

Edgar Filing: State Auto Financial CORP - Form 10-Q

State Auto Financial CORP
Form 10-Q
August 08, 2017

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

ý Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2017

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 000-19289

STATE AUTO FINANCIAL CORPORATION

(Exact name of Registrant as specified in its charter)

Ohio

(State or other jurisdiction of
incorporation or organization)

31-1324304

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

518 East Broad Street, Columbus, Ohio 43215-3976

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (614) 464-5000

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 ý 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 ý 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 definition of "large accelerated filer", "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨

Accelerated filer ý

Non-accelerated filer ¨

Smaller reporting company ¨

(Do not check if a 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. ¨

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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 ☒

On July 28, 2017, the Registrant had 42,069,515 Common Shares outstanding.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

PART I – FINANCIAL STATEMENTS**Item 1. Condensed Consolidated Balance Sheets**

(\$ and shares in millions, except per share amounts)

	June 30, 2017 (unaudited)	December 31, 2016
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost \$2,138.3 and \$2,095.9, respectively)	\$ 2,167.1	\$2,109.3
Equity securities, available-for-sale, at fair value (cost \$321.5 and \$323.1, respectively)	391.4	382.8
Other invested assets, available-for-sale, at fair value (cost \$25.6 and \$25.5, respectively)	50.6	45.1
Other invested assets	5.6	5.4
Notes receivable from affiliate	70.0	70.0
<i>Total investments</i>	2,684.7	2,612.6
Cash and cash equivalents	48.8	51.1
Accrued investment income and other assets	39.7	40.0
Deferred policy acquisition costs (affiliated net assumed \$47.0 and \$50.7, respectively)	125.0	129.8
Reinsurance recoverable on losses and loss expenses payable	2.7	3.6
Prepaid reinsurance premiums	6.0	6.1
Due from affiliate	22.9	—
Current federal income taxes	6.6	6.7
Net deferred federal income taxes	88.9	102.1
Property and equipment, at cost	7.2	7.4
<i>Total assets</i>	\$ 3,032.5	\$2,959.4
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliated net assumed \$660.5 and \$630.9, respectively)	\$ 1,233.6	\$1,181.6
Unearned premiums (affiliated net assumed \$234.9 and \$220.9, respectively)	627.4	617.8
Notes payable (affiliates \$15.2 and \$15.2, respectively)	122.1	122.1
Pension and postretirement benefits (affiliated net ceded \$36.4 and \$40.1, respectively)	67.6	74.4
Due to affiliate	—	2.4
Other liabilities (affiliated net assumed \$17.9 and \$11.0, respectively)	67.4	69.8
<i>Total liabilities</i>	2,118.1	2,068.1
Stockholders' equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued	—	—
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued	—	—
Common stock, without par value. Authorized 100.0 shares; 48.9 and 48.6 shares issued, respectively, at stated value of \$2.50 per share	122.2	121.6
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(116.7)	(116.5)
Additional paid-in capital	165.6	159.9
Accumulated other comprehensive income (affiliated net ceded \$51.9 and \$53.7, respectively)	53.4	32.5
Retained earnings	689.9	693.8
<i>Total stockholders' equity</i>	914.4	891.3
<i>Total liabilities and stockholders' equity</i>	\$ 3,032.5	\$2,959.4

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Income

(\$ in millions, except per share amounts)

	Three months ended June 30	
(unaudited)	2017	2016
Earned premiums (affiliated net assumed \$118.1 and \$117.6, respectively)	\$320.1	\$322.4
Net investment income (affiliates \$1.2 and \$1.2, respectively)	19.1	19.1
Net realized gains (losses) on investments:		
Total other-than-temporary impairment losses	(0.8)	(0.6)
Other net realized investment gains	16.6	7.1
Total net realized gains on investments	15.8	6.5
Other income from affiliates	0.7	0.5
Total revenues	355.7	348.5
Losses and loss expenses (affiliated net assumed \$83.4 and \$86.8, respectively)	230.4	262.9
Acquisition and operating expenses (affiliated net assumed \$71.8 and \$68.4, respectively)	109.9	107.2
Interest expense (affiliates \$0.2 and \$0.2, respectively)	1.5	1.4
Other expenses	2.0	2.1
Total expenses	343.8	373.6
Income (loss) before federal income taxes	11.9	(25.1)
Federal income tax expense (benefit):		
Current	0.2	—
Deferred	3.0	(0.5)
Total federal income tax expense (benefit)	3.2	(0.5)
Net income (loss)	\$8.7	\$(24.6)
Earnings (loss) per common share:		
Basic	\$0.21	\$(0.59)
Diluted	\$0.21	\$(0.59)
Dividends paid per common share	\$0.10	\$0.10

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Income

(\$ in millions, except per share amounts)

	Six months ended June 30	
(unaudited)	2017	2016
Earned premiums (affiliated net assumed \$232.9 and \$231.0, respectively)	\$637.4	\$642.3
Net investment income (affiliates \$2.4 and \$2.4, respectively)	37.8	36.5
Net realized gains (losses) on investments:		
Total other-than-temporary impairment losses	(2.9)	(4.3)
Other net realized investment gains	26.5	12.1
Total net realized gains on investments	23.6	7.8
Other income from affiliates	1.2	1.1
Total revenues	700.0	687.7
Losses and loss expenses (affiliated net assumed \$169.6 and \$180.5, respectively)	464.4	487.9
Acquisition and operating expenses (affiliated net assumed \$152.1 and \$138.9, respectively)	222.1	214.7
Interest expense (affiliates \$0.4 and \$0.4, respectively)	2.9	2.7
Other expenses	3.9	3.7
Total expenses	693.3	709.0
Income (loss) before federal income taxes	6.7	(21.3)
Federal income tax expense:		
Current	0.1	—
Deferred	2.0	0.3
Total federal income tax expense	2.1	0.3
Net income (loss)	\$4.6	\$(21.6)
Earnings (loss) per common share:		
Basic	\$0.11	\$(0.52)
Diluted	\$0.11	\$(0.52)
Dividends paid per common share	\$0.20	\$0.20

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Statements of Comprehensive Income

(\$ in millions, except per share amounts)

	Three months ended June 30	
(unaudited)	2017	2016
Net income (loss)	\$8.7	\$(24.6)
Other comprehensive income, net of tax:		
Net unrealized holding gains on investments:		
Unrealized holding gains	23.8	38.2
Reclassification adjustments for gains realized in net income	(15.8)	(6.5)
Income tax expense	(2.8)	(11.1)
<i>Total net unrealized holding gains on investments</i>	5.2	20.6
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	(1.4)	(1.4)
Net actuarial loss	1.9	2.3
Income tax expense	(0.2)	(0.2)
<i>Total net unrecognized benefit plan obligations</i>	0.3	0.7
<i>Other comprehensive income</i>	5.5	21.3
Comprehensive income (loss)	\$14.2	\$(3.3)

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Statements of Comprehensive Income

(\$ in millions, except per share amounts)

	Six months ended June 30	
(unaudited)	2017	2016
Net income (loss)	\$4.6	\$(21.6)
Other comprehensive income, net of tax:		
Net unrealized holding gains on investments:		
Unrealized holding gains	54.6	75.2
Reclassification adjustments for gains realized in net income	(23.6)	(7.8)
Income tax expense	(10.8)	(23.6)
<i>Total net unrealized holding gains on investments</i>	20.2	43.8
Net unrecognized benefit plan obligations:		
Reclassification adjustments for amortization to statements of income:		
Negative prior service cost	(2.8)	(2.8)
Net actuarial loss	4.0	4.7
Income tax expense	(0.5)	(0.6)
<i>Total net unrecognized benefit plan obligations</i>	0.7	1.3
<i>Other comprehensive income</i>	20.9	45.1
Comprehensive income	\$25.5	\$23.5

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Cash Flows

(\$ in millions)

Six months
ended June 30
2017 2016

(unaudited)

Cash flows from operating activities:

Net income (loss)	\$4.6	\$ (21.6)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization, net	6.1	7.4
Share-based compensation	2.8	2.2
Net realized gains on investments	(23.6)	(7.8)
Changes in operating assets and liabilities:		
Deferred policy acquisition benefits	4.8	(2.7)
Accrued investment income and other assets	0.1	(0.4)
Postretirement and pension benefits	(6.0)	(3.8)
Other liabilities and due to/from affiliates, net	(32.5)	(27.8)
Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums	1.0	0.7
Losses and loss expenses payable	52.0	90.2
Unearned premiums	9.6	7.4
Deferred tax expense (benefit) on share-based awards	1.3	(0.3)
Federal income taxes	1.2	1.0
Net cash provided by operating activities	21.4	44.5

Cash flows from investing activities:

Purchases of fixed maturities available-for-sale	(244.5)	(292.0)
Purchases of equity securities available-for-sale	(69.0)	(45.0)
Purchases of other invested assets	(0.7)	(0.7)
Maturities, calls and pay downs of fixed maturities available-for-sale	94.5	101.2
Sales of fixed maturities available-for-sale	108.2	126.4
Sales of equity securities available-for-sale	91.9	65.0
Sales of other invested assets available-for-sale	0.5	0.4
Net cash used in investing activities	(19.1)	(44.7)

Cash flows from financing activities:

Proceeds from issuance of common stock	4.1	3.3
Payments to acquire treasury stock	(0.2)	(0.2)
Payment of dividends	(8.5)	(8.3)
Deferred tax expense (benefit) on share-based awards	—	0.3
Net cash used in financing activities	(4.6)	(4.9)
Net decrease in cash and cash equivalents	(2.3)	(5.1)
Cash and cash equivalents at beginning of period	51.1	58.1
Cash and cash equivalents at end of period	\$48.8	\$53.0

Supplemental disclosures:

Interest paid (affiliates \$0.4 and \$0.4, respectively)	\$2.8	\$2.6
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See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of State Auto Financial Corporation and Subsidiaries (“State Auto Financial” or the “Company”) have been prepared in accordance 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. generally accepted accounting principles (“GAAP”) for complete financial statements. In the opinion of the Company, all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month period ended June 30, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. The balance sheet at December 31, 2016, has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2016, (the “2016 Form 10-K”). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2016 Form 10-K.

Adoption of Recent Accounting Pronouncements

Employee Share-Based Payment Accounting

The amendments in this guidance simplify the accounting for share-based payment award transactions including: income tax consequences, classification of awards as either equity or liabilities, classification of excess tax benefits, and classification on the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company adopted this guidance prospectively at January 1, 2017, and prior periods were not adjusted. For the three and six months ended June 30, 2017, the Company recognized \$1.3 million of income tax expense as a result of adopting this guidance.

Pending Adoption of Recent Accounting Pronouncements

For information regarding accounting pronouncements that the Company has not yet adopted, see the “Pending Adoption of Recent Accounting Pronouncements” section of Note 1 of the Notes to Consolidated Financial Statements in the 2016 Form 10-K.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

2. Investments

The following tables set forth the cost or amortized cost and fair value of available-for-sale securities by lot at June 30, 2017 and December 31, 2016:

(\$ millions)

June 30, 2017

Fixed maturities:

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
U.S. treasury securities and obligations of U.S. government agencies	\$437.5	\$ 7.8	\$(4.8)	\$440.5
Obligations of states and political subdivisions	613.1	19.4	(0.8)	631.7
Corporate securities	481.3	6.1	(1.2)	486.2
U.S. government agencies mortgage-backed securities	606.4	9.7	(7.4)	608.7
<i>Total fixed maturities</i>	2,138.3	43.0	(14.2)	2,167.1
Equity securities:				
Large-cap securities	80.6	34.1	(0.4)	114.3
Small-cap securities	53.0	19.1	—	72.1
Mutual and exchange traded funds	187.9	19.7	(2.6)	205.0
<i>Total equity securities</i>	321.5	72.9	(3.0)	391.4
Other invested assets	25.6	25.0	—	50.6
<i>Total available-for-sale securities</i>	\$2,485.4	\$ 140.9	\$(17.2)	\$2,609.1

(\$ millions)

December 31, 2016

Fixed maturities:

	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
U.S. treasury securities and obligations of U.S. government agencies	\$401.9	\$ 8.9	\$(6.1)	\$404.7
Obligations of states and political subdivisions	634.6	12.3	(3.2)	643.7
Corporate securities	445.7	6.1	(2.2)	449.6
U.S. government agencies mortgage-backed securities	613.7	8.5	(10.9)	611.3
<i>Total fixed maturities</i>	2,095.9	35.8	(22.4)	2,109.3
Equity securities:				
Large-cap securities	108.9	32.7	(2.6)	139.0
Small-cap securities	57.2	21.9	—	79.1
Mutual and exchange traded funds	157.0	8.5	(0.8)	164.7
<i>Total equity securities</i>	323.1	63.1	(3.4)	382.8
Other invested assets	25.5	19.6	—	45.1
<i>Total available-for-sale securities</i>	\$2,444.5	\$ 118.5	\$(25.8)	\$2,537.2

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following tables set forth the Company's gross unrealized losses and fair value on its investments by lot, aggregated by investment category and length of time for individual securities that have been in a continuous unrealized loss position at June 30, 2017 and December 31, 2016:

(\$ millions, except # of positions)

	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
June 30, 2017									
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$262.4	\$(4.8)	33	\$—	—	—	\$262.4	\$(4.8)	33
Obligations of states and political subdivisions	68.3	(0.8)	9	—	—	—	68.3	(0.8)	9
Corporate securities	103.7	(1.0)	17	15.0	(0.2)	3	119.6	(1.2)	20
U.S. government agencies mortgage-backed securities	295.5	(6.4)	40	30.0	(4.0)	13	325.9	(7.4)	53
<i>Total fixed maturities</i>	729.9	(13.0)	99	46.0	(4.2)	16	776.2	(14.2)	115
Equity securities:									
Large-cap equity securities	3.9	(0.3)	4	4.6	(0.1)	2	8.5	(0.4)	6
Mutual and exchange traded funds	52.8								