

MEADOWBROOK INSURANCE GROUP INC

Form 10-Q

November 09, 2007

**Table of Contents**

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

**Form 10-Q**

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarter ended September 30, 2007**
- or**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Commission File Number 1-14094**

**Meadowbrook Insurance Group, Inc.**

*(Exact name of Registrant as specified in its charter)*

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

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

**26255 American Drive,  
Southfield, Michigan 48034**  
*(Address, zip code of principal executive offices)*

**(248) 358-1100**  
*(Registrant's telephone number, including area code)*

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

Indicate by check mark whether the Registrant is 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

Edgar Filing: MEADOWBROOK INSURANCE GROUP INC - Form 10-Q

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

The aggregate number of shares of the Registrant's Common Stock, \$.01 par value, outstanding on November 1, 2007 was 36,980,439.

---

**TABLE OF CONTENTS**

	<b><u>Page</u></b>
<b><u>PART I FINANCIAL INFORMATION</u></b>	
<b><u>ITEM 1 FINANCIAL STATEMENTS</u></b>	
<u>Consolidated Statements of Income (unaudited)</u>	2-3
<u>Consolidated Statements of Comprehensive Income (unaudited)</u>	4
<u>Consolidated Balance Sheets (unaudited)</u>	5
<u>Consolidated Statements of Cash Flows (unaudited)</u>	6
<u>Notes to Consolidated Financial Statements (unaudited)</u>	7-21
<b><u>ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u></b>	
	22-40
<b><u>ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u></b>	
	40-41
<b><u>ITEM 4 CONTROLS AND PROCEDURES</u></b>	
	41-42
<b><u>PART II OTHER INFORMATION</u></b>	
<b><u>ITEM 1 LEGAL PROCEEDINGS</u></b>	
	43
<b><u>ITEM 1A RISK FACTORS</u></b>	
	43
<b><u>ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u></b>	
	43
<b><u>ITEM 6 EXHIBITS</u></b>	
	43
<b><u>SIGNATURES</u></b>	
	44
<u>Certification of Robert S. Cubbin, Chief Executive Officer pursuant to Rule 13a-14(a)</u>	
<u>Certification of Karen M. Spaun, Senior Vice President and Chief Financial Officer pursuant to Rule 13a-14(a)</u>	
<u>Certification of Robert S. Cubbin, Chief Executive Officer pursuant to Section 906</u>	
<u>Certification of Karen M. Spaun, Senior Vice President and Chief Financial Officer pursuant to Section 906</u>	

Table of Contents**PART 1 FINANCIAL INFORMATION****ITEM 1 FINANCIAL STATEMENTS****MEADOWBROOK INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF INCOME****For the Nine Months Ended September 30,**

	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except share data)</b>	
<b>Revenues</b>		
Premiums earned		
Gross	\$ 251,605	\$ 244,557
Ceded	(51,873)	(53,231)
Net earned premiums	199,732	191,326
Net commissions and fees	35,613	31,599
Net investment income	19,173	16,203
Net realized (losses) gains	(186)	46
Total revenues	254,332	239,174
<b>Expenses</b>		
Losses and loss adjustment expenses	144,880	160,066
Reinsurance recoveries	(31,512)	(49,748)
Net losses and loss adjustment expenses	113,368	110,318
Salaries and employee benefits	42,181	41,397
Policy acquisition and other underwriting expenses	39,739	37,663
Other administrative expenses	23,882	21,694
Amortization expense	1,309	448
Interest expense	4,631	4,445
Total expenses	225,110	215,965
Income before taxes and equity earnings	29,222	23,209
Federal and state income tax expense	8,829	7,215
Equity earnings of affiliates	271	99
Net income	\$ 20,664	\$ 16,093

Earnings Per Share

Table of Contents

Edgar Filing: MEADOWBROOK INSURANCE GROUP INC - Form 10-Q

Basic	\$	0.65	\$	0.56
Diluted	\$	0.65	\$	0.55
Weighted average number of common shares				
Basic		31,666,032		28,894,053
Diluted		31,761,244		29,509,892

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 September 30,**

	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except share data)</b>	
<b>Revenues</b>		
Premiums earned		
Gross	\$ 84,791	\$ 81,164
Ceded	(17,454)	(17,476)
Net earned premiums	67,337	63,688
Net commissions and fees	13,319	9,612
Net investment income	6,788	5,584
Net realized (losses) gains	(200)	28
Total revenues	87,244	78,912
<b>Expenses</b>		
Losses and loss adjustment expenses	43,498	52,247
Reinsurance recoveries	(6,483)	(16,118)
Net losses and loss adjustment expenses	37,015	36,129
Salaries and employee benefits	15,750	14,183
Policy acquisition and other underwriting expenses	12,927	13,059
Other administrative expenses	8,890	6,767
Amortization expense	622	141
Interest expense	1,476	1,558
Total expenses	76,680	71,837
Income before taxes and equity earnings	10,564	7,075
Federal and state income tax expense	3,219	2,056
Equity earnings of affiliates	210	74
Net income	\$ 7,555	\$ 5,093
<b>Earnings Per Share</b>		
Basic	\$ 0.21	\$ 0.18
Diluted	\$ 0.21	\$ 0.17
Weighted average number of common shares		
Basic	35,293,796	28,884,578
Diluted	35,378,119	29,498,596

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 Nine Months Ended September 30,**

	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
Net income	\$ 20,664	\$ 16,093
Other comprehensive income, net of tax:		
Unrealized gains on securities	344	379
Net deferred derivative (loss) gain   hedging activity	(176)	109
Less: reclassification adjustment for gains included in net income	19	19
Other comprehensive income, net of tax	187	507
Comprehensive income	\$ 20,851	\$ 16,600

**MEADOWBROOK INSURANCE GROUP, INC.****CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****For the Three Months Ended September 30,**

	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
Net income	\$ 7,555	\$ 5,093
Other comprehensive income, net of tax:		
Unrealized gains on securities	4,520	5,624
Net deferred derivative losses   hedging activity	(289)	(322)
Less: reclassification adjustment for losses included in net income	(2)	
Other comprehensive income, net of tax	4,229	5,302
Comprehensive income	\$ 11,784	\$ 10,395

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

**Table of Contents****MEADOWBROOK INSURANCE GROUP, INC.****CONSOLIDATED BALANCE SHEETS**

	<b>September 30, 2007 (Unaudited)</b>	<b>December 31, 2006</b>
	<b>(In thousands, except share data)</b>	
<b>ASSETS</b>		
Investments		
Debt securities available for sale, at fair value (amortized cost of \$564,998 and \$486,213)	\$ 564,070	\$ 484,724
Cash and cash equivalents	49,792	42,876
Accrued investment income	6,539	5,884
Premiums and agent balances receivable, net	102,590	85,578
Reinsurance recoverable on:		
Paid losses	2,665	4,257
Unpaid losses	195,313	198,422
Prepaid reinsurance premiums	15,941	20,425
Deferred policy acquisition costs	27,787	27,902
Deferred federal income taxes	16,688	15,732
Goodwill	43,497	31,502
Other assets	59,012	51,698
<b>Total assets</b>	<b>\$ 1,083,894</b>	<b>\$ 969,000</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Liabilities		
Losses and loss adjustment expenses	\$ 528,985	\$ 501,077
Unearned premiums	151,203	144,575
Debt		7,000
Debentures	55,930	55,930
Accounts payable and accrued expenses	24,810	25,384
Reinsurance funds held and balances payable	12,805	15,124
Payable to insurance companies	5,832	5,442
Other liabilities	14,101	12,775
<b>Total liabilities</b>	<b>793,666</b>	<b>767,307</b>
Shareholders Equity		
Common stock, \$0.01 stated value; authorized 75,000,000 shares; 36,980,070 and 29,107,818 shares issued and outstanding	370	291
Additional paid-in capital	194,431	126,828
Retained earnings	96,947	76,282
Note receivable from officer	(870)	(871)

Edgar Filing: MEADOWBROOK INSURANCE GROUP INC - Form 10-Q

Accumulated other comprehensive loss	(650)	(837)
Total shareholders' equity	290,228	201,693
Total liabilities and shareholders' equity	\$ 1,083,894	\$ 969,000

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 Nine Months Ended September 30,**

	<b>2007</b>	<b>2006</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<b>Cash Flows From Operating Activities</b>		
Net income	\$ 20,664	\$ 16,093
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of other intangible assets	1,309	448
Amortization of deferred debenture issuance costs	236	177
Depreciation of furniture, equipment, and building	2,280	1,761
Net accretion of discount and premiums on bonds	2,031	1,947
Loss on sale of investments, net	30	30
Gain on sale of fixed assets	(66)	(66)
Stock-based employee compensation	2	118
Incremental tax benefits from stock options exercised	(656)	(1,386)
Long-term incentive plan expense	596	704
Deferred income tax expense	(1,058)	540
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Premiums and agent balances receivable	(13,138)	(21,753)
Reinsurance recoverable on paid and unpaid losses	4,701	1,160
Prepaid reinsurance premiums	4,484	1,623
Deferred policy acquisition costs	115	(747)
Other assets	686	(1,532)
Increase (decrease) in:		
Losses and loss adjustment expenses	27,907	34,963
Unearned premiums	6,628	4,541
Payable to insurance companies	390	(2,838)
Reinsurance funds held and balances payable	(2,318)	5,186
Other liabilities	(2,599)	2,008
Total adjustments	31,560	26,884
Net cash provided by operating activities	52,224	42,977
<b>Cash Flows From Investing Activities</b>		
Purchase of debt securities available for sale	(293,932)	(156,015)
Proceeds from sales and maturities of debt securities available for sale	213,633	80,182
Capital expenditures	(2,289)	(3,790)
Purchase of books of business	(75)	(133)
Acquisition of U.S Specialty Underwriters, Inc.	(12,644)	
Other investing activities	(110)	300

Net cash used in investing activities