

PROASSURANCE CORP  
Form 10-Q  
November 08, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2006**

**or**

**Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-16533**

**ProAssurance Corporation**

(Exact Name of Registrant as Specified in Its Charter)

Delaware

63-1261433

(State or Other Jurisdiction of  
Incorporation of Organization)

(IRS Employer Identification No.)

100 Brookwood Place, Birmingham, AL

35209

(Address of Principal Executive Offices)

(Zip Code)

(205) 877-4400

(Registrant's Telephone Number, Including Area Code)  
(Former Name, Former Address, and Former Fiscal Year,  
if Changed Since Last Report)

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 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

As of October 27, 2006 there were 33,212,060 shares of the registrant's common stock outstanding.

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**ProAssurance Corporation and Subsidiaries**  
**Condensed Consolidated Balance Sheets (Unaudited)**  
(In thousands, except share data)

	September 30 2006	December 31 2005
<b>Assets</b>		
Investments		
Fixed maturities available for sale, at fair value	<b>\$3,052,315</b>	\$2,403,450
Fixed maturities, trading, at fair value	<b>46,776</b>	
Equity securities, available for sale, at fair value	<b>11,408</b>	10,018
Equity securities, trading, at fair value	<b>5,862</b>	5,181
Short-term investments	<b>239,442</b>	93,066
Business owned life insurance	<b>58,144</b>	56,436
Other	<b>48,094</b>	46,168
Total investments	<b>3,462,041</b>	2,614,319
Cash and cash equivalents	<b>23,568</b>	34,506
Premiums receivable	<b>126,486</b>	106,549
Receivable from reinsurers on unpaid losses and loss adjustment expenses	<b>390,613</b>	327,693
Prepaid reinsurance premiums	<b>20,250</b>	20,379
Deferred taxes	<b>121,025</b>	103,935
Real estate, net	<b>23,338</b>	16,623
Other assets	<b>163,060</b>	117,596
Assets of discontinued operations		567,779
	<b>\$4,330,381</b>	\$3,909,379
<b>Liabilities and Stockholders Equity</b>		
<b>Liabilities</b>		
Policy liabilities and accruals:		
Reserve for losses and loss adjustment expenses	<b>\$2,588,954</b>	\$2,224,436
Unearned premiums	<b>288,445</b>	264,258
Reinsurance premiums payable	<b>100,716</b>	83,314
Total policy liabilities	<b>2,978,115</b>	2,572,008
Other liabilities	<b>91,239</b>	67,572
Long-term debt	<b>179,066</b>	167,240
Liabilities of discontinued operations		337,513
Total liabilities	<b>3,248,420</b>	3,144,333
<b>Commitments and contingencies</b>		
<b>Stockholders Equity</b>		
Common stock, par value \$0.01 per share 100,000,000 shares authorized, 33,330,991 and 31,230,647 shares issued, respectively	<b>333</b>	312
Additional paid-in capital	<b>494,562</b>	387,739
	<b>602</b>	(8,834)

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Accumulated other comprehensive income (loss), net of deferred tax  
expense (benefit) of \$326 and (\$4,755), respectively

Retained earnings	<b>586,520</b>	385,885
	<b>1,082,017</b>	765,102
Less treasury stock, at cost, 121,765 shares	<b>(56)</b>	(56)
Total stockholders' equity	<b>1,081,961</b>	765,046
	<b>\$4,330,381</b>	\$3,909,379

*See accompanying notes*

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**ProAssurance Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Changes in Capital (Unaudited)**  
(In thousands)

	<b>Total</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Retained Earnings</b>	<b>Other Capital Accounts</b>
Balance at December 31, 2005	\$ 765,046	\$ (8,834)	\$385,885	\$387,995
Net income	200,635		200,635	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments:				
Continuing operations	9,063	9,063		
Discontinued operations	373	373		
Common stock issued as compensation	3,027			3,027
Equity issued in purchase transaction:				
Common stock issued	99,128			99,128
Stock-based compensation:				
Continuing operations	3,808			3,808
Discontinued operations	642			642
Common stock options exercised	239			239
Balance at September 30, 2006	\$1,081,961	\$ 602	\$586,520	\$494,839

	<b>Total</b>	<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>Retained Earnings</b>	<b>Other Capital Accounts</b>
Balance at December 31, 2004	\$611,019	\$ 24,397	\$272,428	\$314,194
Net income	78,739		78,739	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments:				
Continuing operations	(20,968)	(20,968)		

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Discontinued operations	(3,543)	(3,543)		
Common stock issued as compensation	2,048			2,048
Equity issued in purchase transaction:				
Common stock issued	67,196			67,196
Fair value of option assumed	192			192
Common stock options exercised	3,789			3,789
Balance at September 30, 2005	\$738,472	\$ (114)	\$351,167	\$387,419

*See accompanying notes*

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**ProAssurance Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Income (Unaudited)**  
(In thousands, except per share data)

	Three Months Ended September 30		Nine Months Ended September 30	
	2006	2005	2006	2005
Revenues:				
Gross premiums written	<b>\$163,273</b>	\$167,308	<b>\$452,264</b>	\$434,741
Net premiums written	<b>\$152,043</b>	\$155,842	<b>\$421,004</b>	\$399,991
Premiums earned	<b>\$163,043</b>	\$159,067	<b>\$465,932</b>	\$436,901
Premiums ceded	<b>(13,599)</b>	(14,104)	<b>(36,637)</b>	(37,009)
Net premiums earned	<b>149,444</b>	144,963	<b>429,295</b>	399,892
Net investment income	<b>38,623</b>	25,280	<b>108,622</b>	71,361
Net realized investment gains (losses)	<b>(510)</b>	(618)	<b>(1,120)</b>	1,315
Other income	<b>1,688</b>	1,105	<b>4,431</b>	3,501
<b>Total revenues</b>	<b>189,245</b>	170,730	<b>541,228</b>	476,069
Expenses:				
Losses and loss adjustment expenses	<b>124,165</b>	132,137	<b>358,972</b>	363,896
Reinsurance recoveries	<b>(10,128)</b>	(14,239)	<b>(30,693)</b>	(32,423)
Net losses and loss adjustment expenses	<b>114,037</b>	117,898	<b>328,279</b>	331,473
Underwriting, acquisition and insurance expenses	<b>25,859</b>	23,498	<b>78,226</b>	66,792
Interest expense	<b>2,886</b>	2,290	<b>8,074</b>	6,457
<b>Total expenses</b>	<b>142,782</b>	143,686	<b>414,579</b>	404,722
Income from continuing operations before income taxes	<b>46,463</b>	27,044	<b>126,649</b>	71,347
Provision for income taxes:				
Current expense (benefit)	<b>17,425</b>	7,815	<b>42,524</b>	19,756
Deferred expense (benefit)	<b>(4,330)</b>	(988)	<b>(7,069)</b>	(1,533)
	<b>13,095</b>	6,827	<b>35,455</b>	18,223



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Income from continuing operations	<b>33,368</b>	20,217	<b>91,194</b>	53,124
Income from discontinued operations, net of tax		9,120	<b>109,441</b>	25,615
Net income	<b>\$ 33,368</b>	\$ 29,337	<b>\$200,635</b>	\$ 78,739
Basic earnings per share:				
Income from continuing operations	<b>\$ 1.03</b>	\$ 0.66	<b>\$ 2.88</b>	\$ 1.79
Income from discontinued operations		0.30	<b>3.46</b>	0.86
Net income	<b>\$ 1.03</b>	\$ 0.96	<b>\$ 6.34</b>	\$ 2.65
Diluted earnings per share:				
Income from continuing operations	<b>\$ 0.96</b>	\$ 0.63	<b>\$ 2.71</b>	\$ 1.70
Income from discontinued operations		0.27	<b>3.17</b>	0.79
Net income	<b>\$ 0.96</b>	\$ 0.90	<b>\$ 5.88</b>	\$ 2.49
Weighted average number of common shares outstanding:				
Basic	<b>32,551</b>	30,480	<b>31,640</b>	29,700
Diluted	<b>35,438</b>	33,345	<b>34,525</b>	32,546

*See accompanying notes*

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**ProAssurance Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Comprehensive Income**  
**(Unaudited)**  
**(In thousands)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30</b>		<b>September 30</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Comprehensive income, after tax:</b>				
Continuing operations:				
Income from continuing operations	<b>\$33,368</b>	\$ 20,217	<b>\$ 91,194</b>	\$ 53,124
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	<b>38,095</b>	(17,744)	<b>9,063</b>	(20,968)
Comprehensive income, continuing operations	<b>\$71,463</b>	\$ 2,473	<b>\$100,257</b>	\$ 32,156
Discontinued operations:				
Income from discontinued operations	<b>\$</b>	\$ 9,120	<b>\$109,441</b>	\$ 25,615
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments		(2,217)	<b>373</b>	(3,543)
Comprehensive income, discontinued operations	<b>\$</b>	\$ 6,903	<b>\$109,814</b>	\$ 22,072

*See accompanying notes*

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**ProAssurance Corporation and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows (Unaudited)**  
(In thousands)

	<b>Nine Months Ended</b>	
	<b>September 30</b>	
	<b>2006</b>	<b>2005</b>
<b><u>Continuing Operations:</u></b>		
<b>Operating Activities</b>		
Net income	\$ 200,635	\$ 78,739
Income from discontinued operations, net of tax		(25,615)
Gain on sale of discontinued operations	<b>(164,006)</b>	
Depreciation and amortization	<b>15,225</b>	18,140
Net realized investment (gains) losses	<b>1,120</b>	(1,315)
Net purchases of trading portfolio securities	<b>(47,378)</b>	(669)
Stock-based compensation	<b>3,808</b>	
Changes in assets and liabilities:		
Premiums receivable	<b>4,404</b>	12,869
Reserve for losses and loss adjustment expenses	<b>138,644</b>	173,835
Unearned premiums	<b>(13,458)</b>	(2,414)
Reinsurance related assets and liabilities	<b>294</b>	3,024
Other	<b>(4,820)</b>	(5,985)
Net cash provided by operating activities of continuing operations	<b>134,468</b>	250,609
<b>Investing Activities</b>		
Purchases of:		
Fixed maturities available for sale	<b>(1,913,786)</b>	(680,929)
Equity securities available for sale		(632)
Other investments		(2,386)
Proceeds from sale or maturities of:		
Fixed maturities available for sale	<b>1,505,036</b>	492,547
Equity securities available for sale	<b>33,577</b>	44,421
Net (increase) decrease in short-term investments	<b>(138,576)</b>	(109,242)
Cash proceeds, net of sale expenses of \$4,080 from sale of discontinued operations	<b>371,038</b>	
Other	<b>(3,665)</b>	(1,249)
Net cash used by investing activities of continuing operations	<b>(146,376)</b>	(257,470)
<b>Financing Activities</b>		
Cash received from options exercised	<b>119</b>	3,640
Excess tax benefit from options exercised	<b>851</b>	
Net cash provided by financing activities of continuing operations	<b>970</b>	3,640

Increase (decrease) in cash and cash equivalents	<b>(10,938)</b>	(3,221)
Cash and cash equivalents at beginning of period	<b>34,506</b>	20,698
Cash and cash equivalents at end of period	<b>\$ 23,568</b>	\$ 17,477

**Discontinued Operations:**

Net cash provided by (used in) operating activities of discontinued operations	<b>\$</b>	\$ 31,750
Net cash provided by (used in) investing activities of discontinued operations		(28,476)
Net cash provided by (used in) financing activities of discontinued operations		

Increase (decrease) in cash and cash equivalents		3,274
Cash and cash equivalents at beginning of period		9,386
Cash and cash equivalents at end of period	<b>\$</b>	\$ 12,660

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:**

Taxes paid, net of refunds (including \$54.6 million paid in 2006 related to the sale of discontinued operations)	<b>\$ 89,040</b>	\$ 27,830
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**SIGNIFICANT NON-CASH TRANSACTIONS:**

Fixed maturities securities received as proceeds from sale of discontinued operations	<b>\$ 24,819</b>	\$
Common stock issued in acquisition	<b>\$ 99,128</b>	\$ 67,196

*See accompanying notes*

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**ProAssurance Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**  
**September 30, 2006**

**1. Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements include the accounts of ProAssurance Corporation and its subsidiaries (ProAssurance). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. The accompanying condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes contained in ProAssurance's December 31, 2005 report on Form 10-K.

**Reclassifications**

Previously, rental income from real estate holdings and real estate related expenses were considered as components of net investment income. In 2006, rental income from real estate holdings is included in other income; real estate expenses are included in underwriting, acquisition and insurance expenses. To conform to the 2006 financial statement presentation, rental income of \$213,000 and \$814,000 and real estate related expenses of \$645,000 and \$1.9 million were reclassified for the three and nine months ended September 30, 2005, respectively. The reclassification had no effect on income from continuing operations or net income.

**Accounting Changes**

On December 16, 2004 the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) 123 (revised 2004), *Share-Based Payment*, hereafter referred to as SFAS 123(R), which is a revision of SFAS 123, *Accounting for Stock-Based Compensation (SFAS 123)*, which superseded Accounting Principles Board (APB) 25, *Accounting for Stock Issued to Employees (APB 25)*, and amends SFAS 95, *Statement of Cash Flows*. The provisions of SFAS 123(R) require all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. SFAS 123(R) also requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under previous literature. ProAssurance adopted SFAS 123(R) on January 1, 2006, the required effective date, using the modified prospective method permitted by the statement. The disclosures required by SFAS 123(R) are provided in Note 12.

The FASB issued SFAS 154, *Accounting Changes and Error Corrections*, in May 2005 as a replacement for APB 20, *Accounting Changes*, and SFAS 3, *Reporting Accounting Changes in Interim Financial Statements*. SFAS 154 applies to voluntary changes in accounting principle and changes the requirements for accounting for and reporting of a change in accounting principle and is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. ProAssurance adopted SFAS 154 effective January 1, 2006; however, to date, the adoption has had no effect.

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FAS 109, Accounting for Income Taxes (FIN 48)*, to create a single model to address accounting for uncertainty in tax positions. FIN 48 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold that a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting for interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. ProAssurance will adopt FIN 48 as of January 1, 2007, as required. ProAssurance has not determined the effect, if any, the adoption of FIN 48 will have on ProAssurance's financial position and results of operations. The cumulative effect of adopting FIN 48, if any, will be recorded in retained earnings.

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**ProAssurance Corporation and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements (Unaudited)**  
**September 30, 2006**

**2. Acquisitions**

ProAssurance acquired 100% of the outstanding shares of Physicians Insurance Company of Wisconsin, Inc. and its subsidiaries (PIC Wisconsin) effective August 1, 2006 as a means of expanding the distribution of its professional liability insurance products geographically. PIC Wisconsin is an insurance company that sells professional liability insurance to physicians and groups of physicians, dentists and hospitals principally in the State of Wisconsin and other Midwestern states.

Under the terms of the agreement, each share of PIC Wisconsin stock was converted into 102.75 shares of ProAssurance stock. In the determination of the purchase price each ProAssurance share was valued at \$49.76 which is the average ProAssurance common stock price for three days before and after July 31, 2006, the date on which the number of shares issued was determined. The acquisition was accounted for as a purchase transaction in accordance with SFAS 141 and the purchase price was allocated to the assets acquired and liabilities assumed based on estimates of their respective fair values at the date of acquisition. Goodwill of \$37.7 million was recognized equal to the excess of the purchase price over the fair values of the identifiable net assets acquired. The goodwill is not expected to be tax deductible.

The fair values of PIC Wisconsin's reserve for losses and loss adjustment expenses and related reinsurance recoverables were estimated based on the present value of the expected underlying cash flows of the loss reserves and reinsurance recoverables, and include a risk premium and a profit margin. In determining the fair value estimate, management discounted PIC Wisconsin's historical undiscounted net loss reserve, which was based on recent actuarial reviews, to present value assuming a discount rate of 4.86%, the risk free treasury rate on August 1, 2006 for maturities of approximately 4 years, which is the average estimated duration of the reserves. The discounting pattern was actuarially developed from PIC Wisconsin's historical loss data. An expected profit margin of 5.00% was applied to the discounted loss reserves, which is consistent with management's understanding of the returns anticipated by the reinsuranc