

SELECTIVE INSURANCE GROUP INC

Form 10-Q

May 02, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

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

**For the quarterly period ended: March 31, 2008**

or

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 001-33067  
SELECTIVE INSURANCE GROUP, INC.  
(Exact name of registrant as specified in its charter)**

New Jersey

22-2168890

(State or Other Jurisdiction of Incorporation or Organization)

(I.R.S. Employer Identification No.)

40 Wantage Avenue  
Branchville, New Jersey

07890

(Address of Principal Executive Offices)

(Zip Code)

(973) 948-3000

(Registrant's Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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 report), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

As of March 31, 2008, there were 53,306,769 shares of common stock, par value \$2.00 per share, outstanding.



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**PART I. FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**  
**SELECTIVE INSURANCE GROUP, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	<b>Unaudited March 31, 2008</b>	<b>December 31, 2007</b>
(\$ in thousands, except share amounts)		
<b>ASSETS</b>		
<b>Investments:</b>		
Fixed maturity securities, held-to-maturity at amortized cost (fair value of: \$4,429 2008; \$5,927 2007)	\$ 4,304	5,783
Fixed maturity securities, available-for-sale at fair value (amortized cost of: \$3,016,348 2008; \$3,049,913 2007)	3,021,670	3,073,547
Equity securities, available-for-sale at fair value (cost of: \$147,174 2008; \$160,390 2007)	232,787	274,705
Short-term investments at cost which approximates fair value	212,545	190,167
Equity securities, trading at fair value (cost of: \$17,358 2008)	23,219	
Other investments	197,097	188,827
<b>Total investments</b>	<b>3,691,622</b>	<b>3,733,029</b>
Cash and cash equivalents	9,837	8,383
Interest and dividends due or accrued	35,153	36,141
Premiums receivable, net of allowance for uncollectible accounts of: \$4,254 2008; \$3,905 2007	496,548	496,363
Other trade receivables, net of allowance for uncollectible accounts of: \$184 2008; \$244 2007	22,493	21,875
Reinsurance recoverable on paid losses and loss expenses	7,307	7,429
Reinsurance recoverable on unpaid losses and loss expenses	222,968	227,801
Prepaid reinsurance premiums	82,761	82,182
Current federal income tax		4,235
Deferred federal income tax	42,302	22,375
Property and equipment at cost, net of accumulated depreciation and amortization of: \$121,693 2008; \$117,832 2007	56,418	58,561
Deferred policy acquisition costs	225,558	226,434
Goodwill	33,637	33,637
Other assets	43,882	43,547
<b>Total assets</b>	<b>\$ 4,970,486</b>	<b>5,001,992</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Liabilities:</b>		
Reserve for losses	\$ 2,199,024	2,182,572
Reserve for loss expenses	368,274	359,975
Unearned premiums	850,494	841,348
Senior convertible notes		8,740
Notes payable	286,158	286,151
Current federal income tax	5,619	

Commissions payable	<b>34,436</b>	60,178
Accrued salaries and benefits	<b>78,257</b>	88,079
Other liabilities	<b>102,532</b>	98,906
Total liabilities	<b>3,924,794</b>	3,925,949

**Stockholders Equity:**

Preferred stock of \$0 par value per share:

Authorized shares: 5,000,000; no shares issued or outstanding

Common stock of \$2 par value per share:

Authorized shares: 360,000,000

Issued: 94,851,326 - 2008; 94,652,930 - 2007

**189,703**

189,306

Additional paid-in capital

**203,789**

192,627

Retained earnings

**1,125,597**

1,105,946

Accumulated other comprehensive income

**53,205**

86,043

Treasury stock at cost (shares: 41,544,557 2008; 40,347,894 2007)

**(526,602)**

(497,879)

Total stockholders equity

**1,045,692**

1,076,043

Commitments and contingencies

Total liabilities and stockholders equity

**\$ 4,970,486**

5,001,992

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

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**Table of Contents****SELECTIVE INSURANCE GROUP, INC.  
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME**

(\$ in thousands, except per share amounts)	Quarters ended March 31,	
	2008	2007
<b>Revenues:</b>		
Net premiums written	\$ 389,840	417,185
Net increase in unearned premiums and prepaid reinsurance premiums	(8,567)	(37,172)
Net premiums earned	381,273	380,013
Net investment income earned	37,866	39,863
Net realized gains	1,515	11,243
Diversified Insurance Services revenue	29,799	29,178
Other income	660	1,812
Total revenues	451,113	462,109
<b>Expenses:</b>		
Losses incurred	210,130	203,310
Loss expenses incurred	43,049	42,983
Policy acquisition costs	128,680	122,918
Dividends to policyholders	535	1,487
Interest expense	5,309	6,331
Diversified Insurance Services expenses	25,514	24,811
Other expenses	11,294	11,070
Total expenses	424,511	412,910
Income before federal income tax	26,602	49,199
<b>Federal income tax expense (benefit):</b>		
Current	11,135	15,611
Deferred	(5,036)	(3,664)
Total federal income tax expense	6,099	11,947
Net income	20,503	37,252
<b>Earnings per share:</b>		
Basic net income	\$ 0.39	0.68
Diluted net income	\$ 0.38	0.62



Dividends to stockholders \$ **0.13** 0.12

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

**Table of Contents****SELECTIVE INSURANCE GROUP, INC.  
UNAUDITED CONSOLIDATED STATEMENTS OF  
STOCKHOLDERS' EQUITY**

(\$ in thousands, except per share amounts)	Quarters ended March 31,			
		2008	2007	
<b>Common stock:</b>				
Beginning of year	\$	189,306		183,124
Dividend reinvestment plan (shares: 19,298 2008; 18,764 2007)		38		38
Convertible debentures (shares: 45,759 2008; 107,344 2007)		92		215
Stock purchase and compensation plans (shares: 133,339 2008; 586,729 2007)		267		1,173
End of period		189,703		184,550
<b>Additional paid-in capital:</b>				
Beginning of year		192,627		153,246
Dividend reinvestment plan		429		422
Convertible debentures		645		171
Stock purchase and compensation plans		10,088		10,702
End of period		203,789		164,541
<b>Retained earnings:</b>				
Beginning of year		1,105,946		986,017
Cumulative-effect adjustment due to adoption of FAS 159, net of deferred income tax effect of \$3,344		6,210		
Net income		20,503	20,503	37,252
Cash dividends to stockholders (\$0.13 per share 2008; \$0.12 per share 2007)		(7,062)		(6,842)
End of period		1,125,597		1,016,427
<b>Accumulated other comprehensive income:</b>				
Beginning of year		86,043		100,601
Cumulative-effect adjustment due to adoption of FAS 159, net of deferred income tax effect of \$(3,344)		(6,210)		
Other comprehensive (loss) income (decrease) increase in:				
Net unrealized gains on investment securities, Net of deferred income tax effect of \$(14,357) 2008; \$(1,740) 2007		(26,663)	(26,663)	(3,232)
				(3,232)

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Defined benefit pension plans, net of deferred income tax effect of \$19 2008; \$51 2007	35	35	93	93
End of period	53,205		97,462	
Comprehensive (loss) income		(6,125)		34,113
<b>Treasury stock:</b>				
Beginning of year	(497,879)		(345,761)	
Acquisition of treasury stock (shares: 1,196,663 2008; 3,127,376 2007)	(28,723)		(78,355)	
End of period	(526,602)		(424,116)	
Total stockholders' equity	\$ 1,045,692		1,038,864	

Selective Insurance Group, Inc. also has authorized, but not issued, 5,000,000 shares of preferred stock without par value, of which 300,000 shares have been designated Series A junior preferred stock without par value. The accompanying notes are an integral part of these unaudited interim consolidated financial statements.

**Table of Contents****SELECTIVE INSURANCE GROUP, INC.  
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW**

(\$ in thousands)	<b>Quarters ended March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Operating Activities</b>		
Net income	\$ 20,503	37,252
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Depreciation and amortization	7,129	6,975
Share-based compensation expense	8,896	8,630
Net realized gains	(1,515)	(11,243)
Deferred tax	(5,036)	(3,664)
Unrealized loss on trading securities	1,888	
<i>Changes in assets and liabilities:</i>		
Increase in reserves for losses and loss expenses, net of reinsurance recoverable on unpaid losses and loss expenses	29,598	63,053
Increase in unearned premiums, net of prepaid reinsurance and advance premiums	8,295	38,107
Increase in net federal income tax payable	9,854	13,206
Increase in premiums receivable	(185)	(37,163)
(Increase) decrease in other trade receivables	(618)	1,633
Decrease (increase) in deferred policy acquisition costs	876	(8,656)
Decrease in interest and dividends due or accrued	1,033	822
Decrease in reinsurance recoverable on paid losses and loss expenses	122	983
Decrease in accrued salaries and benefits	(11,724)	(20,874)
Decrease in accrued insurance expenses	(24,950)	(24,887)
Purchase of trading securities	(4,530)	
Sale of trading securities	4,696	
Other-net	1,621	11,030
Net adjustments	25,450	37,952
Net cash provided by operating activities	45,953	75,204
<b>Investing Activities</b>		
Purchase of fixed maturity securities, available-for-sale	(77,944)	(89,915)
Purchase of equity securities, available-for-sale	(7,212)	(31,550)
Purchase of other investments	(15,506)	(20,228)
Purchase of short-term investments	(341,234)	(285,836)
Sale of fixed maturity securities, available-for-sale	30,452	8,351
Sale of short-term investments	318,696	325,948
Redemption and maturities of fixed maturity securities, held-to-maturity	1,492	172
Redemption and maturities of fixed maturity securities, available-for-sale	79,566	63,004
Sale of equity securities, available-for-sale	6,995	32,149

Proceeds from other investments	<b>2,609</b>	2,578
Purchase of property and equipment	<b>(1,825)</b>	(2,292)
Net cash (used in) provided by investing activities	<b>(3,911)</b>	2,381
<b>Financing Activities</b>		
Dividends to stockholders	<b>(6,572)</b>	(6,262)
Acquisition of treasury stock	<b>(28,723)</b>	(78,355)
Net proceeds from stock purchase and compensation plans	<b>2,196</b>	1,980
Excess tax benefits from share-based payment arrangements	<b>1,265</b>	2,486
Principal payments of convertible bonds	<b>(8,754)</b>	
Net cash used in financing activities	<b>(40,588)</b>	(80,151)
Net increase (decrease) in cash and cash equivalents	<b>1,454</b>	(2,566)
Cash and cash equivalents, beginning of year	<b>8,383</b>	6,443
Cash and cash equivalents, end of period	<b>\$ 9,837</b>	3,877

**Supplemental Disclosures of Cash Flow Information**

Cash paid during the year for:

Interest	<b>\$ 1,968</b>	3,095
Federal income tax		400
Supplemental schedule of non-cash financing activity:		
Conversion of convertible debentures	<b>169</b>	380

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

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**NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1. Organization**

Selective Insurance Group, Inc., through its subsidiaries, (collectively referred to as *we* or *our* ) offers property and casualty insurance products and diversified insurance services and products. Selective Insurance Group, Inc. was incorporated in New Jersey in 1977 and its main offices are located in Branchville, New Jersey. Selective Insurance Group, Inc.'s common stock is publicly traded on the NASDAQ Global Select Market under the symbol *SIGI*.

We classify our business into three operating segments:

Insurance Operations, which sells property and casualty insurance products and services primarily in 21 states in the Eastern and Midwestern United States;

Investments; and

Diversified Insurance Services, which provides human resource administration outsourcing products and services, and federal flood insurance administrative services.

**NOTE 2. Basis of Presentation**

These interim unaudited consolidated financial statements ( *Financial Statements* ) include the accounts of our parent company and its subsidiaries, and have been prepared in conformity with (i) U.S. generally accepted accounting principles ( *GAAP* ); and (ii) the rules and regulations of the U.S. Securities and Exchange Commission ( *SEC* ) regarding interim financial reporting. The preparation of *Financial Statements* in conformity with *GAAP* requires us to make estimates and assumptions that affect the reported financial statement balances, as well as the disclosure of contingent assets and liabilities. Actual results could differ from those estimates. All significant intercompany accounts and transactions between our parent company and its subsidiaries are eliminated in consolidation. These *Financial Statements* reflect all adjustments that, in our opinion, are normal, recurring, and necessary for a fair presentation of our results of operations and financial condition. These *Financial Statements* cover the first quarters ended March 31, 2008 ( *First Quarter 2008* ) and March 31, 2007 ( *First Quarter 2007* ). These *Financial Statements* do not include all of the information and disclosures required by *GAAP* and the *SEC* for audited financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, these *Financial Statements* should be read in conjunction with the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2007 ( *2007 Annual Report* ).

**NOTE 3. Adoption of Accounting Pronouncements**

In June 2007, the Emerging Issues Task Force ( *EITF* ) of the Financial Accounting Standards Board ( *FASB* ) issued *EITF Issue No. 06-11 Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards* ( *EITF 06-11* ). *EITF 06-11* requires that the tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options be recognized as an increase to additional paid-in capital. We applied the provisions of this *EITF*, which was effective on a prospective basis beginning with dividends declared in fiscal years beginning after December 15, 2007, in the first quarter of 2008. The adoption of this *EITF* did not have a material impact on our results of operations or financial condition.

**NOTE 4. Fair Value Measurements**

On January 1, 2008, we adopted *FASB Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( *FAS 159* ). *FAS 159* provides companies with an option to report selected financial assets and liabilities at fair value ( *fair value option* ). We elected to apply the fair value option to a portfolio of securities currently being managed by one outside manager, as this manager requires the flexibility to trade as necessary in order to maximize returns; therefore, we do not have the ability or intent to hold these securities throughout any anticipated recovery periods. The securities for which we elected the fair value option were previously held as available-for-sale securities and are now classified as trading securities.



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The following table provides information regarding the reclassification and corresponding cumulative-effect adjustment on retained earnings resulting from the initial application of FAS 159 for this portfolio:

	<b>Pre-Adoption Carrying/Fair Value at January 1, 2008</b>	<b>Impact of Fair Value Election Adoption</b>	<b>Post-Adoption Carrying/Fair Value at January 1, 2008</b>
Equity Securities:			
Available-for-sale securities	\$ 274,705	(25,113)	249,592
Trading securities		25,113	25,113
Total Equity Securities	274,705		274,705