

MEADOWBROOK INSURANCE GROUP INC

Form 10-Q

August 05, 2005

Table of Contents

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

Form 10-Q

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

For the quarter ended June 30, 2005

or

**o 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

The aggregate number of shares of the Registrant's Common Stock, \$.01 par value, outstanding on August 2, 2005 was 29,017,772.

TABLE OF CONTENTS

Page

PART I FINANCIAL INFORMATION

<u>ITEM 1</u>	<u>FINANCIAL STATEMENTS</u>	2
	<u>Consolidated Statements of Income (unaudited)</u>	2-3
	<u>Consolidated Statements of Comprehensive Income (unaudited)</u>	4-5

	<u>Consolidated Balance Sheets (unaudited)</u>	6
	<u>Consolidated Statement of Cash Flows (unaudited)</u>	7
	<u>Notes to Consolidated Financial Statements (unaudited)</u>	8-20
<u>ITEM 2</u>	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	21-40
<u>ITEM 3</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	40-41
<u>ITEM 4</u>	<u>CONTROLS AND PROCEDURES</u>	41
	<u>PART II OTHER INFORMATION</u>	
<u>ITEM 1</u>	<u>LEGAL PROCEEDINGS</u>	42
<u>ITEM 2</u>	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	42
<u>ITEM 4</u>	<u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	42
<u>ITEM 6</u>	<u>EXHIBITS</u>	43
	SIGNATURES	44
	<u>First Modification to the Amended and Restated Loan and Security Agreement</u>	
	<u>Reciprocal Easement and Operation Agreement</u>	
	<u>First Amendment to Land Contract</u>	
	<u>Amendment to Credit Agreement</u>	
	<u>Demand Note</u>	
	<u>Certification of Robert S Cubbin, CEO</u>	
	<u>Certification of Karen M. Spaun, Senior VP and CFO</u>	
	<u>Certification to Section 906, by Robert S. Cubbin, CEO</u>	
	<u>Certification to Section 906, by Karen M. Spaun, Senior VP and CFO</u>	

Table of Contents**PART 1 FINANCIAL INFORMATION****ITEM 1 Financial Statements****MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME**

	For the Six Months Ended June 30,	
	2005	2004
	(Unaudited) (In thousands, except share data)	
Revenues		
Premiums earned		
Gross	\$ 161,550	\$ 136,100
Ceded	(37,399)	(33,304)
Net earned premiums	124,151	102,796
Net commissions and fees	18,133	20,125
Net investment income	8,568	7,144
Net realized losses	(10)	(152)
Total revenues	150,842	129,913
Expenses		
Losses and loss adjustment expenses	117,864	101,411
Reinsurance recoveries	(43,002)	(36,076)
Net losses and loss adjustment expenses	74,862	65,335
Salaries and employee benefits	26,253	25,133
Policy acquisition and other underwriting expenses	21,793	16,416
Other administrative expenses	13,831	12,565
Interest expense	1,579	843
Total expenses	138,318	120,292
Income before taxes and equity earnings	12,524	9,621
Federal and state income tax expense	4,202	3,534
Equity earnings (losses), of affiliates	1	(35)
Net income	\$ 8,323	\$ 6,052
Earnings Per Share		
Basic	\$ 0.29	\$ 0.21
Diluted	\$ 0.28	\$ 0.21
Weighted average number of common shares		
Basic	29,101,484	29,030,836

Diluted

29,419,606

29,427,512

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

Table of Contents**MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME****For the Three Months Ended
June 30,****2005****2004****(Unaudited)
(In thousands,
except share data)****Revenues**

Premiums earned			
Gross	\$	80,745	\$ 69,922
Ceded		(17,381)	(16,839)
Net earned premiums		63,364	53,083
Net commissions and fees		8,034	8,844
Net investment income		4,477	3,547
Net realized gains (losses)		104	(32)
Total revenues		75,979	65,442

Expenses

Losses and loss adjustment expenses		61,522	49,997
Reinsurance recoveries		(23,794)	(17,171)
Net losses and loss adjustment expenses		37,728	32,826
Salaries and employee benefits		13,648	12,325
Policy acquisition and other underwriting expenses		10,971	8,870
Other administrative expenses		6,046	6,469
Interest expense		806	528
Total expenses		69,199	61,018

Income before taxes and equity earnings		6,780	4,424
---	--	-------	-------

Federal and state income tax expense		2,250	1,546
Equity earnings (losses), of affiliates		50	(58)

Net income	\$	4,580	\$ 2,820
------------	----	-------	----------

Earnings Per Share

Basic	\$	0.16	\$ 0.10
Diluted	\$	0.16	\$ 0.10

Weighted average number of common shares

Basic		29,130,033	29,036,164
Diluted		29,443,933	29,459,390

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

Table of Contents

MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Six Months Ended June 30,	
	2005	2004
	(Unaudited) (In thousands)	
Net income	\$ 8,323	\$ 6,052
Other comprehensive income, net of tax:		
Unrealized losses on securities	(1,211)	(4,671)
Less: reclassification adjustment for losses included in net income	79	60
Other comprehensive loss, net of tax	(1,132)	(4,611)
Comprehensive income	\$ 7,191	\$ 1,441

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

Table of Contents

MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Three Months Ended June 30,	
	2005	2004
	(Unaudited)	
	(In thousands)	
Net income	\$ 4,580	\$ 2,820
Other comprehensive income, net of tax:		
Unrealized gains (losses) on securities	3,252	(6,405)
Less: reclassification adjustment for (gains) losses included in net income	2	(13)
Other comprehensive gain (loss), net of tax	3,254	(6,418)
Comprehensive income (loss)	\$ 7,834	\$ (3,598)

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

Table of Contents

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

	June 30, 2005	December 31, 2004
(Unaudited)		
(In thousands, except share data)		
ASSETS		
Investments		
Debt securities available for sale, at fair value (amortized cost of \$368,969 and \$324,966)	\$ 374,570	\$ 332,242
Equity securities available for sale, at fair value (cost of \$0)		39
Total investments	374,570	332,281
Cash and cash equivalents	32,835	69,875
Accrued investment income	4,704	4,331
Premiums and agent balances receivable, net	100,180	84,094
Reinsurance recoverable on:		
Paid losses	18,685	17,908
Unpaid losses	170,120	151,161
Prepaid reinsurance premiums	25,350	26,075
Deferred policy acquisition costs	26,168	25,167
Deferred federal income taxes	15,188	14,956
Goodwill	28,997	28,997
Other assets	43,225	46,851
Total assets	\$ 840,022	\$ 801,696
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities		
Losses and loss adjustment expenses	\$ 418,069	\$ 378,157
Unearned premiums	139,704	134,302
Debt	9,918	12,144
Debtures	35,310	35,310
Accounts payable and accrued expenses	28,182	38,837
Reinsurance funds held and balances payable	19,285	17,832
Payable to insurance companies	2,969	6,990
Other liabilities	11,590	10,614
Total liabilities	665,027	634,186
Commitments and contingencies (Note 6)		
Shareholders Equity		
Common stock, \$0.01 stated value; authorized 50,000,000 shares; 29,172,892 and 29,074,832 shares issued and	292	290

outstanding		
Additional paid-in capital	126,558	126,085
Retained earnings	45,310	37,175
Note receivable from officer	(861)	(868)
Accumulated other comprehensive income	3,696	4,828
Total shareholders equity	174,995	167,510
Total liabilities and shareholders equity	\$ 840,022	\$ 801,696

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

Table of Contents

MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Six Months Ended June 30,	
	2005	2004
	(Unaudited)	
	(In thousands)	
Cash Flows From Operating Activities		
Net income	\$ 8,323	\$ 6,052
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization of other intangible assets	185	191
Amortization of deferred debenture issuance costs	75	35
Depreciation of furniture, equipment, and building	1,248	656
Net accretion of discount and premiums on bonds	1,180	822
Loss on sale of investments, net	121	92
Gain on sale of fixed assets	(126)	
Stock-based employee compensation	23	44
Long-term incentive plan expense	390	309
Deferred income tax expense	351	137
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Premiums and agent balances receivable	(16,086)	(17,295)
Reinsurance recoverable on paid and unpaid losses	(19,737)	(1,118)
Prepaid reinsurance premiums	725	(2,645)
Deferred policy acquisition costs	(1,000)	(2,958)
Other assets	4,060	1,457
Increase (decrease) in:		
Losses and loss adjustment expenses	39,912	20,673
Unearned premiums	5,401	15,825
Payable to insurance companies	(4,021)	(4,541)
Reinsurance funds held and balances payable	1,454	3,466
Other liabilities	542	5,096
Total adjustments	14,697	20,246
Net cash provided by operating activities	23,020	26,298
Cash Flows From Investing Activities		
Purchase of debt securities available for sale	(152,612)	(62,411)
Proceeds from sales and maturities of debt securities available for sale	106,298	25,944
Proceeds from sales of equity securities available for sale	8	
Capital expenditures	(12,915)	(1,673)
Purchase of books of business	(149)	(272)
Proceeds from sale of assets	633	

Deconsolidation of subsidiary		(4,218)
Other investing activities	399	1,775
Net cash used in investing activities	(58,338)	(40,855)
Cash Flows From Financing Activities		
Proceeds from lines of credit	2,654	9,829
Payment of lines of credit	(4,880)	(11,131)
Net proceeds from debentures		24,250
Book overdraft	757	(343)
Issuance of common stock	952	45
Share repurchases of common stock	(1,094)	
Other financing activities	(111)	10
Net cash (used in) provided by financing activities	(1,722)	22,660
Net (decrease) increase in cash and cash equivalents	(37,040)	8,103
Cash and cash equivalents, beginning of period	69,875	50,647
Cash and cash equivalents, end of period	\$ 32,835	\$ 58,750

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

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS