

SAFETY INSURANCE GROUP INC
Form 10-Q
August 09, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 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: 000-50070

SAFETY INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

13-4181699

(I.R.S. Employer Identification No.)

20 Custom House Street, Boston, Massachusetts 02110

(Address of principal executive offices including zip code)

(617) 951-0600

(Registrant's telephone number, including area code)

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

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Indicate by check mark whether the registrant is large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

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 August 4, 2006, there were 16,002,411 shares of common stock with a par value of \$0.01 per share outstanding.

SAFETY INSURANCE GROUP, INC.

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Balance Sheets

(Dollars in thousands, except share data)

	June 30, 2006 (Unaudited)	December 31, 2005
Assets		
Investment securities available for sale:		
Fixed maturities, at fair value (amortized cost: \$876,134 and \$713,930)	\$ 856,476	\$ 712,538
Equity securities, at fair value (cost: \$3,887 and \$1,895)	3,983	2,005
Total investment securities	860,459	714,543
Cash and cash equivalents	31,543	163,027
Accounts receivable, net of allowance for doubtful accounts	162,075	154,421
Accrued investment income	9,046	7,856
Taxes recoverable	1,339	318
Receivable from reinsurers related to paid loss and loss adjustment expenses	17,382	18,750
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	76,068	80,550
Prepaid reinsurance premiums	36,853	37,174
Deferred policy acquisition costs	50,500	45,480
Deferred income taxes	24,694	18,120
Equity and deposits in pools	30,257	14,631
Other assets	3,559	2,805
Total assets	\$ 1,303,775	\$ 1,257,675
Liabilities		
Loss and loss adjustment expense reserves	\$ 429,621	\$ 450,716
Unearned premium reserves	362,845	341,562
Accounts payable and accrued liabilities	30,063	44,372
Outstanding claims drafts	18,128	19,825
Payable to reinsurers	27,591	12,985
Capital lease obligations	153	266
Total liabilities	868,401	869,726
Commitments and contingencies (Note 7)		
Shareholders' equity		
Common stock: \$0.01 par value; 30,000,000 shares authorized; 15,989,203 and 15,787,947 shares issued and outstanding, respectively	160	158
Additional paid-in capital	125,537	120,451
Accumulated other comprehensive loss, net of taxes	(12,715)	(833)
Retained earnings	322,392	268,173
Total shareholders' equity	435,374	387,949
Total liabilities and shareholders' equity	\$ 1,303,775	\$ 1,257,675

The accompanying notes are an integral part of these financial statements.

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Operations

(Unaudited)

(Dollars in thousands, except per share and share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Net earned premiums	\$ 156,261	\$ 156,514	\$ 314,039	\$ 312,930
Net investment income	9,834	7,653	19,212	15,112
Net realized (losses) gains on investments	(187)	(11)	(261)	396
Finance and other service income	3,720	3,977	7,579	7,946
Total revenue	169,628	168,133	340,569	336,384
Losses and loss adjustment expenses	84,604	93,802	170,355	203,972
Underwriting, operating and related expenses	41,757	39,975	82,152	76,566
Interest expenses	20	225	44	448
Total expenses	126,381	134,002	252,551	280,986
Income before income taxes	43,247	34,131	88,018	55,398
Income tax expense	14,109	10,885	28,078	17,650
Net income	\$ 29,138	\$ 23,246	\$ 59,940	\$ 37,748
Earnings per weighted average common share:				
Basic	\$ 1.84	\$ 1.49	\$ 3.80	\$ 2.43
Diluted	\$ 1.81	\$ 1.46	\$ 3.75	\$ 2.38
Cash dividends paid per common share	\$ 0.18	\$ 0.12	\$ 0.36	\$ 0.24
Weighted average number of common shares outstanding:				
Basic	15,826,992	15,583,473	15,769,133	15,512,120
Diluted	16,056,362	15,874,315	15,992,337	15,845,024

The accompanying notes are an integral part of these financial statements.

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income/(Loss), Net of Taxes	Retained Earnings	Total Shareholders' Equity
Balance at December 31, 2004	\$ 155	\$ 114,070	\$ 8,709	\$ 182,400	\$ 305,334
Net income, January 1 to June 30, 2005				37,748	37,748
Other comprehensive loss, net of deferred federal income taxes			(1,736)		(1,736)
Exercise of options and unearned compensation on restricted stock net of deferred federal income taxes	2	3,934			3,936
Dividends paid				(3,742)	(3,742)
Balance at June 30, 2005	\$ 157	\$ 118,004	\$ 6,973	\$ 216,406	\$ 341,540

	Common Stock	Additional Paid-in Capital	Other Comprehensive Income/(Loss), Net of Taxes	Retained Earnings	Total Shareholders' Equity
Balance at December 31, 2005	\$ 158	\$ 120,451	\$ (833)	\$ 268,173	\$ 387,949
Net income, January 1 to June 30, 2006				59,940	59,940
Other comprehensive loss, net of deferred federal income taxes			(11,882)		(11,882)
Exercise of options and unearned compensation on restricted stock net of deferred federal income taxes	2	5,086			5,088
Dividends paid				(5,721)	(5,721)
Balance at June 30, 2006	\$ 160	\$ 125,537	\$ (12,715)	\$ 322,392	\$ 435,374

The accompanying notes are an integral part of these financial statements.

Safety Insurance Group, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
(Unaudited)
(Dollars in thousands)

	Three Months Ended		Six Months Ended	
	June 30, 2006	2005	June 30, 2006	2005
Net income	\$ 29,138	\$ 23,246	\$ 59,940	\$ 37,748
Other comprehensive (loss) income, net of tax:				
Change in unrealized holding gains, net of tax expense (benefit) of \$(3,004), \$3,131, \$(6,489) and \$(796)	(5,578)	5,813	(12,052)	(1,479)
Reclassification adjustment for losses (gains) included in net income, net of tax expense (benefit) of \$65, \$3, \$91 and \$(139)	122	8	170	(257)
Unrealized (losses) gains on securities available for sale	(5,456)	5,821	(11,882)	(1,736)
Comprehensive income	\$ 23,682	\$ 29,067	\$ 48,058	\$ 36,012

The accompanying notes are an integral part of these financial statements.

Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(Dollars in thousands)

	Six Months Ended June 30,	
	2006	2005
Cash flows from operating activities:		
Net income	\$ 59,940	\$ 37,748
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	4,286	4,177
Benefit for deferred income taxes	(176)	(1,330)
Net realized losses (gains) on investments	261	(396)
Changes in assets and liabilities:		
Accounts receivable	(7,654)	(20,171)
Accrued investment income	(1,190)	(220)
Receivable from reinsurers	5,850	(1,588)
Prepaid reinsurance premiums	321	1,200
Deferred policy acquisition costs	(5,020)	(6,680)
Other assets	(16,902)	(21,287)
Loss and loss adjustment expense reserves	(21,095)	11,832
Unearned premium reserves	21,283	40,248
Accounts payable and accrued liabilities	(14,309)	(18,047)
Payable to reinsurers	14,606	14,003
Other liabilities	(1,810)	4,747
Net cash provided by operating activities	38,391	44,236
Cash flows from investing activities:		
Fixed maturities purchased	(270,442)	(57,485)
Equity securities purchased	(2,455)	(1,132)
Proceeds from sales of fixed maturities	93,154	25,673
Proceeds from maturities of fixed maturities	12,200	4,975
Proceed from sales of equity securities	485	134
Fixed assets purchased	(501)	(494)
Net cash used for investing activities	(167,559)	(28,329)
Cash flows from financing activities:		
Proceeds and excess tax benefits from exercise of stock options	3,405	2,164
Dividends paid to shareholders	(5,721)	(3,742)
Net cash used for financing activities	(2,316)	(1,578)
Net (decrease) increase in cash and cash equivalents	(131,484)	14,329
Cash and cash equivalents at beginning of year	163,027	155,673
Cash and cash equivalents at end of period	\$ 31,543	\$ 170,002

The accompanying notes are an integral part of these financial statements.

Safety Insurance Group, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
(Dollars in thousands except per share and share data)

1. Basis of Presentation

The consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America (GAAP). GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

The consolidated financial statements include Safety Insurance Group, Inc. and its subsidiaries (the Company). The subsidiaries consist of Safety Insurance Company, Safety Indemnity Insurance Company, Whiteshirts Asset Management Corporation (WAMC), and Whiteshirts Management Corporation, which is WAMC 's holding company. All intercompany transactions have been eliminated. Prior period amounts have been reclassified to conform to the current period presentation.

The financial information as of June 30, 2006 and for the three and six months ended June 30, 2006 and 2005 is unaudited; however, in the opinion of the Company, the information includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the financial condition and results of operations for the periods. These unaudited consolidated financial statements may not be indicative of financial results for the full year and should be read in conjunction with the audited financial statements included in the Company 's annual report on Form 10-K filed with the U.S. Securities and Exchange Commission (SEC) on March 16, 2006.

The Company is a leading provider of personal lines property and casualty insurance focused exclusively on the Massachusetts market. The Company 's principal product line is private passenger automobile insurance, which accounted for 80.3% of its direct written premiums in 2005. The Company operates through its insurance company subsidiaries, Safety Insurance Company and Safety Indemnity Insurance Company.

2. New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109 (FIN 48). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. The Company does not believe the adoption of FIN No. 48 will have a material impact on its consolidated results of operations or financial position.

3. Earnings Per Weighted Average Common Share

Basic earnings per weighted average common share (EPS) are calculated by dividing net income by the weighted average number of basic common shares outstanding during the period. Diluted EPS are calculated by dividing net income by the weighted average number of basic common shares outstanding and the net effect of potentially dilutive common shares. At June 30, 2006 and 2005, the Company 's potentially dilutive instruments consisted of common shares under options of 480,797 and 611,295, respectively, and common shares under restriction of 118,790 and 105,960, respectively.

Three Months Ended		Six Months Ended
June 30,		June 30,
2006	2005	2006