

HALLMARK FINANCIAL SERVICES INC
Form 10-Q
August 07, 2015

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, 2015

Commission file number 001-11252

Hallmark Financial Services, Inc.

(Exact name of registrant as specified in its charter)

Nevada	87-0447375
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
777 Main Street, Suite 1000, Fort Worth, Texas	76102
(Address of principal executive offices)	(Zip Code)

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Registrant's telephone number, including area code: (817) 348-1600

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, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, par value \$.18 per share – 19,210,512 shares outstanding as of August 7, 2015.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

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Hallmark Financial Services, Inc. and Subsidiaries**Consolidated Balance Sheets**

(\$ in thousands, except par value)

	June 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Investments:		
Debt securities, available-for-sale, at fair value (cost: \$497,251 in 2015 and \$450,770 in 2014)	\$ 494,054	\$ 450,785
Equity securities, available-for-sale, at fair value (cost: \$25,080 in 2015 and \$25,360 in 2014)	56,629	56,444
Total investments	550,683	507,229
Cash and cash equivalents	116,554	130,985
Restricted cash	14,687	11,914
Ceded unearned premiums	60,333	53,376
Premiums receivable	87,602	71,003
Accounts receivable	2,128	3,141
Receivable for securities	2,567	932
Reinsurance recoverable	112,584	109,719
Deferred policy acquisition costs	21,310	20,746
Goodwill	44,695	44,695
Intangible assets, net	16,193	17,427
Prepaid expenses	2,724	1,823
Other assets	9,882	7,879
Total assets	\$ 1,041,942	\$ 980,869
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Subordinated debt securities	\$ 56,702	\$ 56,702
Reserves for unpaid losses and loss adjustment expenses	444,327	415,135
Unearned premiums	213,290	196,826
Reinsurance balances payable	32,468	26,403
Pension liability	2,527	2,619
Payable for securities	3,412	1,321
Federal income tax payable	3,007	968
Deferred federal income taxes, net	410	3,092
Accounts payable and other accrued expenses	23,487	25,766
Total liabilities	\$ 779,630	\$ 728,832

Commitments and Contingencies (Note 17)

Stockholders' equity:

Common stock, \$.18 par value, authorized 33,333,333; issued 20,872,831 shares in 2015 and 2014	3,757		3,757	
Additional paid-in capital	123,618		123,194	
Retained earnings	131,357		119,638	
Accumulated other comprehensive income	15,956		17,801	
Treasury stock (1,626,863 shares in 2015 and 1,655,306 in 2014), at cost	(12,376	)	(12,353)
Total stockholders' equity	262,312		252,037	
	\$ 1,041,942		\$ 980,869	

The accompanying notes are an integral part of the consolidated financial statements

Hallmark Financial Services, Inc. and Subsidiaries**Consolidated Statements of Operations**

(Unaudited)

(\$ in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Gross premiums written	\$ 133,508	\$ 124,440	\$ 258,567	\$ 240,522
Ceded premiums written	(39,203)	(50,737)	(73,888)	(83,898)
Net premiums written	94,305	73,703	184,679	156,624
Change in unearned premiums	(5,829)	4,343	(9,507)	3,999
Net premiums earned	88,476	78,046	175,172	160,623
Investment income, net of expenses	3,711	2,986	6,556	6,227
Net realized gains	3,439	(284)	4,023	(99)
Finance charges	1,482	1,383	2,781	2,767
Commission and fees	(110)	(1,309)	(101)	(1,599)
Other income	199	14	216	26
Total revenues	97,197	80,836	188,647	167,945
Losses and loss adjustment expenses	59,725	52,502	115,815	105,272
Other operating expenses	26,446	24,510	52,360	50,646
Interest expense	1,134	1,143	2,274	2,295
Amortization of intangible assets	617	639	1,234	1,278
Total expenses	87,922	78,794	171,683	159,491
Income before tax	9,275	2,042	16,964	8,454
Income tax expense	2,899	391	5,245	2,255
Net income	6,376	1,651	11,719	6,199
Net income per share:				
Basic	\$ 0.33	\$ 0.09	\$ 0.61	\$ 0.32
Diluted	\$ 0.33	\$ 0.09	\$ 0.60	\$ 0.32

The accompanying notes are an integral part of the consolidated financial statements

Hallmark Financial Services, Inc. and Subsidiaries**Consolidated Statements of Comprehensive Income**

(Unaudited)

(\$ in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Net income	\$ 6,376	\$ 1,651	\$ 11,719	\$ 6,199
Other comprehensive income (loss):				
Change in net actuarial gain	26	41	52	81
Tax effect on change in net actuarial gain	(9)	(14)	(18)	(28)
Unrealized holding (losses) gains arising during the period	(4,106)	3,766	2,963	2,121
Tax effect on unrealized holding (losses) gains arising during the period	1,437	(1,318)	(1,037)	(742)
Reclassification adjustment for (gains) losses included in net income	(4,992)	284	(5,853)	99
Tax effect on reclassification adjustment for gains (losses) included in net income	1,747	(99)	2,048	(35)
Other comprehensive (loss) income, net of tax	(5,897)	2,660	(1,845)	1,496
Comprehensive income	\$ 479	\$ 4,311	\$ 9,874	\$ 7,695

The accompanying notes are an integral part of the consolidated financial statements

Hallmark Financial Services, Inc. and Subsidiaries**Consolidated Statements of Stockholders' Equity**

(Unaudited)

(\$ in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Common Stock				
Balance, beginning of period	\$3,757	\$3,757	\$3,757	\$3,757
Balance, end of period	3,757	3,757	3,757	3,757
Additional Paid-In Capital				
Balance, beginning of period	123,555	122,937	123,194	122,827
Equity based compensation	166	111	537	221
Shares issued under employee benefit plans	(103)	-	(113)	-
Balance, end of period	123,618	123,048	123,618	123,048
Retained Earnings				
Balance, beginning of period	124,981	110,757	119,638	106,209
Net income	6,376	1,651	11,719	6,199
Balance, end of period	131,357	112,408	131,357	112,408
Accumulated Other Comprehensive Income				
Balance, beginning of period	21,853	15,719	17,801	16,883
Additional minimum pension liability, net of tax	17	27	34	53
Unrealized holding (losses) gains arising during period, net of tax	(2,669)	2,448	1,926	1,379
Reclassification adjustment for (gains) losses included in net income, net of tax	(3,245)	185	(3,805)	64
Balance, end of period	15,956	18,379	15,956	18,379
Treasury Stock				
Balance, beginning of period	(12,428)	(11,558)	(12,353)	(11,558)
Acquisition of treasury stock	(443)	(736)	(730)	(736)
Shares issued under employee benefit plans	495	16	707	16
Balance, end of period	(12,376)	(12,278)	(12,376)	(12,278)
Total Stockholders' Equity	\$262,312	\$245,314	\$262,312	\$245,314

The accompanying notes are an integral part of the consolidated financial statements

Hallmark Financial Services, Inc. and Subsidiaries**Consolidated Statements of Cash Flows**

(Unaudited)

(\$ in thousands)

	Six Months Ended June 30, 2015		2014
Cash flows from operating activities:			
Net income	\$ 11,719		\$ 6,199
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization expense	1,448		2,049
Deferred federal income taxes	(1,834)	)	(1,179)
Net realized (gains) losses	(4,023)	)	99
Share-based payments expense	537		221
Change in ceded unearned premiums	(6,957)	)	(15,664)
Change in premiums receivable	(16,599)	)	(8,632)
Change in accounts receivable	1,013		(823)
Change in deferred policy acquisition costs	(564)	)	2,829
Change in unpaid losses and loss adjustment expenses	29,192		32,657
Change in unearned premiums	16,464		11,665
Change in reinsurance	(2,865)	)	(22,938)

recoverable				
Change in reinsurance balances payable	6,065		13,584	
Change in current federal income tax payable	2,039		125	
Change in all other liabilities	(2,371	)	(2,661)
Change in all other assets	(386	)	2,050	
Net cash provided by operating activities	32,878		19,581	
Cash flows from investing activities:				
Purchases of property and equipment	(2,090	)	(576)
Net transfers into restricted cash	(2,773	)	(3,231)
Purchases of investment securities	(109,799	)	(69,144)
Maturities, sales and redemptions of investment securities	67,489		70,262	
Net cash used in investing activities	(47,173	)	(2,689)
Cash flows from financing activities:				
Activity under revolving credit facility, net	-		(1,473)
Proceeds from exercise of employee stock options	594		16	