Conifer Holdings, Inc.
Form 10-Q
November 07, 2018

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 September 30, 2018
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 001-37536

Conifer Holdings, Inc.
(Exact name of registrant as specified in its charter)

Michigan	27-1298795
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

550 West Merrill Street, Suite 200	
Birmingham, Michigan	48009
(Address of principal executive offices)	(Zip code)

(248) 559-0840
(Registrant’s telephone number, including area code)

Not Applicable
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of outstanding shares of the registrant’s common stock, no par value, as of November 5, 2018, was 8,602,703.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES

Form 10-Q

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PART 1 - FINANCIAL INFORMATION
ITEM 1 - FINANCIAL STATEMENTS
CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(dollars in thousands)

	September 30, 2018 (Unaudited)	December 31, 2017
Assets		
Investment securities:		
Debt securities, at fair value (amortized cost of $125,018 and $137,004, respectively)	$ 121,996	$ 136,536
Equity securities, at fair value (cost of $8,890 and $8,629, respectively)	9,832	9,687
Short-term investments, at fair value	9,905	11,427
Total investments	141,733	157,650
Cash	16,455	11,868
Premiums and agents' balances receivable, net	22,415	22,845
Receivable from affiliate	1,321	1,195
Reinsurance recoverables on unpaid losses	27,118	20,066
Reinsurance recoverables on paid losses	2,540	4,473
Prepaid reinsurance premiums	1,498	1,081
Deferred policy acquisition costs	11,843	12,781
Other assets	8,074	7,073
Total assets	$ 232,997	$ 239,032
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	$ 91,046	$ 87,896
Unearned premiums	51,701	57,672
Reinsurance premiums payable	—	3,299
Debt	29,750	29,027
Accounts payable and other liabilities	13,961	8,312
Total liabilities	186,458	186,206
Commitments and contingencies	—	—
Shareholders' equity:		
Common stock, no par value (100,000,000 shares authorized; 8,602,703 and 8,520,328 issued and outstanding, respectively)	86,915	86,199
Accumulated deficit	(36,982)	(33,010)
Accumulated other comprehensive income (loss)	(3,394)	(363)
Total shareholders' equity	46,539	52,826
Total liabilities and shareholders' equity	$ 232,997	$ 239,032

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Operations (Unaudited)
(dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue				
Premiums				
Gross earned premiums	$27,318	$28,891	$82,899	$85,493
Ceded earned premiums	(3,868)	(11,232)	(11,711)	(19,198)
Net earned premiums	23,450	17,659	71,188	66,295
Net investment income	786	768	2,425	2,008
Net realized investment gains (losses)	(21)	39	152	31
Change in fair value of equity securities	151	—	(116)	—
Other gains	—	—	—	750
Other income	405	477	1,212	1,203
Total revenue	24,771	18,943	74,861	70,287
Expenses				
Losses and loss adjustment expenses, net	16,554	26,468	44,950	58,875
Policy acquisition costs	6,452	6,655	19,437	19,555
Operating expenses	4,786	4,474	13,276	13,374
Interest expense	598	303	1,834	745
Total expenses	28,390	37,900	79,497	92,549
Income (loss) before equity earnings of affiliates and income taxes	(3,619)	(18,957)	(4,636)	(22,262)
Equity earnings of affiliates, net of tax	93	(76)	237	89
Income tax (benefit) expense	25	(135)	52	(410)
Net income (loss)	$(3,551)	$(18,898)	$(4,451)	$(21,763)
Earnings (loss) per common share, basic and diluted	$(0.42)	$(2.46)	$(0.52)	$(2.85)
Weighted average common shares outstanding, basic and diluted	8,553,613	7,675,952	8,531,545	7,647,520

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income (Loss) (Unaudited)
(dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	$(3,551)	$(18,898)	$(4,451)	$(21,763)
Other comprehensive income (loss), net of tax:				
Unrealized investment gains (losses):				
Unrealized investment gains (losses) during the period	(352)	377	(2,574)	1,281
Income tax (benefit) expense	—	117	—	398
Unrealized investment gains (losses), net of tax	(352)	260	(2,574)	883
Less: reclassification adjustments to:				
Net realized investment gains (losses) included in net income (loss)	(18)	7	(22)	57
Income tax (benefit) expense	—	—	—	—
Total reclassifications included in net income (loss), net of tax	(18)	7	(22)	57
Other comprehensive income (loss)	(334)	253	(2,552)	826
Total comprehensive income (loss)	$(3,885)	$(18,645)	$(7,003)	$(20,937)

The accompanying notes are an integral part of the Consolidated Financial Statements.

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CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Shareholders' Equity (Unaudited)
(dollars in thousands)

	No Par, Common Stock				
	Shares	Amount	Accumulated deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances at December 31, 2016	7,633,070	$ 80,342	$ (11,468)	$ (1,080)	$ 67,794
Net loss	—	—	(21,763)	—	(21,763)
Issuance of common stock in private placement	800,000	5,000			5,000
Common stock issuance costs		(13)			(13)
Restricted stock unit expense, net	85,418	650	—	—	650
Other comprehensive income	—	—	—	826	826
Balances at September 30, 2017	8,518,488	85,979	(33,231)	(254)	52,494
Net loss	—	—	221	—	221
Common stock issuance costs	—	(25)	—	—	(25)
Restricted stock unit expense, net	1,840	245	—	—	245
Other comprehensive income	—	—	—	(109)	(109)
Balances at December 31, 2017	8,520,328	86,199	(33,010)	(363)	52,826
Net loss	—	—	(4,451)	—	(4,451)
Restricted stock unit expense, net	82,375	716	—	—	716
Other comprehensive loss	—	—	—	(2,552)	(2,552)
Cumulative effect of adoption of ASU No. 2016-01, net of taxes	—	—	556	(556)	—
Cumulative effect of adoption of ASU No. 2018-02, net of taxes	—	—	(77)	77	—
Balances at September 30, 2018	8,602,703	$ 86,915	$ (36,982)	$ (3,394)	$ 46,539

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows (Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2018	2017
Cash Flows From Operating Activities		
Net income (loss)	$(4,451)	$(21,763)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	254	296
Amortization of bond premium and discount, net	392	395
Net realized investment (gains) losses	(152)	(31)
Change in fair value of equity securities	116	—
Restricted stock unit expenses	716	650
Other	(237)	(89)
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Premiums and agents' balances and other receivables	304	3,467
Reinsurance recoverables	(5,119)	(8,274)
Prepaid reinsurance premiums	(417)	3,038
Deferred policy acquisition costs	938	537
Other assets	(900)	4,025
Increase (decrease) in:		
Unpaid losses and loss adjustment expenses	3,150	28,105
Unearned premiums	(5,971)	(2,457)
Accounts payable and other liabilities	3,866	9,607
Net cash provided by (used in) operating activities	(7,511)	17,506
Cash Flows From Investing Activities		
Purchase of investments	(63,599)	(159,242)
Proceeds from maturities and redemptions of investments	18,460	18,128
Proceeds from sales of investments	56,632	126,345
Purchases of property and equipment	(69)	(6)
Net cash provided by (used in) investing activities	11,424	(14,775)
Cash Flows From Financing Activities		
Proceeds received from issuance of shares of common stock	—	4,375
Borrowings under debt arrangements	22,000	32,000
Repayment of borrowings under debt arrangements	(20,000)	(19,750)
Payment of equity issuance costs	—	(13)
Payment of debt issuance costs	(1,326)	(990)
Net cash provided by (used in) financing activities	674	15,622
Net increase (decrease) in cash	4,587	18,353
Cash at beginning of period	11,868	12,493
Cash at end of period	$16,455	$30,846
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$2,386	$860
Payable for securities - non cash item	1,681	1,500

The accompanying notes are an integral part of the Consolidated Financial Statements.

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include accounts, after elimination of intercompany accounts and transactions, of Conifer Holdings, Inc. (the “Company” or “Conifer”), its wholly owned subsidiaries, Conifer Insurance Company ("CIC"), White Pine Insurance Company ("WPIC"), Red Cedar Insurance Company ("RCIC"), and Sycamore Insurance Agency, Inc. ("SIA"). CIC, WPIC, and RCIC are collectively referred to as the "Insurance Company Subsidiaries." On a stand-alone basis, Conifer Holdings, Inc. is referred to as the "Parent Company."

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The Company has applied the rules and regulations of the United States Securities and Exchange Commission (“SEC”) regarding interim financial reporting and therefore the consolidated financial statements do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments, consisting of items of a normal recurring nature, necessary for a fair presentation of the consolidated interim financial statements, have been included. The results of operations for the nine months ended September 30, 2018, are not necessarily indicative of the results expected for the year ended December 31, 2018.

These consolidated financial statements and the notes thereto should be read in conjunction with the Company's audited consolidated financial statements and related notes included in its Annual Report on Form 10-K/A for the year ended December 31, 2017, as filed with the SEC.

Business

The Company is engaged in the sale of property and casualty insurance products and has organized its business model around two classes of insurance businesses: commercial and personal lines. The Company underwrites a variety of specialty insurance products, including property, general liability, liquor liability, automobile, homeowners and dwelling policies. The Company markets and sells its insurance products through a network of independent agents and managing general agents. Policies are written in all 50 states. The Company’s corporate headquarters is located in Birmingham, Michigan with additional office facilities in Florida, Pennsylvania and Tennessee.

The Company also generates other revenues through investment income and other income which mainly consists of installment fees and policy issuance fees generally related to the policies we write. We also generate equity earnings from SIA's 50% owned agency (the "Affiliate"). The Affiliate places small commercial risks mainly for alarm and security guard markets.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While management believes the amounts included in the consolidated financial statements reflect management's best estimates and assumptions, actual results may differ from these estimates.

Recently Issued Accounting Guidance

Effective January 1, 2018, the Company adopted FASB Accounting Standards Update ("ASU") No. 2016-01, Financial Instruments (Topic 825): Recognition and Measurement of Financial Assets and Financial Liabilities. As a result of adoption of this ASU, equity instruments that do not result in consolidation and are not accounted for under the equity method are measured at fair value and any changes in fair value are recognized in net income. Previously, the Company’s equity securities were classified as available-for-sale and changes in fair value were recorded in other comprehensive income. Upon adoption of this ASU, cumulative net unrealized gains on equity securities of $1.1 million, net of deferred income taxes of $0.5 million, were reclassified from accumulated other comprehensive income into accumulated deficit. Prior periods have not been recast to conform to the current presentation. See Note 2

~ Investments for details regarding the change in net unrealized gains on equity securities included in net income for the current quarter ended September 30, 2018.

Effective January 1, 2018, the Company early adopted ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The ASU provides an option to reclassify tax effects remaining in accumulated other comprehensive income as a result of the Tax Cuts and Jobs Act (TCJA) to retained earnings. Upon enactment of the TCJA, the U.S. corporate tax rate was reduced from 35% to 21% and the Company's U.S. deferred tax balances were remeasured to the lower enacted U.S. corporate tax rate. GAAP requires the effects of changes in tax rates and laws on deferred tax balances to be recorded as a component of income tax expense in the period of enactment, even if the assets and liabilities relate to items of accumulated other comprehensive income. As a result of adopting the ASU, the Company reclassified $77,000 of previously recognized deferred taxes from accumulated other comprehensive income into accumulated deficit as of January 1, 2018.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which addresses the financial reporting of leasing transactions. This update will require the recognition of a right-of-use asset and a corresponding lease liability, discounted to the present value, for all leases that extend beyond 12 months. For operating leases, the asset and liability will be expensed over the lease term on a straight-line basis, with all cash flows included in the operating section of the consolidated statement of cash flows. For finance leases, interest on the lease liability will be recognized separately from the amortization of the right-of-use asset in the consolidated statement of operations and the repayment of the principal portion of the lease liability will be classified as a financing activity while the interest component will be included in the operating section of the consolidated statement of cash flows. This ASU is effective for annual and interim reporting periods beginning after December 15, 2018. Early adoption is permitted. We do not have any financing leases. If the standard were adopted as of September 30, 2018, approximately $4.4 million of future lease liabilities would be added to our balance sheet with a corresponding right-of-use asset. We have approximately $860,000 of operating lease expenses for the nine months ended September 30, 2018, and do not expect that there would be a materially different expense upon adoption.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326), which amends the current methodology and timing for recognizing credit losses. This amendment will replace the current GAAP "incurred loss" methodology for credit losses with a methodology based on expected credit losses. The new guidance will also require expanded consideration of a broader range of reasonable and increased supportable information for the credit loss estimates. This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted for years beginning after December 15, 2018. Management is currently evaluating the impact of the guidance.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 840), which modifies the disclosure requirements for assets and liabilities measured at fair value. The requirements to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, the policy for timing of transfers between levels and the valuation processes for Level 3 fair value measurements have all been removed. However, the changes in unrealized gains and losses included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period must be disclosed along with the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements (or other quantitative information if it is more reasonable). Finally, for investments measured at net asset value, the requirements have been modified so that the timing of liquidation and the date when restrictions from redemption might lapse are only disclosed if the investee has communicated the timing to the entity or announced the timing publicly. This ASU is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted upon the issuance of this update. Management is currently evaluating the impact of the guidance.

2. Investments

The cost or amortized cost, gross unrealized gain or loss, and estimated fair value of the investments in securities classified as available for sale at September 30, 2018 and December 31, 2017, were as follows (dollars in thousands):

	September 30, 2018			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value

Debt Securities:				
U.S. Government	$15,809	$1	$(307)	$15,503
State and local government	16,004	57	(305)	15,756
Corporate debt	31,742	86	(706)	31,122
Asset-backed securities	24,006	22	(187)	23,841
Mortgage-backed securities	31,320	9	(1,524)	29,805
Commercial mortgage-backed securities	3,890	—	(100)	3,790
Collateralized mortgage obligations	2,247	7	(75)	2,179
Total debt securities available for sale	$125,018	$182	$(3,204)	$121,996

CONIFER HOLDINGS, INC. AND SUBSIDIARIES
Notes to Consolidated Financial Statements (Unaudited)

	December 31, 2017			
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt Securities:				
U.S. Government	$ 17,179	$ 10	$ (99)	$ 17,090
State and local government	17,302	255	(54)	17,503
Corporate debt	38,947	170		