

NATIONAL SECURITY GROUP INC
Form 10-Q
August 13, 2018
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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 Quarterly Period Ended June 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 0-18649

The National Security Group, Inc.
(Exact name of registrant as specified in its charter)

Delaware 63-1020300
(State or Other Jurisdiction of (IRS Employer
Incorporation or Organization) Identification No.)

661 East Davis Street 36323
Elba, Alabama
(Address of principal executive offices) (Zip-Code)

Registrant's Telephone Number including Area Code (334) 897-2273

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 (§232.405 of this chapter) 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, or a non-accelerated filer (as defined in rule 12b-2 of the Act). (Check One) : Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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 13, 2018, there were 2,527,136 shares, \$1.00 par value, of the registrant's common stock outstanding.

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THE NATIONAL SECURITY GROUP, INC.

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Cautionary Statement Regarding Forward-Looking Statements

Any statement contained in this report which is not a historical fact, or which might otherwise be considered an opinion or projection concerning the Company or its business, whether expressed or implied, is meant as and should be considered a forward-looking statement as that term is defined in the Private Securities Litigation Reform Act of 1995. The following report contains forward-looking statements that are not strictly historical and that involve risks and uncertainties. Such statements include any statements containing the words “expect,” “plan,” “estimate,” “anticipate” or other words of a similar nature. Management cautions investors about forward-looking statements. Forward-looking statements involve certain evaluation criteria, such as risks, uncertainties, estimates, and/or assumptions made by individuals informed of the Company and industries in which we operate. Any variation in the preceding evaluation criteria could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, without limitation, the following:

The insurance industry is highly competitive and the Company encounters significant competition in all lines of business from other insurance companies. Many of the competing companies have more abundant financial resources than the Company.

Insurance is a highly regulated industry. It is possible that legislation may be enacted which would have an adverse effect on the Company's business.

The Company is subject to regulation by state governments for each of the states in which it conducts business. The Company cannot predict the subject of any future regulatory initiative(s) or its (their) impact on the Company's business. Company insurance rates are also subject to approval by state insurance departments in each of these states. We are often limited in the level of rate increases we can obtain.

The Company is rated by various insurance rating agencies. If a rating is downgraded from its current level by one of these agencies, sales of the Company's products and stock price could be adversely impacted.

The Company's financial results are adversely affected by increases in policy claims received by the Company. While a manageable risk, this fluctuation is often unpredictable.

The Company's investments are subject to a variety of risks. Investments are subject to defaults and changes in market value. Market value can be affected by changes in interest rates, market performance and the economy.

The Company mitigates risk associated with life policies through implementing effective underwriting and reinsurance strategies. These factors mitigate, not eliminate, risk related to mortality and morbidity exposure. The Company has established reserves for claims and future policy benefits based on amounts determined by independent actuaries. There is no assurance that these estimated reserves will prove to be sufficient or that the Company will not incur claims exceeding reserves, which could result in operating losses and loss of capital.

The Company mitigates risk associated with property and casualty policies through implementing effective underwriting and reinsurance strategies. The Company obtains reinsurance which increases underwriting capacity and limits the risk associated with policy claims. The Company is subject to credit risk with regard to reinsurers as reinsurance does not alleviate the Company's liability to its insured's for the ceded risks. The Company utilizes a third-party to develop a reinsurance treaty with reinsurers who are reliable and financially stable. However, there is no guarantee that booked reinsurance recoverable will actually be recovered. A reinsurer's insolvency or inability to make payments due could have a material adverse impact on the financial condition of the Company.

The Company's ability to continue to pay dividends to shareholders is contingent upon profitability and capital adequacy of the insurance subsidiaries. The insurance subsidiaries operate under regulatory restrictions that could

limit the ability to fund future dividend payments of the Company. An adverse event or series of events could materially impact the ability of the insurance subsidiaries to fund future dividends, and consequently, the Board of Directors would have to suspend the declaration of dividends to shareholders.

The Company is subject to the risk of adverse settlements or judgments resulting from litigation of contested claims. It is difficult to predict or quantify the expected results of litigation because the outcome depends on decisions of the court and jury that are based on facts and legal arguments presented at the trial.

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PART I. Financial Information

Item 1. Financial Statements

THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS (In thousands)

	June 30, 2018 (UNAUDITED)	December 31, 2017
ASSETS		
Investments		
Fixed maturities held-to-maturity, at amortized cost (estimated fair value: 2018 - \$1,512; 2017 - \$1,645)	\$ 1,523	\$ 1,616
Fixed maturities available-for-sale, at estimated fair value (cost: 2018 - \$98,514; 2017 - \$94,467)	97,036	95,758
Equity securities, at estimated fair value (cost: 2018 - \$1,842; 2017 - \$1,842)	4,140	4,509
Trading securities	107	107
Mortgage loans on real estate, at cost	160	162
Investment real estate, at book value	2,945	3,221
Policy loans	1,851	1,810
Company owned life insurance	4,838	4,974
Other invested assets	2,346	2,574
Total Investments	114,946	114,731
Cash and cash equivalents	4,543	6,644
Accrued investment income	808	768
Policy receivables and agents' balances, net	12,870	11,653
Reinsurance recoverable	278	366
Deferred policy acquisition costs	8,140	8,124
Property and equipment, net	1,712	1,781
Income tax recoverable	711	393
Deferred income tax asset, net	1,405	1,487
Other assets	886	491
Total Assets	\$ 146,299	\$ 146,438
LIABILITIES AND SHAREHOLDERS' EQUITY		
Property and casualty benefit and loss reserves	\$ 6,847	\$ 7,075
Accident and health benefit and loss reserves	3,583	3,595
Life and annuity benefit and loss reserves	33,538	33,283
Unearned premiums	32,080	30,112
Policy and contract claims	942	903
Other policyholder funds	1,708	1,706
Short-term notes payable and current portion of long-term debt	800	1,300
Long-term debt	14,345	14,339
Other liabilities	6,059	6,500
Total Liabilities	99,902	98,813
Contingencies		
Shareholders' equity		
Common stock	2,527	2,522
Additional paid-in capital	5,554	5,483
Accumulated other comprehensive income (loss)	(1,441)) 2,646
Retained earnings	39,757	36,974

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Total Shareholders' Equity	46,397	47,625
Total Liabilities and Shareholders' Equity	\$ 146,299	\$ 146,438

The Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

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THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
REVENUES				
Net premiums earned	\$15,260	\$15,331	\$30,319	\$30,371
Net investment income	998	930	1,779	1,856
Net realized investment gains (losses)	(203)	77	(328)	237
Other income	148	145	309	297
Total Revenues	16,203	16,483	32,079	32,761
BENEFITS, LOSSES AND EXPENSES				
Policyholder benefits and settlement expenses	9,772	12,581	19,199	23,727
Amortization of deferred policy acquisition costs	787	819	1,590	1,764
Commissions	1,732	1,758	3,792	3,851
General and administrative expenses	2,668	2,215	4,671	4,012
Taxes, licenses and fees	349	517	998	1,206
Interest expense	309	326	611	649
Total Benefits, Losses and Expenses	15,617	18,216	30,861	35,209
Income (Loss) Before Income Taxes	586	(1,733)	1,218	(2,448)
INCOME TAX EXPENSE (BENEFIT)				
Current	216	(572)	(318)	(897)
Deferred	(87)	(162)	608	(236)
	129	(734)	290	(1,133)
Net Income (Loss)	\$457	\$(999)	\$928	\$(1,315)
INCOME (LOSS) PER COMMON SHARE BASIC AND DILUTED	\$0.18	\$(0.39)	\$0.37	\$(0.52)
DIVIDENDS DECLARED PER SHARE	\$0.05	\$0.05	\$0.10	\$0.10

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THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)

(In thousands)

	Three months ended June 30,		Six months ended June 30,	
	2018	2017	2018	2017
Net income (loss)	\$457	\$(999)	\$928	\$(1,315)
Other comprehensive income (loss), net of tax				
Changes in:				
Unrealized gains (losses) on securities, net of reclassification adjustment of \$102 and \$155 for 2018 and 2017, respectively	(811)	502	(2,187)	846
Unrealized gain on interest rate swap	75	40	207	110
Other comprehensive income (loss), net of tax	(736)	542	(1,980)	956
Comprehensive income (loss)	\$(279)	\$(457)	\$(1,052)	\$(359)

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THE NATIONAL SECURITY GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (UNAUDITED)
(In thousands)

	Total	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock	Additional Paid-in Capital
Balance at December 31, 2017	\$47,625	\$36,974	\$ 2,646	\$ 2,522	\$ 5,483
Cumulative effect of change in accounting principle	—	2,107	(2,107)	—	—
Comprehensive income (loss):					
Net income for June 30, 2018	928	928			