to the Board and elected Chairman of the Board during his employment. Pursuant to the New Mercy Agreement, Mr. Mercy may terminate his position as Chairman of the Board, remain a director and otherwise continue his employment under the New Mercy Agreement, unless it is otherwise terminated.

Michael Catalano was employed as Executive Vice President of Development, General Counsel and Secretary of the Company from July 12, 1996 through September 1, 1998 pursuant to an employment agreement (the "Old Catalano Agreement") which established a minimum annual base salary of $160,000 and such additional compensation as determined by the Compensation Committee from time to time. On September 1, 1998, Mr. Catalano and the Company amended and restated the Old Catalano Agreement (the "New Catalano Agreement") pursuant to which Mr. Catalano was appointed President and Chief Executive Officer of the Company. The New Catalano Agreement establishes a minimum annual base salary of $190,000 and such additional compensation as may be determined by the Compensation Committee from time to time. Pursuant to the Old Catalano Agreement, on July 12, 1996, the Company awarded to Mr. Catalano options to purchase 60,000 shares of Common Stock at an exercise price of $13.125 per share under the Company's Amended Incentive Stock Plan. The stock options vest ratably on each of the succeeding three anniversaries of the date of the options and shall be exercisable for a period of ten years from the date of the grant. Upon termination without cause or a change of control of the Company, all unexercised stock options granted to Mr. Catalano under the Company's Amended Incentive Stock Plan shall accelerate and immediately vest. The issuance of the Preferred Stock to Capital Partners and Executive Partners upon conversion of the Notes would constitute a change of control under the New Catalano Agreement. Also, in the event of termination as a result of death or disability, termination without cause or termination following a change in control of the Company, Mr. Catalano or his estate is entitled to two-year's compensation plus an amount equal to the incentive compensation that Mr. Catalano would have earned in the year of termination, not to be less than 45% of Mr. Catalano's annual base salary on the date of termination. Mr. Catalano is subject to certain non-competition and confidentiality agreements following termination. The New Catalano Agreement provides for perpetual employment until terminated by appropriate written notice by either party. The New Catalano Agreement also provides that the Board of Directors shall take all necessary actions to ensure that Mr. Catalano is slated as a management nominee to the Board during his employment.

On February 12, 1998, Gerard F. Boyle entered into an employment agreement (the "Boyle Agreement") with the Company pursuant to which he was appointed Executive Vice President and Chief Operating Officer of the Company. The Boyle Agreement establishes a minimum annual salary of $180,000 and such additional compensation as may be determined by the Compensation Committee from time to time. The Boyle Agreement provides for perpetual employment until terminated by either party upon thirty days notice. If there is a change of control of the Company, all unexercised stock options granted to Mr. Boyle under the Company's Amended Incentive Stock Plan shall accelerate and immediately vest. The issuance of the Preferred Stock to Capital Partners and Executive Partners upon conversion of the Notes would constitute a change of control under the Boyle Agreement. Also, in the event of a termination without cause, including termination following a change in control, Mr. Boyle's options shall vest and his annual base salary as of the

date of his termination shall be continued for one year following such termination date. Mr. Boyle is subject to certain non-competition and confidentiality agreements following termination.

On February 20, 1998, Bruce Teal entered into an employment agreement (the"Teal Agreement") with the Company pursuant to which he was appointed Senior Vice President and Chief Financial Officer of the Company. Mr. Teal had been serving as Vice President, Controller and Treasurer of the Company since December 1996; however, the Company and Mr. Teal had not entered into an employment agreement for his service in that capacity. The Teal Agreement establishes a minimum annual salary of $160,000 and such additional compensation as may be determined by the Compensation Committee from time to time. The Teal Agreement provides for perpetual employment until terminated by either party upon thirty days notice. If there is a change of control of the Company, all unexercised stock options granted to Mr. Teal under the Company's Amended Incentive Stock Plan shall accelerate and immediately vest. The issuance of the Preferred Stock to FFT upon conversion of the Notes would constitute a change of control under the Teal Agreement. Also, in the event of a termination without cause, including termination following a change in control, Mr. Teal's options shall vest and his annual base salary as of the date of his termination shall be continued for one year following such termination date. Mr. Teal is subject to certain non-competition and confidentiality agreements following termination.

COMPENSATION OF DIRECTORS

During 1998, the Company granted each non-employee Director options to purchase 4,000 shares of Common Stock at an exercise price of $13.56 per share for serving on the Board and its committees. The Chairman of the Board of Directors of the Company until September 1, 1998, Mr. William D. Eberle, was also paid $25,000 for consulting services which he provided to the Company during 1998. Directors who are also employees of the Company receive no additional compensation from the Company for attendance at Board or committee meetings. Under the terms of the Company's Amended Incentive Stock Plan, any person who is not an employee or independent contractor of the Company and who becomes a Director will receive an option to purchase 15,000 shares of the Common Stock at an exercise price equal to the fair market value of the Common Stock on the date such person becomes a Director. Such options will vest with respect to 25% of the shares covered thereby on each successive anniversary of the date of grant. David A. Freeman was granted such options, effective January 26, 1999, upon his appointment to the Board.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

COMMON STOCK

Information with respect to the beneficial ownership of the Common Stock, as of March 23, 1999, by the Company's directors, director-nominees and executive officers is included above in Item 10 and is incorporated herein by reference. The following table sets forth certain information with respect to the beneficial ownership of the Common Stock, as of March 23, 1999, by each person who was known by the Company to own beneficially more than 5% of the Common Stock as of such date, based on information furnished to the Company. Except as otherwise indicated, each person has sole voting and dispositive power with respect to the shares beneficially owned by such person.

NAME AND ADDRESS	SHARES BENEFICIALLY OWNED	% OF SHARES OUTSTANDING
A group comprised of Health Care Capital Partners L.P. ("Capital Partners")and Health Care Executive Partners L.P. ("Executive Partners")..............................	664,100(1)	15.7%
A group comprised of J. Carlo Cannell D/B/A Cannell Capital Management, Tonga Partners LP, Pleiades Investment Partners, LP, the Cuttyhunk Fund Limited and Canal Ltd.(2)..	397,300(3)	11.1%

NAME AND ADDRESS	SHARES BENEFICIALLY OWNED	% OF SHARES OUTSTANDING
Scott L. Mercy... Columbia/HCA 4526 Harding Road Nashville, Tennessee 37205	361,000(4)	9.6%
Sirach Capital Management, Inc............................. 3323 One Union Square Seattle, Washington 98101	267,000(5)	7.5%
A group comprised of Mark E. Brady, Robert J. Suttman, III and Ronald Eubel.. 777 Washington Village Drive	190,170(6)	5.3%

Suite 210 Dayton, Ohio 45459		
A group comprised of Wachovia Corporation and Wachovia Bank, N.A. (collectively, the "Wachovia Group")................ 100 North Main Street Winston Salem, North Carolina 27104	183,500(7)	5.1%
A group comprised of Sandera Partners, L.P., Sandera Capital Management, L.L.C., Sandera Capital, L.L.C., John A. Bricker, Jr., Hunt Financial Partners, L.P. (collectively, the "Sandera Group"), and Newcastle Partners, L.P. and Mark Schwartz (collectively, the "Newcastle Group")(8)....	155,500(9)	4.4%

</TABLE>

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(1) Includes shares of Common Stock issuable upon exercise of the Warrants and the Preferred Stock issued to Capital Partners and Executive Partners on January 26, 1999 which such entities are deemed to beneficially own. Based on a Schedule 13D filed with the SEC on February 5, 1999, Capital Partners beneficially owns 637,788 shares of Common Stock and Executive Partners beneficially owns 26,312 shares of Common Stock.

(2) The address of J. Carlo Cannell D/B/A Cannell Capital Management and Tonga Partners LP is 600 California Street, Floor 14, San Francisco, California 94108. The address of Pleiades Investment Partners, LP is 6022 West Chester Pike, Newtown Square, Pennsylvania 19073. The address of the Cuttyhunk Fund Limited is 73 Front Street, Hamilton, HM12, Bermuda. The address of Canal, Ltd. is 9 Church Street, HM 951, Hamilton HM DX, Bermuda.

(3) Based on a Schedule 13G filed with the SEC on March 1, 1999, J. Carlo Cannell D/B/A Cannell Capital Management beneficially owns 397,300 shares of Common Stock, Tonga Partners, LP beneficially owns 167,800 shares of Common Stock, Pleiades Investment Partners beneficially owns 46,600 shares of Common Stock, the Cuttyhunk Fund Limited beneficially owns 146,200 shares of Common Stock and Canal Ltd. beneficially owns 36,700 shares of Common Stock.

(4) Includes 146,000 shares of Common Stock purchased by Mr. Mercy from the Company, 40,000 shares of Common Stock issued under the Old Mercy Agreement (which are presently held in the name of his spouse and beneficial ownership of which he disclaims), and options to purchase 175,000 shares of Common Stock. The shares of Common Stock purchased by Mr. Mercy and the shares of Common Stock issued under the Old Mercy Agreement are subject to certain repurchase rights in favor of the Company and Mr. Mercy. See "Executive Compensation -- Employment Agreements."

(5) Based upon a Schedule 13G filed with the SEC on February 2, 1999.

(6) Based on a Schedule 13G filed with the SEC on March 11, 1999, each of Mark E. Brady, Robert J. Suttman and Ronald Eubel beneficially owns 190,170 shares of Common Stock.

(7) Based on a Schedule 13G filed with the SEC on February 12, 1999, each of Wachovia Corporation and Wachovia Bank, N.A. beneficially owns 183,500 shares of Common Stock.

(8) The address of each member of the Sandera Group is 1601 Elm Street, Suite 4000, Dallas, Texas 75201. The address of each member of the Newcastle Group is 4650 Cole Avenue, Suite 331, Dallas, Texas 75205.

(9) Based upon Amendment No. 1 to Schedule 13G filed with the SEC on February 16, 1999, the Sandera Group beneficially owns 151,500 shares of Common Stock, Newcastle Partners L.P. beneficially owns 4,000 shares and Mark Schwartz beneficially owns 155,500 shares.

PREFERRED STOCK

Capital Partners owns 48,020 shares of Preferred Stock, which represents approximately 96% of the outstanding shares of Preferred Stock. Executive Partners owns 1,980 shares of Preferred Stock, which represents approximately 4% of the outstanding shares of Preferred Stock. The principal business address of Capital Partners and Executive Partners is c/o Ferrer Freeman Thompson & Co. LLC, The Mill, 10 Glenville Street, Greenwich, Connecticut 06831. The shares of Preferred Stock owned by Capital Partners and Executive Partners constitute all of the outstanding shares of Preferred Stock. The general partner of each of Capital Partners and Executive Partners is Ferrer Freeman Thompson & Co ("FFT"). David A. Freeman, a director and director-nominee of the Company, is a member of FFT and is thereby deemed to beneficially own all of the Preferred Stock owned by Capital Partners and Executive Partners.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

David A. Freeman, a director and a director-nominee of the Company, is a member of FFT. On January 26, 1999, the Company entered into the Securities Purchase Agreement and certain other agreements with Capital Partners and Executive Partners, investment management companies whose general partner is

FFT, pursuant to which the Company issued the Convertible Securities to Capital Partners and Executive Partners. See Item 13, "Business -- Recent Developments." Capital Partners and Executive Partners currently own 100% of the outstanding shares of the Preferred Stock, the Notes and the Warrants. In addition, if the Stock Issuance is approved by the Company's stockholders at the Company's 1999 Annual Meeting, Capital Partners and Executive Partners will have the right to receive additional shares of Preferred Stock upon conversion of the Notes and shares of Common Stock upon conversion of the Preferred Stock and the Warrants. Mr. Freeman is deemed to beneficially own the Convertible Securities currently owned by Capital Partners and Executive Partners and will be deemed to beneficially own any additional Convertible Securities or Common Stock acquired by Capital Partners and Executive Partners.

On the January 26, 1999, the Board of Directors appointed Mr. Freeman to the Board of Directors, pursuant to a provision of the Securities Purchase Agreement which obligated the Company to appoint a designee of Capital Partners and Executive Partners to the Board of Directors on the date of the closing of the Securities Purchase Agreement. Pursuant to the Securities Purchase Agreement, if the stockholders approve the Stock Issuance at the Company's 1999 Annual Meeting, the Company will be obligated to increase the number of members of the Board of Directors to nine and to nominate designees of Capital Partners and Executive Partners to three of the nine directorships. Capital Partners and Executive Partners have designated Mr. Freeman, Richard D. Wright and Jeffrey L. McWaters to be nominated to directorships. FFT has a 17.3% ownership interest in Amerigroup Corporation of which Mr. McWaters is Chairman, President and Chief Executive Officer.

Scott L. Mercy, Chairman of the Board of Directors, is a limited partner of Executive Partners. His interest in Executive Partners represents 1.5% of Executive Partners' capital.

Scott L. Mercy is Chairman and Chief Executive Officer of LifePoint Hospitals, a group of rural hospitals owned by Columbia/HCA Healthcare Corp. ("Columbia"). Richard M. Mastaler, a director-nominee, is the Chairman and Chief Executive Officer of CCN Managed Care, Inc. In ordinary course of its business, the Company makes payments to Columbia and CCN for health care services rendered by Columbia and CCN to the Company on terms no less favorable than those that it would have received from independent third parties.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULE, AND REPORTS ON FORM 8-K

(a)(1) Financial Statements

Listed on the Index to the Consolidated Financial Statements and Schedule on page F-1 of this Report.

(2) Financial Statement Schedule

Listed on the Index to the Consolidated Financial Statements and Schedule on page F-1 of this Report.

(3) Exhibits

<TABLE>
<CAPTION>

EXHIBIT		DESCRIPTION
<C>	<S>	<C>
2.1	--	Stock Purchase Agreement, dated as of December 18, 1998, between the Company and InPhyNet Administrative Services, Inc. (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on January 5, 1999).
2.2	--	First Amendment to Stock Purchase Agreement, dated as of January 26, 1999, between the Company and InPhyNet Administrative Services, Inc. (incorporated herein by reference to Exhibit 99.8 to the Company's Current Report on Form 8-K filed on February 10, 1999).
2.3	--	Securities Purchase Agreement , dated as of January 26, 1999, among the Company, Health Care Capital Partners L.P. and Health Care Executive Partners L.P. (incorporated herein by reference to Exhibit 99.2 to the Company's Current Report on Form 8-K filed on February 10, 1999).
2.4	--	Plan and Agreement of Merger, as amended, dated October 1, 1997, between the Company, MedPartners, Inc. and ASG Merger Corporation, a wholly-owned subsidiary of MedPartners, Inc.

		(incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on form 8-K filed on October 2, 1997 and Exhibit 2.1 to the Company's Current Report on Form 8-K filed on December 30, 1997).
2.5	--	Consent and Agreement, dated January 19, 1998, by and among the Company, MedPartners, Inc. and ASG Merger Corporation, a wholly-owned subsidiary of MedPartners, Inc. (incorporated herein by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on January 20, 1998).
2.6	--	Release and Settlement Agreement, dated February 25, 1998, by and among the Company, MedPartners, Inc. and ASG Merger Corporation and EMSA Correctional Care, Inc. (incorporated herein by reference to Exhibit 2.3 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1997).
3.1	--	Amended and Restated Certificate of Incorporation of America Service Group Inc. (incorporated herein by reference to Exhibit 3.1 to the Company's Registration Statement on Form S-1, Registration No. 33-43306).
3.2	--	Certificate of Designation of the Series A Convertible Preferred Stock (incorporated herein by reference to Exhibit 99.3 to the Company's Current Report on Form 8-K filed on February 10, 1999).
3.3	--	Amended and Restated Bylaws of America Service Group Inc. (incorporated herein by reference to Exhibit 3.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1996).
4.1	--	The Company's 12% Subordinated Convertible Bridge Notes due January 26, 2000, issued to Health Care Capital Partners L.P. on January 26, 1999 (incorporated herein by reference to Exhibit 99.4 to the Company's Current Report on Form 8-K filed on February 10, 1999).
4.2	--	The Company's 12% Subordinated Convertible Bridge Notes due January 26, 2000, issued to Health Care Executive Partners L.P. on January 26, 1999 (incorporated herein by reference to Exhibit 99.5 to the Company's Current Report on Form 8-K filed on February 10, 1999).
4.1	--	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1, Registration No. 33-43306, as amended).

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EXHIBIT		DESCRIPTION
<C>	<S>	<C>
10.1	--	Amended and Restated Credit Agreement, dated as of January 26, 1999, among the Company, as Borrower, the Company's subsidiaries as listed therein, as Guarantors, the Lenders identified therein and NationsBank, N.A., as Administrative Agent and as Issuing Bank (incorporated herein by reference to Exhibit 99.1 to the Company's Current Report on Form 8-K filed on February 10, 1999).
10.2	--	Warrant, dated as of January 26, 1999, issued by the Company to Health Care Capital Partners L.P. to purchase shares of the Common Stock (incorporated herein by reference to Exhibit 99.6 to the Company's Current Report on Form 8-K filed on February 10, 1999).
10.3	--	Warrant, dated as of January 26, 1999, issued by the Company to Health Care Executive Partners L.P. to purchase shares of the Common Stock, dated as of January 26, 199 (incorporated herein by reference to Exhibit 99.7 to the Company's Current Report on Form 8-K filed on February 10, 1999).
10.4	--	Registration Rights Agreement , dated as of January 26, 1999, among the Company, Health Care Capital Partners L.P. and Health Care Executive Partners L.P. (incorporated herein by reference to Exhibit 99.8 to the Company's Current Report on Form 8-K filed on February 10, 1999).
10.5	--	Prison Health Services, Inc. 1986 Employees' Stock Option Plan (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1, Registration No. 33-43306, as amended).
10.6	--	America Service Group Inc. Amended Incentive Stock Plan (as adopted by the Board of Directors on March 19, 1996) (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the three month period ending June 30, 1996), as subsequently amended by resolution

		of the Board of Directors on September 16, 1996 to increase the number of shares reserved for issuance thereunder from 1,075,000 to 1,182,500.
10.7	--	America Service Group Inc. 401(k) Profit Sharing Plan (incorporated by reference to Exhibit 10.9 to the Company's Annual Report on Form 10-K for the year ended December 31, 1992).
10.8	--	Prison Health Services, Inc. Medical Services Agreement for Alameda County, California, dated July 1, 1992 (incorporated by reference to Exhibit 10.6 to the Company's Annual Report on Form 10-K for the year ended December 31, 1992).
10.9	--	Prison Health Services, Inc. Agreement for the Department of Corrections of the State of Kansas, dated February 22, 1991, and Amendment thereto, dated August 27, 1991 (incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-1, Registration No. 33-43306, as amended).
10.10	--	Prison Health Services, Inc. Health Services Contract for State of Maryland, Department of Public Safety and Correctional Services dated November 30, 1992 (incorporated by reference to Exhibit 10.14 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994).
10.11	--	Prison Health Services, Inc. Health Services Contract for the City of Philadelphia Department of Public Health (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K for the year ended December 31, 1993).
10.12	--	Healthcare Services Contract with the State of Delaware, dated June 3, 1996 (incorporated by reference to Exhibit 10.5 to the Company's Quarterly Report on Form 10-Q for the three month period ending June 30, 1996).
10.13	--	Contractual Agreement between the Indiana Department of Correction and Prison Health Services, Inc. dated April 18, 1997 (incorporated by reference to Exhibit 10.26 to the Company's Quarterly Report on Form 10-Q for the three month period ending June 30, 1997).
10.14	--	Credit Agreement dated May 30, 1997 for $20,000,000 with NationsBank of Tennessee, N.A. (incorporated by reference to Exhibit 10.25 to the Company's Quarterly Report on Form 10-Q for the three month period ending June 30, 1997).

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EXHIBIT		DESCRIPTION
<C>	<S>	<C>
10.15	--	Employment Agreement, dated April 1, 1996, between Scott L. Mercy and the Company, as amended (incorporated herein by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the three month period ended June 30, 1996 and 10.28 to the Company's Quarterly Report on Form 10-Q for the three month period ended June 30, 1997).
10.16	--	Amended and Restated Employment Agreement, dated September 1, 1998, between Scott L. Mercy and America Service Group Inc.
10.17	--	Employment Agreement, dated November 1, 1996, between Jeffrey J. Bairstow and the Company (incorporated by reference to Exhibit 10.17 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.18	--	Non-qualified Stock Option by the Company and Jeffrey J. Bairstow, dated December 18, 1996, (incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.19	--	Employment Agreement, dated July 12, 1996, between Michael Catalano and the Company (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the three month period ending September 31, 1996).
10.20	--	Amended and Restated Employment Agreement, dated September 1, 1998, between Michael Catalano and the Company (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the three month period ending September 31, 1998).
10.21	--	Non-Qualified Stock Option between the Company and Michael Catalano, dated July 12, 1996, (incorporated by reference to Exhibit 10.20 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996).
10.22	--	Employment Agreement dated February 20, 1998 between Bruce

		A. Teal and the Company (incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.23	--	Non-Qualified Stock Option between the Company and Bruce A. Teal dated, December 18, 1996, (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K for the year ended December 31, 1996).
10.24	--	Employment Agreement, dated February 12, 1998, between Gerard F. Boyle and the Company (incorporated by reference to Exhibit 10.20 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.25	--	Non-Qualified Stock Option between the Company and Gerard F. Boyle, dated February 12, 1998 (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.26	--	Lease Agreement for office located at Two Penns Way, Suite 200, New Castle, Delaware 19720, and amendments thereto (incorporated herein by reference to Exhibit 10.8 to the Company's Annual Report on Form 10-K for the year ended December 31, 1995).
10.27	--	Lease by and between Principal Mutual Life Insurance Company and America Service Group Inc. dated September 6, 1996 (incorporated herein by reference to Exhibit 10.23 to the Company's Annual Report on Form 10-K for the year ended December 31, 1997).
10.28	--	Sublease Agreement, dated April 22, 1997, between the Company and Citibank Delaware for office space located at Two Penns Way, Suite 200, New Castle, Delaware (incorporated herein by reference to Exhibit 10.24 to the Company's Quarterly Report on Form 10-Q for the three months ending March 31, 1997).
10.29	--	Amended and Restated Incentive Stock Plan of the Company (incorporated by reference to Exhibit 10.27 to the Company's Quarterly Report on Form 10-Q for the three months ending June 30, 1997).
21.1	--	Subsidiaries of the Company.
23.1	--	Consent of Ernst & Young LLP.
27.1	--	Financial Data Schedule for the year ended December 31, 1998 (for SEC use only).

</TABLE>

(b) Reports on Form 8-K.

The following report on Form 8-K was filed during the fourth quarter of 1998.

(a) Current Report on Form 8-K dated September 3, 1998 reporting certain changes in the executive officers and Chairman of the Board of the Company.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registration has duly caused this report to be signed on behalf of the undersigned, thereunto duly authorized, on March 26, 1999.

AMERICA SERVICE GROUP INC.

By: /s/ MICHAEL CATALANO

Michael Catalano
President and
Chief Executive Officer

Pursuant to the Requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities indicated on March 26, 1999.

<TABLE>
<CAPTION>

SIGNATURES	TITLE
<C>	<S>

/s/ MICHAEL CATALANO Michael Catalano	Director, President and Chief Executive Officer
/s/ BRUCE A. TEAL Bruce A. Teal	Senior Vice President and Chief Financial Officer
/s/ SCOTT L. MERCY Scott L. Mercy	Director, Chairman of the Board
 Thomas Bogan	Director
/s/ JACK O. BOVENDER, JR. Jack O. Bovender, Jr.	Director
/s/ WILLIAM EBERLE William Eberle	Director
/s/ DAVID A. FREEMAN David A. Freeman	Director
/s/ JOHN GILDEA John Gildea	Director
/s/ CAROL R. GOLDBERG Carol R. Goldberg	Director

</TABLE>

AMERICA SERVICE GROUP INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE

All other schedules are omitted as the required information is inapplicable or is presented in the Company's Consolidated Financial Statements or the Notes thereto.

REPORT OF INDEPENDENT AUDITORS

Board of Directors and Stockholders
America Service Group Inc.

We have audited the accompanying consolidated balance sheets of America

Service Group Inc. as of December 31, 1998 and 1997, and the related consolidated statements of operations, changes in common stock, additional paid-in capital, retained earnings (deficit) and treasury stock, and cash flows for each of the three years in the period ended December 31, 1998. Our audits also included the financial statement schedule listed in the Index at Item 14(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of America Service Group Inc. at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects the information set forth therein.

/s/ ERNST & YOUNG LLP

Nashville, Tennessee
February 12, 1999, except for
Note 3, as to which the date is
March 16, 1999

AMERICA SERVICE GROUP INC.

CONSOLIDATED BALANCE SHEETS

<TABLE>
<CAPTION>

<S>	DECEMBER 31, 1998 <C>	DECEMBER 31, 1997 <C>
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,211,000	$ 3,445,000
Short-term investments	--	1,559,000
Accounts receivable: Healthcare and other less allowance for doubtful accounts of $20,000 and $384,000 at December 31, 1998 and 1997	13,760,000	8,242,000
Prepaid expenses and other current assets	1,098,000	2,384,000
Current deferred taxes	2,730,000	2,116,000
Total current assets	24,799,000	17,746,000
Restricted investments	--	5,639,000
Property and equipment, net	1,886,000	2,468,000
Deferred taxes	1,341,000	1,193,000
Cost in excess of net assets acquired, net	--	411,000
Other assets	349,000	297,000
Total assets	$28,375,000	$27,754,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,438,000	$ 3,243,000
Accrued expenses	11,846,000	12,836,000
Deferred revenue	--	1,410,000
Total current liabilities	14,284,000	17,489,000
Noncurrent portion of accrued expenses	1,300,000	3,624,000
Commitments and contingencies		
Redeemable common stock, $.01 par value, 186,000 shares issued and outstanding at December 31, 1998 and 1997	1,842,000	1,842,000
Preferred stock, $.01 par value, 2,000,000 shares authorized; none outstanding	--	--
Common stock, $.01 par value, 10,000,000 shares authorized;		

3,573,000 and 3,529,000 shares issued and outstanding at December 31, 1998 and 1997	36,000	35,000
Additional paid-in-capital	8,351,000	7,926,000
Retained earnings (deficit)	2,562,000	(3,162,000)
Total liabilities and stockholders' equity	$28,375,000	$27,754,000

</TABLE>

See accompanying notes.

AMERICA SERVICE GROUP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
<S>	<C>	<C>	<C>
Healthcare revenue	$113,287,000	$129,211,000	$152,282,000
Investment and interest income	600,000	679,000	751,000
Total revenue	113,887,000	129,890,000	153,033,000
Healthcare expenses	100,619,000	118,631,000	145,618,000
Gross margin	13,268,000	11,259,000	7,415,000
Selling, general, and administrative expenses	9,416,000	9,461,000	11,065,000
Nonrecurring (gain) loss	(1,247,000)	--	6,241,000
Income (loss) from operations	5,099,000	1,798,000	(9,891,000)
Interest expense	--	12,000	42,000
Income (loss) before income taxes (benefits)	5,099,000	1,786,000	(9,933,000)
Provision for income taxes (benefits)	(625,000)	101,000	(1,247,000)
Net income (loss)	5,724,000	1,685,000	(8,686,000)
Decrease (increase) in redeemable common stock	--	57,000	(226,000)
Net income (loss) attributable to common shares	$ 5,724,000	$ 1,742,000	$ (8,912,000)
Net income (loss) per common share:			
Basic	$ 1.61	$ .50	$ (2.81)
Diluted	$ 1.57	$ .48	$ (2.81)
Weighted average common shares outstanding:			
Basic	3,554,000	3,480,000	3,171,000
Diluted	3,653,000	3,657,000	3,171,000

</TABLE>

See accompanying notes.

AMERICA SERVICE GROUP INC.

CONSOLIDATED STATEMENTS OF CHANGES IN COMMON STOCK, ADDITIONAL PAID-IN CAPITAL, RETAINED EARNINGS (DEFICIT) AND TREASURY STOCK

<TABLE>
<CAPTION>

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	TREASURY STOCK
	SHARES	AMOUNT			
<S>	<C>	<C>	<C>	<C>	<C>
Balance at January 1, 1996	3,404,000	$34,000	$ 6,887,000	$ 4,008,000	$(2,262,000)
Purchase of treasury stock (130,000 shares)	--	--	--	--	(875,000)

Issuance of redeemable common stock	--	--	--	--	1,004,000
Issuance of common stock under employee stock plan	--	--	67,000	--	50,000
Exercise of options	--	--	(1,442,000)	--	1,875,000
Compensation for stock options	--	--	2,034,000	--	--
Increase in redemption value of common stock	--	--	--	(226,000)	--
Net loss	--	--	--	(8,686,000)	--
Balance at December 31, 1996	3,404,000	34,000	7,546,000	(4,904,000)	(208,000)
Issuance of common stock under employee stock plan	8,000	--	68,000	--	--
Exercise of options	117,000	1,000	312,000	--	208,000
Decrease in redemption value of common stock	--	--	--	57,000	--
Net income	--	--	--	1,685,000	--
Balance at December 31, 1997	3,529,000	35,000	7,926,000	(3,162,000)	--
Issuance of common stock under employee stock plan	13,000	--	138,000	--	--
Exercise of options	31,000	1,000	287,000	--	--
Net income	--	--	--	5,724,000	--
	3,573,000	$36,000	$ 8,351,000	$ 2,562,000	$ --

</TABLE>

See accompanying notes.

AMERICA SERVICE GROUP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
<S>	<C>	<C>	<C>
OPERATING ACTIVITIES			
Net income (loss)	$ 5,724,000	$ 1,685,000	$(8,686,000)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	802,000	1,114,000	1,533,000
Write-off of cost in excess of net assets acquired	397,000	--	--
Noncash compensation charge	--	--	2,384,000
Noncash change in redeemable common stock	--	(17,000)	62,000
Provision for contract cancellation		--	3,802,000
Provision for doubtful accounts	--	841,000	1,822,000
Deferred income tax provision	(762,000)	(101,000)	--
Loss on asset disposals	--	457,000	--
Changes in operating assets and liabilities:			
Accounts receivable	(5,518,000)	63,000	5,621,000
Assets held for sale	--	2,900,000	--
Prepaid expenses and other current assets	1,286,000	1,304,000	(2,136,000)
Other assets	(52,000)	(132,000)	(72,000)
Accounts payable	(805,000)	(4,413,000)	243,000
Accrued expenses	(3,314,000)	(9,209,000)	4,839,000
Deferred revenue	(1,410,000)	(3,590,000)	(4,109,000)
Income taxes payable	--	--	(284,000)
Net cash provided by (used in) operating activities	(3,652,000)	(9,098,000)	5,019,000
INVESTING ACTIVITIES			
Proceeds (purchases) of short-term investments	1,559,000	546,000	(1,405,000)
Proceeds from sale of restricted investments	7,191,000	625,000	1,392,000
Purchases of restricted investments	(1,552,000)	(806,000)	(2,276,000)
Capital expenditures	(739,000)	(961,000)	(4,268,000)
Proceeds from sale of property and equipment	533,000	--	81,000
Net cash provided by (used in) investing activities	6,992,000	(596,000)	(6,476,000)
FINANCING ACTIVITIES			
Purchase of treasury stock	--	--	(875,000)
Issuance of redeemable common stock	--	--	1,278,000
Issuance of common stock	138,000	68,000	67,000
Exercise of stock options	288,000	521,000	1,487,000

Net cash provided by financing activities..............	426,000	589,000	1,957,000
Net increase (decrease) in cash and cash equivalents....	3,766,000	(9,105,000)	500,000
Cash and cash equivalents at beginning of year..........	3,445,000	12,550,000	12,050,000
Cash and cash equivalents at end of year................	$ 7,211,000	$ 3,445,000	$12,550,000
SUPPLEMENTAL CASH FLOW INFORMATION			
Cash paid for interest..................................	$ --	$ 12,000	$ 42,000
Cash paid for income taxes..............................	$ 58,000	--	$ 326,000

</TABLE>

See accompanying notes.

AMERICA SERVICE GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1998

1. DESCRIPTION OF BUSINESS

America Service Group Inc. (the "Company") and its consolidated subsidiaries provide managed healthcare services to correctional facilities under capitated contracts (with certain adjustments) with state and local governments. The health status of inmates may impact results of operations under such contractual arrangements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Prison Health Services, Inc. (PHS) and its wholly-owned captive insurance subsidiary, Harbour Insurance, Inc. (Harbour), Southern Health Partners, Inc. (SHP) and UniSource, Inc. (UniSource). The Company liquidated and dissolved Harbour in November 1998 and sold all fixed operating assets of UniSource during 1998. The Company disposed of 90% of its interest in SHP in July 1996 and the remaining 10% in July 1997. All significant intercompany transactions and account balances have been eliminated.

Use of Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Estimates are used primarily in the recording of the accruals of unbilled medical services and professional and general liability claims. Additional estimates in 1996 were used in the recording of estimated losses on the Georgia Department of Corrections contract, sublease receipts and employee severance.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments reported in the Consolidated Balance Sheets, consist of cash and cash equivalents, short-term investments, accounts receivable, restricted investments, and accounts payable and approximate their fair values.

Revenue and Cost Recognition

The Company engages principally in fixed price contracts with correctional institutions adjusted for census fluctuations. Revenues earned under contracts with correctional institutions are recognized in the period that services are rendered. Cash received in advance for future services is recorded as deferred revenue and recognized as income when the service is performed. Revenues on pharmaceutical and related products are recorded when shipped.

Healthcare expenses include the compensation of physicians, nurses and other healthcare professionals including any related benefits and all other direct costs of providing the managed care. The cost of healthcare services provided or contracted for are recognized in the period in which they are provided based in part on estimates, including an accrual for unbilled medical services rendered through the balance sheet dates. Additionally, reserves have been recorded for certain reported and unreported professional and general liability claims associated with the delivery of medical services.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, demand deposits, money market funds and investments with original maturities of three months or less.

Short-Term Investments

Short-term investments consist of temporary investments in certificates of deposit. Investments are available for sale and by their nature are stated at fair value.

Depreciation

Depreciation is provided using straight-line and accelerated methods over the estimated useful lives of the assets.

Cost in Excess of Net Assets Acquired

Cost in excess of net assets acquired represents the unamortized excess of the acquisition cost over the fair value of the net assets received at the date of acquisition. Amortization expense of $14,000, $42,000 and $43,000 for 1998, 1997 and 1996, respectively, was computed using the straight-line method over 15 years. Accumulated amortization as of December 31, 1997 was $323,000. The Company wrote off the unamortized portion of cost in excess of net assets acquired of $397,000 in June 1998 with the sale of UniSource.

Long-Lived Assets

Statement of Financial Accounting Standards (SFAS) No. 121, Accounting for the Impairment of Long-Used Assets and for Long-Lived Assets to be Disposed Of, requires that companies consider whether indicators of impairment of long-lived assets held for use are present. If such indicators are present, companies determine whether the sum of the estimated undiscounted future cash flows attributable to such assets is less than their carrying amount, and if so, companies recognize an impairment loss based on the excess of the carrying amount of the assets over their fair value. Accordingly, management periodically evaluates the ongoing value of property and equipment and cost in excess of net assets acquired.

Treasury Stock

Prior to December 1996, the Board of Directors had authorized the Company to purchase treasury stock to be available for issuance under stock options and other benefits under the Company's Incentive Stock Plan. Upon exercise of the stock options, the difference between the cost of the treasury shares, on a first-in, first-out basis, and the price of options exercised is reflected in additional paid-in capital. Treasury stock includes 31,000 common shares at December 31, 1996. The 31,000 common shares held in treasury as of December 31, 1996, were issued during 1997.

Preferred Stock

The Board of Directors has the power and authority to establish preferences related to dividends, redemptions, payment on liquidation, conversion privileges and voting rights. As of December 31, 1998 and 1997, the Company had no shares of preferred stock issued.

Income Taxes

The Company uses the liability method of accounting for federal and state income taxes. Under the liability method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Differences between taxable income and income for financial statement purposes result from the recognition of certain income and expense items for tax purposes in periods which differ from those used for financial statement purposes.

Income (Loss) Per Share

In 1997, the Financial Accounting Standards Board ("FASB") issued Statement No. 128, Earnings Per Share ("Statement 128"). Statement 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share, and uses the treasury stock method in calculating dilution. All earnings per share amounts for all periods have been presented and restated to conform to Statement 128 requirements.

Stock Options

The Company has elected to follow Accounting Principles Board Opinion No. 25, (Accounting for Stock Issued to Employees) ("APB 25"), and related Interpretations in accounting for its employee stock options because the alternative fair value accounting provided for under SFAS No. 123, (Accounting for Stock-Based Compensation), requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, compensation expense is recognized as the difference between the exercise price of the Company's employee stock options and the market price of the underlying stock on the date of grant.

3. ACQUISITION OF GOVERNMENT SERVICES DIVISION

On January 26, 1999, the Company purchased all of the outstanding stock of EMSA Government Services, Inc. ("EMSA") from InPhyNet Administrative Services, Inc. ("InPhyNet") for $67.0 million in cash pursuant to a Stock Purchase Agreement, dated as of December 18, 1998 (the "Stock Purchase Agreement"), as amended by the First Amendment to Stock Purchase Agreement, dated as of January 26, 1999 (the "First Amendment"), between the Company and InPhyNet. InPhyNet is a wholly-owned subsidiary of MedPartners, Inc. ("MedPartners").

EMSA conducts its operations through two wholly-owned subsidiaries, EMSA Correctional Care, Inc. and EMSA Military Services, Inc., each of which became indirect subsidiaries of the Company pursuant to its acquisition of EMSA. EMSA Correctional provides comprehensive managed healthcare solutions to state and local correctional facilities, managing healthcare for approximately 70,000 inmates. Following the EMSA acquisition, the Company, through EMSA Correctional and PHS, manages healthcare for approximately 133,000 inmates in 25 states. EMSA Military contracts with the U.S. Department of Defense (the "DOD") and the Veterans Administration (the "VA") to provide emergency medicine and primary healthcare services to active and retired military personnel and their dependents at medical facilities operated by the DOD and the VA.

The purchase price paid to InPhyNet was subject to increase or decrease on a dollar-for-dollar basis by an amount equal to the amount by which EMSA's working capital, as defined, and as reflected on its balance sheet as of January 25, 1999 (the "Closing Date Balance Sheet"), was in excess of or was less than $27.6 million. The Closing Date Balance Sheet reflected working capital, as defined, of $24.0 million. Accordingly, the Company received $3.6 million in March 1999 as part of the purchase price adjustment. The Company will account for the EMSA acquisition using the purchase method of accounting.

In connection with the EMSA acquisition: (i) the Company and all of its subsidiaries, including EMSA, EMSA Military and EMSA Correctional, entered into an Amended and Restated Credit Agreement, dated as of January 26, 1999, with NationsBank, N.A., as Administrative Agent and Issuing Bank ("NationsBank"), which provides for a revolving credit facility of up to $52.0 million (the "Credit Facility") and (ii) the Company entered into a Securities Purchase Agreement, dated as of January 26, 1999 (the "Securities Purchase Agreement") with Health Care Capital Partners L.P. ("Capital Partners") and Health Care Executive Partners L.P. ("Executive Partners"), investment funds managed by Ferrer Freeman Thompson &

Co. (collectively, with Capital Partners and Executive Partners, "FFT"). On January 26, 1999, pursuant to the Securities Purchase Agreement, the Company issued to Capital Partners and Executive Partners (i) $15.0 million aggregate principal amount of the Company's 12% Subordinated Convertible Bridge Notes due January 26, 2000 (the "Notes") with detachable warrants (the "Warrants") to purchase an aggregate 135,000 shares of the Company's common stock, par value $0.01 per share (the "Common Stock"), and (ii) 50,000 shares of the Company's Series A Convertible Preferred Stock, par value $0.01 per share (the "Preferred Stock"), for $5.0 million. The Notes, Warrants and Preferred Stock are referred to collectively as the "Convertible Securities."

The Company used $47.0 million in borrowings under the Credit Facility and the aggregate $20 million in proceeds received from its issuance of the Convertible Securities to Capital Partners and Executive Partners to finance, in part, the EMSA acquisition.

4. RELEASE AND SETTLEMENT AGREEMENT

On October 1, 1997, the Company entered into a Plan and Agreement of Merger (the "Merger Agreement") with MedPartners, Inc., a Delaware corporation ("MedPartners"), and a wholly owned subsidiary of MedPartners, pursuant to which the Company would have been acquired by MedPartners (the "Merger").

On February 26, 1998, the Company announced the termination of the Merger Agreement and the execution of a Release and Settlement Agreement (the "Settlement Agreement") with MedPartners relating to the Merger Agreement. Pursuant to the Settlement Agreement, MedPartners agreed to pay the Company approximately $3.5 million in cash and to reimburse or assume certain other costs incurred by the Company in connection with the Merger in the amount of approximately $2.0 million.

Approximately $1,700,000 of these payments reimbursed the Company for costs directly associated with the terminated merger. In connection with the anticipated merger, all of the UniSource employees were informed of the Company's intent to cease operations and sell or dispose of all of UniSource's operating assets. Accordingly, all costs associated with the disposal of UniSource, including $397,000 of unamortized cost in excess of net assets acquired, severance and other miscellaneous expenses, have been considered in determining the non-recurring gain of $1,247,000.

5. NONRECURRING CHARGES

During the fourth quarter of 1996, the Company commenced the move of its corporate headquarters from New Castle, Delaware to Brentwood, Tennessee. Related costs accrued were $1,055,000 for reengineering and downsizing of the Company's administrative processes.

The Company increased its 1996 second quarter $1,000,000 loss estimate relating to the State of Georgia Department of Corrections contract by $2,802,000 in the fourth quarter of 1999, upon notification from the state in October 1996 of its intention not to renew the contract when it expired in June 1997. The estimate includes an approximate $500,000 write-down of equipment, which the State of Georgia agreed to purchase for $2,900,000.

In April 1996, the Company entered into an agreement to grant the former Chief Executive Officer 175,000 stock options at the fair market value of the shares on March 28, 1996. The options were granted in May 1996 upon approval by the Shareholders, pursuant to an amendment to the Incentive Stock Plan in May 1996. The options contained accelerated vesting provisions, based upon the Company's stock achieving certain targeted price levels. During 1996, these price levels were obtained and a $2,034,000 noncash compensation charge was recognized, based upon the difference between the exercise price agreed upon in March 1996 and the fair market value on the date of grant. The former Chief Executive Officer was also awarded 40,000

redeemable common shares which resulted in a $350,000 compensation charge based upon the fair market value of the shares on the date of award.

6. RESTRICTED INVESTMENTS

Restricted investments represent required funding for Harbour, the captive insurance subsidiary, and accordingly, were intended to be held to maturity. All restricted investments are stated at cost, adjusted for amortization of premiums and accretion of discounts, which are recognized as adjustments to interest income.

The amortized cost and approximate market value of restricted investments are as follows:

<TABLE>
<CAPTION>

	DECEMBER 31, 1997	
	AMORTIZED COST	MARKET VALUE

U.S. Treasury and governmental agency obligations	$1,723,000	$1,738,000
Corporate bonds	3,262,000	3,194,000
Mortgage backed securities	654,000	654,000
	$5,639,000	$5,586,000

In October 1998, the Company completed a portfolio transfer of all outstanding medical malpractice claims covered under Harbour related to the period December 1, 1997 and prior through the execution of a Novation Agreement, which transferred the risk of all reported claims to a third party. Subsequent to all restrictions being removed on the investments, the Company dissolved Harbour in November 1998.

7. PROPERTY AND EQUIPMENT

Property and equipment is stated at cost and comprised of the following:

	DECEMBER 31, 1998	DECEMBER 31, 1997	ESTIMATED USEFUL LIVES
Building and improvements	$ 41,000	$ 604,000	10 - 31.5 years
Equipment and furniture	3,326,000	3,988,000	5 - 10 years
Medical equipment	366,000	344,000	5 - 7 years
Automobile	12,000	14,000	3 - 5 years
	3,745,000	4,950,000	
Less: Accumulated depreciation	(1,859,000)	(2,482,000)	
	$ 1,886,000	$ 2,468,000	

Depreciation expense for the years ended December 31, 1998, 1997 and 1996 was $788,000, $1,072,000 and $1,490,000, respectively.

8. ACCRUED EXPENSES

Accrued expenses consist of the following:

	DECEMBER 31, 1998	DECEMBER 31, 1997
Salaries and employee benefits	$ 5,937,000	$ 4,345,000
Medical claims	4,243,000	6,047,000
Liability claims	2,408,000	4,494,000
Legal	190,000	429,000
Severance	19,000	290,000
Merger costs	--	247,000
Accrued loss on Georgia contract	--	200,000
Other	349,000	408,000
	13,146,000	16,460,000
Less: Noncurrent portion of liability claims	(1,300,000)	(3,624,000)
	$11,846,000	$12,836,000

9. BANKING ARRANGEMENTS

On March 28, 1997, the Company entered into a $20,000,000 line of credit facility expiring September 2000 for general corporate purposes including working capital, the issuance of letters of credit for performance bonds and the funding of acquisitions. The interest rate was based on LIBOR or prime rates subject to the quarterly operating performance of the Company, as defined in such facility. The line of credit was collateralized by all assets of the Company and its operating subsidiaries and is also subject to certain quarterly financial covenants of which the Company was in compliance with throughout 1998. No borrowings were outstanding under the lines of credit at December 31, 1998 and 1997. Such credit facility was replaced by the Credit Facility.

PHS had open letters of credit of $503,000 and $3,641,000 at December 31, 1998 and 1997, respectively, supporting performance guaranteed on specific contracts. Subsequent to December 31, 1998, the Company had the remaining $503,000 letters of credit returned.

10. INCOME TAXES

The Company's provision (benefit) for income taxes consists of the following:

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
Current income taxes:			
Federal	$ 50,000	$ --	$(1,110,000)
State	87,000	--	(137,000)
	137,000	--	(1,247,000)
Deferred taxes:			
Federal	(682,000)	--	--
State	(80,000)	101,000	--
	(762,000)	101,000	--
Income taxes (benefits)	$(625,000)	$101,000	$(1,247,000)

Deferred tax assets (liabilities) are comprised of the following at December 31:

	YEAR ENDED DECEMBER 31,	
	1998	1997
Net operating loss carryforwards	$2,161,000	$ 2,835,000
Executive stock options	773,000	773,000
Self-insurance reserves	733,000	1,714,000
Accrued vacation	421,000	299,000
Bad debt allowance	59,000	146,000
Depreciation	48,000	(461,000)
Accrued legal	(134,000)	140,000
Accrued severance	6,000	109,000
Accrued merger costs	--	247,000
Accrued loss on Georgia contract	--	76,000
Other	4,000	96,000
	4,071,000	5,974,000
Valuation allowance	--	(2,665,000)
	$4,071,000	$ 3,309,000

The valuation allowance for deferred tax assets has been eliminated at December 31, 1998 as it is more likely than not that the deferred tax assets will be realized through the future reversion of existing taxable temporary differences and the generation of future taxable income. As of December 31, 1998, the Company had federal and state net operating loss carryforwards of $5,686,000 expiring in 2005 through 2006.

A reconciliation of the federal statutory rate to the effective tax rate is as follows:

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
Federal tax	34.0%	34.0%	(34.0)%
State income taxes	4.0	5.7	(1.4)
Alternative minimum tax	1.0	--	--
Other	1.0	1.0	--
Increase (decrease) in valuation allowance	(52.3)	(35.0)	22.8
	(12.3)%	5.7%	(12.6)%

11. REDEEMABLE COMMON STOCK

During 1996, the Company sold 146,000 shares of common stock (purchased shares) and awarded 40,000 shares (awarded shares) of common stock to its then Chief Executive Officer. The 146,000 shares were sold at the then current fair market value of $8.75 per share. The vesting of the awarded shares could be, and was accelerated under the terms of the award and a compensation charge of $8.75 per share was recorded representing the fair market value of the shares on the date of issuance. As of March 31, 1997, the redemption price was fixed at $9.90 per share, through an amendment to the employment agreement. Changes in the redemption value of the purchased and awarded shares were recorded as adjustments to retained earnings and compensation expense, respectively. During 1997, the Company decreased the redemption value of the purchased and awarded shares, respectively, by $57,000 and $17,000, and during 1996 increased the redemption value by $226,000 and $62,000.

12. NET INCOME (LOSS) PER SHARE

The table below sets forth the computation of basic and diluted earnings per share as required by FASB Statement No. 128 for the three years in the period ended December 31, 1998.

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996
NUMERATOR:			
Net Income (loss)	$5,724,000	$1,685,000	$(8,686,000)
Redeemable Common Stock	--	57,000	(226,000)
Numerator for basic and diluted earnings per share -- income (loss) available to common stockholders	$5,724,000	$1,742,000	$(8,912,000)
DENOMINATOR:			
Denominator for basic earnings per share -- weighted average shares	3,554,000	3,480,000	3,171,000
Effect of dilutive securities:			
Employee stock options	99,000	177,000	--
Denominator for diluted earnings per share -- adjusted weighted average shares and assumed conversions	3,653,000	3,657,000	3,171,000
Basic earnings per share	$ 1.61	$ .50	$ (2.81)
Diluted earnings per share	$ 1.57	$ .48	$ (2.81)

During any given quarter for the years ended December 31, 1998, 1997, and

1996 there were no more than 388,000, 175,100 and 762,000 options, respectively, to purchase common stock with weighted average exercise prices of $12.04, $12.84 and $8.60, respectively, not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price for the period of the common shares or there was a loss for the year and, therefore, the effect would be antidilutive.

In addition, during any given quarter for the year ended December 31, 1998 and 1997 there were no more than 186,000 shares of common stock which the Company is required to repurchase upon termination of the former Chief Executive Officer, as part of the written put option included in the employment agreement, which were not included in the computation of diluted earnings per share because the exercise (redemption) price was less than the average market price of the common shares for the period or there was a loss for the year and, therefore, the effect would be antidilutive.

13. STOCK OPTION PLANS

The Company has an Incentive Stock Plan, which provides for the granting of options, stock awards and stock appreciation rights to officers, key employees and non-employee directors for up to 1,483,000 shares of the Company's common stock. Awards and vesting periods under the plan are discretionary and are administered by a committee of the Board of Directors. The exercise price of the options can not be less than the fair market value at the date of grant. Options and other benefits expire at such times as the committee determines at the time of grant, but no later than ten years from the grant date.

The following is a summary of stock option activity under the plan:

<TABLE>
<CAPTION>

	OPTIONS	PRICE RANGE	WEIGHTED AVERAGE EXERCISE PRICE
<S>	<C>	<C>	<C>
Outstanding, December 31, 1995	668,000	$2.33 -- $11.19	$ 5.00
Granted	402,000	6.93 -- 13.13	10.53
Exercised	(325,000)	2.33 -- 6.50	3.39
Stock award vested	(40,000)	8.75 -- 8.75	8.75
Canceled	(19,000)	4.50 -- 13.12	12.16
Outstanding, December, 1996	686,000	2.67 -- 13.12	8.66
Granted	97,000	10.19 -- 14.44	12.98
Exercised	(147,000)	2.67 -- 13.13	3.45
Canceled	(42,000)	4.50 -- 13.88	11.91
Outstanding, December 31, 1997	594,000	4.50 -- 14.44	10.41
Granted	186,000	8.69 -- 13.56	9.89
Exercised	(6,000)	6.50 -- 10.63	9.19
Canceled	(91,000)	6.31 -- 14.44	11.33
Outstanding, December 31, 1998	683,000	$4.50 -- $14.44	$10.12

</TABLE>

Total options available for future grants at December 31, 1998 and 1997, were 280,000 and 76,000, respectively. Under separate plans and as part of the recruitment of the Chief Operating Officer and Vice President of Marketing, the Company granted 75,000 options and 60,000 options, respectively, at fair market value during 1998.

In April 1996, the Company granted the former Chief Executive Officer 175,000 stock options pursuant to an amendment to the Incentive Stock Plan in May 1996 which resulted in a $2,034,000 noncash compensation charge.

As of December 31, 1998, 439,000 options were exercisable under all plans. The Company has reserved 1,483,000 shares of common stock for options outstanding and for options which may be granted in the future.

<TABLE>
<CAPTION>

OPTIONS OUTSTANDING	OPTIONS EXERCISABLE
WEIGHTED AVERAGE	

RANGE OF EXERCISE PRICES	OUTSTANDING AT 12/31/98	REMAINING CONTRACTUAL LIVE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT 12/31/98	WEIGHTED AVERAGE EXERCISE PRICE
<S>	<C>	<C>	<C>	<C>	<C>
$4.50 -- 6.50........	63,000	5.91	$5.69	63,000	$5.69
8.69 -- 11.19........	574,000	9.49	9.52	274,000	9.45
13.13 -- 14.44........	181,000	8.87	13.58	102,000	13.44
$4.50 -- 14.14........	818,000			439,000	

</TABLE>

Options exercisable at December 31, 1998 had a weighted average exercise of $9.84.

Pro forma information regarding net income (loss) and earnings per share is required by SFAS No. 123 which also requires that the information be determined as if the Company has accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method of that Statement. The fair value of these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31, 1998	1997
<S>	<C>	<C>
Volatility..	0.6	0.7
Interest rate...	5.0%	5.8%
Expected life (years).....................................	3	3
Dividend yields...	0.0%	0.0%

</TABLE>

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma information for the years ended December 31, 1998, 1997 and 1996 are as follows:

<TABLE>
<CAPTION>

	YEAR ENDED DECEMBER 31,					
	1998		1997		1996	
	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA	AS REPORTED	PRO FORMA
	(IN THOUSANDS, EXCEPT PER SHARE DATA)					
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Net income (loss)..................	$5,724	$5,231	$1,685	$1,029	$(8,686)	$(7,190)
Income per common share:						
Basic............................	$ 1.61	$ 1.47	$ .50	$ .30	$ (2.81)	$ (2.04)
Diluted..........................	$ 1.57	$ 1.44	$ .48	$ .28	$ (2.81)	$ (2.04)

</TABLE>

The resulting pro forma disclosures may not be representative of that to be expected in future years. The weighted average fair value of options granted during 1998, 1997 and 1996 is $4.26, $5.41 and $4.93, respectively.

14. EMPLOYEE BENEFIT PLAN

The Company has a 401(k) Retirement Savings Plan (the Plan) covering substantially all employees who have completed one year and 1,000 hours of service. The Plan permits eligible employees to defer and contribute to the plan a portion of their compensation. The Company matches such employee contributions to the Plan ranging from 1% to 3% depending on their years of participation. The Company recorded an expense of $316,000, $266,000 and $299,000 for the years ended December 31, 1998, 1997 and 1996, respectively, related to the matching contributions of the Plan.

The Company instituted an Employee Stock Purchase Plan during 1996. Employees who have completed one year of service are eligible to contribute up to 10% of their annual salaries whereby common shares will be purchased at 85% of the Company's fair market value as defined within the agreement. At December 31, 1997, the Company had recorded $136,000, included in accrued expenses, related to a one-time opportunity

for employees to rescind the purchase of common stock under the plan and to receive a refund of their payroll deductions for the July 1, 1997 through December 31, 1997 period.

15. PROFESSIONAL AND GENERAL LIABILITY INSURANCE

Subsequent to December 1, 1997, the Company has maintained third party commercial insurance on a claims-made basis with primary limits of $1,000,000 each occurrence and $3,000,000 in the aggregate. In addition, the Company has maintained excess liability insurance of $15,000,000 for each claim and $15,000,000 annual aggregate. For the period prior to December 1, 1997, Harbour Insurance, Inc., a wholly-owned captive insurance company incorporated under the laws of the State of Delaware, provided professional and general liability coverage to PHS with limits of $1,000,000 per claim and various aggregate limits per policy year. The aggregate limit for policy years ended 1997 and 1996 was $3,500,000 and $3,250,000, respectively.

Possible claims in excess of the individual and aggregate claims per policy year up to a maximum of $15,000,000 for 1997 and $5,000,000 for 1996 are covered by third-party insurance policies on a claims-made basis.

Any liabilities in excess of the third-party insurance limits are assumed by the Company. The Harbour policy relative to the contract with the Georgia Department of Corrections, which terminated on June 30, 1997, is an occurrence-based policy with similar levels of self-insured retention.

The Company records a liability for reported and unreported professional and general liability claims based upon an actuarial estimate of the cost of settling losses and loss adjustment expenses discounted at 7% in 1998 and 6% in 1997. Amounts accrued were $2,408,000 and $4,494,000 at December 31, 1998 and 1997, respectively, and are included in accrued expenses and non-current portion of accrued expenses. Changes in estimates of losses resulting from the continuous review process and differences between estimates and loss payments are recognized in the period in which the estimates are changed or payments are made. Reserves for medical malpractice exposures are subject to fluctuations in frequency and severity. Given the inherent degree of variability in any such estimates, the reserves reported at December 31, 1998, represent management's best estimate of the amounts necessary to discharge the Company's obligations.

During 1998, the Company completed a portfolio transfer of all Harbour claims made prior to December 1, 1997 through the execution of a Novation Agreement and dissolved Harbour resulting in no gain or loss.

16. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company leases office space and equipment through October 2003 under certain noncancelable operating leases.

The Company has a sublease agreement with a third party for its former corporate office space in New Castle, Delaware. The sublease is for the period May 1, 1997 through April 30, 2000. The original lease term expires July 31, 2000.

In connection with the MedPartners Settlement Agreement, the Company closed its regional offices in Atlanta, Georgia, and Newark, Delaware and assigned future lease payments to MedPartners.

Future minimum annual lease payments at December 31, 1998 are as follows:

YEAR ENDING DECEMBER 31:	
1999	$ 725,000
2000	605,000
2001	349,000
2002	290,000
2003	254,000
Thereafter	19,000
	2,242,000
Sublease receipts	(499,000)
	$1,743,000

Rental expense under operating leases was $394,000, $516,000, and $564,000 for the years ended December 1998, 1997 and 1996, respectively.

Catastrophic Limits

Many of the Company's contracts require reimbursement to the Company for all treatment costs or, in some cases, only out-of-pocket treatment costs related to certain catastrophic events, and/or for AIDS or AIDS-related illnesses. Certain contracts do not contain such limits. The Company attempts to compensate for the increased financial risk when pricing contracts that do not contain individual, catastrophic or AIDS-related limits. However, the occurrence of severe individual cases, AIDS-related illnesses or a catastrophic event in a facility governed by a contract without such limitations could render the contract unprofitable and could have a material adverse effect on the Company's operations. The Company maintains insurance from an unaffiliated insurer for contracts, which do not contain catastrophic protection for hospitalization amounts in excess of $125,000 per inmate through September 1998 and $200,000 per inmate thereafter. The Company believes this insurance significantly mitigates its exposure to unanticipated expenses of catastrophic hospitalization.

Litigation and Claims

The Company is a party to various legal proceedings incidental to its business. Certain claims, suits and complaints arising in the ordinary course of business have been filed or are pending against the Company. An estimate of the amounts payable on existing claims for which the liability of the Company is probable is included in accrued expenses at December 31, 1998 and 1997. The Company is not aware of any material unasserted claims and, based on its past experience, would not anticipate that potential future claims would have a material adverse effect on its consolidated financial position or results of operations.

17. MAJOR CUSTOMERS AND GEOGRAPHICAL CONCENTRATIONS

The Company considers its managed healthcare services business to be one segment for reporting under Financial Accounting Standards Board Statement No. 131, Disclosures about Segments of an Enterprise and Related Information. Consequently, other than the following enterprise-wide disclosures relating to major customers and geographic concentrations, reportable segment information is not applicable. The following is a summary of revenues from major customers:

	YEAR ENDED DECEMBER 31,		
	1998	1997	1996

	REVENUE	PERCENT	REVENUE	PERCENT	REVENUE	PERCENT
			(IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>	<C>	<C>
State of Indiana.........	$23,968	21.2%	$ 7,688	5.9%	$ --	--%
State of Kansas..........	19,223	17.0	18,095	14.0	17,096	11.2
City of Philadelphia.....	17,966	15.9	17,865	13.8	16,034	10.5
County of Alameda........	12,122	10.7	11,601	9.0	11,619	7.6
State of Georgia.........	291	.02	30,854	23.9	56,662	37.2
State of Maryland........	--	--	6,022	4.6	15,479	10.2

</TABLE>

Estimated credit losses associated with the receivables are provided for in the consolidated financial statements. The contract with the State of Georgia expired June 30, 1997.

18. FOURTH QUARTER ADJUSTMENTS

The Company made a year end adjustment in 1997 resulting from a change in estimate relating to medical malpractice reserves. The adjustment of $1,400,000 increased basic and diluted earnings per share by $.40 and $.39, respectively.

The Company made a year end adjustment in 1998 resulting from a change in estimate relating to the valuation allowance for deferred tax assets. The adjustment of $763,000 increased basic and diluted earnings per share by $.21.

SCHEDULE II

AMERICA SERVICE GROUP INC.

VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

<TABLE>
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	BALANCE AT BEGINNING OF PERIOD	ADDITIONS CHARGED TO COSTS AND EXPENSES	DEDUCTIONS	BALANCE AT END OF PERIOD
<S>	<C>	<C>	<C>	<C>
DECEMBER 31, 1998				
Allowance for doubtful accounts................	$ 384,000	$ --	$ 364,000	$ 20,000
Valuation allowance for deferred tax asset......	2,665,000	--	2,665,000	--
	$3,049,000	$ --	$3,029,000	$ 20,000
DECEMBER 31, 1997				
Allowance for doubtful accounts................	$2,016,000	$ 841,000	$2,473,000	$ 384,000
Valuation allowance for deferred tax asset......	3,009,000	--	344,000	2,665,000
	$5,025,000	$ 841,000	$2,817,000	$3,049,000
DECEMBER 31, 1996				
Allowance for doubtful accounts................	$ 840,000	$1,822,000	$ 646,000	$2,016,000
Valuation allowance for deferred tax asset......	--	3,009,000	--	3,009,000
	$ 840,000	$4,831,000	$ 646,000	$5,025,000

</TABLE>

EXHIBIT 10.16

AMENDED AND RESTATED
EMPLOYMENT AGREEMENT

AGREEMENT originally dated the 1st day of April, 1996 (the "Original Date") subsequently amended by Amendment No. 1 dated the 30th day of June, 1997, further amended and restated by these presents dated September 1, 1998, between Scott L. Mercy ("Employee") and America Service Group Inc. a Delaware corporation (the "Company").

WHEREAS, the Board of Directors of the Company (the "Board") heretofore recruited and employed the Employee as President and Chief Executive Officer of the Company and a director of the Company;

WHEREAS, the Board now desires to employ the Employee as the nonexecutive Chairman of the Board of Directors of the Company, in addition to serving as a director;

WHEREAS, the Employee has made a meaningful personal investment in the common stock of the Company; and

WHEREAS, the Employee accepts the position of Chairman as contemplated herein;

NOW, THEREFORE, the parties hereby agree as follows:

1. Employment and Duties. The Company hereby employs the Employee as Nonexecutive Chairman of the Board of Directors of the Company to perform the duties of such office. The Board shall also take all necessary steps to ensure that Employee is slated as a nominee to the Board and elected Chairman during his employment, provided that Employee may terminate his chairmanship, as provided herein, and remain a director and Employee hereunder.

2. Performance. Employee agrees to devote reasonable time and effort to the performance of his duties hereunder and to promote the interests and welfare of the Company. However, it is understood that Employee has additional employment with and provides services for third parties (except as otherwise provided in Section 9).

3. Term. The term of Employee's employment hereunder commenced as of the Original Date and shall continue from the date hereof as an employment at will unless terminated by written notice from either party to the other as herein provided.

4. Compensation. For all services rendered by Employee, the Company agrees from the date hereof to pay Employee from and after the date hereof: (i) a salary at a minimum annual rate of $60,000 until January 1, 1999,

and $24,000 per annum thereafter; (ii) with respect to calendar year 1998, incentive compensation at a rate and under the incentive compensation plan as presently approved by the Board, to be calculated upon the total amount of Employee's base salary payments for 1998; plus (iii) such additional compensation as the

Compensation Committee of the Board shall from time to time determine. Employee's compensation as a director shall be separate and equal to the amount set by the Board of Directors for all directors.

5. Purchase of Stock.

(a) Purchase. Employee has purchased from the Company 146,000 shares of common stock of the Company at a price of $8.75 per share (the "Purchase Price").

(b) Put Option. Upon termination of Employee's employment hereunder for any reason or without cause, Employee, or Employee's estate if applicable, shall, for a period of forty-five (45) days following the Termination Date (as defined hereafter), have the right to sell, and the Company shall thereupon have an obligation to purchase (or cause a third party to purchase) such number of the shares purchased under Section 5(a) (the "Mercy Shares") and of the shares vested pursuant to the stock award received under Section 6(a) (the "Vested Award Shares") as Employee, or Employee's estate if applicable, shall elect, at $9.90 per share. Completion of said transaction, including stock certificate delivery and wire transfer of proceeds in accordance with the Employee's instructions, shall occur within five (5) business days of said notification. "Termination Date" shall mean the date of death, or the date specified in the notice of termination, as the case may be, provided that if a dispute exists, the Termination Date shall be the date on which the dispute is finally determined either by mutual written agreement of the parties, or by the final judgment, order or decree of a court of competent jurisdiction.

(c) Company's Right to Repurchase. Upon termination of Employee's employment hereunder for any reason or without cause, the Company shall for a period for forty-five (45) days following the Termination Date have the right to purchase (or cause a third party to purchase), and Employee shall thereupon have an obligation to sell to the Company (or to such purchaser) such number of the Mercy Shares and of the Vested Award Shares as the Company shall elect, at a price equal to the average closing price of the Company's common stock for the thirty (30) trading days immediately preceding notification by the Company to the Employee of the Company's intention to exercise this right.

Completion of said transaction, including stock certificate delivery and wire transfer of proceeds in accordance with the Employee's instructions, shall occur within five (5) business days of said notification.

(d) Registration of Mercy Shares. The sale of the Mercy Shares to Employee has been registered by the Company on Form S-8 in accordance with all applicable laws and regulations.

(e) Exception to Repurchase Obligation. Anything to the contrary notwithstanding, the Company shall not be obligated to purchase the Mercy Shares or the Vested Award Shares if and to the extent such purchase would violate the Delaware General Corporation Law, or any loan agreement to which the Company is then a party. Within five business days following notification by Employee or his estate, if applicable, of an election (the "Original

Election") to sell shares under Section 5(b), the Company shall determine whether and to what extent the requested purchase would violate the Delaware General Corporation Law or any such loan agreement and so advise the Employee or his estate, in writing (the "Company Notice"). If and to the extent the Employee or his estate sells the shares which the Company is prohibited from purchasing, as described above (the "Restricted Shares"), within thirty (30) days (or such longer period as the parties shall agree) following the Company Notice, the Company shall pay the Employee or his estate, if applicable, the amount, if any, by which the price otherwise payable for such shares under Section 5(b) exceeds the net proceeds received, provided that:

(i) neither the Employee nor his estate sells any shares of Common Stock other than Restricted Shares between the date of the Original Election and the last date on which Restricted Shares are sold hereunder; and

(ii) Employee and his estate use commercially reasonable efforts to realize the maximum net proceeds from the sale of Restricted Shares hereunder.

(f) Transfer of Mercy Shares and Vested Award Shares. Sections 5(b), 5(c) and 5(e) hereof shall continue to apply to any Mercy Shares and/or Vested Award Shares transferred by Employee to trusts for his benefit or to his spouse or direct descendants or trusts for their benefit (collectively, "Permitted Transferees"). Each such person shall have the same rights and obligations under Section 5(b), 5(c) and 5(e) as Employee or his estate, if applicable, would have with respect to such shares upon termination of Employee's employment hereunder. Sections 5(b), 5(c) and 5(e) hereof shall cease to apply to any Mercy Shares and/or Vested Award Shares otherwise transferred by Employee (or by his Permitted Transferees) and the transferee thereof shall have no rights or obligations under Sections 5(b), 5(c) or 5(e).

(g) Legend. All certificates representing Mercy Shares and Vested Award Shares, including any Mercy Shares or Vested Award Shares transferred to a Permitted Transferee, shall bear the following legend:

> The shares represented by this certificate are subject to certain options and rights to repurchase, as set forth in an Amended and Restated Employment Agreement between America Service Group Inc. and Scott L. Mercy dated____________, 1998.

(h) Precedence. In the event rights to sell are exercised under Section 5(b) and rights to purchase are exercised under Section 5(c), following Employee's termination of employment, then, notwithstanding the order in which such rights are exercised, rights to sell exercised under Section 5(b) by the Employee, his estate or Permitted Transferees shall take precedence.

6. Incentive Compensation.

(a) Stock Awards. The Company has awarded to Employee 40,000 shares of the Company's common stock as a restricted stock award pursuant to the Company's Incentive Stock Plan, subject to the terms and conditions set forth in Exhibit A hereto. The issuance of such shares has been registered on Form S-8.

(b) Stock Options. The Company has granted to the Employee, pursuant to stockholder approval of the Company's Amended Incentive Stock Plan, options to purchase 175,000 shares of the Company's common stock at $8.75 per share (the "Options") pursuant to the terms of the Company's Amended Incentive Stock Plan and subject to the terms and conditions set forth in Exhibit B. The Options will expire ten (10) years from the date of grant and have fully vested.

7. Expenses. The Company shall promptly pay or reimburse Employee for all reasonable expenses incurred by him in connection with the performance of his duties and responsibilities hereunder.

8. Termination.

(a) Resignation; Termination. Employee may resign or be terminated as Chairman hereunder and this Agreement, as applicable, shall remain in force. Either party to this Agreement may terminate Employee's employment on thirty (30) days' notice.

(b) Disability; Death. If Employee shall fail to or be unable to perform the duties required hereunder because of any physical or mental infirmity, and such failure or inability shall continue for any six (6) consecutive months during the term of this Agreement, the Company shall have the right to terminate this Agreement. Except as otherwise provided herein, and except for Section 5(b) and 5(c), this Agreement shall terminate upon the death of Employee, and the estate of Employee shall be entitled to receive all unpaid amounts due Employee hereunder to such date of death.

9. Covenant Not to Compete.

(a) Employee acknowledges that in the course of his employment he has become familiar with the Company and its affiliates' confidential information concerning the Company and its affiliates and that his services are of special, unique and extraordinary value to the Company and

its affiliates. Therefore, Employee agrees that, during his employment with the Company, and for one year after Employee ceases to perform duties hereunder, neither Employee nor any company with which Employee is affiliated as an employee, consultant or independent contractor, will directly or indirectly engage in any business similar to the Business of the Company, as described below, anywhere in the United States of America, or have any interest directly or indirectly in any Business; provided, however, that nothing herein shall prohibit Employee from (i) owning in the aggregate not more than 5% of the outstanding stock of any class of stock of a corporation so long as Employee has no active participation in the business of such corporation, (ii) affiliating with any company which may participate in the Business, so long as that participation at the time of affiliation aggregates less than 10% of such company's revenue, or (iii) directly or through an affiliate, acquiring, merging or otherwise gaining control, or purchasing an interest in an organization as long as the Business represents less than 10% of the acquiree's revenue at the time of the transaction. For purposes hereof, the "Business" shall consist of (A) delivery of contract health care to correctional facilities, (B) drug and alcohol abuse treatment programs by correctional institutions or criminal justice programs, and (C) any other business in which the Company is engaged as of the date that Employee ceases to perform duties hereunder.

(b) If, at the time of enforcement of this Section 9, a court shall hold that the duration, scope or area restrictions stated herein are unreasonable under circumstances then existing, the parties agree that the maximum duration, scope or area reasonable under such circumstances shall be substituted for the stated duration, scope or area.

(c) In the event of the breach by Employee of any of the provisions of this Section 9, the Company, in addition and supplementary to other rights and remedies existing in its favor, may apply to any court of law or equity of competent jurisdiction for specific performance and/or injunctive or other relief in order to enforce or prevent any violations of the provisions hereof.

10. Notices. All notices hereunder, to be effective, shall be in writing and shall be deemed delivered when delivered by and or when sent by first-class, certified mail, postage and fees prepaid, to the following addresses or as otherwise indicated in writing by the parties:

(a) If to the Company:

America Service Group Inc.
105 Westpark Drive, Suite 300
Brentwood, TN 37027
Attn: Chief Executive Officer

(b) If to Employee:

Mr. Scott L. Mercy
3600 Franklin Road
Nashville, TN 37204

11. Assignment. This Agreement is based upon the personal services of Employee and the rights and obligations of Employee hereunder shall not be assignable except as herein expressed provided. This Agreement shall inure to the benefit of and be enforceable by the Employee's personal and legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If the Employee should die while any amounts would still be payable to him hereunder if he would have continued to live, all such amounts, unless otherwise provided herein, shall be paid in accordance with the terms of this Agreement to the Employee's devisee, legatee or other designee and if there is no such devisee, legatee or designee, to the Employee's estate.

12. Entire Agreement. This Agreement supersedes all prior understandings and agreements with respect to the provisions hereof and contains the entire agreement of the parties and may be amended only in writing, signed by the parties hereto.

13. Severability. The provisions of this Agreement are severable, and the invalidity of any provision shall not affect the validity of any other

provision. In the event that any arbitrator or court of competent jurisdiction shall determine that any provision of this Agreement or the application thereof is unenforceable because of the duration or scope thereof, the parties hereto agree that said arbitrator or court in making such determination shall have the power to reduce the duration and scope of each provision to the extent necessary to make it enforceable, and that the Agreement in its reduced form shall be valid and enforceable to the full extent permitted by law.

14. Non-Exclusivity of Rights. Nothing in this Agreement shall prevent or limit the Employee's continuing or future participation in any benefit, bonus, incentive or other plan or program provided by the Company (except for any severance or termination policies, plans, programs or practices) and for which the Employee may qualify, nor shall anything herein limit or reduce such rights as the Employee may have under any other Agreement with the Company. Amounts which are vested benefits or which the Employee is otherwise entitled to receive under any plan or program of the Company shall be payable in accordance with such plan or program, except as explicitly modified by this Agreement.

15. Governing Law. This Agreement shall be construed under and governed by the internal laws of the State of Delaware.

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as a binding contract as of the day and year first above written.

AMERICA SERVICE GROUP INC.

By: /s/ W.D. Eberle

W.D. Eberle
Chairman of the Executive Committee,
Board of Directors

EMPLOYEE:

By: /s/ Scott L. Mercy

Scott L. Mercy

EXHIBIT 21.1

America Service Group Inc.

List of Subsidiaries	State of Incorporation
1. Prison Health Services, Inc.	Delaware
2. Prison Health Services of Indiana LLC	Indiana
3. EMSA Government Services, Inc.	Florida
4. EMSA Correctional Care, Inc.	Florida
5. EMSA Military, Inc.	Florida
6. EMSA, L.P.	

EXHIBIT 23.1

CONSENT OF ERNST & YOUNG, LLP, INDEPENDENT AUDITORS

We consent to the incorporation by reference in the America Service Group Inc. Registration Statements on Form S-8 (Registration Nos. 33-48231, 333-03010, 333-04903, 333-04895, 333-26903, 333-26905, 333-50161, 333-50171, 333-58093), of our report dated February 12, 1999, except for Note 3, as to which the date is March 16, 1999, with respect to the consolidated financial statements and schedule of America Service Group Inc. included in the Annual Report (Form 10-K) for the year ended December 31, 1998.

/s/ Ernst & Young LLP

Nashville, Tennessee
March 22, 1999

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE FINANCIAL STATEMENTS OF AMERICAN SERVICE CORP. FOR THE YEAR ENDED DECEMBER 31, 1998 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.
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