

MEADOWBROOK INSURANCE GROUP INC

Form 10-Q

November 07, 2005

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington D.C. 20549**

**FORM 10-Q**

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

**For the quarter ended September 30, 2005**

**or**

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

**Commission File Number 1-14094**  
**Meadowbrook Insurance Group, Inc.**  
*(Exact name of Registrant as specified in its charter)*

**Michigan**  
*(State of Incorporation)*

**38-2626206**  
*(IRS Employer Identification No.)*

**26255 American Drive, Southfield, Michigan 48034**  
*(Address, zip code of principal executive offices)*  
**(248) 358-1100**  
*(Registrant's telephone number, including area code)*

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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

The aggregate number of shares of the Registrant's Common Stock, \$.01 par value, outstanding on November 1, 2005 was 28,684,282.

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**Certification of Robert S. Cubbin, Chief Executive Officer, Pursuant to Rule 13a-14(a)**

**Certification of Karen M. Spaun, Senior Vice President and Chief Financial Officer, Pursuant to Rule 13a-14(a)**

**Certification of Robert S. Cubbin, Chief Executive Officer, Pursuant to Section 906**

**Certification of Karen M. Spaun, Senior Vice President and Chief Financial Officer, Pursuant to Section 906**

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CONSOLIDATED STATEMENTS OF INCOME**

	<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Unaudited) (In thousands, except share data)</b>	
<b>Revenues</b>		
Premiums earned		
Gross	\$ 244,016	\$ 211,125
Ceded	(56,660)	(55,366)
Net earned premiums	187,356	155,759
Net commissions and fees	27,333	32,794
Net investment income	13,159	10,901
Net realized gains (losses)	31	(73)
<b>Total revenues</b>	<b>227,879</b>	<b>199,381</b>
<b>Expenses</b>		
Losses and loss adjustment expenses	179,669	158,467
Reinsurance recoveries	(66,338)	(61,303)
Net losses and loss adjustment expenses	113,331	97,164
Salaries and employee benefits	39,166	39,417
Policy acquisition and other underwriting expenses	33,740	24,585
Other administrative expenses	19,868	19,367
Interest expense	2,527	1,529
<b>Total expenses</b>	<b>208,632</b>	<b>182,062</b>
<b>Income before taxes and equity earnings</b>	<b>19,247</b>	<b>17,319</b>
Federal and state income tax expense	6,250	6,043
Equity (losses) earnings, of affiliates	(12)	28
<b>Net income</b>	<b>\$ 12,985</b>	<b>\$ 11,304</b>
<b>Earnings Per Share</b>		
Basic	\$ 0.45	\$ 0.39
Diluted	\$ 0.44	\$ 0.38
<b>Weighted average number of common shares</b>		
Basic	29,052,785	29,040,503

Diluted

29,363,045

29,420,049

The accompanying notes are an integral part of the Consolidated Financial Statements.

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**MEADOWBROOK INSURANCE GROUP, INC.  
CONSOLIDATED STATEMENTS OF INCOME**

	<b>For the Three Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Unaudited) (In thousands, except share data)</b>	
<b>Revenues</b>		
Premiums earned		
Gross	\$ 82,466	\$ 75,025
Ceded	(19,261)	(22,062)
Net earned premiums	63,205	52,963
Net commissions and fees	9,200	12,669
Net investment income	4,591	3,757
Net realized gains	41	79
<b>Total revenues</b>	<b>77,037</b>	<b>69,468</b>
<b>Expenses</b>		
Losses and loss adjustment expenses	61,805	57,056
Reinsurance recoveries	(23,336)	(25,227)
Net losses and loss adjustment expenses	38,469	31,829
Salaries and employee benefits	12,913	14,284
Policy acquisition and other underwriting expenses	11,947	8,169
Other administrative expenses	6,037	6,802
Interest expense	948	686
<b>Total expenses</b>	<b>70,314</b>	<b>61,770</b>
<b>Income before taxes and equity earnings</b>	<b>6,723</b>	<b>7,698</b>
Federal and state income tax expense	2,048	2,509
Equity (losses) earnings, of affiliates	(13)	63
<b>Net income</b>	<b>\$ 4,662</b>	<b>\$ 5,252</b>
<b>Earnings Per Share</b>		
Basic	\$ 0.16	\$ 0.18
Diluted	\$ 0.16	\$ 0.18
<b>Weighted average number of common shares</b>		
Basic	28,957,369	29,059,626
Diluted	29,269,638	29,425,674

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**MEADOWBROOK INSURANCE GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>For the Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
Net income	\$ 12,985	\$ 11,304
Other comprehensive income (loss), net of tax:		
Unrealized losses on securities	(4,844)	(1,386)
Less: reclassification adjustment for losses included in net income	61	41
Other comprehensive loss, net of tax	(4,783)	(1,345)
Comprehensive income	\$ 8,202	\$ 9,959

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**MEADOWBROOK INSURANCE GROUP, INC.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**

	<b>For the Three Months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
	<b>(Unaudited) (In thousands)</b>	
Net income	\$ 4,662	\$ 5,252
Other comprehensive income (loss), net of tax:		
Unrealized (losses) gains on securities	(3,633)	3,285
Less: reclassification adjustment for (gains) losses included in net income	(18)	(19)
Other comprehensive (loss) gain, net of tax	(3,651)	3,266
Comprehensive income	\$ 1,011	\$ 8,518

The accompanying notes are an integral part of the Consolidated Financial Statements.

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**MEADOWBROOK INSURANCE GROUP, INC.  
CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
<b>(Unaudited)</b>		
<b>(In thousands, except share data)</b>		
<b>ASSETS</b>		
Investments		
Debt securities available for sale, at fair value (amortized cost of \$382,183 and \$324,966)	\$ 382,250	\$ 332,242
Equity securities available for sale, at fair value (cost of \$0)		39
<b>Total investments</b>	<b>382,250</b>	<b>332,281</b>
Cash and cash equivalents	51,897	69,875
Accrued investment income	4,631	4,331
Premiums and agent balances receivable, net	105,815	84,094
Reinsurance recoverable on:		
Paid losses	15,095	17,908
Unpaid losses	181,262	151,161
Prepaid reinsurance premiums	24,743	26,075
Deferred policy acquisition costs	26,594	25,167
Deferred federal income taxes	16,354	14,956
Goodwill	28,997	28,997
Other assets	44,168	46,851
<b>Total assets</b>	<b>\$ 881,806</b>	<b>\$ 801,696</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Liabilities		
Losses and loss adjustment expenses	\$ 443,294	\$ 378,157
Unearned premiums	143,312	134,302
Debt	2,298	12,144
Debentures	55,930	35,310
Accounts payable and accrued expenses	28,997	38,837
Reinsurance funds held and balances payable	15,388	17,832
Payable to insurance companies	5,526	6,990
Other liabilities	13,107	10,614
<b>Total liabilities</b>	<b>707,852</b>	<b>634,186</b>
Commitments and contingencies (Note 6)		
Shareholders Equity		
Common stock, \$0.01 stated value; authorized 50,000,000 shares; 28,759,282 and 29,074,832 shares issued and outstanding	288	290

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Additional paid-in capital	124,968	126,085
Retained earnings	49,512	37,175
Note receivable from officer	(859)	(868)
Accumulated other comprehensive income	45	4,828
<b>Total shareholders equity</b>	<b>173,954</b>	<b>167,510</b>
Total liabilities and shareholders equity	\$ 881,806	\$ 801,696

The accompanying notes are an integral part of the Consolidated Financial Statements.

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**MEADOWBROOK INSURANCE GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS**

**For the Nine Months  
Ended September 30,**

**2005                      2004**

**(Unaudited)  
(In thousands)**

**Cash Flows From Operating Activities**

Net income	\$ 12,985	\$ 11,304
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of other intangible assets	277	284
Amortization of deferred debenture issuance costs	116	73
Depreciation of furniture, equipment, and building	1,853	1,087
Net accretion of discount and premiums on bonds	1,786	1,318
Loss on sale of investments, net	94	63
Gain on sale of fixed assets	(148)	(22)
Stock-based employee compensation	32	61
Long-term incentive plan expense	585	488
Deferred income tax expense	1,067	2,193
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Premiums and agent balances receivable	(21,721)	(22,572)
Reinsurance recoverable on paid and unpaid losses	(27,289)	(11,104)
Prepaid reinsurance premiums	1,332	(3,514)
Deferred policy acquisition costs	(1,427)	(3,918)
Other assets	6,172	4,244
Increase (decrease) in:		
Losses and loss adjustment expenses	65,137	32,677
Unearned premiums	9,010	20,035
Payable to insurance companies	(1,464)	(106)
Reinsurance funds held and balances payable	(2,444)	5,946
Other liabilities	2,746	4,807
Total adjustments	35,714	32,040
Net cash provided by operating activities	48,699	43,344
<b>Cash Flows From Investing Activities</b>		
Purchase of debt securities available for sale	(174,301)	(87,022)
Proceeds from sales and maturities of debt securities available for sale	115,196	38,294
Proceeds from sales of equity securities available for sale	8	
Capital expenditures	(14,050)	(3,156)
Purchase of books of business	(342)	(361)
Proceeds from sale of assets	633	2,784
Deconsolidation of subsidiary		(4,218)

Other investing activities	(1,942)	2,398
Net cash used in investing activities	(74,798)	(51,281)
<b>Cash Flows From Financing Activities</b>		
Proceeds from lines of credit	6,388	9,829
Payment of lines of credit	(16,234)	(13,585)
Net proceeds from debentures	19,400	24,250
Book overdraft	1,172	(607)
Stock options exercised	995	125
Share repurchases of common stock	(3,404)	
Other financing activities	(196)	14
Net cash provided by financing activities	8,121	20,026
Net (decrease) increase in cash and cash equivalents	(17,978)	12,089
Cash and cash equivalents, beginning of period	69,875	50,647
Cash and cash equivalents, end of period	\$ 51,897	\$ 62,736

The accompanying notes are an integral part of the Consolidated Financial Statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**Note 1 Summary of Significant Accounting Policies**

*Basis of Presentation and Management Representation*