

PROASSURANCE CORP
Form 10-Q
November 06, 2007

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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 September 30, 2007 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 0-16533

ProAssurance Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware

63-1261433

(State or Other Jurisdiction of
Incorporation or Organization)

(IRS Employer Identification No.)

100 Brookwood Place, Birmingham, AL

35209

(Address of Principal Executive Offices)

(Zip Code)

(205) 877-4400

(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 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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer

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 November 1, 2007 there were 32,672,841 shares of the registrant's common stock outstanding.

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FORWARD-LOOKING STATEMENTS

Any statements in this Form 10Q that are not historical facts are specifically identified as forward-looking statements. These statements are based upon our estimates and anticipation of future events and are subject to certain risks and uncertainties that could cause actual results to vary materially from the expected results described in the forward-looking statements. Forward-looking statements are identified by words such as, but not limited to, anticipate, believe, estimate, expect, hope, hopeful, intend, may, optimistic, preliminary, project, should, expressions. There are numerous important factors that could cause our actual results to differ materially from those in the forward-looking statements. Thus, sentences and phrases that we use to convey our view of future events and trends are expressly designated as forward-looking statements as are sections of this Form 10Q that are identified as giving our outlook on future business.

Forward-looking statements relating to our business include among other things: statements concerning liquidity and capital requirements, return on equity, financial ratios, net income, premiums, losses and loss reserves, premium rates and retention of current business, competition and market conditions, the expansion of product lines, the development or acquisition of business in new geographical areas, the availability of acceptable reinsurance, actions by regulators and rating agencies, court judgment, legislative actions, payment or performance of obligations under indebtedness, payment of dividends, and other matters.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following important factors that could affect the actual outcome of future events:

general economic conditions, either nationally or in our market area that are different than anticipated;

regulatory and legislative actions or decisions that affect our business plans or operations;

inflation and changes in the interest rate environment;

performance of financial markets that affect the market value of our investments or that make it more difficult to determine the value of our investments;

changes in laws or government regulations affecting medical professional liability insurance;

changes to our ratings assigned by rating agencies;

the effects of health care changes, including managed care and government programs;

uncertainties inherent in the estimate of loss and loss adjustment expense reserves, reinsurance and/or insurance, and changes in the availability, cost, quality, or collectibility of reinsurance and/or insurance;

bad faith litigation which may arise from our involvement in the settlement of claims;

the results of litigation, including trials, post-trial motions and/or appeals we undertake that may be unsuccessful;

changes in competition among insurance providers and related pricing in some markets;

our ability to achieve growth through expansion into other states or through acquisitions or business combinations;

the expected benefits from acquisitions may not be achieved or may be delayed longer than expected due to, among other reasons, business disruption, loss of customers and employees, increased operating costs or inability to achieve cost savings, and assumption of greater than expected liabilities;

changes in accounting policies and practices that may be adopted by our regulatory agencies and the Financial Accounting Standards Board;

changes in our organization, compensation and benefit plans; and

ability to recruit and retain senior management.

Our results may differ materially from those we expect and discuss in any forward-looking statements. The principal risk factors that may cause these differences are described in various documents we file with the Securities and Exchange Commission, including the Registration Statement filed on February 15, 2006 and updated on June 2, 2006, as well as in our periodic reports filed with the Securities and Exchange Commission, such as our current reports on Form 8-K, and our regular reports on Forms 10-Q and 10-K, particularly in Item 1A, Risk Factors.

We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advise readers that the factors listed above could affect our financial performance and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Except as required by law or regulations, we do not undertake and specifically decline any obligation to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Balance Sheets
(In thousands, except share data)

	September 30 2007 (Unaudited)	December 31 2006
Assets		
Investments		
Fixed maturities available for sale, at fair value	\$3,196,107	\$3,136,222
Fixed maturities, trading, at fair value		49,218
Equity securities, available for sale, at fair value	7,482	7,220
Equity securities, trading, at fair value	13,870	7,638
Short-term investments	279,163	184,280
Business owned life insurance	60,874	58,721
Investment in unconsolidated subsidiaries	20,798	9,331
Other	58,401	39,468
 Total investments	 3,636,695	 3,492,098
 Cash and cash equivalents	 2,535	 29,146
Premiums receivable	110,432	113,023
Receivable from reinsurers on unpaid losses and loss adjustment expenses	344,741	370,763
Prepaid reinsurance premiums	15,393	18,954
Deferred taxes	108,190	112,201
Real estate, net	23,348	23,135
Other assets	192,818	183,533
	\$4,434,152	\$4,342,853
 Liabilities and Stockholders Equity		
Liabilities		
Policy liabilities and accruals:		
Reserve for losses and loss adjustment expenses	\$2,596,885	\$2,607,148
Unearned premiums	248,043	253,773
Reinsurance premiums payable	124,280	106,176
 Total policy liabilities	 2,969,208	 2,967,097
Other liabilities	87,292	78,032
Long-term debt	179,511	179,177
 Total liabilities	 3,236,011	 3,224,306
Commitments and contingencies		
Stockholders Equity		
Common stock, par value \$0.01 per share 100,000,000 shares authorized, 33,557,816 and 33,398,028 shares issued, respectively	336	334
Additional paid-in capital	506,094	495,848
Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of (\$4,721) and \$62, respectively	(8,771)	111

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Retained earnings	741,803	622,310
	1,239,462	1,118,603
Treasury stock, at cost, 886,095 shares and 121,765 shares, respectively	(41,321)	(56)
Total stockholders' equity	1,198,141	1,118,547
	\$4,434,152	\$4,342,853

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Changes in Capital (Unaudited)
(In thousands)

	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2006	\$1,118,547	\$ 111	\$622,310	\$496,126
Cumulative effect of accounting change	2,670		2,670	-
Net income	116,823		116,823	-
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	(8,882)	(8,882)		-
Purchase of treasury stock	(41,265)			(41,265)
Common stock issued as compensation	3,136			3,136
Stock-based compensation	6,377			6,377
Common stock options exercised	735			735
Balance at September 30, 2007	\$1,198,141	\$ (8,771)	\$741,803	\$465,109
		Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
	Total			
Balance at December 31, 2005	\$ 765,046	\$ (8,834)	\$385,885	\$387,995
Net income	200,635		200,635	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments:				
Continuing operations	9,063	9,063		
Discontinued operations	373	373		
Common stock issued as compensation	3,027			3,027

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Equity issued in purchase transaction:				
Common stock issued	99,128			99,128
Stock-based compensation:				
Continuing operations	3,808			3,808
Discontinued operations	642			642
Common stock options exercised	239			239
Balance at September 30, 2006	\$1,081,961	\$ 602	\$586,520	\$494,839

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Income (Unaudited)
(In thousands, except per share data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2007	2006	2007	2006
Revenues:				
Gross premiums written	\$149,138	\$163,273	\$440,186	\$452,264
Net premiums written	\$139,483	\$152,043	\$401,809	\$421,004
Premiums earned	\$147,130	\$163,043	\$446,437	\$465,932
Premiums ceded	(11,622)	(13,599)	(41,089)	(36,637)
Net premiums earned	135,508	149,444	405,348	429,295
Net investment income	41,075	38,699	128,194	107,012
Equity in earnings (loss) of unconsolidated subsidiaries	(589)	(76)	1,241	1,610
Net realized investment gains (losses)	1,321	(510)	(1,564)	(1,120)
Other income	1,302	1,688	4,409	4,431
Total revenues	178,617	189,245	537,628	541,228
Expenses:				
Losses and loss adjustment expenses	99,142	124,165	338,793	358,972
Reinsurance recoveries	(11,034)	(10,128)	(52,844)	(30,693)
Net losses and loss adjustment expenses	88,108	114,037	285,949	328,279
Underwriting, acquisition and insurance expenses	27,439	25,859	79,913	78,226
Interest expense	3,006	2,886	8,950	8,074
Total expenses	118,553	142,782	374,812	414,579
Income from continuing operations before income taxes	60,064	46,463	162,816	126,649
Provision for income taxes:				
Current expense (benefit)	14,997	17,425	37,200	42,524
Deferred expense (benefit)	1,955	(4,330)	8,793	(7,069)
	16,952	13,095	45,993	35,455

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Income from continuing operations	43,112	33,368	116,823	91,194
Income from discontinued operations, net of tax				109,441
Net income	\$ 43,112	\$ 33,368	\$ 116,823	\$ 200,635
Basic earnings per share:				
Income from continuing operations	\$ 1.32	\$ 1.03	\$ 3.53	\$ 2.88
Income from discontinued operations				3.46
Net income	\$ 1.32	\$ 1.03	\$ 3.53	\$ 6.34
Diluted earnings per share:				
Income from continuing operations	\$ 1.23	\$ 0.96	\$ 3.31	\$ 2.71
Income from discontinued operations				3.17
Net income	\$ 1.23	\$ 0.96	\$ 3.31	\$ 5.88
Weighted average number of common shares outstanding:				
Basic	32,779	32,551	33,082	31,640
Diluted	35,604	35,438	35,949	34,525

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)
(In thousands)

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2007	2006	2007	2006
Comprehensive income, after tax:				
Continuing operations:				
Income from continuing operations	\$43,112	\$33,368	\$116,823	\$ 91,194
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	19,411	38,095	(8,882)	9,063
Comprehensive income, continuing operations	\$62,523	\$71,463	\$107,941	\$100,257
Discontinued operations:				
Income from discontinued operations	\$	\$	\$	\$109,441
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments				373
Comprehensive income, discontinued operations	\$	\$	\$	\$109,814

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Nine Months Ended September 30	
	2007	2006
Operating Activities		
Net income	\$ 116,823	\$ 200,635
Income from discontinued operations, net of tax		(109,441)
Depreciation and amortization	11,727	15,225
Net realized investment (gains) losses	1,564	1,120
Net sales (purchases) of trading portfolio securities	43,619	(47,378)
Stock-based compensation	6,377	3,808
Taxes paid related to gain on sale of discontinued operations		(54,565)
Changes in assets and liabilities:		
Premiums receivable	2,591	4,404
Reserve for losses and loss adjustment expenses	(10,263)	138,644
Unearned premiums	(5,730)	(13,458)
Reinsurance related assets and liabilities	47,687	294
Other	(7,184)	(4,820)
Net cash provided by operating activities	207,211	134,468
Investing Activities		
Purchases of:		
Fixed maturities available for sale	(1,063,682)	(1,913,786)
Equity securities available for sale	(657)	
Other investments	(552)	
Proceeds from sale or maturities of:		
Fixed maturities available for sale	970,261	1,505,036
Equity securities available for sale	811	33,577
Other investments	8,279	
Net (increase) decrease in short-term investments	(94,883)	(138,576)
Proceeds from sale of discontinued operations, net of sales expense paid of \$4,080		371,038
Other	(13,925)	(3,665)
Net cash provided by (used by) investing activities	(194,348)	(146,376)
Financing Activities		
Proceeds from options exercised	118	119
Treasury stock repurchased	(41,265)	
Excess tax benefit from options exercised	1,673	851
Net cash provided by (used by) financing activities	(39,474)	970

Increase (decrease) in cash and cash equivalents	(26,611)	(10,938)
Cash and cash equivalents at beginning of period	29,146	34,506
Cash and cash equivalents at end of period	\$ 2,535	\$ 23,568

Significant Non-cash Transactions:

Fixed maturities securities received as proceeds from sale of discontinued operations	\$	\$ 24,819
Fixed maturity securities, available-for-sale, transferred to Other Investments, at fair value	\$ 34,732	\$
Common stock issued in acquisition	\$	\$ 99,128

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2007

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes contained in ProAssurance's December 31, 2006 report on Form 10-K.

Reclassifications/Investment in Unconsolidated Subsidiaries

In 2007, due to the increased significance of the amounts involved, ProAssurance has separately reported its investments in unconsolidated subsidiaries and its equity in the earnings of unconsolidated subsidiaries. Previously, investments in unconsolidated subsidiaries were included as a component of other investments and earnings of unconsolidated subsidiaries were considered as a component of net investment income. Prior period balances in this report have been reclassified to conform to the 2007 presentation. The reclassification had no effect on income from continuing operations, net income or total assets.

Investments in unconsolidated subsidiaries consist of ownership interests in non-public investment entities. ProAssurance uses the equity method of accounting for investments in entities in which its ownership interest does not require consolidation but for which ProAssurance's ownership interest is a greater than minor interest. ProAssurance includes its proportionate share of the income (losses) of its unconsolidated subsidiaries in its results of operations as a separate line item in its Consolidated Statements of Income.

Accounting Changes

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FAS 109, Accounting for Income Taxes* (FIN 48), to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting for interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. ProAssurance adopted FIN 48 as of January 1, 2007. The cumulative effect of adopting FIN 48 increased retained earnings and reduced tax liabilities by \$2.7 million.

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2007

1. Basis of Presentation (continued)

Recent Accounting Developments

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements* (SFAS 157). The standard establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 is applicable to other accounting pronouncements that require or permit fair value measurements but does not require any new fair value measurements. The statement is effective for fiscal years beginning after November 15, 2007, unless early adopted. ProAssurance will adopt SFAS 157 on its effective date, and does not expect the implementation of SFAS 157 to have a material effect on its results of operations or financial condition.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 allows many financial assets and liabilities and other items to be reported at fair value that are not currently measured at fair value; unrealized gains and losses on items for which the fair value has been elected would be reported in earnings at each subsequent reporting date. SFAS 159 also establishes new disclosure requirements with respect to fair values. SFAS 159 is effective for fiscal years beginning after November 15, 2007, unless early adopted. ProAssurance will adopt SFAS 159 on its effective date, but has not completed its determination of the effect, if any, of adoption on its results of operations or financial condition.

2. Acquisitions

ProAssurance acquired 100% of the outstanding shares of Physicians Insurance Company of Wisconsin, Inc. (PIC Wisconsin) on August 1, 2006 as a means of expanding its operations geographically. PIC Wisconsin is an insurance company that focuses on medical professional insurance; its largest premium states are Wisconsin and Iowa.

The acquisition was a stock-for-stock exchange accounted for as a purchase transaction in accordance with SFAS 141. The aggregate purchase price of \$103.7 million was allocated to the assets acquired and liabilities assumed based on their respective fair values at the date of acquisition. Goodwill of \$42.7 million was recognized equal to the excess of the purchase price over the fair values of the identifiable net assets acquired.

For additional information regarding the acquisition of PIC Wisconsin see Note 2 of the Notes to the Consolidated Financial Statements in ProAssurance's December 31, 2006 Annual Report on Form 10K.

3. Discontinued Operations

Effective January 1, 2006 ProAssurance sold its wholly owned subsidiaries, MEEMIC Insurance Company and MEEMIC Insurance Services (collectively, the MEEMIC Companies) to Motors Insurance Corporation, a subsidiary of GMAC Insurance Holdings, Inc., for total consideration of \$400 million before taxes and transaction expenses.

The MEEMIC Companies were the only active entities of ProAssurance's personal lines operations. In accordance with SFAS 144, results attributed to the personal lines operations are reported as discontinued operations in the Condensed Consolidated Financial Statements. In 2006, income from discontinued operations consists solely of the gain recognized on the sale of \$164.0 million net of related taxes of \$54.6 million.

For additional information regarding the sale of the MEEMIC Companies see Note 3 of the Notes to the Consolidated Financial Statements in ProAssurance's December 31, 2006 Annual Report on Form 10K.

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**ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
September 30, 2007**

4. Investments

The amortized cost and estimated fair value of available-for-sale fixed maturities and equity securities are as follows:

**September 30, 2007
Gross**