PICO HOLDINGS INC /NEW
Form 10-K/A
May 27, 2005

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A

Amendment No. 1

(MARK ONE)

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004

OR

o 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 0-18786

PICO HOLDINGS, INC.
(Exact Name of Registrant as Specified in its Charter)

California	**94-2723335**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

875 Prospect Street, Suite 301
La Jolla, California 92037
(Address of Principal Executive Offices)

Registrant s Telephone Number, Including Area Code (858) 456-6022

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, $.001 Par Value
(Title of Class)

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III or this Form 10-K/A or any amendment to this Form 10-K/A. þ

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes þ No o

Approximate aggregate market value of the registrant s voting and non-voting common equity held by non-affiliates of the registrant (based on the closing sales price of such stock as reported in the NASDAQ National Market) on the last business day of the registrant s most recently completed second fiscal quarter, was $106,209,458.

On March 9, 2005, the registrant had 12,366,440 shares of common stock, $.001 par value, outstanding, excluding 3,228,261 shares of common stock which are held by the registrant s subsidiaries.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Definitive Proxy Statement to be filed with the Commission pursuant to Regulation 14A in connection with the registrant s 2005 Annual Meeting of Stockholders, to be filed subsequent to the date hereof, are incorporated by reference into Part III of this Report. Such Definitive Proxy Statement will be filed with the Securities and Exchange Commission not later than 120 days after the conclusion of the registrant s fiscal year ended December 31, 2004.

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PICO HOLDINGS, INC.

ANNUAL REPORT ON FORM 10-K/A

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2005 Restatement

Overview:

We are filing an amendment to PICO Holdings, Inc. Annual Report on Form 10-K/A for the year ended December 31, 2004, to amend and restate footnote disclosure with respect to stock-based compensation related to our stock appreciation rights. The restatement has no effect on our financial condition, results of operations and cash flows.

For convenience and ease of reference, we are filing this Form 10-K/A in its entirety, as amended. However, this amendment amends and restates only those items of the previously filed 10-K which have been affected by the restatement as noted above. In order to preserve the nature and character of the disclosures set forth in such items as originally filed, no attempt has been made in this amendment to modify or update the disclosures in the original Form 10-K except as required to reflect the effects of the restatement. As a result, this Form 10-K/A contains forward-looking information, which has not been updated for events subsequent to the date of the original filing, and the Company directs you to its SEC filings made subsequent to that original filing date for additional information.

We have also restated our Quarterly Report on Form 10-Q/A for the three months ended March 31, 2005, which is being amended and re-filed as of the date hereof to restate the same disclosure item noted above.

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PART I

This Annual Report on Form 10-K/A (including the Management s Discussion and Analysis of Financial Condition and Results of Operations section) contains forward-looking statements regarding our business, financial condition, results of operations and prospects, including, without limitation, statements about our expectations, beliefs, intentions, anticipated developments, and other information concerning future matters. Words such as expects, anticipates, intends, plans, believes, seeks, estimates and similar expressions variations of such words are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this Annual Report on Form 10-K/A.

Although forward-looking statements in this Annual Report on Form 10-K/A reflect the good faith judgment of our management, such statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and the actual results and outcomes could differ from those discussed in or anticipated by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those discussed under the heading Risk Factors below, as well as those discussed elsewhere in this Annual Report on Form 10-K/A. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Annual Report on Form 10-K/A. We undertake no obligation to revise or update any forward-looking statements in order to reflect any event or circumstance that may arise after the date of this Annual Report on Form 10-K/A. Readers are urged to carefully review and consider the various disclosures made in this Annual Report, which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.

ITEM 1. BUSINESS

Introduction

PICO Holdings, Inc. (PICO and its subsidiaries are referred to as PICO, the Company, we, and our) is a diversif holding company. PICO seeks to acquire businesses and interests in businesses which we identify as undervalued based on fundamental analysis that is, our assessment of what the business is worth, based on the private market value of its assets, earnings, and cash flow. We prefer long-established businesses, with a history of operating successfully through industry cycles, recessions and geo-political disruptions, in basic, old economy industries. Typically, the business will be generating free cash flow and have a low level of debt, or, alternatively, strong interest coverage ratios or the ability to realize surplus assets. As well as being undervalued, the business must have special qualities such as unique assets, a potential catalyst for change, or be in an industry with attractive economics. We are also interested in acquiring businesses and interests in businesses where there is significant unrecognized value in land and other tangible assets.

We have acquired businesses and interests in businesses by the acquisition of private companies, and the purchase of shares in public companies, both directly through participation in financing transactions and through open market purchases. When we buy a business or an interest in a business, we have a long-term horizon, typically 5 years or more. Selected acquisitions may become core operations; however, we are prepared to sell businesses if the price received exceeds the return we expect to earn if we retain ownership. We expect that most of our businesses and interests in businesses will eventually be sold to other companies in the same industry seeking to expand or gain economies of scale.

Our objective is to generate superior long-term growth in shareholders equity, as measured by book value per share. Over time, we anticipate that most of our net income and growth in shareholders equity will come from realized gains on the sale of businesses and interests in businesses, as opposed to ongoing operating earnings. Consequently, we anticipate that PICO s earnings will fluctuate from year to year, and that the results for any one year are not necessarily indicative of our future performance.

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Our business is separated into five major operating segments: Water resource & water storage operations, real estate operations in Nevada, Business Acquisitions & Financing, Insurance Operations in Run Off, and the operations of HyperFeed Technologies, Inc. (HyperFeed). Our Business Acquisitions & Financing segment contains businesses, interests in businesses, and other parent company assets. Each of these business segments is discussed in greater detail below.

Currently our major consolidated subsidiaries are:

Vidler Water Company, Inc. (Vidler), which develops and owns water rights and water storage operations in the southwestern United States, primarily in Nevada and Arizona;

Nevada Land & Resource Company, LLC (Nevada Land), which owns approximately 1 million acres of land in Nevada, and the mineral rights and water rights related to the property;

Citation Insurance Company, which is running off its historical property & casualty and workers compensation loss reserves, and Physicians Insurance Company of Ohio, which is running off its medical professional liability loss reserves; and

HyperFeed Technologies, which became a 51%-owned subsidiary in 2003. HyperFeed is a developer and provider of software, ticker plant technologies, and managed services to the financial markets industry.

In 2003, we closed on the sale of Sequoia Insurance Company (Sequoia), which is accounted for in our consolidated financial statements for 2003 and prior years as a discontinued operation. *See Discontinued Operations.*

The address of our main office is 875 Prospect Street, Suite 301, La Jolla, California 92037, and our telephone number is (858) 456-6022.

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports are made available on our website (www.picoholdings.com) as soon as reasonably practicable after the reports are electronically filed with the SEC. Our website also contains other material about PICO, and links to other sites, including some of the companies with which we are associated.

History

PICO was incorporated in 1981 and began operations in 1982. The company was known as Citation Insurance Group until a reverse merger with Physicians Insurance Company of Ohio on November 20, 1996. After the reverse merger, the former shareholders of Physicians owned approximately 80% of Citation Insurance Group, the Board of Directors and management of Physicians replaced their Citation counterparts, and Citation Insurance Group changed its name to PICO Holdings, Inc. You should be aware that some data on Bloomberg and other information services pre-dating the reverse merger relates to the old Citation Insurance Group only, and does not reflect the performance of Physicians prior to the merger.

Subsidiary Companies & Major Operating Segments

The following section describes our subsidiaries and operating segments. Unless otherwise indicated, we own 100% of each subsidiary.

Vidler Water Company, Inc.

Vidler is the leading private company in the water resource development business in the southwestern United States. PICO identified water resource development in the Southwest as an attractive business opportunity due to the continued growth in demand for water resulting from population growth, economic development, environmental requirements, and the claims of Native Americans. We develop new sources of water for municipal and industrial use, and necessary storage infrastructure to facilitate the efficient allocation of available water supplies. Vidler is not a water utility, and does not intend to enter into regulated utility activities.

The inefficient allocation of available water between agricultural users and municipal or industrial users, or the lack of available known water supply in a particular location, provide opportunities for Vidler:

- the majority of water rights are currently owned or controlled by agricultural users, and in many locations there are insufficient water rights owned or controlled by municipal and industrial users to meet present and future demand;

- certain areas of the Southwest experiencing rapid growth have insufficient supplies of known water to support future growth. Vidler identifies and develops new water supplies for communities with no other known water resources to support future growth;

- currently there are not effective procedures in place for the transfer of water from private parties with excess supply in one state to end-users in other states. However, regulations and procedures are steadily being developed to facilitate the interstate transfer of water; and

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infrastructure to store water will be required to accommodate and allow interstate transfer, and transfers from wet years to dry years. Currently there is limited storage capacity in place.

We entered the water resource development business with the acquisition of Vidler in 1995. At the time, Vidler owned a limited quantity of water rights and related assets in Colorado. Since then, Vidler has acquired or developed:

additional water rights and related assets, predominantly in Arizona and Nevada. Vidler seeks to acquire water rights at prices consistent with their current use, with the expectation of an increase in value if the water right can be converted to a higher use. A water right is the legal right to divert water and put it to beneficial use. Water rights are assets which can be bought and sold. In some states, the use of the water can also be leased. The value of a water right depends on a number of factors, including location, the seniority of the right, and whether or not the right is transferable. The majority of Vidler s water rights are in Nevada and Arizona, the two states which are leading the nation in population growth and new home construction. Our objective is to monetize our water rights for municipal and industrial use in Arizona and Nevada. Typically, our water rights are the most competitive source of water to support new growth in municipalities and new industry in Arizona and Nevada; and

a water storage facility in Arizona and an interest in Semitropic, a water storage facility in California. At December 31, 2004, Vidler had net recharge credits representing approximately 63,000 acre-feet of water in storage on its own account at the Vidler Arizona Recharge Facility.

Vidler is engaged in the following activities:

supplying water to end-users in the Southwest, namely water utilities, municipalities, developers, or industrial users. The source of water could be from identifying and developing a new water supply, or a change in the use of water from agricultural to municipal and industrial use; and

development of storage and distribution infrastructure to generate cash flow from the purchase and storage of water for resale, and charging customers fees for recharge, or placing water into storage.

After an acquisition and development phase spanning several years, Vidler completed its first significant sales of water rights for industrial use in 2001 and municipal use in 2002. Vidler s priority is to either monetize or develop recurring cash flow from its most important assets by:

securing supply contracts utilizing its water rights in Arizona and Nevada; and

storing additional water at the Vidler Arizona Recharge Facility, and providing water supplies from net recharge credits already in storage.

Vidler has also entered into partnering arrangements with parties who have water assets but lack the capital or expertise to commercially develop these assets. Vidler continues to explore additional partnering opportunities throughout the Southwest.

This table details the water rights and water storage assets owned by Vidler at December 31, 2004. Please note that this is intended as a summary, and that some numbers are rounded. Item 7 of this Form 10-K/A contains more detail about these assets, recent developments affecting them, and the current outlook.

An acre-foot is a unit commonly used to measure the volume of water, being the volume of water required to cover one acre to a depth of one foot. As a rule of thumb, one acre-foot of water would sustain two families of four persons each for one year.

Name of asset & approximate location	Brief Description	Present commercial use
WATER RIGHTS		
Arizona:		
Harquahala Valley ground water basin La Paz & Maricopa Counties 75 miles northwest of metropolitan Phoenix	15,023 acres of land, plus 3,149 acres under Option	Leased to farmers
	35,699 acre-feet of transferable ground water, plus 9,365 acre-feet under option	
	State legislation allows Harquahala Valley ground water to be made available as assured municipal water supply to cities and communities in Arizona through agreements with the Central Arizona Ground Water Replenishment District	

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Nevada:

Fish Springs Ranch, LLC (51% interest) & **V&B, LLC (50% interest)**	8,600 acres of deeded ranchland	Vidler is currently farming the property. Cattle graze on part of the property on a revenue-sharing basis
Washoe County, 40 miles north of Reno	8,000 acre-feet of permitted water rights, which are transferable to the Reno/Sparks area	
Lincoln County Agreement	Applications* for more than 100,000 acre-feet of water rights through an agreement with Lincoln County, of which it is currently anticipated that up to 40,000 acre-feet will be permitted and put to use in Lincoln County/northern Clark County.	Partnership to supply water to the planned Coyote Springs development, which will be located approximately 40 miles north of Las Vegas. The developer expects the first houses to go up in 2007. The delivery of the water is expected to occur over the build-out of the project, which could be 25 years or more.
	2,100 acre-feet of permitted water rights in the Tule Desert Groundwater Basin	
	570 acre-feet of permitted water rights at Meadow Valley, located in Lincoln and Clark counties	
Clark County		
Sandy Valley Near the Nevada / California state line In the Interstate 15 corridor	415 acre-feet of permitted water rights Application for 1,000 acre-feet of water rights	

Muddy River water rights Approximately 35 miles east of Las Vegas, in the Interstate 15 corridor	221 acre-feet of water rights, plus approximately 46 acre-feet under option _*The numbers indicated for water rights applications are the maximum amount which we have filed for. In some cases, we anticipate that the actual permits received will be for smaller quantities._	
Colorado:		
Colorado water rights	94 acre-feet of senior water rights	Agreement to sell 94 acre-feet of senior water rights to the City of Golden, Colorado over a period of 11 years
	185 acre-feet of senior water rights	66 acre-feet leased. The balance is available for sale or lease. Approximately 5.7 acre-feet were sold to residential users in Summit County in 2004.
WATER STORAGE		
Arizona:		
Vidler Arizona Recharge Facility Harquahala Valley, Arizona	An underground water storage facility with estimated capacity exceeding 1 million acre-feet and annual recharge capability of up to 35,000 acre-feet	Vidler is currently buying water and storing it on its own account. At December 31, 2004, Vidler had net recharge credits equivalent to approximately 63,000 acre-feet of water in

		Storage at the Arizona Recharge Facility, as well as 3,250 acre-feet of water purchased but not yet recharged. In addition, Vidler has ordered approximately 35,750 acre-feet of water for purchase and recharge in 2005.
California:		
Semitropic water storage facility	The right to store 30,000 acre-feet of water underground until 2035. This includes the right to minimum guaranteed recovery of approximately 2,700 acre-feet of water every year, and the right to recovery up to approximately 6,800 acre-feet in one year in certain circumstances	

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Nevada Land & Resource Company, LLC

In April 1997, PICO paid $48.6 million to acquire Nevada Land, which at the time owned approximately 1,352,723 acres of deeded land in northern Nevada, and the water, mineral, and geothermal rights related to the property. Much of Nevada Land s property is checker-boarded in square mile sections with publicly owned land. The lands generally parallel the Interstate 80 corridor and the Humboldt River from Fernley, in western Nevada, to Elko County, in northeast Nevada.

Nevada Land is the largest private landowner in the state of Nevada. According to census data, Nevada has experienced the most rapid population growth of any state in the United States for the past 18 years in a row. The population of Nevada increased 66% in the 10 years ended April 1, 2000, and increased another 15.7%, to approximately 2.3 million people, from 2000 to 2004. Most of the growth is centered in southern Nevada, which includes the city of Las Vegas and surrounding municipalities. Land available for private development in Nevada is relatively scarce, as governmental agencies own approximately 87% of the land in Nevada.

Before we acquired Nevada Land, the property had been under the ownership of a succession of railway companies, to whom it was a non-core asset. Accordingly, when we acquired the company, we believed that the commercial potential of the property had not been maximized.

After acquiring Nevada Land, we completed a highest and best use study which divided the land into seven major categories. We developed strategies to maximize the value of each type of asset, with the objective of monetizing assets once they had reached their highest and best use. These strategies include:

- the sale of land and water rights. There is demand for land and water for a variety of purposes including residential development, residential estate living, farming, ranching, and from industrial users;
- transactions where Nevada Land exchanges parcels of its land in return for land owned by other parties;
- the development of water rights. Nevada Land has applied for additional water rights on land it owns and intends to improve. Where water rights are permitted, we anticipate that the value, productivity, and marketability of the related land will increase;
- the development of land in and around growing municipalities; and
- the management of mineral rights.

A cost basis has been assigned to each category of land and other asset, which, in aggregate, equals Nevada Land s original purchase price.

During the period from April 23, 1997 to December 31, 2004, Nevada Land received consideration of approximately $33.5 million from the sale and exchange of land and the sale of water rights. This is comprised of $31.6 million from the sale of land, $752,000 of cash and land received in an exchange transaction, and $1.1 million from the sale of water rights related to land that was sold. Over this period, we have divested approximately 363,000 acres of land at an average price of $92 per acre, which compares to our average basis of $42 in the acres disposed of. The average gross margin percentage on the disposal of land and water rights over this period is 54.1%. The average cost for the total land, water, and mineral assets acquired with Nevada Land was $35 per acre.

At December 31, 2004, Nevada Land owned approximately 992,000 acres of former railroad land. In addition to the former railroad property, Nevada Land has acquired:

17,558 acres of land in a land exchange with a private landowner. This land is contiguous with Native American tribal lands and is culturally sensitive; and

Spring Valley Ranches, which is located approximately 40 miles east of Ely in White Pine County, Nevada. This property was purchased out of bankruptcy proceedings in 2000. We believe that the land has significant environmental value. The real estate assets consist of approximately 8,626 acres of deeded land and 500,000 acres of Forest Service and Bureau of Land Management allotment land. There are 18,829 acre-feet of agricultural water rights related to the property.

We anticipate continuing to sell smaller parcels of land for residential, agricultural, and industrial use, and that significantly larger parcels of land which has environmental, cultural, or historical value, will be divested through exchange-type transactions. These transactions could be structured as outright sales or as exchanges for land which is either more marketable or suitable for future development.

In recent years, Nevada Land has filed additional applications for approximately 70,480 acre-feet of water rights on the Company s lands. The applications consist of:

on the former railroad lands, approximately 4,797 acre-feet of water rights have been certificated and permitted, and applications are pending for approximately 42,840 acre-feet of water use for agricultural, municipal, and industrial use; and

27,640 acre-feet of water rights for the beneficial use of irrigating another 6,910 acres of Spring Valley Ranches.

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Business Acquisitions and Financing

Our Business Acquisitions and Financing segment contains businesses, interests in businesses, and other parent company assets.

PICO seeks to acquire businesses which we identify as undervalued based on fundamental analysis that is, our assessment of what the business is worth, based on the private market value of its assets, earnings, and cash flow. We prefer long-established businesses, with a history of operating successfully through industry cycles, recessions and wars, in basic old economy industries. Typically, the business will be generating free cash flow and have a low level of debt, or, alternatively, strong interest coverage ratios or the ability to realize surplus assets. As well as being undervalued, the business must have special qualities such as unique assets, a potential catalyst for change, or be in an industry with attractive economics. We are also interested in acquiring businesses and interests in businesses where there is significant unrecognized value in land and other tangible assets.

We have acquired businesses and interests in businesses through the acquisition of private companies, and the purchase of shares in public companies, both directly through participation in financing transactions and through open market purchases. When we buy a company, we have a long-term horizon, typically 5 years or more; however, we are prepared to sell companies if the price received exceeds the return we expect to earn if we retain ownership. We expect that most of our interests in businesses will eventually be sold to other companies in the same industry seeking to expand or gain economies of scale. Consistent with our focus on increasing our shareholders equity and book value per share, we anticipate that most of the return from our interests in businesses will come from realized gains on the ultimate sale of our holding, rather than dividends, equity income, or operating earnings during our ownership.

When we acquire an interest in a public company, we are prepared to play an active role, for example encouraging companies to use proper financial criteria when making capital expenditure decisions, or by providing financing or strategic input.

At the time we acquire an interest in a public company, we believe that the intrinsic value of the underlying business significantly exceeds the current market capitalization. The gap between market price and intrinsic value may persist for several years, and the stock price may decline while our estimate of intrinsic value is stable or increasing. Sometimes, the gap is not eliminated until another party attempts to acquire the company, as was the case with our holding in Australian Oil & Gas Corporation Limited (AOG).

Between 1998 and 2002, we became the largest shareholder in AOG, an international provider of drilling services. We identified AOG as undervalued as rig utilization, which is critical to earnings and cash flow for drilling companies, had begun to recover in the U.S., but was still near cyclical lows in the international markets where AOG operates. Historically, there has been a time lag between recovery in rig utilization in the U.S. and in international markets.

We acquired our interest, at an average cost of approximately A$1.35 per share, through open market purchases, the reinvestment of dividends, and assisting AOG with a financing in early 2002. AOG had secured two major new contracts with multinational oil companies, but needed to raise capital to purchase equipment necessary to perform the contracts. We provided AOG with a bridging loan facility, which was repaid with the proceeds of a rights offering which we partly underwrote. After AOG s expanded activities and earnings base became apparent, Ensign (Australia) Holdings Pty. Limited, a subsidiary of a Canadian oil services company which was already a shareholder in AOG, made a takeover offer for AOG at A$1.70 per share. Ensign was overbid by a number of other companies, before lifting its bid several times and eventually acquiring AOG in July 2002 for A$2.70 per share. Immediately prior to Ensign s first bid, AOG shares had been trading at A$1.40. We believe that our active participation as shareholders was instrumental in achieving this positive outcome.

PICO began to invest in European companies in 1996. We have been accumulating shares in a number of undervalued asset-rich companies, particularly in Switzerland, which we believe will benefit from pan-European consolidation. At December 31, 2004, the market value (and carrying value) of our European portfolio was $67.9 million. This includes our 22.3% interest in Jungfraubahn Holding AG (Jungfraubahn), which had a market value (and carrying value) of $40.8 million at the end of 2004.

Before a substantial acquisition is made, after significant research and analysis, we must be convinced that for an acceptable level of risk there is sufficient value to provide the opportunity for superior returns. We also have a small portfolio of alternative investments where intrinsic value is more speculative, in an attempt to capitalize on areas of potentially greater growth without incurring undue risk. At December 31, 2004, the total before-tax carrying value of this portfolio was less than $500,000.

During the late 1990 s, the businesses we acquired were primarily private companies and foreign public companies. During this period, we perceived that acquisitions in these areas carried less downside risk and offered greater upside potential than the acquisition opportunities available among publicly traded companies in North America.

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In the foreseeable future, our acquisition efforts are likely to be focused on domestic and foreign public companies, where we perceive greater scope for value creation than with private companies.

Insurance Operations in Run Off

Our Insurance Operations in Run Off segment is comprised of Physicians Insurance Company of Ohio and Citation Insurance Company.

Physicians Insurance Company of Ohio

Until 1995, Physicians and The Professionals Insurance Company (Professionals) wrote medical professional liability insurance, mostly in the state of Ohio.

Due to persistent uneconomic pricing by competitors, Physicians and Professionals were unable to generate adequate premium volume in 1994 and the early part of 1995. Faced with these market conditions, and the opportunity for higher returns from activities other than medical professional liability insurance, in 1995 we concluded that maximum value would be obtained by placing Physicians in run off. This means handling the claims arising from its historical business, but not writing new business. In addition, the future book of business essentially the opportunity to renew expiring policies was sold for $6 million in cash.

After Physicians went into run off, the company expanded its insurance operations by acquisition:

in 1995, we purchased Sequoia Insurance Company, which primarily wrote commercial lines of insurance in California and Nevada. After the acquisition, we re-capitalized Sequoia, which provided the capital to support growth in the book of business; and

in 1996, Physicians completed a reverse merger with the parent company of Citation Insurance Company. At that time, Citation wrote various lines of commercial property and casualty insurance and workers compensation insurance, primarily in California and Arizona. The operations of Sequoia and Citation were combined, and eventually the business previously written by Citation was transferred to Sequoia. At the end of 2000, Citation ceased writing business and went into run off. In 2003, we sold Sequoia Insurance Company. *See Discontinued Operations later in Item 1.*

Physicians and Citation obtain the funds to pay claims from the maturity of fixed-income securities, the sale of investments, and collections from reinsurance companies (that is, specialized insurance companies who share in our claims risk).

Typically, most of the revenues of an insurance company in run off come from investment income on funds held as part of the insurance business. During the run off process, as claims are paid, both the loss reserve liabilities and the corresponding fixed-income investment assets decrease. Since interest income in this segment will decline over time, we are attempting to minimize segment overhead expenses as much as possible. For example, in recent years we have reduced head count and office space, and merged Professionals into Physicians, which simplified administration and reduced costs.

Although we regularly evaluate the strategic alternatives, we currently believe that the most advantageous option is for Physicians own claims personnel to manage the run off. We believe that this will ensure a high standard of claims handling for our policyholders and, from the Company s perspective, ensure the most careful examination of claims made to minimize loss and loss adjustment expense payments. If we were to reinsure Physicians entire book of business and outsource claims handling, this would involve giving up management of the corresponding investment assets.

Administering our own run off also provides us with the following opportunities:

we retain management of the associated investment portfolios. After we resumed direct management of our insurance company portfolios in 2000, we believe that the return on our portfolio assets has been attractive in absolute terms, and very competitive in relative terms. The fixed-income securities and unaffiliated common stocks in the run off insurance company investment portfolios generated total returns upwards of 20% in 2003 and 22% in 2004, including total returns for the stocks component in excess of 39% in 2003 and 41% in 2004. Since the claims reserves of the run off insurance companies effectively recognize the cost of paying and handling claims in future years, the investment return on the corresponding investment assets, less non-insurance expenses, will accrue to PICO. We aim to maximize this source of income; and

to participate in favorable development in our claims reserves if there is any, although this entails the corresponding risk that we could be exposed to unfavorable development.

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As the run off progresses, at an indeterminate time in the future, Physicians claims reserves may diminish to the point where it is more cost-effective to outsource claims handling to a third party administrator.

At December 31, 2004, Physicians had $16.4 million in medical professional liability loss reserves, net of reinsurance.

Citation Insurance Company

In 1996, Physicians completed a reverse merger with Citation s parent company. In the past, Citation wrote various lines of commercial property and casualty insurance and workers compensation insurance, primarily in California and Arizona.

After the merger was completed, we identified redundancy between Sequoia and Citation, and combined the operations of the two companies. After we assumed management of Citation, we tightened underwriting standards significantly and did not renew much of the business which Citation had written previously. Eventually all business in California and Nevada was transitioned to Sequoia, and at the end of 2000 Citation ceased writing business and went into run off.

Prior to the reverse merger, Citation had been a direct writer of workers compensation insurance. Since PICO did not wish to be exposed to that line of business, shortly after the merger was completed Citation reinsured 100% of its workers compensation business with a subsidiary, Citation National Insurance Company (CNIC), and sold CNIC to Fremont Indemnity Company (Fremont) in 1997. As part of the sale of CNIC, all assets and liabilities, including the assets which corresponded to the workers compensation reserves reinsured with CNIC, and all records, computer systems, policy files, and reinsurance arrangements were transferred to Fremont. Fremont merged CNIC into Fremont, and administered and paid all of the workers compensation claims which had been sold to it. From 1997 until the second quarter of 2003, Citation booked the losses reported by Fremont, and recorded an equal and offsetting reinsurance recoverable from Fremont, as an admitted reinsurer, for all losses and loss adjustment expenses. This resulted in no net impact on Citation s reserves and financial statements, and no net impact on PICO s consolidated financial statements.

On June 4, 2003, the California Department of Insurance obtained a conservation order over Fremont, and applied for a court order to liquidate Fremont. On July 2, 2003, the California Superior Court placed Fremont in liquidation. Since Fremont was no longer an admitted reinsurance company under the statutory basis of insurance accounting, Citation reversed the $7.5 million reinsurance recoverable from Fremont in both its statutory basis and GAAP basis financial statements in the three months ended June 30, 2003 and year ended December 31, 2003. Citation was unsuccessful in court action to recover deposits reported as held by Fremont for Citation s insureds.

In September 2004, Citation entered into a third-party administration agreement with Cambridge Integrated Services, Inc. to administer the claims handling and claims payment for Citation s workers compensation insurance run-off book of business.

At December 31, 2004, Citation had $22.3 million in loss reserves, net of reinsurance. Citation s loss reserves consist of $10.2 million for property and casualty insurance, principally in the artisans/contractors line of business, and $12.1 million for workers compensation insurance.

HyperFeed Technologies, Inc.

HyperFeed is a provider of ticker plant technologies and fully managed ticker plant services to the financial community. HyperFeed is a publicly traded company, based in Chicago, Illinois, and became a 51%-owned subsidiary of PICO Holdings on May 15, 2003, when we acquired direct ownership of a majority voting interest. HyperFeed became a separate reporting segment from May 15, 2003. Previously, HyperFeed was part of the Business Acquisitions & Financing segment.

PICO first invested in HyperFeed in 1995 through the purchase of common stock. We invested further capital as debt, which was later converted to equity, and received warrants for providing financing. In 2000, 2001, and 2002, we further increased our holding through open market purchases, the conversion of preferred stock, and the exercise of warrants. On May 15, 2003, PICO purchased an additional 443,622.9 HyperFeed common shares in a private placement for $1.2 million, or approximately $2.705 per share (adjusted for the August 2003 1:10 reverse stock split). PICO now owns 1,546,311.7 HyperFeed common shares, representing a voting ownership of approximately 51%.

During 2002 and 2003, HyperFeed restructured its operations, culminating in the sale of its consolidated market data feed customers to Interactive Data Corporation for $8.5 million on October 31, 2003.

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Discontinued Operations

Sequoia Insurance Company

On March 31, 2003, we closed on the sale of Sequoia. The gross sale proceeds were approximately $43.1 million, consisting of $25.2 million in cash and a dividend of $17.9 million. The dividend included the common stocks previously held in Sequoia s investment portfolio with a value of $16.4 million. The common stocks included in the dividend primarily consisted of a number of holdings in small-capitalization value stocks, which we believed were still undervalued based on the private market value of the underlying assets, earnings, and cash flow. These common stocks were added to the investment portfolio of Physicians, which was Sequoia s direct parent company.

Physicians acquired Sequoia in 1995. Sequoia s core business was property and casualty insurance in California and Nevada, focusing on the niche markets of commercial insurance for small to medium-sized businesses and farm insurance. Sequoia also wrote selected lines of personal insurance in California. During the period of our ownership, Sequoia s management applied a selective approach to underwriting, aiming to earn a profit from underwriting (that is, a profit before investment income), and implemented numerous initiatives to improve efficiency and reduce expenses. As a result, Sequoia consistently had loss ratios and combined ratios better than the industry averages. During 2000, 2001, and 2002, Sequoia generated increased average premiums per commercial policy, and significant growth in its book of business, with combined ratios of 106.3%, 105.4%, and 101.6%, in those respective years.

From April 1, 2000, when we resumed direct management of Sequoia s investment portfolio, the company s portfolio of unaffiliated stocks, bonds, and cash equivalents earned returns (that is, interest and dividend income plus realized and unrealized gains, before fees and taxes) of approximately 6.1% in the last nine months of 2000, 10.4% in 2001, 12.6% in 2002, and 2.5% in the first three months of 2003.

Despite these factors, Sequoia continued to generate a return on capital lower than our expectation, and we concluded that value would be maximized by sale of the company, particularly given the increasingly restrictive regulatory & rating environment, and the highly competitive marketplace.

HyperFeed Technologies, Inc.

During 2003, HyperFeed completed the sale of two businesses, which are now recorded as discontinued operations:

- its retail trading business, PCQuote.com, which was sold for $370,000 in June 2003; and

- its consolidated market data feed customers, which were sold to Interactive Data Corporation, for $8.375 million. HyperFeed received $7 million in cash on closing, and $500,000 during 2004. HyperFeed could realize an additional $875,000 during 2005 if, and when, milestones are met.

Employees

At December 31, 2004, PICO had 84 employees. A total of 9 employees were engaged in land and related mineral rights and water rights operations; 5 in water rights and storage operations; 3 in property and casualty insurance operations; 2 in medical professional liability operations; and 17 in holding company activities. HyperFeed Technologies, Inc. has 48 employees.

Executive Officers

The executive officers of PICO are as follows:

Name	Age	Position
Ronald Langley	60	Chairman of the Board, Director
John R. Hart	45	President, Chief Executive Officer and Director
Richard H. Sharpe	49	Chief Operating Officer
James F. Mosier	57	General Counsel and Secretary
Maxim C. W. Webb	43	Chief Financial Officer and Treasurer
W. Raymond Webb	43	Vice President, Investments
John T. Perri	35	Vice President, Finance

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Except for Maxim C. W. Webb, W. Raymond Webb and John T. Perri, each executive officer of PICO was an executive officer of Physicians prior to the 1996 merger between Physicians Insurance Company of Ohio and Citation Insurance Group, the predecessors to PICO Holdings, Inc. Each became an officer of PICO in November 1996 as a result of the merger. Maxim C. W. Webb was an officer of Global Equity Corporation and became an officer of PICO upon the effective date of the PICO/Global Equity Corporation Combination in December 1998. W. Raymond Webb and John T. Perri were elected as officers of PICO in April 2003.

Mr. Langley has been Chairman of the Board of PICO since November 1996 and of Physicians since July 1995. Mr. Langley has been a Director of PICO since November 1996 and a Director of Physicians since 1993. Mr. Langley has been a Director of HyperFeed Technologies, Inc., formerly, PC Quote, Inc., (HyperFeed) since 1995 and a Director of Jungfraubahn Holding AG since 2000.

Mr. Hart has been President and Chief Executive Officer of PICO since November 1996 and of Physicians since July 1995. Mr. Hart has been a Director of PICO since November 1996 and a Director of Physicians since 1993. Mr. Hart has been a Director of HyperFeed since 1997.

Mr. Sharpe has served as Chief Operating Officer of PICO since November 1996, and in various executive capacities since joining Physicians in 1977.

Mr. Mosier has served as General Counsel and Secretary of PICO since November 1996 and of Physicians since October 1984 and in various other executive capacities since joining Physicians in 1981.

Mr. Maxim Webb has been Chief Financial Officer and Treasurer of PICO since May 14, 2001. Mr. Webb served in various capacities with the Global Equity Corporation group of companies since 1993, including Vice President, Investments of Forbes Ceylon Limited from 1994 through 1996. Mr. Webb became an officer of Global Equity Corporation in November 1997 and Vice President, Investments of PICO on November 20, 1998.

Mr. Raymond Webb has been with the Company since August 1999 as Chief Investment Analyst and became Vice President, Investments in April 2003.

Mr. Perri has been Vice President, Finance of PICO since August 2003 and served in various capacities since joining the Company in 1998, including Financial Reporting Manager and Corporate Controller.

RISK FACTORS

In addition to the risks and uncertainties discussed in certain sections of Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and elsewhere in this document, the following risk factors should be considered carefully in evaluating PICO and its business. The statements contained in this Form 10-K/A that are not purely historical are forward-looking statements within the meaning of Section 27A of the Exchange Act, including statements regarding our expectations, beliefs, intentions, plans or strategies regarding the future. All forward-looking statements included in this document are based on information available to us on the date thereof, and we assume no obligation to update any such forward-looking statements.

Because our operations are diverse, analysts and investors may not be able to evaluate our Company adequately, which may negatively influence our share price.

PICO is a diversified holding company with operations in land and related water rights and mineral rights; water rights and water storage; insurance operations in run-off; and business acquisitions and financing. Each of these areas is unique, complex in nature, and difficult to understand. In particular, the water resource business is a developing industry within the western United States with very little historical data, very few experts and a limited following of analysts. Because we are complex, analysts and investors may not be able to adequately evaluate our operations, and PICO in total. This could cause them to make inaccurate evaluations of our stock, or to overlook PICO, in general. These factors could have a negative impact on the trading volume and price of our stock.

If we do not successfully locate, select and manage investments and acquisitions, or if our investments or acquisitions otherwise fail or decline in value, our financial condition could suffer.

We invest in businesses that we believe are undervalued or that will benefit from additional capital, restructuring of operations or improved competitiveness through operational efficiencies. If a business in which we invest fails or its market value declines, we could experience a material adverse effect on our business, financial condition, the results of operations and cash flows. Additionally, our failure to successfully locate, select and manage investment and acquisition opportunities could have a material adverse effect on our business, financial condition, the results of operations and cash flows. Such business failures, declines in market values, and/or failure to successfully locate, select and manage investments and acquisitions could result in an inferior return on shareholders equity. We could also lose part or all of our capital in these businesses and experience reductions in our net income, cash flows, assets and shareholders equity.

Failure to successfully manage newly acquired companies could adversely affect our business.

Our management of the operations of acquired businesses requires significant efforts, including the coordination of information technologies, research and development, sales and marketing, operations, and finance. These efforts result in additional expenses and involve significant amounts of management s time. To successfully manage newly acquired companies, we must, among other things, continue to attract and retain key management and other personnel. The diversion of the attention of management from the day-to-day operations, or difficulties encountered in the integration process, could have a material adverse effect on our business, financial condition, and the results of operations and cash flows. If we fail to integrate acquired businesses into our operations successfully, we may be unable to achieve our strategic goals and the value of your investment could suffer.

Our acquisitions may not achieve expected rates of return, and we may not realize the value of the funds we invest.

We will continue to make selective acquisitions, and endeavor to enhance and realize additional value to these acquired companies through our influence and control. You will be relying on the experience and judgment of management to locate, select and develop new acquisition and investment opportunities. Any acquisition could result in the use of a significant portion of our available cash, significant dilution to you, and significant acquisition-related charges. Acquisitions may also result in the assumption of liabilities, including liabilities that are unknown or not fully known at the time of the acquisition, which could have a material adverse effect on us.

We do not know of any reliable statistical data that would enable us to predict the probability of success or failure of our acquisitions and investments, or to predict the availability of suitable investments at the time we have available cash. We may not be able to find sufficient opportunities to make this business strategy successful. Additionally, when any of our acquisitions does not achieve acceptable rates of return or we do not realize the value of the funds invested, we may write-down the value of such acquisitions or sell the acquired businesses at a loss. We have made a number of acquisitions in the past that have been highly successful, and we have also made acquisitions that have lost either part or all of the capital invested. Further details of realized and unrealized gains and losses can be found in the Notes 1, 2, 3 and 4 to the accompanying consolidated financial statements and in Item 7A in this Form 10-K/A. Our ability to achieve an acceptable rate of return on any particular investment is subject to a number of factors which are beyond our control, including increased competition and loss of market share, quality of management, cyclical or uneven financial results, technological obsolescence, foreign currency risks and regulatory delays.

We may make investments and acquisitions that may yield low or negative returns for an extended period of time, which could temporarily or permanently depress our return on investments.

We generally make investments and acquisitions that tend to be long term in nature. We acquire businesses that we believe to be undervalued or may benefit from additional capital, restructuring of operations or management or improved competitiveness through operational efficiencies with our existing operations. We may not be able to develop acceptable revenue streams and investment returns. We may lose part or all of our investment in these assets. The negative impacts on cash flows, income, assets and shareholders equity may be temporary or permanent. We make investments for the purpose of enhancing and realizing additional value by means of appropriate levels of shareholder influence and control. This may involve restructuring of the financing or management of the entities in which we invest and initiating or facilitating mergers and acquisitions. These processes can consume considerable amounts of time and resources. Consequently, costs incurred as a result of these investments and acquisitions may exceed their revenues and/or increases in their values for an extended period of time until we are able to develop the potential of these investments and acquisitions and increase the revenues, profits and/or values of these investments. Ultimately, however, we may not be able to develop the potential of these assets that we originally anticipated.

We may not be able to sell our investments when it is advantageous to do so and we may have to sell these investments at a discount.

No active market exists for some of the companies in which we invest. We invest in private companies that are not as liquid as investments in public companies. Additionally, some of our investments may be in restricted or unregistered stock of U.S. public companies. Moreover, even our investments for which there is an established market are subject to dramatic fluctuations in their market price. These illiquidity factors may affect our ability to divest some of our investments and could affect the value that we receive for the sale of such investments.

Our acquisitions of and investments in foreign companies subject us to additional market and liquidity risks which could affect the value of our stock.

We have acquired, and may continue to acquire, shares of stock in foreign public companies. Typically, these foreign companies are not registered with the SEC and regulation of these companies is under the jurisdiction of the relevant foreign country. The respective foreign regulatory regime may limit our ability to obtain timely and comprehensive financial information for the foreign companies in which we have invested. In addition, if a foreign company in which we invest were to take actions which could be deleterious to its shareholders, foreign legal systems may make it difficult or time-consuming for us to challenge such actions. These factors may affect our ability to dispose of our foreign investments or realize the full fair value of our foreign investments. In addition, investments in foreign countries may give rise to complex cross-border tax issues. We aim to manage our tax affairs efficiently, but given the complexity of dealing with domestic and foreign tax jurisdictions, we may have to pay tax in both the U.S. and in foreign countries, and we may be unable to offset any U.S. tax liabilities with foreign tax credits. If we are unable to manage our foreign tax issues, our financial condition and the results of operations and cash flows could be adversely affected.

Variances in physical availability of water, along with environmental and legal restrictions and legal impediments, could impact profitability from our water rights.

The water rights held by us and the transferability of these rights to other uses and places of use are governed by the laws concerning water rights in the states of Arizona, Colorado and Nevada. The volumes of water actually derived from the water rights applications or permitted rights may vary considerably based upon physical availability and may be further limited by applicable legal restrictions. As a result, the amounts of acre-feet anticipated from the water rights applications or permitted rights do not in every case represent a reliable, firm annual yield of water, but in some cases describe the face amount of the water right claims or management s best estimate of such entitlement. Legal impediments may exist to the sale or transfer of some of these water rights, which in turn may affect their commercial value. If we were unable to transfer or sell our water rights, we will not be able to make a profit, we will not have enough cash receipts to cover cash needs, and we may lose some or all of our value in our water rights acquisitions.

Water we lease or sell may be subject to regulation as to quality by the United States Environmental Protection Agency acting pursuant to the federal Safe Drinking Water Act. While environmental regulations do not directly affect us, the regulations regarding the quality of water distributed affects our intended customers and may, therefore, depending on the quality of our water, impact the price and terms upon which we may in the future sell our water rights.

Our future water revenues are uncertain and depend on a number of factors, which may make our revenue streams and profitability volatile.

We engage in various water rights acquisition, management, development, and sale and lease activities. Accordingly, our long-term future profitability will be primarily dependent on our ability to develop and sell or lease water and water rights, and will be affected by various factors, including timing of acquisitions, transportation arrangements, and changing technology. To the extent we possess junior or conditional water rights, such rights may be subordinated to superior water right holders in periods of low flow or drought.

In addition to the risk of delays associated with receiving all necessary regulatory approvals and permits, we may also encounter unforeseen technical difficulties which could result in construction delays and cost increases with respect to our water and water storage development projects.

Our profitability is significantly affected by changes in the market price of water. In the future, water prices may fluctuate widely as demand is affected by climatic, demographic and technological factors.

Our water activities may become concentrated in a limited number of assets, making our growth and profitability vulnerable to fluctuations in local economies and governmental regulations.

In the future, we anticipate that a significant amount of Vidler s revenues and asset value will come from a limited number of assets, including our water rights in the Harquahala Valley and the Vidler Arizona Recharge Facility. Although we continue to

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acquire and develop additional water assets, in the foreseeable future we anticipate that our revenues will still be derived from a limited number of assets, primarily located in Arizona and Nevada.

Our water sales may meet with political opposition in certain locations, thereby limiting our growth in these areas.

The transfer of water rights from one use to another may affect the economic base of a community and will, in some instances, be met with local opposition. Moreover, certain of the end users of our water rights, namely municipalities, regulate the use of water in order to manage growth. If we are unable to effectively transfer water rights, our liquidity will suffer and our revenues would decline.

The market values of our real estate and water assets are linked to external growth factors.

The real estate and water assets we hold have market values that are significantly affected by the growth in population and the general state of the local economies where our real estate and water assets are located, primarily in the states of Arizona and Nevada.

In certain circumstances, we finance sales of real estate and water assets, and we secure such financing through deeds of trust on the property, which are only released once the financing has been fully paid off.

Purchasers of our real estate and water assets may default on their financing obligations and the market value of the secured property may be affected by the factors noted above. Accordingly, such defaults and declines in market values may have an adverse effect on our business, financial condition, and the results of operations and cash flows.

If we underestimate the amount of insurance claims, our financial condition could be materially misstated and our financial condition could suffer.

Our insurance subsidiaries may not have established reserves that are adequate to meet the ultimate cost of losses arising from claims. It has been, and will continue to be, necessary for our insurance subsidiaries to review and make appropriate adjustments to reserves for claims and expenses for settling claims. Inadequate reserves could have a material adverse effect on our business, financial condition, and the results of operations and cash flows. Inadequate reserves could cause our financial condition to fluctuate from period to period and cause our financial condition to appear to be better than it actually is for periods in which insurance claims reserves are understated. In subsequent periods when we discover the underestimation and pay the additional claims, our cash needs will be greater than expected and our financial results of operations for that period will be worse than they would have been had our reserves been accurately estimated originally.

The inherent uncertainties in estimating loss reserves are greater for some insurance products than for others, and are dependent on:

- the length of time in reporting claims;
- the diversity of historical losses among claims;
- the amount of historical information available during the estimation process;
- the degree of impact that changing regulations and legal precedents may have on open claims; and
- the consistency of reinsurance programs over time.

Because medical malpractice liability, commercial property and casualty, and workers compensation claims may not be completely paid off for several years, estimating reserves for these types of claims can be more uncertain than estimating reserves for other types of insurance. As a result, precise reserve estimates cannot be made for several years following the year for which reserves were initially established.

During the past several years, the levels of the reserves for our insurance subsidiaries have been very volatile. We have had to significantly increase and decrease these reserves in the past several years.

Furthermore, we have reinsurance agreements on all of our insurance books of business with reinsurance companies. We base the level of reinsurance purchased on our direct reserves on our assessment of the overall direct underwriting risk.

We attempt to ensure that we have acceptable net risk, but it is possible that we may underestimate the amount of reinsurance required to achieve the desired level of net claims risk.

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In addition, while we carefully review the creditworthiness of the companies we have reinsured part, or all, of our initial direct underwriting risk with, our reinsurers could default on amounts owed to us for their portion of the direct insurance claim. Our insurance subsidiaries, as direct writers of lines of insurance, have ultimate responsibility for the payment of claims, and any defaults by reinsurers may result in our established reserves not being adequate to meet the ultimate cost of losses arising from claims.

Significant increases in the reserves may be necessary in the future, and the level of reserves for our insurance subsidiaries may be volatile in the future. These increases or volatility may have an adverse effect on our business, financial condition, and the results of operations and cash flows.

State regulators could require changes to our capitalization and/or to the operations of our insurance subsidiaries, and/or place them into rehabilitation or liquidation.

Beginning in 1994, Physicians and Citation became subject to the provisions of the Risk-Based Capital for Insurers Model Act which has been adopted by the National Association of Insurance Commissioners for the purpose of helping regulators identify insurers that may be in financial difficulty. The Model Act contains a formula which takes into account asset risk, credit risk, underwriting risk and all other relevant risks. Under this formula, each insurer is required to report to regulators using formulas which measure the quality of its capital and the relationship of its modified capital base to the level of risk assumed in specific aspects of its operations. The formula does not address all of the risks associated with the operations of an insurer. The formula is intended to provide a minimum threshold measure