

BRISTOL WEST HOLDINGS INC
Form 10-Q
May 10, 2007

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 the quarterly period ended March 31, 2007

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 No. 001-31984

BRISTOL WEST HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

13-3994449

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

5701 Stirling Road, Davie, Florida

(Address of principal executive offices)

33314

(Zip Code)

(954) 316-5200

(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

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. (Check one):

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

At April 30, 2007, the registrant had outstanding an aggregate of 29,543,076 shares of its common stock.



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PART I - FINANCIAL INFORMATION**Item 1. Financial Statements**

BRISTOL WEST HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	March 31, 2007	December 31, 2006
	(in thousands, except share data)	
Assets:		
Investments:		
Fixed maturities available-for-sale (amortized cost \$488,412 and \$496,813 at March 31, 2007 and December 31, 2006, respectively)	\$ 486,499	\$ 493,727
Equity securities (cost \$2,500 and \$2,000 at March 31, 2007 and December 31, 2006)	2,500	2,000
Total investments	488,999	495,727
Cash and cash equivalents	58,598	49,293
Accrued investment income	5,231	5,637
Premiums and other receivables (net of allowance for doubtful accounts of \$6,517 and \$6,096 at March 31, 2007 and December 31, 2006, respectively)	174,693	175,892
Reinsurance recoverables on paid and unpaid losses and loss adjustment expenses	46,901	37,911
Prepaid reinsurance	3,063	2,730
Deferred policy acquisition costs	47,171	47,243
Property, software and equipment - net	20,009	20,036
Goodwill	101,481	101,481
Other assets	12,132	8,609
Total assets	\$ 958,278	\$ 944,559
Liabilities and Stockholders' Equity:		
Liabilities:		
Policy liabilities:		
Reserve for losses and loss adjustment expenses	\$ 250,879	\$ 239,177
Unearned premiums	197,626	189,605
Total policy liabilities	448,505	428,782
Reinsurance payables	4,240	3,265
Accounts payable and other liabilities	35,314	45,858
Deferred income taxes	9,718	9,903
Long-term debt, including current portion	100,000	100,000
Total liabilities	597,777	587,808
Commitments and contingent liabilities (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.01 par value (15,000,000 shares authorized; 0 shares outstanding at March 31, 2007 and December 31, 2006)	-	-
Common stock, \$0.01 par value (200,000,000 shares authorized; 33,346,514 and		

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33,269,364 shares issued at March 31, 2007 and December 31, 2006,
 respectively)

	333	332
Additional paid-in capital	236,272	235,086
Retained earnings	180,224	178,270
Treasury stock at cost (3,777,068 and 3,768,670 shares held at March 31, 2007 and December 31, 2006, respectively)	(55,083)	(54,937)
Stock subscription receivable	(22)	(27)
Accumulated other comprehensive loss	(1,223)	(1,973)
Total stockholders' equity	360,501	356,751
Total liabilities and stockholders' equity	\$ 958,278	\$ 944,559

The accompanying notes are an integral part of the condensed consolidated financial statements.

BRISTOL WEST HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

	Three Months Ended March 31,	
	2007	2006
	(in thousands, except per share data)	
Revenues:		
Net earned premium	\$ 151,179	\$ 144,278
Net investment income	6,055	4,967
Realized gain on investments, net	17	68
Policy service fee revenue	14,101	13,836
Other income	1,009	734
Total revenues	172,361	163,883
Costs and Expenses:		
Losses and loss adjustment expenses incurred	112,703	97,658
Commissions and other underwriting expenses	39,723	37,526
Other operating and general expenses	11,913	10,383
Interest expense	1,640	1,206
Total costs and expenses	165,979	146,773
Income before income taxes	6,382	17,110
Income taxes	2,119	5,920
Net Income	\$ 4,263	\$ 11,190
Net income per common share - Basic	\$ 0.15	\$ 0.38
Net income per common share - Diluted	\$ 0.14	\$ 0.36
Dividends declared per common share	\$ 0.08	\$ 0.07

The accompanying notes are an integral part of the condensed consolidated financial statements.

BRISTOL WEST HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)

	Three Months Ended March	
	2007	2006
	(in thousands, except share data)	
STOCKHOLDERS' EQUITY:		
Common Stock		
Balance, beginning of period	\$ 332	\$ 328
Exercise of options and warrants, including tax benefit (21,843 shares--2007; 127,075 shares--2006)	-	1
Shares issued for services (2,357 shares--2007; 3,470 shares--2006)	-	-
Issuance of restricted common stock (52,862 shares--2007; 259,322 shares--2006)	1	3
Shares issued in payment of dividend (87 shares--2007; 81 shares--2006)	-	-
Balance, end of period	333	332
Additional Paid-In Capital		
Balance, beginning of period	235,086	235,308
Exercise of options and warrants, including tax benefit (21,843 shares--2007; 127,075 shares--2006)	368	1,179
Shares issued for services (2,357 shares--2007; 3,470 shares--2006)	52	88
Issuance of restricted common stock (52,862 shares--2007; 259,322 shares--2006)	-	(3)
Shares issued in payment of dividend (87 shares--2007; 81 shares--2006)	2	1
Restricted stock forfeited (437 shares--2007; 2,724 shares--2006)	8	51
Amortization of deferred compensation on restricted stock	755	660
Tax benefit on vesting of restricted stock	1	-
Reclassification resulting from adoption of accounting principle (SFAS No. 123R)	-	(5,763)
Balance, end of period	236,272	231,521
Retained Earnings		
Balance, beginning of period	178,270	144,609
Net income	4,263	11,190
Dividend to common shareholders (\$0.08 per share--2007; \$0.07 per share--2006)	(2,309)	(2,086)
Balance, end of period	180,224	153,713
Deferred Compensation on Restricted Stock		
Balance, beginning of period	-	(5,763)
Reclassification resulting from adoption of accounting principle (SFAS No. 123R)	-	5,763
Balance, end of period	-	-
Treasury Stock		
Balance, beginning of period	(54,937)	(34,078)
Acquisition of treasury stock (7,961 shares--2007; 476,562 shares--2006)	(138)	(8,816)

Restricted stock forfeited (437 shares--2007; 2,724 shares--2006)	(8)	(51)
Balance, end of period	(55,083)	(42,945)

Stock Subscription Receivable

Balance, beginning of period	(27)	(59)
Payment of stock subscriptions receivable	5	15
Balance, end of period	(22)	(44)

Accumulated Other Comprehensive Loss

Balance, beginning of period	(1,973)	(3,390)
Unrealized holdings gains/(losses) arising during the period	741	(2,171)
Reclassification adjustment	9	7
Net unrealized gain/(losses) on securities	750	(2,164)
Balance, end of period	(1,223)	(5,554)

Total Stockholders' Equity	\$	360,501	\$	337,023
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COMPREHENSIVE INCOME:

Net income	\$	4,263	\$	11,190
Net unrealized gain/(losses) on securities		750		(2,164)
Comprehensive Income	\$	5,013	\$	9,026

The accompanying notes are an integral part of the condensed consolidated financial statements.

BRISTOL WEST HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months Ended March 31,	
	2007	2006
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 4,263	\$ 11,190
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion of fixed maturity investments	900	1,116
Depreciation and amortization	1,829	1,705
Realized loss on disposal of property, software and equipment	17	-
Realized investment gain	(17)	(68)
Deferred federal and state income taxes	(613)	165
Stock based compensation	814	734
Changes in assets and liabilities:		
Accrued investment income	406	443
Premiums and other receivables	1,199	(5,725)
Reinsurance receivables	(8,990)	21,984
Prepaid reinsurance premiums	(333)	18,333
Deferred policy acquisition costs	72	(6,448)
Losses and loss adjustment expenses	11,702	(4,544)
Unearned premiums	8,021	10,407
Reinsurance payables	975	(26,797)
Other assets and liabilities	(3,683)	(9,517)
Net cash provided by operating activities	16,562	12,978
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of fixed maturity investments - available-for-sale	(37,171)	(24,523)
Sales and maturities of fixed maturity investments - available-for-sale	34,104	11,311
Purchase of equity securities	(500)	-
Acquisition of property, software and equipment	(1,764)	(1,298)
Net cash used in investing activities	(5,331)	(14,510)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of stock options	309	62
Tax benefit on exercise of stock options and vesting of restricted stock	67	693
Acquisition of treasury stock	-	(7,927)
Principal payments on long-term debt	-	(975)
Payment of dividends to stockholders	(2,307)	(2,084)
Other	5	15
Net cash used in financing activities	(1,926)	(10,216)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,305	(11,748)

Cash and cash equivalents, January 1	49,293	32,399
Cash and cash equivalents, March 31	\$ 58,598	\$ 20,651

The accompanying notes are an integral part of the condensed consolidated financial statements.

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BRISTOL WEST HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(dollars in thousands, except per share data)

1. Nature of Operations

Bristol West Holdings, Inc. (the "Company") is a property and casualty insurer writing and distributing private passenger automobile insurance. Given the homogeneity of the product, the regulatory environments in which the Company operates, the type of customer and the method of distribution, the operations of the Company are one segment. As of March 31, 2007, the Company is licensed in 38 states and the District of Columbia. The Company consists of a holding company, five statutory insurance companies (Bristol West Casualty Insurance Company, Bristol West Insurance Company, Security National Insurance Company, Coast National Insurance Company, and Bristol West Preferred Insurance Company), agencies and claims servicing companies. Bristol West Preferred Insurance Company was incorporated on September 7, 2006. This new company was capitalized with \$10,000 and is domiciled in the state of Michigan.

Merger of Bristol West and a Subsidiary of Farmers Group, Inc.

On March 1, 2007, the Company entered into a merger agreement (the "Farmers Merger Agreement") with Farmers Group, Inc. ("Farmers") pursuant to which BWH Acquisition Company, currently a wholly owned subsidiary of Farmers ("Merger Sub"), will be merged with and into the Company, with the Company being the surviving corporation (the "Proposed Farmers Merger"). Farmers is a Nevada corporation which, along with its subsidiaries, provides insurance management services to members of the Farmers Insurance Exchange, Truck Insurance Exchange and Fire Insurance Exchange (the "Exchanges"), which are among the leading U.S. property and casualty insurers. Merger Sub is a Delaware corporation formed in connection with the execution of the Farmers Merger Agreement. Farmers is currently owned by Zurich Financial Services Group, which, if the Proposed Farmers Merger is completed, will indirectly own all of the outstanding capital stock of the Company immediately after the Proposed Farmers Merger. Immediately prior to the consummation of the Proposed Farmers Merger, Farmers will contribute 50% of the issued and outstanding common stock of Merger Sub to each of two of Farmers' subsidiaries. Farmers and these subsidiaries have agreed that, immediately following the Proposed Farmers Merger, the subsidiaries will distribute certain assets and assign certain employees of the Company to Farmers and then sell all of the outstanding capital stock of the Company to the Exchanges and Mid-Century Insurance Company. Following the sale, Farmers will continue to provide insurance management services with respect to the Company's insurance operations.

Pursuant to the Farmers Merger Agreement, at the effective time of the Proposed Farmers Merger, each share (each a "Share") of the Company's common stock, par value \$0.01 per share ("Common Stock"), issued and outstanding immediately before the effective time of the Proposed Farmers Merger (other than shares owned by Farmers, Merger Sub and their respective subsidiaries and affiliates or held in the treasury of the Company or shares held by a holder who has validly demanded appraisal rights) will be cancelled and converted automatically into the right to receive a cash payment of \$22.50, without interest and less any applicable withholding taxes. At, or immediately prior to, the effective time of the Proposed Farmers Merger, each outstanding option and warrant to acquire Common Stock (other than unvested, performance based options) granted under the Company's equity-based compensation or stock option plans or otherwise, vested or unvested, will become fully vested and converted into a right to receive a cash payment in an amount equal to (1) the excess, if any, of \$22.50 over the exercise price of Common Stock subject to the option or warrant, multiplied by (2) the number of shares of Common Stock subject to the option or warrant, without interest and net of any applicable withholding taxes. The Company expects that certain unvested, outstanding, performance based options to acquire Common Stock will have no right to receive any consideration in connection with the Proposed Farmers Merger. Additionally, each share of restricted stock that is subject to vesting or other lapse restrictions and has not otherwise been forfeited immediately prior to the effective time of the Proposed Farmers

Merger will vest and become free of such restrictions as of the effective time of the Proposed Farmers Merger and the holder thereof will be entitled to receive \$22.50 in cash with respect to each restricted share held by such holder, plus any declared and unpaid dividends, without interest and less any applicable holding taxes. Further, each hypothetical share of Common Stock that immediately prior to the effective time of the Proposed Farmers Merger is included in a non-employee director's deferred compensation account (each a "Phantom Share") under the Company's Non-Employee Directors' Deferred Compensation and Stock Award Plan will entitle the holder to receive \$22.50 in cash for each Phantom Share held by such holder, without interest and less any applicable holding taxes.

BRISTOL WEST HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(dollars in thousands, except per share data)

Consummation of the Proposed Farmers Merger is subject to various closing conditions, including, but not limited to, the following: (1) the expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and related rules, (2) all insurance antitrust approvals and regulatory approvals from certain insurance departments, (3) absence of certain orders preventing the Proposed Farmers Merger, and (4) the approval of the Farmer's Merger Agreement by a majority of the outstanding shares of Common Stock entitled to vote.

Under certain circumstances, the Company and Farmers may terminate the Farmers Merger Agreement and abandon the Proposed Farmers Merger prior to the effective time of the Proposed Farmers Merger, whether before or after obtaining the stockholder approval of the Farmer's Merger Agreement required by that agreement. The Company may terminate the Farmers Merger Agreement under certain specified circumstances before obtaining the required stockholder approval of the Farmer's Merger Agreement if the Company's board of directors approves and the Company concurrently enters into a definitive alternative acquisition agreement pursuant to an acquisition proposal submitted by a third party that constitutes a Superior Proposal (as defined in the Farmers Merger Agreement). In connection with such a termination, the Company must pay a termination fee of \$21 million to Farmers. The circumstances under which the termination fee would have been \$14 million are no longer applicable. The Farmers Merger Agreement provides that in certain other circumstances specified therein where either the Company or Farmers unilaterally terminates the Merger Agreement, the Company will be required to pay a termination fee of \$21 million to Farmers. In certain other circumstances specified therein where the Company is not obligated to pay such a termination fee, the Farmers Merger Agreement provides that the Company must pay certain expenses incurred by Farmers and Merger Sub in connection with the Proposed Farmers Merger up to \$4 million.

The Farmers Merger Agreement contains customary covenants by the Company, including, without limitation, (1) to conduct its business in the ordinary and usual course during the interim period between the execution of the Farmers Merger Agreement and consummation of the Proposed Farmers Merger, (2) not to engage in certain kinds of transactions during that period, (3) that, subject to certain exceptions, the Company's Board of Directors will recommend approval of the Farmers Merger Agreement by its stockholders, and (4) unless the Farmers Merger Agreement is terminated, to convene and hold a meeting of the Company's stockholders to consider and vote upon the approval of the Farmers Merger Agreement.

The terms of certain of the Company's agreements including contracts, employee benefit arrangements and debt instruments have provisions which could result in changes to the terms or settlement amounts of these agreements upon a change in control of the Company such as the Proposed Farmers Merger.

2. Basis of Presentation

The unaudited condensed consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited condensed consolidated financial statements and the notes thereto should be read in conjunction with the Company's audited financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

BRISTOL WEST HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(dollars in thousands, except per share data)

3. Recent Accounting Pronouncements

In February 2007, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 159, *“The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of SFAS 115”* (“SFAS 159”). SFAS 159 allows entities to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not otherwise required to be measured at fair value. If an entity elects the fair value option for an eligible item, changes in that item’s fair value in subsequent reporting periods must be recognized in current earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the effect, if any, that this statement will have on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *“Fair Value Measurements”* (“SFAS 157”). This statement defines fair value, establishes a framework for measuring fair value under GAAP, and enhances disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007, with earlier application encouraged only in the initial quarter of an entity’s fiscal year. The Company is currently evaluating the effect, if any, that this statement will have on its consolidated financial statements.

In June 2006, the FASB issued Interpretation No. 48, *“Accounting for Uncertainty in Income Taxes”* (“FIN 48”), an interpretation of SFAS No. 109, *“Accounting for Income Taxes”* (“SFAS 109”), which became effective for the Company on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS 109. FIN 48 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. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, and disclosure.

The evaluation of a tax position in accordance with FIN 48 is a two-step process. The first step is a recognition process whereby the entity determines whether it is more likely than not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more likely than not recognition threshold, the entity should presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information. The second step is a measurement process whereby a tax position that meets the more likely than not recognition threshold is calculated to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

The provisions of FIN 48 were effective beginning January 1, 2007, and are to be applied to all tax positions upon initial adoption of this standard. Only tax positions that meet the more likely than not recognition threshold at the effective date may be recognized or continue to be recognized upon adoption of FIN 48. The Company’s adoption of FIN 48 on January 1, 2007 did not result in a cumulative effect adjustment to retained earnings (see Note 8).

Effective January 1, 2007, the Company adopted SFAS No. 155, *“Accounting for Certain Hybrid Financial Instruments”* (“SFAS 155”), which amends portions of SFAS No. 133, *“Accounting for Derivative Instruments and Hedging Activity”*, and SFAS No. 140, *“Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.”* SFAS 155 provides guidance for accounting for certain securities with embedded derivative instruments and was effective for financial instruments issued or acquired after an entity’s first fiscal year that begins after September 15, 2006. The Company’s adoption of SFAS 155 as of January 1, 2007 did not have any

effect on the Company's consolidated financial statements.

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BRISTOL WEST HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(dollars in thousands, except per share data)

4. Stock Ownership

(Number of shares, options, warrants, and share prices expressed in whole numbers)

Employee Stock Options

The Company has issued stock options to its employees under two plans: the 1998 Stock Option Plan for Management and Key Employees (the "1998 Plan") of Bristol West Holdings, Inc. and its subsidiaries and the 2004 Stock Incentive Plan (the "2004 Plan") of Bristol West Holdings, Inc. and its subsidiaries. The options issued under these plans vest ratably over periods of two or five years, or earlier if there is an acceleration event, such as a change in control. Options expire on and are no longer exercisable after the tenth anniversary of the grant date. The original amount of shares authorized for grant under the 1998 Plan and the 2004 Plan were 2,607,600 and 3,000,000, respectively. In the aggregate, there were 1,218,921 and 1,224,589 options exercisable under these plans at March 31, 2007 and December 31, 2006, respectively. The weighted average remaining contractual life of options outstanding under these plans was 1.77 years as of March 31, 2007.

There were no employee option grants made during the three months ended March 31, 2007 and 2006. Employee stock option activity under both the 1998 Plan and the 2004 Plan for the three months ended March 31, 2007 is detailed below:

Option shares	Number of Shares	Weighted Average Exercise Price
Outstanding December 31, 2006	1,295,128	\$ 4.54
Exercised during 2007	(21,843)	14.14
Expired during 2007	(774)	9.39
Outstanding March 31, 2007	1,272,511	\$ 4.37

Exercise Price	Shares	Options Outstanding Weighted Average Price	Remaining Term (in years)	Options Exercisable Shares	Weighted Average Price
\$3.83	1,167,530	\$			