

AXIS CAPITAL HOLDINGS LTD
Form 10-Q
May 02, 2007

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 **March 31, 2007**

Commission file number **001-31721**

AXIS CAPITAL HOLDINGS LIMITED

(Exact name of registrant as specified in its charter)

BERMUDA

(State or other jurisdiction of incorporation or organization)

98-0395986

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

92 Pitts Bay Road, Pembroke, Bermuda HM 08

(Address of principal executive offices and zip code)

(441) 496-2600

(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 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.

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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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 April 30, 2007 there were 153,747,277 Common Shares, \$0.0125 par value per share, of the registrant outstanding.

AXIS CAPITAL HOLDINGS LIMITED

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Cautionary Statement Regarding Forward-looking Statements

This quarterly report contains forward-looking statements within the meaning of the U.S. federal securities laws. We intend these forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in the United States securities laws. In some cases, these statements can be identified by the use of forward-looking words such as may, should, could, anticipate, estimate, expect, plan, believe, predict, potential, and intend. Forward-looking statements contained in this report include information regarding our estimates of losses related to hurricanes and other catastrophes, our expectations regarding pricing and other market conditions, our growth prospects, the amount of our acquisition costs, the amount of our net losses and loss reserves, the projected amount of our capital expenditures, managing interest rate and foreign currency risks, valuations of potential interest rate shifts and foreign currency rate changes and measurements of potential losses in fair market values of our investment portfolio. Forward-looking statements only reflect our expectations and are not guarantees of performance. These statements involve risks, uncertainties and assumptions. Actual events or results may differ materially from our expectations. Important factors that could cause actual events or results to be materially different from our expectations include (1) our limited operating history, (2) the occurrence of natural and man-made disasters, (3) actual claims exceeding our loss reserves, (4) the failure of any of the loss limitation methods we employ, (5) the effects of emerging claims and coverage issues, (6) the failure of our cedants to adequately evaluate risks, (7) the loss of one or more key executives, (8) a decline in our ratings with rating agencies, (9) loss of business provided to us by our major brokers, (10) changes in governmental regulations, (11) increased competition, (12) general economic conditions, (13) changes in the political environment of certain countries in which we operate or underwrite business and (14) the other matters set forth under Item 1A, Risk Factors and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2006 filed with the SEC on March 1, 2007. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

ITEM 1. FINANCIAL STATEMENTS

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AXIS CAPITAL HOLDINGS LIMITED
CONSOLIDATED BALANCE SHEETS
MARCH 31, 2007 (UNAUDITED) AND DECEMBER 31, 2006

(in thousands)	2007	2006
Assets		
Investments:		
Fixed maturity investments available for sale, at fair value (<i>Amortized cost 2007: \$6,822,978; 2006: \$6,574,249</i>)	\$ 6,805,333	\$ 6,532,723
Other investments, at fair value	1,094,828	1,130,664
Total investments	7,900,161	7,663,387
Cash and cash equivalents	2,090,834	1,989,287
Accrued interest receivable	68,056	76,967
Insurance and reinsurance premium balances receivable	1,507,855	1,125,822
Reinsurance recoverable balances	1,307,609	1,293,660
Reinsurance recoverable balances on paid losses	94,284	65,494
Deferred acquisition costs	345,904	251,799
Prepaid reinsurance premiums	238,359	241,821
Securities lending collateral	895,832	794,149
Goodwill and intangible assets	28,786	29,041
Other assets	134,757	133,860
Total assets	\$ 14,612,437	\$ 13,665,287
Liabilities		
Reserve for losses and loss expenses	\$ 5,186,191	\$ 5,015,113
Unearned premiums	2,466,213	2,015,556
Insurance and reinsurance balances payable	286,068	294,374
Securities lending payable	893,692	791,744
Senior notes	499,180	499,144
Liability under repurchase agreement	400,000	400,000
Net payable for investments purchased	92,608	62,185
Other liabilities	146,738	174,524
Total liabilities	9,970,690	9,252,640
Shareholders' Equity		
Preferred shares Series A and B	\$ 500,000	\$ 500,000
Common shares (<i>issued and outstanding 2007: 150,417; 2006: 149,982</i>)	1,880	1,875
Additional paid-in capital	1,936,518	1,929,406
Accumulated other comprehensive loss	(22,125)	(44,638)
Retained earnings	2,225,474	2,026,004
Total shareholders' equity	4,641,747	4,412,647
Total liabilities and shareholders' equity	\$ 14,612,437	\$ 13,665,287

See accompanying notes to consolidated financial statements

AXIS CAPITAL HOLDINGS LIMITED
CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2007 AND 2006

	2007 (in thousands, except per share amounts)	2006
Revenues		
Net premiums earned	\$ 685,304	\$ 633,594
Net investment income	125,280	93,568
Net realized investment gains (losses)	301	(10,929)
Other insurance related income	1,940	624
Total revenues	812,825	716,857
Expenses		
Net losses and loss expenses	392,797	358,658
Acquisition costs	98,139	89,704
General and administrative expenses	62,606	55,411
Foreign exchange gains	(2,391)	(9,264)
Interest expense and financing costs	15,144	8,085
Total expenses	566,295	502,594
Income before income taxes	246,530	214,263
Income tax expense	9,747	9,447
Net income	236,783	204,816
Preferred shares dividends	9,204	9,631
Net income available to common shareholders	\$ 227,579	\$ 195,185
Weighted average common shares and common share equivalents:		
Basic	150,433	149,314
Diluted	166,035	163,555
Earnings per common share:		
Basic	\$ 1.51	\$ 1.31
Diluted	\$ 1.37	\$ 1.19
Cash dividends declared per common share	\$ 0.165	\$ 0.15

See accompanying notes to the consolidated financial statements.

AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2007 AND 2006

	2007 (in thousands)	2006
Net income	\$ 236,783	\$ 204,816
Other comprehensive income, net of tax		
Change in unrecognized prior period service cost on the supplemental executive retirement plan (SERP)	563	
Unrealized gains (losses) arising during the period	25,176	(63,686)
Adjustment for re-classification of investment (gains) losses realized in net income	(3,226)	7,246
Comprehensive income	\$ 259,296	\$ 148,376

See accompanying notes to the consolidated financial statements.

AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2007 AND 2006

	2007 (in thousands)	2006
Preferred shares - Series A and B		
Balance at beginning and end of period	\$ 500,000	\$ 500,000
Common shares		
Balance at beginning of period	1,875	1,861
Shares issued, net	5	11
Balance at end of period	1,880	1,872
Additional paid-in capital		
Balance at beginning of period	1,929,406	1,886,356
Shares issued	1,115	451
Shares repurchased	(2,889)	(179)
Stock options exercised	1,513	12,876
Share-based compensation expense	7,373	6,100
Balance at end of period	1,936,518	1,905,604
Accumulated other comprehensive loss		
Balance at beginning of period	(44,638)	(77,798)
Change in unrealized gains (losses) on fixed maturity investments	22,713	(57,496)
Change in unrecognized prior period service cost on the SERP	563	
Change in deferred taxes	(763)	1,056
Balance at end of period	(22,125)	(134,238)
Retained earnings		
Balance at beginning of period	2,026,004	1,201,932
Net income	236,783	204,816
Series A and B preferred share dividends	(9,204)	(9,631)
Common share dividends	(28,109)	(25,127)
Balance at end of period	2,225,474	1,371,990
Total Shareholders' Equity	\$ 4,641,747	\$ 3,645,228

See accompanying notes to consolidated financial statements.

AXIS CAPITAL HOLDINGS LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
THREE MONTHS ENDED MARCH 31, 2007 AND 2006

	2007 (in thousands)	2006
Cash flows from operating activities:		
Net income	\$ 236,783	\$ 204,816
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized investment (gains) losses	(301)	10,929
Net change in fair value of other investments	(19,583)	(10,506)
Amortization/accretion of fixed maturity investments	4,715	7,518
Other amortization and depreciation	1,854	2,535
Share-based compensation expense	7,373	6,100
<i>Changes in:</i>		
Accrued interest receivable	8,911	1,182
Reinsurance recoverable balances	(42,739)	42,604
Deferred acquisition costs	(94,105)	(70,178)
Prepaid reinsurance premiums	3,463	(13,636)
Reserve for loss and loss expenses	171,078	70,178
Unearned premiums	450,657	372,374
Insurance and reinsurance balances, net	(390,339)	(291,642)
Other items	(33,083)	(34,850)
Net cash provided by operating activities	304,684	297,424
Cash flows from investing activities:		
Purchase of available-for-sale securities	(1,740,912)	(1,095,273)
Sales and maturities of available-for-sale securities	1,520,091	1,172,473
Purchases of other investments	(20,171)	(126,000)
Sales of other investments	72,479	
Net cash used in investing activities	(168,513)	(48,800)
Cash flows from financing activities:		
Dividends paid common shares	(28,583)	(22,925)
Dividends paid preferred shares	(9,204)	(10,134)
Repurchase of shares	(2,889)	(179)
Issuance of common shares, net	2,633	13,338
Net cash used in financing activities	(38,043)	(19,900)
Effect of exchange rate changes on foreign currency cash	3,419	1,905
Increase in cash and cash equivalents	101,547	230,629
Cash and cash equivalents beginning of period	1,989,287	1,280,990
Cash and cash equivalents end of period	\$ 2,090,834	\$ 1,511,619

See accompanying notes to the consolidated financial statements.

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION AND ACCOUNTING POLICIES

Basis of Presentation

Our consolidated balance sheet at March 31, 2007 and the consolidated statements of operations, comprehensive income, shareholders' equity and cash flows for the three months ended March 31, 2007 and 2006 have not been audited. These statements and have been prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. 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 footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, these financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of our financial position and results of operations as at the end of and for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year. All significant inter-company accounts and transactions have been eliminated. In these notes, the terms we, us, our, or the Company refer to AXIS Capital and its direct and indirect subsidiaries.

The following information is unaudited and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2006. Tabular dollars are in thousands, except per share amounts. Certain reclassifications have been made to prior period amounts to conform to the current period presentation. In particular, we reclassified the additional capital above par value on our Series A and B preferred shares from additional paid-in capital to the preferred shares caption in our Consolidated Balance Sheets and Statements of Changes in Shareholders' Equity.

Adoption of New Accounting Standards

The terms FAS and FASB used in these notes refer to Statements of Financial Accounting Standards issued by the United States Financial Accounting Standards Board.

On July 13, 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109 (FIN 48). This Interpretation prescribes detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. Under FIN 48, the tax benefits of uncertain tax positions may only be recognized when the position is more-likely-than-not to be sustained upon audit by the relevant taxing authorities. The amount recognized represents the largest amount of tax benefit that is greater than fifty percent likely of being recognized. We adopted the provisions of FIN 48 on January 1, 2007. There were no unrecognized tax benefits as of the date of adoption and there was no change in the liability for unrecognized tax benefits. Our U.S. subsidiaries are not under examination but remain subject to examination in the U.S. for tax years 2003-2006. Our various European operating subsidiaries and branch operations in Ireland, the United Kingdom, and Switzerland are not under examination in any of these tax jurisdictions, but generally remain subject to examination for tax years 2002-2006.

Accounting Standards Not Yet Adopted

In September 2006, the FASB issued FAS No. 157, Fair Value Measurement (FAS 157). This Statement provides guidance for using fair value to measure assets and liabilities. Under this standard, the definition of fair value focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). FAS 157 clarifies that fair value is a marketbased measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets and the lowest priority to unobservable data. Further, FAS 157 requires tabular disclosures of the fair value measurements by level within the fair value hierarchy. FAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Although early adoption is permitted as of January 1, 2007, we have not yet adopted FAS 157 and are evaluating the potential impact of adoption on our financial condition, results of operations and cash flows.

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. **BASIS OF PRESENTATION AND ACCOUNTING POLICIES (Continued)**

In February 2007, the FASB issued FAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (FAS 159). This standard permits an entity to irrevocably elect fair value on a contract-by-contract basis as the initial and subsequent measurement attribute for many financial instruments and certain other items including insurance contracts. An entity electing the fair value option would be required to recognize changes in fair value in earnings and provide disclosure that will assist investors and other users of financial information to more easily understand the effect of the company's choice to use fair value on its earnings. Further, the entity is required to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. This standard does not eliminate the disclosure requirements about fair value measurements included in FAS 157 and FAS No. 107, *Disclosures about Fair Value of Financial Instruments*. FAS 159 is effective for fiscal years beginning after November 15, 2007. Although early adoption is permitted as of January 1, 2007, we have not yet adopted FAS 159 and are evaluating the potential adoption impact on our financial condition, results of operations and cash flows.

2. **SEGMENT INFORMATION**

Our underwriting operations are organized around our two global underwriting platforms, AXIS Insurance and AXIS Re and therefore we have determined that we have two reportable segments, insurance and reinsurance. We do not allocate our assets by segment as we evaluate the underwriting results of each segment separately from the results of our investment portfolio.

Insurance

Our insurance segment provides insurance coverage on a worldwide basis. In January 2007, we announced the reorganization of AXIS Insurance to further strengthen the global operations of the segment. This reorganization reflects the management of AXIS Insurance along global product lines rather than by geographical location. The new structure enables us to design insurance programs on a global basis in alignment with the global needs of many of our clients. Through December 31, 2006, we subdivided our insurance segment into two sub-segments: global insurance and U.S insurance. However, as a result of the reorganization such sub-segment information is no longer relevant.

The following are the lines of business in our insurance segment:

- *Property*: provides physical damage and business interruption coverage for industrial and commercial properties and physical damage, business interruption and liability coverage for onshore energy properties and operations. The book consists of both primary and excess risks, some of which are catastrophe-exposed.
- *Marine*: provides coverage for hull, liability, cargo and specie and recreational marine risks. These risks include property damage or physical loss to ships, pollution damage caused by vessels on a sudden and accidental basis, protection for general cargo and the contents of armored cars, vaults, exhibitions and museums, and specific war related risks. This line of business also provides physical damage, business interruption and liability coverage for offshore energy property and operations.
- *Terrorism*: provides coverage for physical damage and business interruption of an insured following an act of terrorism.
- *Aviation*: includes hull and liability and specific war coverage for passenger and cargo airlines and privately owned aircraft as well as select aviation product liability coverage.
- *Political risk*: generally provides protection against sovereign default or sovereign actions resulting in impairment of cross-border investments for banks and major corporations. It also provides protection on structured

credit based transactions where lenders seek to mitigate some of the non-payment risk of their borrowers, both public and private.

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. SEGMENT INFORMATION (Continued)

- *Professional lines:* primarily consists of coverage for directors and officers liability, errors and omissions liability and employment practices liability.
- *Liability:* primarily targets general liability and umbrella and excess liability in the U.S. excess and surplus lines markets. Target classes include mercantile, manufacturing and building/premises, with particular emphasis on commercial and consumer products, commercial construction and miscellaneous general liability.
- *Accident & Health:* primarily provides employee medical coverage for self-insured, small and medium sized employers for losses in excess of a retention.

Reinsurance

Our reinsurance segment provides property and casualty reinsurance to insurance companies on a worldwide basis. The following are the lines of business we write on both a treaty and facultative basis in our reinsurance segment:

- *Catastrophe:* provides protection for most catastrophic losses that are covered in the underlying insurance policies written by our ceding company clients. The exposure in the underlying policies is principally property exposure but also covers other exposures including workers compensation, personal accident and life. The principal perils in this portfolio are hurricane and windstorm, earthquake, flood, tornado, hail and fire. In some instances, terrorism may be a covered peril or the only peril. We underwrite catastrophe reinsurance principally on an excess of loss basis, meaning that our exposure only arises when our customers' claims exceed a certain retained amount.
- *Property:* includes reinsurance written on both a pro rata and a per risk basis and covers underlying personal lines and commercial property exposures. Property pro rata treaty reinsurance covers a cedent's aggregate losses from all events in the covered period on a proportional basis. Property per risk treaty reinsurance reinsures a portfolio of particular property risks of ceding companies on an excess of loss basis.
- *Professional Liability:* covers directors and officers liability, employment practices liability, medical malpractice and miscellaneous errors and omissions insurance risks.
- *Credit and Bond:* consists principally of reinsurance of trade credit insurance products and includes both proportional and excess-of loss structures. The underlying insurance indemnifies sellers of goods and services against a payment default by the buyer of those goods and services. Also included in this book is coverage for ceding insurers against losses arising from a broad array of surety bonds issued by bond insurers principally to satisfy regulatory demands in a variety of jurisdictions around the world, but predominantly in Europe.
- *Motor:* provides coverage to insurers for motor liability losses arising out of any one occurrence. The occurrence can involve one or many claimants where the ceding insurer aggregates the claims from the occurrence.

- *Liability*: provides coverage to insurers of standard casualty lines, including auto liability, general liability, personal and commercial umbrella and workers compensation.
- *Other*: includes aviation, engineering, marine, personal accident and crop reinsurance.

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

2. SEGMENT INFORMATION (Continued)

The following tables summarize the underwriting results of our operating segments for the three months ended March 31:

	2007			2006			
	Insurance	Reinsurance	Total	Insurance	Reinsurance	Total	
Gross premiums written	\$ 436,488	\$ 866,134	\$ 1,302,622	\$ 437,050	\$ 727,690	\$ 1,164,740	
Net premiums written	282,046	857,311	1,139,357	275,150	717,178	992,328	
Net premiums earned	314,932	370,372	685,304	322,713	310,881	633,594	
Other insurance related income	767	1,173	1,940	624		624	
Net losses and loss expenses	(185,952)	(206,845)	(392,797)	(156,170)	(202,488)	(358,658)	
Acquisition costs	(35,348)	(62,791)	(98,139)	(37,456)	(52,248)	(89,704)	
General and administrative expenses	(35,523)	(14,743)	(50,266)	(33,055)	(10,714)	(43,769)	
Underwriting income	\$ 58,876	\$ 87,166	146,042	\$ 96,656	\$ 45,431	142,087	
Corporate expenses			(12,340)			(11,642)	
Net investment income			125,280			93,568	
Net realized investment gains (losses)			301			(10,929)	
Foreign exchange gains			2,391			9,264	
Interest expense			(15,144)			(8,085)	
Income before income taxes			\$ 246,530			\$ 214,263	
Net loss and loss expense ratio	59.0	% 55.8	% 57.3	% 48.4	% 65.1	% 56.6	%
Acquisition cost ratio	11.2	% 17.0	% 14.3	% 11.6	% 16.8	% 14.2	%
General and administrative expense ratio	11.3	% 4.0	% 9.1	% 10.2	% 3.4	% 8.7	%
Combined ratio	81.5	% 76.8	% 80.7	% 70.2	% 85.3	% 79.5	%

AXIS CAPITAL HOLDINGS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)