

AMERICAN SAFETY INSURANCE HOLDINGS LTD
Form 10-Q
November 07, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM 10 Q

Ö QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 30, 2008

“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 1-14795

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.
(Exact name of Registrant as specified in its charter)

Bermuda
(State or other jurisdiction
of incorporation)

Not Applicable
(I.R.S. Employer
Identification No.)

The Boyle Building, 2nd Floor
31 Queen Street
Hamilton, HM 11Bermuda
(Address, zip code of principal executive offices)

(441) 296-8560
(Registrant's telephone number, including area code)

Indicate by check mark whether 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 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
Non-accelerated filer

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

The aggregate number of shares outstanding of Registrant's common stock, \$0.01 par value, on November 3, 2008 was 10,279,040.

AMERICAN SAFETY INSURANCE HOLDINGS, LTD.

FORM 10-Q

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Balance Sheets

	September 30, <u>2008</u>	December 31, <u>2007</u>
	(Unaudited)	
<u>Assets</u>		
Investments:		
Fixed maturity securities available for sale,		
at fair value	\$ 528,640,154	\$ 529,569,518
Common stock, at fair value	24,239,770	25,393,664
Preferred stock, at fair value	3,323,300	5,793,165
Short-term investments, at fair value	<u>77,970,554</u>	<u>56,454,862</u>
Total investments	634,173,778	617,211,209
Cash and cash equivalents	10,752,693	12,859,681
Accrued investment income	6,298,913	5,771,983
Premiums receivable	29,320,519	22,851,520
Ceded unearned premiums	40,715,967	30,950,752
Reinsurance recoverable	190,185,627	190,299,574
Deferred income taxes	15,456,881	9,767,816
Deferred policy acquisition costs	18,592,999	16,831,357
Property, plant and equipment, net	10,746,391	9,216,015
Goodwill	9,695,572	2,316,629
Other assets	<u>25,577,952</u>	<u>15,932,723</u>
Total assets	<u>\$ 991,517,292</u>	<u>\$ 934,009,259</u>

Liabilities and Shareholders' Equity

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Liabilities:

Unpaid losses and loss adjustment expenses	\$550,787,544	\$ 504,779,132
Unearned premiums	129,845,518	111,459,142
Ceded premiums payable	31,838,197	15,368,967
Deferred revenues	1,050,075	1,074,238
Accounts payable and accrued expenses	9,134,940	10,004,721
Deferred rent	1,666,113	1,780,213
Funds held	15,871,967	18,509,621
Loans payable	38,899,508	38,645,936
Minority interest	<u>1,507,642</u>	<u>1,986,844</u>
Total liabilities	<u>780,601,504</u>	<u>703,608,814</u>

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	September 30, <u>2008</u>	December 31, <u>2007</u>
	(Unaudited)	
Shareholders' equity		
Preferred stock, \$0.01 par value; authorized 5,000,000 shares; no shares issued and outstanding	\$ -	\$ -
Common stock, \$0.01 par value; authorized 30,000,000 shares; issued and outstanding at September 30, 2008, 10,274,368 and December 31, 2007, 10,703,457		
Additional paid-in capital	102,744	107,034
Retained earnings	100,254,398	106,238,456
Accumulated other comprehensive (loss) earnings, net	127,694,502	119,181,362
Total shareholders' equity	<u>(17,135,856)</u>	<u>4,873,593</u>
	<u>210,915,788</u>	<u>230,400,445</u>
Total liabilities and shareholders' equity	\$ 991,517,292	\$ 934,009,259
Book value per share	\$20.53	\$ 21.53
Diluted book value per share	\$19.94	\$ 20.81

See accompanying notes to consolidated financial statements (unaudited).

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American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Operations

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, <u>2008</u>	<u>2007</u>	September 30, <u>2008</u>	<u>2007</u>
Revenues:				
Direct premiums earned	\$53,786,053	\$52,211,331	\$148,057,024	\$162,613,244
Assumed premiums earned	13,107,158	2,372,544	35,219,646	5,537,696
Ceded premiums earned	<u>(25,200,797)</u>	<u>(18,012,022)</u>	<u>(55,393,667)</u>	<u>(53,810,894)</u>
Net premiums earned	<u>41,692,414</u>	<u>36,571,853</u>	<u>127,883,003</u>	<u>114,340,046</u>
Net investment income	7,497,249	7,790,710	22,140,282	22,496,605
Net realized losses	(9,153,457)	(80,852)	(8,358,250)	(88,624)
Fee income	499,217	411,129	2,017,468	1,675,047
Other (loss) income	<u>(37,203)</u>	<u>17,873</u>	<u>(6,994)</u>	<u>50,049</u>
Total revenues	<u>40,498,220</u>	<u>44,710,713</u>	<u>143,675,509</u>	<u>138,473,123</u>
Expenses:				
Losses and loss adjustment expenses	25,058,586	21,012,676	77,468,416	68,586,303
Acquisition expenses	9,685,095	7,185,279	30,722,752	21,031,182
Payroll and related expenses	5,729,097	4,319,713	15,974,698	12,995,958
Other underwriting expenses	3,042,097	2,768,468	8,973,911	7,764,803
Interest expense	714,860	846,109	2,370,065	2,484,275
Corporate and other expenses	695,737	697,243	(612,417)	2,133,623
Minority interest	<u>(311,606)</u>	<u>26,178</u>	<u>(159,603)</u>	<u>150,266</u>
Total expenses	<u>44,613,866</u>	<u>36,855,666</u>	<u>134,737,822</u>	<u>115,146,410</u>
(Loss) earnings before income taxes	(4,115,646)	7,855,047	8,937,687	23,326,713
Income taxes	<u>178,952</u>	<u>808,906</u>	<u>421,822</u>	<u>1,916,696</u>
Net (loss) earnings	\$ (4,294,598)	\$ 7,046,141	\$ 8,515,865	\$ 21,410,017
Net (loss) earnings per share:				
Basic	<u>\$(0.42)</u>	<u>\$0.66</u>	<u>\$0.81</u>	<u>\$2.02</u>
Diluted	<u>\$(0.42)</u>	<u>\$0.64</u>	<u>\$0.79</u>	<u>\$1.95</u>

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Weighted average number of shares outstanding:

Basic	10,326,661	10,709,996	10,521,209	10,624,416
Diluted	10,326,661	11,044,340	10,782,741	10,938,607

See accompanying notes to consolidated financial statements (unaudited).

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American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Cash Flow

(Unaudited)

Nine Months Ended

September 30,
2008

2007

Cash flow from operating activities:

Net earnings	\$ 8,515,865	\$21,410,017
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Realized losses on investments	8,358,250	88,624
Depreciation expense	3,001,560	2,080,462
Stock based compensation expense	883,514	394,779
Amortization of deferred acquisition costs, net	(1,761,642)	(2,992,356)
Amortization of premiums on investments	386,992	328,207
Deferred income taxes	(1,110,721)	(40,717)
Change in operating assets and liabilities:		
Accrued investment income	(526,930)	(1,081,960)
Premiums receivable	(6,468,999)	(9,604,000)
Reinsurance recoverable	113,945	11,854,793
Ceded unearned premiums	(9,765,215)	5,634,472
Funds held	(2,637,657)	854,273
Unpaid losses and loss adjustment expenses	46,008,414	37,189,602
Unearned premiums	18,386,376	(4,546,262)
Ceded premiums payable	16,469,230	(4,431,878)
Deferred revenues	(24,163)	(217,509)
Accounts payable and accrued expenses	(1,064,125)	(2,846,510)
Deferred rent	(114,100)	409,579
Other, net	<u>(8,468,034)</u>	<u>611,092</u>
Net cash provided by operating activities	<u>\$ 70,182,560</u>	<u>\$ 55,094,708</u>

Cash flow from investing activities:

Purchases of fixed maturities	\$(146,241,497)	\$(175,182,921)
Purchases of common stock	(2,811,572)	(7,736,877)
Proceeds from sale of fixed maturities	117,932,134	129,198,373
Proceeds from sale of equity securities	362,397	1,273,597
Consideration paid for acquired companies	(8,927,052)	-
(Increase) decrease in short-term investments	(21,515,692)	12,007,343
Purchase of fixed assets	<u>(4,228,613)</u>	<u>(3,773,100)</u>
Net cash used in investing activities	<u>\$ (65,429,895)</u>	<u>\$ (44,213,585)</u>

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	Nine Months Ended	
	September 30, <u>2008</u>	<u>2007</u>
Cash flow from financing activities:		
Repurchase of common stock	\$ (7,564,917)	\$ -
Proceeds from exercised stock options	<u>705,264</u>	<u>1,370,907</u>
Net cash (used in) provided by financing activities	<u>(6,859,653)</u>	1,370,907
Net (decrease) increase in cash and cash equivalents	(2,106,988)	12,252,030
Cash and cash equivalents at beginning of period	<u>12,859,681</u>	<u>11,293,296</u>
Cash and cash equivalents at end of period	\$ 10,752,693	\$23,545,326
Supplemental disclosure of cash flow information:		
Income taxes paid	\$ 115,339	\$ 5,000
Interest paid	\$ 1,562,768	\$ 2,358,831
Non-cash activity (1)		
Fixed asset additions	\$ -	\$ 1,409,340
Deferred rent	\$ -	\$ 1,409,340

(1) Represents tenant build out allowance and future reduction in rent over the term of the lease.

See accompanying notes to consolidated financial statements (unaudited).

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American Safety Insurance Holdings, Ltd. and Subsidiaries

Consolidated Statements of Comprehensive Earnings

(Unaudited)

	Three Months Ended		Nine Months Ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2008</u>	<u>2007</u>	<u>2008</u>	<u>2007</u>
Net (loss) earnings	\$ (4,294,598)	\$ 7,046,141	\$ 8,515,865	\$ 21,410,017
Other comprehensive (loss) earnings before income taxes:				
Unrealized (losses) gains on securities available-for-sale, net of minority interest of \$(222,068) and \$64,385 for the three months ended September 30, 2008 and 2007, respectively, and \$(266,875) and \$(30,123) for the nine months ended September 30, 2008 and 2007, respectively.	(24,082,589)	5,084,171	(34,934,186)	99,953
Unrealized gains (losses) on hedging transactions	10,776	(109,932)	(93,528)	(206,378)
Reclassification adjustment for realized losses included in net (loss) earnings	<u>9,153,457</u>	<u>75,819</u>	<u>8,358,250</u>	<u>83,972</u>
Total other comprehensive (loss) earnings before taxes	(14,918,356)	5,050,058	(26,669,464)	(22,453)
Income tax (benefit) expense related to items of other comprehensive income, net of minority interest of \$80,924 and \$(38,380) for the three months ended September 30, 2008 and 2007 respectively, and \$56,755 and \$(63,402) for the nine months ended September 30, 2008 and 2007, respectively.	<u>(2,833,489)</u>	<u>732,167</u>	<u>(4,660,015)</u>	<u>(312,680)</u>
Other comprehensive (loss) earnings net of income taxes	<u>(12,084,867)</u>	<u>4,317,891</u>	<u>(22,009,449)</u>	<u>290,227</u>
Total comprehensive (loss) earnings	\$ (16,379,465)	\$ 11,364,032	\$ (13,493,584)	\$ 21,700,244

See accompanying notes to consolidated financial statements (unaudited).

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American Safety Insurance Holdings, Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

September 30, 2008

(Unaudited)

Note 1 - Basis of Presentation

The accompanying consolidated financial statements of American Safety Insurance Holdings, Ltd. ("American Safety Insurance") and its subsidiaries and American Safety Risk Retention Group, Inc. ("American Safety RRG"), a non-subsiary risk retention group affiliate (collectively, the "Company"), are prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates, based on the best information available, in recording transactions resulting from business operations. The balance sheet amounts that involve a greater extent of accounting estimates and/or actuarial determinations subject to future changes are the Company's invested assets, deferred income taxes and the liabilities for unpaid losses and loss adjustment expenses. As additional information becomes available (or actual amounts are determinable), the recorded estimates may be revised and reflected in operating results. While management believes that these estimates are adequate, such estimates may change in the future.

The results of operations for the nine months ended September 30, 2008 may not be indicative of the results that may be expected for the fiscal year ending December 31, 2008. These unaudited interim consolidated financial statements and notes should be read in conjunction with the financial statements and notes included in the audited consolidated financial statements on Form 10-K of the Company for the fiscal year ended December 31, 2007.

The unaudited interim consolidated financial statements include the accounts of American Safety Insurance, each of its subsidiaries and American Safety RRG. All significant intercompany balances have been eliminated.

Certain balance sheet and statement of operations items have been reclassified for the periods ending September 30, 2007 and December 31, 2007. The presentation is consistent with the presentation for the three and nine months ended September 30, 2008 and did not result in any impact to net earnings or shareholders' equity.

Note 2 - Nature of Operations

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We are a Bermuda-based specialty insurance and reinsurance company that provides customized products and solutions to small and medium-sized businesses in industries that we believe are underserved by the standard market. For over twenty years we have developed specialized coverages and alternative risk transfer products not generally available to our customers in the standard market because of the unique characteristics of the risks involved and the associated needs of the insureds. We specialize in underwriting these products for insureds with certain environmental, products liability, construction, healthcare and property risks, as well as developing programs for other specialty classes of risks and providing third party reinsurance. See Part II – Other Information, Item 1A for risks facing the Company.

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Note 3 - Investments

The amortized cost and estimated fair values of the Company's investments at September 30, 2008 and December 31, 2007 are as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
<u>September 30, 2008:</u>				
Securities available for sale:				
Fixed maturities:				
U.S. Treasury securities and obligations of U.S. Government corporations and agencies				
	\$ 63,145,452	\$ 1,932,632	\$ -	\$ 65,078,084
States of the U.S. and political subdivisions of the states	40,239,306	31,123	1,533,389	38,737,040
Corporate securities	242,536,885	683,477	19,230,680	223,989,682
Mortgage-backed securities	<u>201,503,899</u>	<u>1,178,244</u>	<u>1,846,795</u>	<u>200,835,348</u>
Total fixed maturities	\$547,425,542	\$ 3,825,476	\$22,610,864	\$528,640,154
Common Stock	\$ 25,689,794	\$ 1,987,594	\$ 3,437,618	\$ 24,239,770
Preferred Stock	\$ 4,989,240	\$ 36,950	\$ 1,702,890	\$ 3,323,300

December 31, 2007:

Securities available for sale:

Fixed maturities:

U.S. Treasury securities and obligations of
U.S. Government corporations and agencies

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	\$ 84,566,516	\$ 1,581,197	\$ 12,959	\$ 86,134,754
States of the U.S. and political subdivisions of the states	7,548,971	49,633	118,463	7,480,141
Corporate securities	212,127,071	3,075,142	1,740,186	213,462,027
Mortgage-backed securities	<u>221,402,220</u>	<u>1,840,989</u>	<u>750,613</u>	<u>222,492,596</u>
Total fixed maturities	\$525,644,778	\$ 6,546,961	\$ 2,622,221	\$529,569,518
Common stock	\$ 23,188,713	\$ 3,313,413	\$ 1,108,462	\$ 25,393,664
Preferred stock	\$ 6,939,220	\$ -	\$ 1,146,055	\$ 5,793,165

During the nine months ended September 30, 2008, the Company recorded an other-than-temporary impairment charge of \$7.7 million related to debt and equity securities issued by Fannie Mae, Freddie Mac and Lehman Brothers.

Note 4 - Segment Information

We segregate our business into insurance operations and other, with the insurance operations segment being further classified into four segments: excess and surplus lines (E&S), alternative risk transfer (ART), assumed reinsurance (Assumed Re) and other. E&S is further classified into seven business lines: property, environmental, construction, products liability, excess, surety and healthcare. ART is further classified into two business lines: specialty programs and fully funded. Assumed Re consists of specialty property and casualty business assumed from unaffiliated specialty insurers and reinsurers, and began operations in the first quarter of 2007. Other includes lines of business that we no longer write (run off) as well as real estate and other ancillary product lines. Prior year amounts have been reclassified to conform to the current year presentation.

Within the E&S segment, our property coverage encompasses non-standard, surplus lines commercial property business and commercial multi-peril (CMP) policies. The casualty focus of our CMP products is premises liability. Our environmental insurance group provides general, professional and pollution liability to contractors, consultants and property owners. Construction provides commercial casualty insurance coverages, generally for residential and commercial contractors. Products liability offers general liability and product liability coverages for smaller manufacturers and distributors, non-habitational real estate and certain real property owner, landlord and tenant risks. Excess provides excess and umbrella liability coverages over our own and other carriers' primary casualty policies, with a focus on construction risks. Surety provides payment and performance bonds primarily to the environmental remediation and construction industries. Our healthcare line provides customized liability insurance solutions for long-term care facilities.

In our ART segment, specialty programs facilitate the offering of insurance to homogeneous niche groups of risk through third party program managers. Our fully funded business provides a mechanism for insureds to post collateral so as to fully self-insure their risks and we are paid a fee for arranging this type of transaction.

In our Assumed Re segment, the Company provides both traditional and structured specialty property and casualty reinsurance for unaffiliated specialty insurers and reinsurers with a focus on small specialty insurers, risk retention groups and captives.

The Other segment consists of amounts associated with realized gains and losses on investments, the Company's investment in real estate which was essentially completed in 2005, and lines of business that we have placed in run-off, such as workers' compensation, excess liability insurance for municipalities and commercial lines.

The Company measures all segments using net earnings, total assets and total equity. The reportable insurance operations segments are measured by net premiums earned, incurred losses and loss adjustment expenses and acquisition expenses. Assets are not allocated to the reportable insurance operations segments.

The following table presents key financial data by segment for the three months ended September 30, 2008 and September 30, 2007 (in thousands of \$ US):

September 30, 2008 Insurance											Other	Total		
	E & S							Assumed Re	ART	Specialty Programs	Fully Funded			
	Property	Environ	Construction	Products Liability		Excess	Surety							Healthcare
Gross premiums written	\$ 1,415	\$11,345	\$ 8,183	\$ 1,385	\$1,544	\$3,561	\$ 3,121	\$ 13,828	\$ 30,088	\$ -	\$ -	\$ 74,470		
Net premiums written	1,351	9,048	7,019	1,134	935	2,506	2,028	5,975	10,551	-	-	40,547		
Net premiums earned	1,622	8,576	8,550	1,280	550	1,907	1,060	7,908	10,239	-	-	41,692		
Fee income earned	-	-	-	-	-	-	-	-	-	352	147	499		
Losses & loss adjustment expenses	1,027	4,898	5,138	764	329	655	551	5,514	6,183	-	-	25,059		
Acquisition expenses	326	2,410	1,897	263	58	537	64	1,965	2,165	-	-	9,685		
Gross underwriting profit	269	1,268	1,515	253	163	715	445	429	1,891	352	147	7,447		
Income tax expense (benefit)						\$ 253						\$ (74)	\$ 179	
Net earnings (loss)						\$ 4,785						\$ (9,080)	\$ (4,295)	

September 30, 2007 Insurance											Other	Total		
	E & S							Assumed Re	ART	Specialty Programs	Fully Funded			
	Property	Environ	Construction	Products Liability		Excess	Surety							Healthcare
Gross premiums written	\$ 1,050	\$ 11,391	\$ 14,481	\$ 899	\$ 1,756	\$ 1,645	\$ -	\$ 4,188	\$ 14,920	\$ -	\$ -	\$ 50,330		