AMERICAN PHYSICIANS SERVICE GROUP INC
Form 10-Q
August 05, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

þ Quarterly Report Pursuant to Sections 13 or 15(d) of the Securities Exchange Act of 1934

For the period ended

June 30, 2009

or

¨ Transition Report Pursuant to Sections 13 or 15(d) of

the Securities and Exchange Act of 1934

For the transition period from

__________ to __________

Commission File Number 001-31434

AMERICAN PHYSICIANS SERVICE GROUP, INC.

(Exact name of registrant as specified in its charter)

Texas	**75-1458323**
(State or other jurisdiction of incorporation or organization)	(I.R.S. employer Identification No.)

1301 S. Capital of Texas Highway, Suite C-300, Austin, Texas 78746
(Address of principal executive offices)(Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Sections 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 þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer þ

Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

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

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

Title of Each Class	Number of Shares Outstanding At July 31, 2009
Common Stock, $.10 par value	6,909,481

AMERICAN PHYSICIANS SERVICE GROUP, INC.

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For the Quarter Ended June 30, 2009

PART 1

FINANCIAL INFORMATION

AMERICAN PHYSICIANS SERVICE GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands)		June 30, 2009		December 31, 2008
Assets				
Investments:				
Fixed maturities available for sale, at fair value	$	200,881	$	198,011
Equity securities available for sale, at fair value		11,344		10,099
Other invested assets		1,545		1,599
Total investments		213,770		209,709
Cash and cash equivalents		28,831		22,060
Accrued investment income		1,534		1,489
Premium and maintenance fees receivable		17,416		17,186
Reinsurance recoverables on paid and unpaid loss adjustment expenses		10,498		13,796
Other amounts receivable under reinsurance contracts		-		1,497
Deferred policy acquisition costs		2,417		2,500
Subrogation recoverables		-		219
Federal income tax receivable		838		738
Deferred tax assets		9,089		9,488
Property and equipment, net		491		590
Intangible assets		2,268		2,264
Other assets		1,696		2,018
Total assets	$	288,848	$	283,554

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

AMERICAN PHYSICIANS SERVICE GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(in thousands, except share data)		**June 30, 2009**		**December 31, 2008**
Liabilities				
Reserve for loss and loss adjustment expense	$	90,403	$	92,141
Unearned premiums and maintenance fees		36,389		36,785
Reinsurance premiums payable		28		61
Funds held under reinsurance treaties		4,264		3,978
Trade accounts payable		699		290
Accrued expenses and other liabilities		6,288		6,266
Federal income tax payable		-		-
Mandatorily redeemable preferred stock		6,531		7,568
Total liabilities		144,602		147,089
Commitments and contingencies				
Shareholders' Equity				
Preferred stock, $1.00 par value, 1,000,000 shares authorized, 7,030 and 8,074 issued				
and outstanding at June 30, 2009 and December 31, 2008, respectively				
Common stock, $0.10 par value, 20,000,000 shares authorized, 6,909,481 and 7,014,386				
issued and outstanding at June 30, 2009 and December 31, 2008, respectively		691		701
Additional paid-in capital		81,670		82,329
Accumulated other comprehensive income, net of taxes		2,943		368

Retained earnings		58,942		53,067
Total shareholders' equity		144,246		136,465
Total liabilities & shareholders' equity	$	288,848	$	283,554

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

AMERICAN PHYSICIANS SERVICE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands)	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
REVENUES				
Gross premiums and maintenance fees written	$ 14,682	$ 15,124	$ 32,222	$ 29,860
Premiums ceded	335	(1,019)	663	376
Change in unearned premiums & maintenance fees	1,808	489	397	1,712
Net premiums and maintenance fees earned	16,825	14,594	33,282	31,948
Investment income, net of investment expense	2,666	2,959	5,217	6,015
Realized capital gains (losses), net	(142)	(35)	(517)	14
Other-than-temporary impairments	(1,100)	(1,208)	(2,007)	(3,852)
Financial services	1,827	1,477	3,275	3,277
Other revenue	45	36	102	53
Total revenues	20,121	17,823	39,352	37,455
EXPENSES				
Losses and loss adjustment expenses	6,797	1,579	12,918	9,088
Other underwriting expenses	2,510	2,498	5,731	5,102
Change in deferred policy acquisition costs	264	104	83	197
Financial services expenses	1,747	3,316	3,375	5,886
General and administrative expenses	1,164	1,161	2,388	2,719

Total expenses		12,482		8,658		24,495		22,992
Income from operations		7,639		9,165		14,857		14,463
Income tax expense		2,718		3,019		5,206		4,937
Net income	$	4,921	$	6,146	$	9,651	$	9,526

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

AMERICAN PHYSICIANS SERVICE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except share data)	**Three Months Ended**				**Six Months Ended**			
	June 30,				**June 30,**			
	2009		**2008**		**2009**		**2008**	
Net income per common share								
Basic:								
Net Income	$	0.71	$	0.86	$	1.39	$	1.33
Diluted:								
Net Income	$	0.70	$	0.84	$	1.36	$	1.30
Basic weighted average shares outstanding		6,923		7,153		6,958		7,173
Diluted weighted average shares outstanding		7,007		7,284		7,089		7,305

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

AMERICAN PHYSICIANS SERVICE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME

For the Six Months ended June 30, 2009

(Unaudited)

(In thousands, except share amounts)	Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2008	7,014,386	$ 701	$ 82,329	$ 53,067		$ 368	$ -	$ 136,465
Comprehensive income:								
Net income	-	-	-	4,730	4,730	-	-	4,730
Other comprehensive income, net of tax:								
Unrealized gain on securities, (net of reclassification adjustment)	-	-	-	-	1,821	1,821	-	1,821
Comprehensive income:					$ 6,551			
Stock options expensed	-	-	161	-		-	-	161
Stock options exercised-exchanged	30,000	3	415	-		-	-	418
Tax benefit from exercise of stock	-	-	5	-		-	-	5

options								
Treasury stock purchases	-	-	-	-		-	(1,506)	(1,506)
Cancelled treasury stock - purchased	(55,082)	(5)	(648)	(435)		-	1,088	-
Cancelled treasury stock - exchanged	(20,480)	(2)	(241)	(175)		-	418	-
Deferred compensation granted	2,300	-	45	-		-	-	45
Balance March 31, 2009 (As Restated)	6,971,124	$ 697	$ 82,066	$ 57,187		$ 2,189	$ -	$ 142,139
Comprehensive income:								
Net income	-	-	-	4,921	4,921	-	-	4,921
Other comprehensive income, net of tax:								
Unrealized gain on securities, (net of reclassification adjustment)	-	-	-	-	754	754	-	754
Comprehensive income:					$ 5,675			
Stock options expensed	-	-	121	-		-	-	121
Stock options exercised-exchanged	70,450	7	860	-		-	-	867
Tax benefit from exercise of stock options	-	-	181	-		-	-	181
Treasury stock purchases	-	-	-	-		-	(2,709)	(2,709)
Cancelled treasury stock - purchased	(84,020)	(8)	(990)	(685)		-	1,683	-
Cancelled treasury stock - exchanged	(48,073)	(5)	(568)	(453)		-	1,026	-

Dividends paid ($0.30 per share)	-	-	-	(2,028)	-	-	(2,028)
Balance June 30, 2009	6,909,481	$ 691	$ 81,670	$ 58,942	$ 2,943	$ -	$ 144,246

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

AMERICAN PHYSICIANS SERVICE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME

For the Six Months ended June 30, 2008

(Unaudited)

(In thousands, except share amounts)	Shares Outstanding	Common Stock	Additional Paid-In Capital	Retained Earnings	Comprehensive Income	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Shareholders' Equity
Balance December 31, 2007	7,213,626	$ 721	$ 83,407	$ 39,307		$ 545	$ -	$ 123,980
Comprehensive income:								
Net income	-	-	-	3,380	3,380	-	-	3,380
Other comprehensive income, net of tax:								
Unrealized gain on securities, (net of reclassification adjustment)	-	-	-	-	214	214	-	214
Comprehensive income:					$ 3,594			
Stock options expensed	-	-	155	-		-	-	155
Stock options exercised-proceeds	9,000	1	83	-		-	-	84
	23,000	2	207	-		-	-	209

Stock options exercised-exchanged								
Tax benefit from exercise of stock options	-	-	103	-		-	-	103
Treasury stock purchases	-	-	-	-		-	(1,598)	(1,598)
Cancelled treasury stock - purchased	(71,746)	(7)	(830)	(503)		-	1,340	-
Cancelled treasury stock - exchanged	(13,278)	(1)	(155)	(102)		-	258	-
Common stock awarded	16,500	2	300	-		-	-	302
Balance March 31, 2008	7,177,102	$ 718	$ 83,270	$ 42,082		$ 759	$ -	$ 126,829
Comprehensive income:								
Net income	-	-	-	6,146	6,146	-	-	6,146
Other comprehensive income, net of tax:								
Unrealized loss on securities, (net of reclassification adjustment)	-	-	-	-	(2,108)	(2,108)	-	(2,108)
Comprehensive income:					$ 4,038			
Stock options expensed	-	-	165	-		-	-	165
Stock options exercised-exchanged	62,500	7	578	-		-	-	585
Tax benefit from exercise of stock options	-	-	257	-		-	-	257
Treasury stock purchases	-	-	-	-		-	(1,994)	(1,994)
Cancelled treasury stock - purchased	(57,273)	(6)	(662)	(558)		-	1,226	-

Cancelled treasury stock - exchanged	(35,103)	(4)	(407)	(357)	-	768	-
Dividends paid ($0.30 per share)	-	-	-	(2,096)	-	-	(2,096)
Balance June 30, 2008	7,147,226	$ 715	$ 83,201	$ 45,217	$ (1,349)	$ -	$ 127,784

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

AMERICAN PHYSICIANS SERVICE GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)	Six Months Ended June 30, 2009	2008
Cash flows from operating activities:		
Net Income	$ 9,651	$ 9,526
Adjustments to reconcile net income to cash provided by operating activities:		
Amortization and accretion of investments	(98)	(253)
Depreciation and amortization	377	360
Realized losses on investments	517	(14)
Other than temporary impairments	2,007	3,852
Change in deferred acquisition costs	83	197
Common stock awarded	45	302
Stock options expensed	282	320
Deferred income tax benefit	(802)	(1,462)
Excess tax benefits from stock-based compensation	(186)	(360)
Other non-cash items	125	(53)
Changes in operating assets and liabilities, net of business acquisition:		
Restricted cash	-	569
Premium receivables, net	(230)	(353)
Other amounts receivable under reinsurance contracts	1,497	4,533
Reinsurance recoverables on unpaid and paid loss expenses	3,274	1,745
Funds held under reinsurance treaties	286	748
Reserve for losses and loss adjustment expenses	(1,738)	(3,503)
Unearned premiums and maintenance fees	(396)	(1,790)
Other receivables and assets	409	935
Federal income tax payable	(100)	1,813
Accrued expenses & other liabilities	184	(2,433)
Net cash provided by operating activities	15,187	14,679

Cash flows used in investing activities:				
Capital expenditures		(170)		(662)
Proceeds from the sale and maturities of available-for-sale equity and fixed income securities		64,794		23,739
Purchase of available-for-sale equity and fixed income securities		(67,343)		(26,877)
Funds loaned to others		-		(433)
Collection of notes receivable and other		125		495
Net cash used in investing activities		(2,594)		(3,738)
Cash flows used in financing activities:				
Exercise of stock options		-		84
Excess tax benefits from stock-based compensation		186		360
Repurchases of common stock		(2,771)		(2,566)
Preferred stock redemption		(1,209)		(1,331)
Dividend paid		(2,028)		(2,096)
Net cash used in financing activities		(5,822)		(5,549)
Net change in cash and cash equivalents		6,771		5,392
Cash and cash equivalents at beginning of period		22,060		18,391
Cash and cash equivalents at end of period	$	28,831	$	23,783

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

AMERICAN PHYSICIANS SERVICE GROUP, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2009

(Unaudited)

1.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations. The consolidated unaudited financial statements as of and for the three and six month periods ended June 30, 2009 and 2008 reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. These consolidated financial statements have not been audited by our independent registered public accounting firm. The operating results for the interim periods are not necessarily indicative of results for the full fiscal year.

The notes to consolidated financial statements appearing in our Annual Report on Form 10-K for the year ended December 31, 2008 filed with the SEC should be read in conjunction with this Quarterly Report on Form 10-Q.

2.

Immaterial Restatement of Shareholders Equity

We have restated retained earnings and additional paid-in capital as of December 31, 2007 and subsequent periods. After the issuance of our Annual Report on Form 10-K for the year ended December 31, 2008 in connection with a review of our accounting practices for the purchase and retirement of treasury stock, we determined that we had not correctly allocated the excess of the purchase price over the stated value of the treasury stock between additional paid-in capital and retained earnings in accordance with Accounting Principles Board Opinion No. 6. This adjustment affects only the balance sheet presentation of our equity accounts and has no impact on total shareholders equity, net income, earnings per share, or cash flows for the periods presented.

The tables below summarize the effects of such immaterial adjustments on our previously issued consolidated financial statements:

(Amounts in thousands)	As of December 31, 2007		
	As Reported	**Adjustment**	**As Adjusted**
Shareholders' Equity			
Common stock, $0.10 par value	$ 721	$ -	$ 721
Additional paid-in capital	79,752	3,655	83,407
Accumulated other comprehensive income, net of taxes	545	-	545
Retained earnings	42,962	(3,655)	39,307
Total shareholders' equity	$ 123,980	$ -	$ 123,980

(Amounts in thousands)	As of March 31, 2008		
	As Reported	**Adjustment**	**As Adjusted**
Shareholders' Equity			
Common stock, $0.10 par value	$ 718	$ -	$ 718
Additional paid-in capital	79,010	4,260	83,270
Accumulated other comprehensive income, net of taxes	759	-	759
Retained earnings	46,342	(4,260)	42,082
Total shareholders' equity	$ 126,829	$ -	$ 126,829

(Amounts in thousands)	As of June 30, 2008		
	As Reported	Adjustment	As Adjusted
Shareholders Equity			
Common stock, $0.10 par value	$ 715	$ -	$ 715
Additional paid-in capital	78,026	5,175	83,201
Accumulated other comprehensive loss, net of taxes	(1,349)	-	(1,349)
Retained earnings	50,392	(5,175)	45,217
Total shareholders equity	$ 127,784	$ -	$ 127,784

(Amounts in thousands)	As of December 31, 2008		
	As Reported	Adjustment	As Adjusted
Shareholders' Equity			
Common stock, $0.10 par value	$ 701	$ -	$ 701
Additional paid-in capital	75,367	6,962	82,329
Accumulated other comprehensive income, net of taxes	368	-	368
Retained earnings	60,029	(6,962)	53,067
Total shareholders' equity	$ 136,465	$ -	$ 136,465

(Amounts in thousands)	As of March 31,2009		
	As Reported	Adjustment	As Adjusted
Shareholders' Equity			
Common stock, $0.10 par value	$ 697	$ -	$ 697
Additional paid-in capital	75,104	6,962	82,066
Accumulated other comprehensive income, net of taxes	2,189	-	2,189
Retained earnings	64,149	(6,962)	57,187
Total shareholders' equity	$ 142,139	$ -	$ 142,139

3.

Management s Estimates

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

On an on-going basis, we evaluate our estimates, including our most significant estimates related to: reserve for losses and loss adjustment expenses; death, disability and retirement reserves; reinsurance premiums recoverable/payable; premiums ceded; deferred policy acquisition costs; impairment of assets including the fair value of investments; bad debts; income taxes; and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

Although considerable judgment is inherent in these estimates, management believes that the current estimates are reasonable in all material respects. The estimates are reviewed regularly and adjusted, as necessary. Adjustments related to changes in estimates are reflected in the Company s results of operations, or other comprehensive income, in the period in which those estimates are changed.

4.

New Accounting Pronouncements

Effective January 1, 2008, we adopted SFAS 157, *Fair Value Measurements*, for our financial assets and financial liabilities, but did not adopt SFAS 157 as it related to nonfinancial assets and liabilities based on the February 2008 issuance of FASB Staff Position 157-2, *Effective Date of FASB Statement No. 157*, which permits a one-year deferral of the application of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008. The adoption of SFAS 157 as it pertains to financial assets and liabilities did not have a material impact on our results of operations, financial position and cash flows. Effective January 1, 2009, we adopted FAS 157 for non-financial assets and non-financial liabilities and it did not have a material effect on our results of operations, financial position or cash flows.

In September 2008, the SEC and FASB issued joint guidance providing clarification of issues surrounding the determination of fair value measurements under the provisions of SFAS 157 in the current market environment. In October 2008, the FASB issued FSP No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active,* which amended SFAS 157 to provide an illustrative example of how to determine the fair value of a financial asset when the market for that asset is not active.

In April 2009, FSP No. FAS 157-4 (FSP 157-4), *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, was issued. It provides additional guidance to highlight and expand on the factors that should be considered in estimating fair value when there has been a significant decrease in market activity for a financial asset and identifying circumstances that indicate a transaction is not orderly. This FSP also requires new disclosures relating to fair value measurement inputs and valuation techniques (including changes in inputs and valuation techniques). FSP 157-4 does not change the objective of fair value measurement. That is, even though there has been a significant decrease in market activity for a security, the fair value objective remains the same. Fair value is the price that would be received to sell a security in an orderly transaction (i.e not a forced liquidation or distressed sale), between market participants at the measurement date under current market conditions (i.e., an exit price notion). We adopted FSP 157-4 during the quarter ended June 30, 2009. The adoption of this pronouncement did not have a material impact on our results of operations, financial position or cash flows.

In April 2009, the FASB issued FSP No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP 115-2), which replaces the requirement in FSP No. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, for management to assert that it has the intent and ability to hold an impaired debt security until recovery with the requirement that management assert if it either has the intent to sell the debt security or if it is more likely than not it will be required to sell the debt security before recovery of its amortized cost basis. If management intends to sell the debt security or it is more likely than not it will be required to sell the debt security before recovery of its amortized cost basis, an other-than-temporary impairment (OTTI) shall be recognized in earnings equal to the difference between the debt security s amortized cost basis and its fair value at the balance sheet date. After the recognition of an OTTI, the debt security is accounted for as if it had been purchased on the measurement date of the OTTI, with an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings.

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If management does not intend to sell the debt security and it is not likely that it will be required to sell the debt security before recovery of its amortized cost basis, but the present value of the cash flows expected to be collected is less than the amortized cost basis of the debt security (referred to as the credit loss), an OTTI is also considered to have occurred. In this instance, FSP 115-2 requires the separation of the total OTTI into the amount related to the credit loss, which is recognized in earnings, with the remaining amount of the total OTTI attributed to other factors (referred to as the noncredit portion) and recognized as a separate component in other comprehensive income (OCI). After the recognition of an OTTI, the debt security is accounted for as if it had been purchased on the measurement date of the OTTI, with an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. In addition, FSP 115-2 expands and increases the frequency of existing disclosures about OTTIs for debt securities regarding expected cash flows, credit losses and aging of securities with unrealized losses. Upon adoption, the cumulative effect of this pronouncement is recognized as an adjustment to the opening balance of retained earnings with a corresponding adjustment to OCI for those securities that management does not have the intent to sell or it is not likely that it will be required to sell the debt security before recovery of its amortized cost basis. The adoption of this pronouncement did not have a material impact on our results of operations, financial position or cash flows.

In April 2009, the FASB issued FSP No. FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FSP 107-1), which extends the disclosure requirements of SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, to interim financial statements. FSP 107-1 also requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments in the financial statements on an interim basis and to highlight any changes of the methods and significant assumptions from prior periods. The disclosures in FSP 107-1 are effective for interim reporting periods ending after June 15, 2009, and are not required for earlier periods that are presented for comparative purposes at initial adoption. In periods after initial adoption, FSP 107-1 requires comparative disclosures only for periods ending after initial adoption. The adoption of these pronouncements did not have a material impact on our results of operations, financial position or cash flows.

In December 2007, the FASB issued Statement of Financial Accounting Standards, or SFAS No. 141 (Revised December 2007) *Business Combinations* (SFAS 141R). SFAS 141R replaces FASB Statement No. 141, *Business Combinations* but retains the fundamental requirement in SFAS 141 that the acquisition method (referred to as the purchase method in SFAS 141) of accounting be used for all business combinations. SFAS 141R provides new and additional guidance with respect to business combinations including: defining the acquirer in a transaction, the valuation of assets and liabilities when non-controlling interests exist, the treatment of contingent consideration, the treatment of costs incurred to effect the acquisition, the treatment of reorganization costs, and the valuation of assets and liabilities when the purchase price is below the net fair value of assets acquired. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption was prohibited. We have adopted the Statement on its effective date; however, because there were no acquisitions during the current quarter, there was no impact on our financial position, results of operations or cash flows.

In April 2008, the FASB issued FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*. FSP No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets*. FSP No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008. Early adoption is prohibited. We adopted this pronouncement and it did not have a material impact on our financial position, results of operations or cash flows.

The FASB issued Statement of Financial Accounting Standards No. 165, *Subsequent Events*, (FAS 165) on May 28, 2009. FAS 165 establishes general standards of accounting and disclosure for events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Although there is new terminology, the standard is based on the same principles as those that currently exist in the auditing standards. FAS 165 defines subsequent events as either recognized or nonrecognized subsequent events. An entity should recognize in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. An entity should not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet. FAS 165 also requires the disclosure of the date through which subsequent events have been evaluated, as well as whether the date is the date the financial statements were issued or were available to be issued. The standard is effective for interim or annual periods ending after June 15, 2009. We adopted FAS 165 effective with the quarter ended June 30, 2009. We were not aware of any recognized or nonrecognized subsequent events as of August 4, 2009, the date the financial statements were issued.

5.

Investments

Available-For-Sale Fixed Maturities. Of the total $200,881,000 portfolio balance in available-for-sale fixed income maturities at June 30, 2009, all but $1,674,000 are considered investment grade securities. The primary goal of our investment strategy for our Insurance Services segment is to ensure that we have sufficient assets to meet our obligations to our policyholders, and our secondary goal is to provide investment income. The investment plan for our Insurance Services segment provides guidance on diversification, duration of the portfolio, sector allocation and specific restrictions, such as the size of investment in any one issue and limitations on the purchases of securities rated lower than investment grade by Moody s, Standard and Poor s or a comparable rating institution.

Our Insurance Services segment employs an investment strategy that emphasizes asset quality to minimize the credit risk of our investment portfolio and also matches fixed-income maturities to anticipated claim payments and expenditures or other liabilities. The amounts and types of investments that may be made by our Insurance Services segment are regulated under the Texas Insurance Code. We utilize APS Asset Management, Inc., our asset management subsidiary, as our fixed-income advisor. We review our fixed-income advisor s performance and compliance with our investment guidelines on a quarterly basis.

Our entire fixed-income portfolio consists of investment grade securities rated BBB or higher by Standard and Poor s, Moody s or Fitch rating agencies with the exception of one corporate bond and three non-agency CMOs with a combined fair market value of approximately $1,674,000. The following table reflects the composition of our fixed-income portfolio by security rating category of the issuer, as of June 30, 2009. In cases where the rating agencies had a different rating assigned to a security, the classification in the table is the lower rating.

Rating Category	Fair Value (in thousands)	Percentage
AAA / Aaa	$ 157,330	78%
AA / Aa	20,245	10%
A / A	19,867	10%
BBB	1,765	1%
Non-investment grade	1,674	1%
Total	$ 200,881	100%

Available-For-Sale Equity Securities. Our equity portfolio consists of $11,344,000 in available-for-sale equity securities as of June 30, 2009. We account for equity securities as available-for-sale.

The amortized cost and estimated fair values of investments in fixed income and equity securities at June 30, 2009 and December 31, 2008 are as follows (in thousands):

June 30, 2009	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Fixed Maturities:				
U.S. treasury notes / bills	$ 24,139	$ 665	$ 16	$ 24,788
U.S. government agency mortgage-backed bonds	25,519	1,317	-	26,836
U.S. government agency collateralized mortgage obligations	46,273	2,100	-	48,373
Collateralized mortgage obligations:				
Prime CMOs	5,346	38	-	5,384
Alt A CMOs	2,419	102	-	2,521
U.S. government agency bonds / notes	22,120	346	-	22,466
Government tax-exempt bonds	34,219	772	143	34,848
Corporate bonds	35,407	394	136	35,665
Total fixed maturities	195,442	5,734	295	200,881
Equity securities	12,255	191	1,102	11,344
Total fixed maturities and equity securities	$ 207,697	$ 5,925	$ 1,397	$ 212,225

December 31, 2008	**Cost or Amortized Cost**	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Estimated Fair Value**
Fixed Maturities:				
U.S. treasury notes / bills	$ 30,226	$ 836	$ 70	$ 30,992
U.S. government agency mortgage-backed bonds	29,090	1,339	-	30,429
U.S. government agency collateralized mortgage obligations	51,831	1,660	9	53,482
Collateralized mortgage obligations:				
Prime CMOs	23,523	704	1,803	22,424
Alt A CMOs	2,968	46	-	3,014

U.S. government agency bonds / notes		23,904		511		-		24,415
Government tax-exempt bonds		26,565		131		1,249		25,447
Corporate bonds		7,784		143		119		7,808
Total fixed maturities		195,891		5,370		3,250		198,011
Equity securities		11,652		159		1,712		10,099
Total fixed maturities and equity securities	$	207,543	$	5,529	$	4,962	$	208,110

Of our entire invested assets at June 30, 2009, including unrestricted cash,

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31% is comprised of agency-backed mortgage obligations, with underlying collateral consisting of GNMA, FHLMC, or FNMA loans;

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3% is comprised of non-agency collateralized mortgage obligations (non-agency CMOs);

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49% is comprised of U.S. Treasury, government agency bonds and notes, municipal tax exempt bonds and corporate bonds; and;

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17% is comprised of cash, equities and other invested assets.

The majority of the non-agency CMOs in our portfolio have underlying mortgages categorized as prime quality loans, and none of our CMOs have underlying mortgages classified as subprime. Also, all CMO underlying mortgages have fixed rates. Within our portfolio at June 30, 2009, there were seven CMO securities classified as Alternative-A or Alt-A . These Alt-A securities are generally considered to have underlying mortgages with underwriting characteristics that are stronger than subprime mortgages but less stringent than prime mortgages. All but one of our Alt-A securities are investment grade, have underlying fixed rate mortgage collateral and as of June 30, 2009 are rated either AA or A. The Alt-A security that is non-investment grade had a book value at June 30, 2009 of $23,000.

We regularly review our fixed maturity and equity securities for declines in fair value that we determine to be other-than-temporary. For an equity security, if we do not have the ability and intent to hold the security for a sufficient period of time to allow for a recovery in value, we conclude that an OTTI has occurred, and the amortized cost of the equity security is written down to the current fair value, with a corresponding change to realized loss in our Condensed Consolidated Statements of Operations. During the three and six months ended June 30, 2009, we evaluated our equity portfolio for other than temporary impairments of certain securities. We based our review on a number of factors including, but not limited to, the severity and duration of the decline in fair value of the equity security as well as the cause of the decline, the length of time we have held the equity security, any third party research reports or analysis, and the financial condition and near-term prospects of the security s issuer, taking into consideration the economic prospects of the issuer s industry and geographical location. For the three and six months ended June 30, 2009, the write-downs in equity securities resulted in a realized loss of $0 and $352,000, respectively. The fair value of these equities at June 30, 2009 was $365,000.

We adopted FSP 115-2, effective for the period ended June 30, 2009. One of the key changes as a result of this new pronouncement is the modification of the previous requirement for debt securities that in order to determine if an OTTI should be recognized, an entity must assert that it has both the intent and ability to hold a security for a period of time sufficient to allow for an anticipated recovery in its fair value to its amortized cost basis. Instead under FAS 115-2 in determining if an OTTI has occurred, a holder must assess whether (a) it has the intent to sell the debt security, or (b) it is more likely than not it will be required to sell the debt security before its anticipated recovery. Specifically, if we intend to sell a security or it is more likely than not we will be required to sell a debt security before recovery of its amortized cost basis and the fair value of the debt security is below amortized cost, we conclude that an OTTI has occurred and the amortized cost is written down to current fair value, with a corresponding charge to realized loss on our Condensed Consolidated Statements of Operations.

If we do not intend to sell a debt security or it is not more likely that we will be required to sell a debt security before recovery of its amortized cost basis but the present value of the cash flows expected to be collected is less than the amortized cost of the debt security (referred to as the credit loss), we conclude that an OTTI has occurred and the amortized cost is written down to the estimated recovery value with a corresponding charge to realized loss on our Condensed Consolidated Statements of Operations, as this is also deemed the credit portion of the OTTI. The remainder of the decline to fair value is recorded to OCI, as an unrealized OTTI loss on our Condensed Consolidated Balance Sheets, as this is considered a noncredit (i.e., recoverable) impairment.

Beginning with the three months ended September 30, 2007, we saw a significant and rapid decline in the market value of our non-agency CMOs, specifically our Alt-A securities. We have considered the deepening national housing crisis and its potential effects on the underlying collateral in evaluating this decline, and concluded that the continued decreases in value of our Alt-A securities should be considered to be OTTI. Beginning in three months ended December 31, 2008, we also began to observe an increase in the market-reported delinquency rates for not only our Alt-A CMOs, but also our non-agency CMOs backed by prime loans. The delinquency data suggests that continuing home price declines and growth in unemployment are now affecting the behavior by a broader sector of mortgage borrowers, particularly those mortgages with originated subsequent to 2005. Rising unemployment, accelerating house price declines, tight credit conditions, volatility in interest rates and weakening consumer confidence not only contributed to rising delinquencies, but also significantly impacted our expectations regarding future performance, both of which are critical to assessing our other-than-temporary impairments. As such, we also concluded that three non-agency CMOs with 2006 originations were deemed OTTI in prior quarters.

Additionally, due to the risk and uncertainty of the current economic crisis and the ultimate impact on the non-agency CMO market, we sold 29 non-agency CMOs with a book value of $15,004,000 during the first six months of 2009 and recognized a net realized loss of $263,000 on the sale of these securities. As a result of these sales, the fair market value of our non-agency CMOs has been reduced from $25,438,000 as of December 31, 2008 to $7,905,000 as of June 30, 2009.

While we have the ability to hold our remaining non-agency CMOs to maturity, we have concluded that we have the intent to sell these securities which will further reduce our exposure to a continued deterioration of the housing sector provided we can obtain an appropriate price. For the three months ended June 30, 2009, a realized loss was recognized in the Condensed Consolidated Statement of Operations equal to $1,100,000 or the difference between the book value and the fair value as of June 30, 2009. The fair value of these securities became their new cost basis.

The amount of pretax charges taken as a result of OTTIs (in thousands) that were recognized in earnings and included in realized loss for the three and the six months ended June 30, 2009 and 2008 were as follows:

	Three Months ended		**Six Months ended**	
	June 30, 2009	**June 30, 2008**	**June 30, 2009**	**June 30, 2008**
Fixed Maturities:				
U.S. treasury notes / bills	$ -	$ -	$ -	$ -
U.S. government agency mortgage-backed bonds	-	-	-	-
U.S. government agency collateralized mortgage obligations	-	-	-	-
Collateralized mortgage obligations:				
Prime	867	-	1,151	-
Alt-A	233	1,124	504	3,768
U.S. government agency bonds / notes	-	-	-	-
Government tax-exempt bonds	-	-	-	-
Corporate bonds	-	-	-	-
Total fixed maturities	1,100	1,124	1,655	3,768
Equity securities	-	84	352	84
Total fixed maturities and equity securities	$ 1,100	$ 1,208	$ 2,007	$ 3,852

The aggregate write-down on the Alt-A securities beginning with the quarter ended September 30, 2007 through June 30, 2009 is $10,888,000 and the book value of all the Alt-A securities is $2,419,000 as of June 30, 2009. As of June 30, 2009, outside of our Alt-A s and prime CMOs as shown in the table above, no other debt securities were deemed OTTI. While we have the ability to hold all of our securities indefinitely, we will continue to closely monitor our non-agency CMOs and their underlying collateral.

Gross realized gains and losses as result of both sales and OTTI write-downs included in net realized loss in the statement of operations for the three and six month periods ended June 30, 2009 and 2008 were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Realized gains (losses):				
Fixed maturities:				
Gross realized gain	$ 40	$ 23	$ 273	$ 129
Gross realized loss	(139)	-	(435)	(3)
Other-than-temporary losses	(1,100)	(1,124)	(1,655)	(3,768)
Net realized loss	(1,199)	(1,101)	(1,817)	(3,642)
Equities:				
Gross realized gain	82	39	93	73
Gross realized loss	(125)	(97)	(448)	(185)
Other-than-temporary losses	-	(84)	(352)	(84)
Net realized loss	(43)	(142)	(707)	(196)
Total net realized loss	$ (1,242)	$ (1,243)	$ (2,524)	$ (3,838)

A summary of the amortized cost and fair market value of the Company s investments in fixed maturities as of June 30, 2009, by contractual maturity, is as follows (in thousands):

	Cost or Amortized Cost	Estimated Fair Value
Fixed maturity securities:		
Due one year or less	$ 16,793	$ 16,960
Due after one year through five years	24,603	24,952
Due after five years through ten years	60,798	61,842

Due after ten years	13,691	14,013
	115,885	117,767
Mortgage backed securities	79,557	83,114
Total	$ 195,442	$ 200,881

The following two tables reflect securities whose fair values were lower than the related cost basis at June 30, 2009 and December 31, 2008, respectively (in thousands). However, these declines in value were not deemed to be other than temporary . The tables show the fair value and the unrealized losses, aggregated by investment category and category of duration that individual securities have been in a continuous unrealized loss position.

June 30, 2009	**Less than 12 Months**		**12 Months or More**		**Total**	
	Estimated Fair Value	**Unrealized Loss**	**Estimated Fair Value**	**Unrealized Loss**	**Estimated Fair Value**	**Unrealized Loss**
U.S. treasury notes / bills	$ 3,988	$ 16	$ -	$ -	$ 3,988	$ 16
U.S. government agency collateralized mortgage obligations	-	-	-	-	-	-
Collateralized mortgage obligations:						
Prime	-	-	-	-	-	-
ALT-A	-	-	-	-	-	-
Government tax-exempt bonds	3,903	84	2,611	59	6,514	143
Corporate bonds	20,211	124	1,038	12	21,249	136
Total fixed maturities	$ 28,102	$ 224	$ 3,649	$ 71	$ 31,751	$ 295
Equity securities	$ 6,376	$ 788	$ 1,353	$ 314	$ 7,729	$ 1,102
Total fixed maturities and equity securities	$ 34,478	$ 1,012	$ 5,002	$ 385	$ 39,480	$ 1,397

December 31, 2008	**Less than 12 Months**		**12 Months or More**		**Total**	
	Estimated Fair Value	**Unrealized Loss**	**Estimated Fair Value**	**Unrealized Loss**	**Estimated Fair Value**	**Unrealized Loss**
U.S. treasury notes / bills	$ 3,821	$ 70	$ -	$ -	$ 3,821	$ 70
U.S. government agency collateralized mortgage obligations	6	-	604	9	610	9
Collateralized mortgage obligations:						
Prime	10,829	1,184	3,878	619	14,707	1,803
ALT-A	-	-	-	-	-	-
Government tax-exempt bonds	13,367	709	7,260	540	20,627	1,249
Corporate bonds	3,643	89	926	30	4,569	119
Total fixed maturities	$ 31,666	$ 2,052	$ 12,668	$ 1,198	$ 44,334	$ 3,250

Equity securities	$	6,487	$	1,182	$	964	$	530	$	7,451	$	1,712
Total fixed maturities and equity securities	$	38,153	$	3,234	$	13,632	$	1,728	$	51,785	$	4,962

The unrealized losses on the fixed maturities and equities are primarily due to market fluctuations resulting from cyclical and other economic pressures including the recent economic recession and market dislocation of certain securities. All fixed maturities with an unrealized loss over 12 months or more are investment grade securities. As of June 30, 2009, we believe that these unrealized losses are temporary and that the fair value will recover to a level equal to or greater than the cost basis. In addition, as of June 30, 2009, we had the ability to hold to maturity and except for our investments in non-agency CMOs, we do not have the intent to sell these investments until there is a recovery in fair value, which may be maturity for the applicable securities. In the future, information may come to light or circumstances may change that would cause us to record an OTTI or sell any of our fixed maturity or equity securities and possibly, incur a realized loss.

The major categories of the net investment income included in the statement of operations are summarized for the three and six months ended June 30, 2009 and 2008, as follows (in thousands):

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Investment income:				
Fixed Maturities	$ 2,544	$ 2,752	$ 4,930	$ 5,575
Equity Securities	95	74	179	136
Short-term investments and other	65	151	151	339
Finance charges on premiums receivable	26	30	61	59
Structured annuity	18	19	36	38
Total investment income	2,748	3,026	5,357	6,147
Investment expense	82	67	140	132
Net investment income	$ 2,666	$ 2,959	$ 5,217	$ 6,015

In connection with our acquisition of our insurance subsidiary, American Physicians Insurance Company (API), the Texas Department of Insurance (TDI) required that funds be set aside in an escrow account with a bank to remain until the aggregate remaining redemption obligation of our Series A redeemable preferred stock is less than the amount of the escrow balance, with no withdrawals to be made from this escrow account without prior approval from TDI. To satisfy this requirement, we maintain a fixed income security in escrow in the amount of $2,500,000 paying 1.0% interest. This security is included in fixed maturities, available-for-sale.

At June 30, 2009, investments with a fair market value of $1,475,000 were on deposit with state insurance departments to satisfy regulatory requirements and these securities are included in fixed maturities, available-for-sale.

6.

Fair Value Measurements

In September 2006, the FASB issued SFAS 157, *Fair Value Measurements*. SFAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. Under the standard, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts its business. SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing the asset or liability. In support of this principle, SFAS 157 establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. Our assessments with respect to assumptions that market participants would make are inherently difficult to determine and use of different assumptions could result in material changes to these fair value measurements. Effective January 1, 2008, the Company adopted the provisions of SFAS 157 as it relates to financial assets and financial liabilities. The adoption of SFAS 157 did not have a material effect on our results of operations, financial position or liquidity.

In September 2008, the SEC and FASB issued joint guidance providing clarification of issues surrounding the determination of fair value measurements under the provisions of SFAS 157 in the current market environment. In October 2008, the FASB issued FSP No. FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active,* which amended SFAS 157 to provide an illustrative example of how to determine the fair value of a financial asset when the market for that asset is not active. In April 2009, FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, was issued and provides additional guidance to highlight and expand on the factors that should be considered in estimating fair value when there has been a significant decrease in market activity for a financial asset and identifying circumstances that indicate a transaction is not orderly. This FSP also requires new disclosures relating to fair value measurement inputs and valuation techniques (including changes in inputs and valuation techniques during interim periods).

FSP 157-4 does not change the objective of fair value measurement. That is, even though there has been a significant decrease in market activity for a security, the fair value objective remains the same. Fair value is the price that would be received to sell a security in an orderly transaction (i.e not a forced liquidation or distressed sale), between market participants at the measurement date under current market conditions (i.e., an exit price notion).

Fair value is used on a recurring basis for our equity and fixed maturity, available-for-sale securities in which fair value is the primary basis of accounting. Fair value for these securities is the market value based on quoted market prices, when available (Level 1) or quoted prices for similar assets or liabilities in active markets or market prices obtained from third-party pricing services for identical or comparable assets (Level 2). Certain assets and liabilities are not actively traded in observable markets with listed prices or quotes and we must use alternative valuation techniques based on independent dealer quotes on the security, our own assumptions including internal pricing models and professional judgment to derive a fair value measurement (Level 3). In these instances when significant valuation assumptions are not readily observable in the market, instruments are valued based on the best available data to approximate fair value. This data would consider a risk premium that a market participant would require. We use prices and inputs that are current as of the measurement date, including periods of market dislocation. Typically, during periods of market dislocation, the observability of prices and inputs may be reduced for the instruments we hold. This condition could cause an instrument to be reclassified to a lower level during any given period.

The following table presents the estimated fair value of our financial instruments measured on a recurring basis as of June 30, 2009:

(in thousands)		**Fair Value Measurements at June 30, 2009 Using:**		
	Total	**Quoted prices**	**Significant**	**Significant**
	June 30,	**in active markets for identical assets**	**other ob-servable inputs**	**other unob-servable inputs**
Description	**2009**	**Level 1**	**Level 2**	**Level 3**
Fixed Maturities:				
U.S. treasury notes / bills	$ 24,788	$ 24,788	$ -	$ -
U.S. government agency mortgage-backed bonds	26,836	-	26,836	-
U.S. government agency collateralized mortgage obligations	48,373	-	48,373	-

Collateralized mortgage obligations:				
Prime	5,384	-	4,236	1,148
Alt-A	2,521	-	949	1,572
U.S. government agency bonds / notes	22,466 &nb			