

State Auto Financial CORP
Form 10-Q
August 08, 2006
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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 quarterly period ended June 30, 2006

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 000-19289

STATE AUTO FINANCIAL CORPORATION

(Exact name of Registrant as specified in its charter)

Ohio
(State or other jurisdiction of
incorporation or organization)

31-1324304
(I.R.S. Employer
Identification No.)

518 East Broad Street, Columbus, Ohio
(Address of principal executive offices)

43215-3976
(Zip Code)

Registrant's telephone number, including area code: (614) 464-5000

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

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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

On August 2, 2006, the Registrant had 40,971,162 Common Shares outstanding.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

PART I FINANCIAL STATEMENTS**Item 1. Condensed Consolidated Balance Sheets**

(\$ millions, except per share amount)

	June 30 2006 (unaudited)	December 31 2005 (see note 1)
Assets		
Fixed maturities, available for sale, at fair value (amortized cost \$1,617.1 and \$1,597.3, respectively)	\$ 1,596.1	1,617.3
Equity securities, available for sale, at fair value (cost \$223.7 and \$224.8, respectively)	258.0	255.6
Other invested assets	6.9	7.0
<i>Total investments</i>	1,861.0	1,879.9
Cash and cash equivalents	33.8	28.7
Securities lending collateral		99.0
Accrued investment income and other assets	44.0	45.1
Deferred policy acquisition costs	106.3	106.0
Net prepaid pension expense	55.5	59.2
Reinsurance recoverable on losses and loss expenses payable (affiliates \$4.8 and \$5.5, respectively)	15.3	17.4
Prepaid reinsurance premiums (affiliates none and \$0.2, respectively)	5.7	6.1
Due from affiliate	16.9	7.1
Current federal income taxes	19.0	3.7
Deferred federal income taxes	28.1	10.1
Property and equipment, at cost (net of accumulated depreciation of \$4.9 and \$4.8, respectively)	12.6	12.6
Total assets	\$ 2,198.2	2,274.9
Liabilities and Stockholders Equity		
Losses and loss expenses payable (affiliates \$312.5 and \$302.6, respectively)	\$ 729.4	728.7
Unearned premiums (affiliates \$125.6 and \$128.4, respectively)	436.6	432.9
Notes payable (affiliates \$15.5)	118.5	118.7
Postretirement benefit liabilities	93.2	89.2
Securities lending obligation		99.0
Other liabilities	33.6	42.9
Total liabilities	1,411.3	1,511.4
Stockholders equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued		
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued		
Common stock, without par value. Authorized 100.0 shares; 45.5 and 45.1 shares issued, respectively, at stated value of \$2.50 per share	113.8	112.8
Less 4.7 and 4.6 treasury shares, at cost, respectively	(57.7)	(56.8)
Additional paid-in capital	81.2	70.2

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Accumulated other comprehensive income	9.6	34.3
Retained earnings	640.0	603.0
<i>Total stockholders' equity</i>	786.9	763.5
<i>Total liabilities and stockholders' equity</i>	\$ 2,198.2	2,274.9

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Income

(\$ millions, except per share amounts)

	Three months ended June 30	
	2006	2005
(unaudited)		
Earned premiums (ceded to affiliates \$171.2 and \$171.3, respectively)	\$ 256.7	263.7
Net investment income	20.6	19.3
Net realized gains on investments	1.4	
Other income (affiliates \$0.7)	1.3	1.2
Total revenues	280.0	284.2
Losses and loss expenses (ceded to affiliates \$120.4 and \$95.6, respectively)	194.0	140.7
Acquisition and operating expenses	80.9	83.6
Interest expense (affiliates \$0.4 and \$0.7, respectively)	1.9	2.2
Other expenses, net	3.4	3.3
Total expenses	280.2	229.8
(Loss) income before federal income taxes	(0.2)	54.4
Federal income tax (benefit) expense	(4.3)	15.6
Net income	\$ 4.1	38.8
Earnings per common share:		
Basic	\$ 0.10	0.96
Diluted	\$ 0.10	0.94
Dividends paid per common share	\$ 0.090	0.045

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Income

(\$ millions, except per share amounts)

	Six months ended June 30	
(unaudited)	2006	2005
Earned premiums (ceded to affiliates \$341.2 and \$340.4, respectively)	\$ 512.8	526.8
Net investment income	41.0	38.3
Net realized gains on investments	0.5	2.4
Other income (affiliates \$1.5)	2.5	2.6
Total revenues	556.8	570.1
Losses and loss expenses (ceded to affiliates \$205.8 and \$186.4, respectively)	321.3	279.5
Acquisition and operating expenses	168.4	167.4
Interest expense (affiliates \$0.7 and \$1.4, respectively)	3.7	4.4
Other expenses, net	6.9	6.6
Total expenses	500.3	457.9
Income before federal income taxes	56.5	112.2
Federal income tax expense	12.2	32.6
Net income	\$ 44.3	79.6
Earnings per common share:		
Basic	\$ 1.09	1.98
Diluted	\$ 1.07	1.94
Dividends paid per common share	\$ 0.180	0.090

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Cash Flows

<i>(\$ millions)</i>	Six months ended June 30	
<i>(unaudited)</i>	2006	2005
Cash flows from operating activities:		
Net income	\$ 44.3	79.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	4.9	4.8
Share-based compensation	4.1	0.6
Net realized gains on investments	(0.5)	(2.4)
Changes in operating assets and liabilities:		
Deferred policy acquisition costs	(0.3)	(4.8)
Accrued investment income and other assets	1.0	1.2
Net prepaid pension expense	3.7	1.6
Postretirement benefit liabilities	4.0	4.4
Other liabilities and due to/from affiliates, net	(23.7)	(24.1)
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	2.5	11.5
Losses and loss expenses payable	0.7	(9.3)
Unearned premiums	3.7	5.6
Federal income taxes	(20.2)	(2.3)
Cash provided from adding Meridian Security Insurance Company and Meridian Citizens Mutual Insurance Company business to the reinsurance pool, effective 1/1/2005		54.0
Net cash provided by operating activities	24.2	120.4
Cash flows from investing activities:		
Purchase of fixed maturities available-for-sale	(122.6)	(327.6)
Purchase of equity securities available-for-sale	(41.9)	(38.3)
Purchase of other invested assets	(0.3)	(2.8)
Maturities, calls and pay downs of fixed maturities available-for-sale	47.9	49.7
Sale of fixed maturities available-for-sale	51.3	163.3
Sale of equity securities available-for-sale	46.7	11.7
Sale of other invested assets	0.7	
Net additions of property and equipment	(0.2)	(0.2)
Net cash used in investing activities	(18.4)	(144.2)
Cash flows from financing activities:		
Proceeds from stock option exercises	4.2	2.7
Change in securities lending collateral	99.0	98.0
Change in securities lending obligation	(99.0)	(98.0)
Payment of common stock dividends	(7.3)	(1.3)
Excess tax benefits on share-based awards	2.4	
Net cash (used in) provided by financing activities	(0.7)	1.4
Net increase (decrease) in cash and cash equivalents	5.1	(22.4)

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Cash and cash equivalents at beginning of period	28.7	64.3
Cash and cash equivalents at end of period	\$ 33.8	41.9
Supplemental disclosures:		
Federal income taxes paid	\$ 29.4	34.9
Interest paid (affiliates \$0.7 and \$1.3, respectively)	\$ 3.8	4.6

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of State Auto Financial Corporation (State Auto Financial or the Company) have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of the Company, all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation have been included. Operating results for the six month period ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2005 (the 2005 Form 10-K). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2005 Form 10-K.

Certain items in the prior period consolidated financial statements have been reclassified to conform to the 2006 presentation.

In September 2005, the Accounting Standards Executive Committee issued Statement of Position 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection With Modifications or Exchanges of Insurance Contracts (SOP 05-1), which is to be effective for fiscal years beginning after December 15, 2006, with earlier adoption encouraged. SOP 05-1 provides guidance on accounting for deferred acquisition costs on internal replacements of insurance contracts that are modifications to product features that occur by the exchange of a contract for a new contract. Insurance contracts issued by the Company include nonintegrated contract features as defined in SOP 05-1. Those nonintegrated contract features that provide coverage that is underwritten and priced only for that incremental insurance coverage do not result in reunderwriting or repricing of other components of the contract. Nonintegrated contract features do not change the existing base contract and do not require further evaluation under SOP 05-1. Given the nature of the policies written by the Company, the impact of SOP 05-1 upon implementation is not expected to be material.

In May 2005, the FASB issued FASB Statement 154, Accounting Changes and Error Corrections (SFAS 154) which replaces APB Opinion 20, Accounting Changes (APB 20) and FASB Statement 3, Reporting Accounting Changes in Interim Financial Statements (SFAS 3). SFAS 154 changes the requirements for the accounting for and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. SFAS 154 requires voluntary changes in accounting principles be recognized retrospectively to prior periods financial statements, rather than recognition in the net income of the current period. Retrospective application requires restatement of prior period financial statements as if that accounting principle had always been used. SFAS 154 carries forward without change the guidance contained in APB 20 for reporting the corrections of errors in previously issued financial statements and changes in accounting estimates. The provisions of SFAS 154 are effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company adopted SFAS 154 effective January 1, 2006 and there was no material impact on its financial position or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), which is to be effective for fiscal years beginning after December 15, 2006, with earlier adoption encouraged. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold 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 in interim periods, disclosure and transition. The Company is currently assessing the impact of this new guidance, but does not believe it will be material.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements Continued (Unaudited)

2. Earnings per Common Share

The following table sets forth the computation of basic and diluted earnings per common share:

(\$ millions, except per share amounts)

Three months ended
June 30