

State Auto Financial CORP
Form 10-Q
May 06, 2011
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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, 2011

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 29, 2011, the Registrant had 40,209,284 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	December 31
	2011	2010
	(unaudited)	(see note 1)
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost \$2,031.4 and \$1,862.3, respectively)	\$ 2,066.7	1,900.7
Equity securities, available-for-sale, at fair value (cost \$219.0 and \$200.2, respectively)	282.2	256.2
Other invested assets, available-for-sale, at fair value (cost \$64.6 and \$64.4, respectively)	82.6	79.7
Other invested assets	0.5	0.5
Notes receivable from affiliate	70.0	70.0
Total investments	2,502.0	2,307.1
Cash and cash equivalents	82.4	88.3
Accrued investment income and other assets	32.5	38.0
Deferred policy acquisition costs	157.2	150.2
Reinsurance recoverable on losses and loss expenses payable (affiliates none)	17.9	18.8
Prepaid reinsurance premiums (affiliates none)	8.0	7.6
Due from affiliate	9.6	6.5
Current federal income taxes	3.2	7.6
Net deferred federal income taxes	85.1	86.3
Property and equipment, at cost	11.5	11.6
Total assets	\$ 2,909.4	2,722.0
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliates \$509.2 and \$375.8, respectively)	\$ 1,031.2	893.0
Unearned premiums (affiliates \$271.6 and \$234.6, respectively)	640.6	613.2
Notes payable (affiliates \$15.5 and \$15.5, respectively)	116.7	116.8
Postretirement and pension benefits	191.3	186.9
Other liabilities	64.7	60.3
Total liabilities	2,044.5	1,870.2
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		
	117.4	117.3

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Common stock, without par value. Authorized 100.0 shares; 46.9 and 46.9 shares issued, respectively, at stated value of \$2.50 per share

Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(115.8)	(115.8)
Additional paid-in capital	123.1	122.1
Accumulated other comprehensive loss	(2.6)	(7.9)
Retained earnings	742.8	736.1
<i>Total stockholders equity</i>	864.9	851.8
 <i>Total liabilities and stockholders equity</i>	 \$ 2,909.4	 2,722.0

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

<i>(\$ millions, except per share amounts)</i>	Three months ended March 31	
(unaudited)	2011	2010
Earned premiums (ceded to affiliates \$205.5 and \$201.7, respectively)	\$ 350.2	302.3
Net investment income (affiliate \$1.2 and \$1.2, respectively)	21.0	20.5
Net realized gain on investments:		
Total other-than-temporary impairment losses	(0.1)	(0.8)
Portion of loss recognized in other comprehensive income		
Other net realized investment gains	8.3	4.0
Total net realized gain on investments	8.2	3.2
Other income from affiliates	0.8	0.4
Total revenues	380.2	326.4
Losses and loss expenses (ceded to affiliates \$143.4 and \$134.1, respectively)	242.6	200.0
Acquisition and operating expenses	118.1	101.2
Interest expense (affiliates \$0.2 and \$0.2, respectively)	1.8	1.8
Other expenses	2.3	2.8
Total expenses	364.8	305.8
Income before federal income taxes	15.4	20.6
Federal income tax expense	2.7	7.7
Net income	\$ 12.7	12.9
Earnings per common share:		
Basic	\$ 0.32	0.32
Diluted	\$ 0.32	0.32
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)	2011	2010
Cash flows from operating activities:		
Net income	\$ 12.7	12.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	2.1	2.2
Share-based compensation	0.8	0.6
Net realized gain on investments	(8.2)	(3.2)
Changes in operating assets and liabilities:		
Deferred policy acquisition costs	1.3	(0.9)
Accrued investment income and other assets	(2.4)	(0.1)
Postretirement and pension benefits	5.7	3.9
Other liabilities and due to/from affiliates, net	(16.8)	(16.7)
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	0.6	0.8
Losses and loss expenses payable	13.7	5.4
Unearned premiums	(6.9)	1.6
Excess tax benefits on share based awards		0.1
Federal income taxes	2.7	5.1
Cash provided from pooling change, January 1, 2011 and 2010 see note 4	69.1	3.7
Net cash provided by operating activities	74.4	15.4
Cash flows from investing activities:		
Purchases of fixed maturities available-for-sale	(188.2)	(87.9)
Purchases of equity securities available-for-sale	(56.2)	(47.0)
Purchases of other invested assets	(0.5)	(8.3)
Maturities, calls and pay downs of fixed maturities available-for-sale	89.7	66.4
Sales of fixed maturities available-for-sale	21.4	36.8
Sales of equity securities available-for-sale	45.6	19.5
Sales of other invested assets	0.3	0.3
Sale of subsidiary, net of expenses	13.2	
Net cash used in investing activities	(74.7)	(20.2)
Cash flows from financing activities:		
Proceeds from issuance of common stock	0.4	0.5
Payment of dividends	(6.0)	(5.9)

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<i>Net cash used in financing activities</i>	(5.6)	(5.4)
Net decrease in cash and cash equivalents	(5.9)	(10.2)
Cash and cash equivalents at beginning of period	88.3	90.3
Cash and cash equivalents at end of period	\$ 82.4	80.1
Supplemental disclosures:		
Interest paid (affiliates \$0.2 and \$0.2, respectively)	\$ 0.2	0.2
Federal income taxes paid	\$	2.5

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)

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, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The balance sheet at December 31, 2010 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, 2010 (the 2010 Form 10-K). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2010 Form 10-K.

Adoption of Accounting Pronouncements

Improving Disclosures about Fair Value Measurements

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance to improve the disclosures related to fair value measurements. The guidance requires the information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements to be presented separately on a gross basis, rather than as one net number. The Company adopted this guidance effective January 1, 2011. The disclosures required by this guidance are provided in the accompanying Note 3.

Pending Adoption of Accounting Pronouncements

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the FASB issued updated guidance to address diversity in practice for the accounting of costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. The new guidance is effective on a prospective basis for fiscal years beginning after December 15, 2011, with early adoption permitted. Retrospective application is also permitted, but not required. The Company is still assessing the impact the provisions of the new guidance will have on its 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, Continued (Unaudited)

2. Investments

The following tables set forth the cost or amortized cost and fair value of available-for-sale securities by lot at March 31, 2011 and December 31, 2010:

(\$ millions)

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
At March 31, 2011:				
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 513.7	14.4	(3.0)	525.1
Obligations of states and political subdivisions	911.2	21.7	(5.7)	927.2
Corporate securities	197.3	5.6	(0.3)	202.6
U.S. government agencies residential mortgage-backed securities	409.2	7.3	(4.7)	411.8
<i>Total fixed maturities</i>	2,031.4	49.0	(13.7)	2,066.7
Equity securities:				
Large-cap securities	183.9	50.2	(1.5)	232.6
Small-cap securities	35.1	14.5		49.6
<i>Total equity securities</i>	219.0	64.7	(1.5)	282.2
Other invested assets	64.6	18.0		82.6
<i>Total available-for-sale securities</i>	\$ 2,315.0	131.7	(15.2)	2,431.5

(\$ millions)

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
At December 31, 2010:				
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 450.5	12.9	(2.3)	461.1
Obligations of states and political subdivisions	916.6	23.6	(6.6)	933.6
Corporate securities	136.3	6.2	(0.1)	142.4
U.S. government agencies residential mortgage-backed securities	358.9	8.4	(3.7)	363.6
<i>Total fixed maturities</i>	1,862.3	51.1	(12.7)	1,900.7
Equity securities:				
Large-cap securities	167.1	45.5	(1.5)	211.1

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Small-cap securities	33.1	12.0		45.1
<i>Total equity securities</i>	200.2	57.5	(1.5)	256.2
Other invested assets	64.4	15.3		79.7
<i>Total available-for-sale securities</i>	\$ 2,126.9	123.9	(14.2)	2,236.6

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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)

The following tables set forth the Company's gross unrealized losses and fair value on its investments by lot, aggregated by investment category and length of time for individual securities that have been in a continuous unrealized loss position at March 31, 2011 and December 31, 2010:

(\$ millions, except # of positions)	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
At March 31, 2011:									
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$ 172.7	\$ (3.0)	47	\$	\$		\$ 172.7	\$ (3.0)	47
Obligations of states and political subdivisions	246.5	(5.7)	95				246.5	(5.7)	95
Corporate securities	30.9	(0.3)	14				30.9	(0.3)	14
U.S. government agencies residential mortgage-backed securities	163.1	(4.2)	44	17.1	(0.5)	9	180.2	(4.7)	53
<i>Total fixed maturities</i>	613.2	(13.2)	200	17.1	(0.5)	9	630.3	(13.7)	209
Large-cap equity securities	21.0	(1.0)	7	3.6	(0.5)	2	24.6	(1.5)	9
<i>Total temporarily impaired securities</i>	\$ 634.2	\$ (14.2)	207	\$ 20.7	\$ (1.0)	11	\$ 654.9	\$ (15.2)	218

(\$ millions, except # of positions)	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
At December 31, 2010:									
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$ 102.0	\$ (2.3)	25	\$	\$		\$ 102.0	\$ (2.3)	25
Obligations of states and political subdivisions	239.0	(6.6)	92				239.0	(6.6)	92
Corporate securities	12.6	(0.1)	5				12.6	(0.1)	5
U.S. government agencies residential mortgage-backed securities	116.6	(3.0)	26	20.3	(0.7)	9	136.9	(3.7)	35

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<i>Total fixed maturities</i>	470.2	(12.0)	148	20.3	(0.7)	9	490.5	(12.7)	157
Large-cap equity securities	14.8	(1.4)	6	2.2	(0.1)	1	17.0	(1.5)	7
<i>Total temporarily impaired securities</i>	\$ 485.0	\$ (13.4)	154	\$ 22.5	\$ (0.8)	10	\$ 507.5	\$ (14.2)	164

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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)

The following table sets forth the realized losses related to other-than-temporary impairments on the Company's investment portfolio recognized for the three months ended March 31, 2011 and 2010:

<i>(\$ millions)</i>	Three months ended March 31	
	2011	2010
Equity securities:		
Large-cap securities	\$	0.3
Small-cap securities	0.1	0.5
	 	