

State Auto Financial CORP
Form 10-Q
May 05, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2010

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	

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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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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

On April 30, 2010, the Registrant had 39,946,987 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)

	March 31 2010 (unaudited)	December 31 2009 (see note 1)
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost \$1,771.6 and \$1,788.1, respectively)	\$ 1,817.0	1,831.8
Equity securities, available-for-sale, at fair value (cost \$220.7 and \$189.7, respectively)	260.6	224.1
Other invested assets, available-for-sale, at fair value (cost \$52.1 and \$44.1, respectively)	61.4	52.3
Other invested assets	1.0	0.9
Note receivable from affiliate	70.0	70.0
Total investments	2,210.0	2,179.1
Cash and cash equivalents	80.1	90.3
Accrued investment income and other assets	25.6	35.1
Deferred policy acquisition costs	127.9	127.3
Reinsurance recoverable on losses and loss expenses payable (affiliates \$0.0 and \$0.1, respectively)	19.7	20.8
Prepaid reinsurance premiums (affiliates none)	14.3	7.2
Due from affiliate	7.4	7.7
Current federal income taxes	7.9	9.1
Net deferred federal income taxes	69.0	75.9
Property and equipment, at cost	11.9	12.0
Total assets	\$ 2,573.8	2,564.5
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliates \$341.6 and \$346.2, respectively)	\$ 841.6	840.2
Unearned premiums (affiliates \$180.1 and \$180.7, respectively)	547.2	547.0
Notes payable (affiliates \$15.5 and \$15.5, respectively)	117.1	117.2
Postretirement and pension benefits	153.9	150.4
Other liabilities	50.5	60.3
Total liabilities	1,710.3	1,715.1
Stockholders' equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued		

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Class B Preferred stock, without par value. Authorized 2.5 shares; none issued		
Common stock, without par value. Authorized 100.0 shares; 46.7 and 46.6 shares issued, respectively, at stated value of \$2.50 per share	116.7	116.6
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(115.7)	(115.7)
Additional paid-in capital	117.1	115.8
Accumulated other comprehensive income (loss)	2.8	(2.9)
Retained earnings	742.6	735.6
<i>Total stockholders equity</i>	863.5	849.4
 <i>Total liabilities and stockholders equity</i>	 \$ 2,573.8	 2,564.5

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)

(unaudited)	Three months ended March 31	
	2010	2009
Earned premiums (ceded to affiliates \$201.7 and \$179.9, respectively)	\$ 302.3	286.0
Net investment income (affiliates \$1.2 in 2010)	20.5	18.3
Net realized gain (loss) on investments:		
Total other-than-temporary impairment losses	(0.8)	(6.4)
Portion of loss recognized in other comprehensive income		
Other net realized investment gains (losses)	4.0	(4.9)
Total net realized gain (loss) on investments	3.2	(11.3)
Other income (affiliates \$0.5 and \$0.7, respectively)	0.4	1.0
Total revenues	326.4	294.0
Losses and loss expenses (ceded to affiliates \$134.1 and \$139.7, respectively)	200.0	224.8
Acquisition and operating expenses	101.2	95.4
Interest expense (affiliates \$0.2 and \$0.2, respectively)	1.8	2.0
Other expenses	2.8	2.7
Total expenses	305.8	324.9
Income (loss) before federal income taxes	20.6	(30.9)
Federal income tax expense (benefit)	7.7	(16.9)
Net income (loss)	\$ 12.9	(14.0)
Earnings (loss) per common share:		
Basic	\$ 0.32	(0.35)
Diluted	\$ 0.32	(0.35)
Dividends paid per common share	\$ 0.15	0.15

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>	Three months ended March 31	
(unaudited)	2010	2009
Cash flows from operating activities:		
Net income (loss)	\$ 12.9	(14.0)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization, net	2.2	4.9
Share-based compensation	0.6	0.7
Net realized (gain) loss on investments	(3.2)	11.3
Changes in operating assets and liabilities:		
Deferred policy acquisition costs	(0.9)	(0.1)
Accrued investment income and other assets	(0.1)	(0.7)
Postretirement and pension benefits	3.9	(0.5)
Other liabilities and due to/from affiliates, net	(16.7)	(27.3)
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	0.8	2.3
Losses and loss expenses payable	5.4	20.3
Unearned premiums	1.6	1.5
Excess tax benefits on share based awards	0.1	
Federal income taxes	5.1	(16.8)
Cash provided from pooling change, January 1, 2010 (Note 4)	3.7	
Net cash provided by (used in) operating activities	15.4	(18.4)
Cash flows from investing activities:		
Purchases of fixed maturities available-for-sale	(87.9)	(79.8)
Purchases of equity securities available-for-sale	(47.0)	(2.0)
Purchases of other invested assets	(8.3)	(0.3)
Maturities, calls and pay downs of fixed maturities available-for-sale	66.4	28.2
Sales of fixed maturities available-for-sale	36.8	65.9
Sales of equity securities available-for-sale	19.5	9.3
Sales of other invested assets	0.3	0.1
Net cash (used in) provided by investing activities	(20.2)	21.4
Cash flows from financing activities:		
Proceeds from issuance of common stock	0.5	0.1
Payment of dividends	(5.9)	(5.9)
Net cash used in financing activities	(5.4)	(5.8)

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Net decrease in cash and cash equivalents	(10.2)	(2.8)
Cash and cash equivalents at beginning of period	90.3	150.5
Cash and cash equivalents at end of period	\$ 80.1	147.7
Supplemental disclosures:		
Interest paid (affiliates \$0.2 and \$0.2, respectively)	\$ 0.2	0.2
Federal income taxes paid (received)	\$ 2.5	(0.1)

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 and Subsidiaries (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 U.S. generally accepted accounting principles (GAAP) 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 three month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP 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, 2009 (the 2009 Form 10-K). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2009 Form 10-K.

Adoption of Recent Accounting Pronouncements

Amendments to Accounting for Variable Interest Entities

In June 2009, the Financial Accounting Standards Board (FASB) issued revised guidance on the accounting for variable interest entities. The revised guidance, which was issued as Statement of Financial Accounting Standards (SFAS) No. 167, *Amendments to FASB Interpretation No. 46(R)*, is included in the Consolidation Topic of the FASB Accounting Standards Codification (ASC). The revised guidance eliminates the concept of a qualifying special-purpose entity and replaces the quantitative-based risks and rewards calculation of the previous guidance for determining which company, if any, has a controlling financial interest in a variable interest entity. The revised guidance requires an analysis of whether a company has: (1) the power to direct the activities of a variable interest entity that most significantly impact the entity s economic performance and (2) the obligation to absorb the losses that could potentially be significant to the entity or the right to receive benefits from the entity that could potentially be significant to the entity. An entity is required to be re-evaluated as a variable interest entity when the holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights to direct the activities that most significantly impact the entity s economic performance. Additional disclosures are required about a company s involvement in variable interest entities and an ongoing assessment of whether a company is the primary beneficiary. The adoption of the new guidance effective January 1, 2010 had no effect on the Company s consolidated financial statements.

Improving Disclosures about Fair Value Measurements

In January 2010, the FASB issued guidance to improve the disclosures related to fair value measurements. The new guidance requires expanded fair value disclosures, including the reasons for significant transfers between Level 1 and Level 2 and the amount of significant transfers into each level disclosed separately from transfers out of each level. For Level 3 fair value measurements, information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements shall be presented separately on a gross basis, rather than as one net number. In addition, clarification is provided about existing disclosure requirements, such as presenting fair value measurement disclosures for each *class* of assets and liabilities that are determined based on their nature and risk characteristics and their placement in the fair value hierarchy (that is, Level 1, 2, or 3), as opposed to each *major category* of assets and liabilities, as required in the previous guidance. Disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements are required for fair value measurement that fall in either Level 2 or Level 3. The Company adopted this new guidance effective January 1, 2010, except for the gross presentation of purchases, sales, issuances and settlements in the Level 3 reconciliation, which is effective for annual and interim reporting periods beginning after December 15, 2010. The disclosures required by this new guidance are provided in the accompanying Note 3.

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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. Investments

The following tables summarize the cost or amortized cost and fair value of available-for-sale securities at March 31, 2010 and December 31, 2009:

(\$ millions)

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
At March 31, 2010:				
Fixed Maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 388.2	6.6	(0.8)	394.0
Obligations of states and political subdivisions	988.0	31.3	(1.6)	1,017.7
Corporate securities	107.7	3.3	(0.1)	110.9
U.S. government agencies residential mortgage-backed securities	287.7	7.5	(0.8)	294.4
<i>Total fixed maturities</i>	1,771.6	48.7	(3.3)	