

PROFESSIONALS DIRECT INC
Form 10QSB
May 14, 2007

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

FORM 10-QSB

(MARK ONE)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2007

TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number: **000-49786**

PROFESSIONALS DIRECT, INC.

(Exact Name of Small Business Issuer as Specified in its Charter)

Michigan

(State or Other Jurisdiction of
Incorporation or Organization)

38-3324634

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

5211 Cascade Road, S.E.

Grand Rapids, Michigan 49546

(Address of Principal Executive Offices)

(616) 456-8899

(Issuer's Telephone Number,
Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 X No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes No X

There were 333,300 shares of Common Stock outstanding as of April 30, 2007.

Transitional Small Business Disclosure Format (check one): Yes No X

PROFESSIONALS DIRECT, INC.
INDEX

| PART I. | FINANCIAL INFORMATION | Page No. |
|------------|---|----------|
| | Item 1. <u>Financial Statements</u> | |
| | Condensed Consolidated Balance Sheet - March 31, 2007 (Unaudited) | 3 |
| | Condensed Consolidated Statements of Income and Comprehensive Income - Three Months Ended March 31, 2007 (Unaudited) and March 31, 2006 (Unaudited) | 4 |
| | Condensed Consolidated Statements of Cash Flows - Three Months Ended March 31, 2007 (Unaudited) and March 31, 2006 (Unaudited) | 5 |
| | Notes to Condensed Consolidated Financial Statements (Unaudited) | 6 |
| | Item 2. <u>Management's Discussion and Analysis</u> | 8 |
| | Item 3. <u>Controls and Procedures</u> | 15 |
| PART II. | OTHER INFORMATION | |
| | Item 6. <u>Exhibits</u> | 16 |
| SIGNATURES | | |

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

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
(Unaudited)

| <i>March 31,</i> | 2007 (000) |
|---|-----------------------|
| Assets | |
| Fixed maturities held to maturity, at amortized cost | \$ 7,030 |
| Fixed maturities available for sale, at fair value | 31,102 |
| Other invested asset, at cost which approximates fair value | 277 |
| Total investments | 38,409 |
| Cash and cash equivalents | 4,425 |
| Receivables: | |
| Amounts due from reinsurers | 17,034 |
| Other | 1,902 |
| Prepaid reinsurance premiums | 3,683 |
| Deferred acquisition costs | 1,509 |
| Net deferred federal income taxes | 1,225 |
| Other assets | 1,278 |
| Total Assets | \$ 69,465 |
| Liabilities and Shareholders' Equity | |
| Liabilities | |
| Loss and loss adjustment expense reserves | \$ 32,746 |
| Unearned premiums | 12,218 |
| Amounts due to reinsurers | 1,827 |
| Other liabilities | 2,510 |
| Accrued interest | 986 |
| Surplus certificates | 1,343 |
| Trust preferred securities | 5,000 |
| Total Liabilities | 56,630 |
| Shareholders' Equity | |
| Preferred stock, no par (500,000 shares authorized, no shares issued) | - |
| Common stock, no par (5,000,000 shares authorized, 333,300 shares issued and outstanding) | 3,204 |
| Retained earnings | 9,871 |
| Accumulated other comprehensive loss | (240) |
| Total Shareholders' Equity | 12,835 |
| Total Liabilities and Shareholders' Equity | \$ 69,465 |

See accompanying notes to condensed consolidated financial statements.

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(Unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2007 | 2006 |
| | (000) | (000) |
| Revenues | | |
| Net premiums earned | \$ 3,958 | \$ 4,004 |
| Fees and commissions | 256 | 212 |
| Net investment income | 403 | 359 |
| Finance and other income - including unusual gain of \$82 and \$113, respectively (Note 3) | 124 | 160 |
| Total revenues | 4,741 | 4,735 |
| Expenses | | |
| Losses and loss adjustment expenses | 2,787 | 2,835 |
| Operating and administrative | 1,223 | 948 |
| Interest | 128 | 139 |
| Total expenses | 4,138 | 3,922 |
| Income before federal income taxes | 603 | 813 |
| Federal income taxes | 158 | 250 |
| Net income | 445 | 563 |
| Other comprehensive income (loss) (net of tax (benefit) of \$34 and \$(62), respectively) | 66 | (121) |
| Comprehensive income | \$ 511 | \$ 442 |
| Per share of common stock (not in thousands): | | |
| Basic and diluted net income per share | \$ 1.33 | \$ 1.69 |
| Basic and diluted comprehensive income per share | 1.53 | 1.33 |

See accompanying notes to condensed consolidated financial statements.

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------------|
| | 2007 (000) | 2006 (000) |
| Operating activities | | |
| Net income | \$ 445 | \$ 563 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Deferred federal income taxes | (21) | 29 |
| Gain from redemption of surplus certificates | (82) | (113) |
| Depreciation and amortization | 160 | 168 |
| Changes in operating assets and liabilities: | | |
| Amounts due from reinsurers | (653) | (76) |
| Other receivables | 146 | (62) |
| Prepaid reinsurance premiums | 436 | 194 |
| Deferred acquisition costs | (93) | 26 |
| Other assets | 68 | (126) |
| Loss and loss adjustment expense reserves | (131) | 929 |
| Amounts due to reinsurers | 97 | 74 |
| Unearned premiums | 433 | (369) |
| Other liabilities | (305) | (190) |
| Accrued interest | (159) | (132) |
| Net cash from operating activities | 341 | 915 |
| Investing activities | | |
| Cost of fixed maturities acquired | (2,486) | (5,703) |
| Proceeds from sales or maturities of fixed maturities | 1,256 | 1,670 |
| Cost of property and equipment acquired | (50) | (105) |
| Net cash for investing activities | (1,280) | (4,138) |
| Financing activities | | |
| Repayments of surplus certificates | (178) | (141) |
| Net repayments under lines of credit | - | (170) |
| Net cash for financing activities | (178) | (311) |
| Net decrease in cash and cash equivalents | (1,117) | (3,534) |
| Cash and cash equivalents, beginning of period | 5,542 | 9,309 |
| Cash and cash equivalents, end of period | \$ 4,425 | \$ 5,775 |

**Supplemental disclosures of cash flow
information**

| | | | | |
|-----------------------------|----|------------|----|------------|
| Federal income tax payments | \$ | - | \$ | 220 |
| Interest payments | | 287 | | 271 |

See accompanying notes to condensed consolidated financial statements.

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries (Professionals Direct Insurance Company (PDIC), a property and casualty insurance company providing professional liability insurance to attorneys; Professionals Direct Employer Organization, Inc., an inactive Michigan professional employer organization; Professionals Direct Finance, Inc. (Finance), a premium finance company; and Professionals Direct Insurance Services, Inc. (Services), a company providing underwriting, claims, accounting, information technology services and selling professionals liability and other insurance), plus Lawyers Direct Risk Purchasing Group, Inc. which the Company controls. Professionals Direct Statutory Trust I and Professionals Direct Statutory Trust II are accounted for under the equity method in the accompanying financial statements and are not consolidated because the Company is not the primary beneficiary.

The condensed consolidated financial statements and notes as of and for the three months ended March 31, 2007 and 2006 are unaudited. The condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year.

2. Income per Share

Basic income per share is computed by dividing net income by the weighted average number of shares of common stock outstanding for the period (333,300 for the three months ended March 31, 2007, and 333,500 for the three months ended March 31, 2006). Diluted income per share is equal to basic income per share as there are no stock options or other dilutive instruments outstanding.

3. Unusual Gain

Other income includes an unusual gain of \$82,000 and \$113,000 in 2007 and 2006, respectively, the portion of principal surplus certificate holders forgave in return for early redemption.

4. Recent Accounting Pronouncements

On January 1, 2007 the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48) which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 requires an entity to recognize the benefit of tax positions only when it is more likely than not, based on the position's technical merits, that the position would be sustained upon examination by the respective taxing authorities. The tax benefit is measured as the largest benefit that is more than fifty-percent likely of being realized upon final settlement with the respective taxing authorities. The adoption of FIN 48 did not have an impact on our financial position or results of operations and we have taken no tax positions which would require disclosure under the new guidance. Although the IRS is not currently examining any of our income tax returns, tax years 2004-2006 remain open and are subject to examination.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS No. 157 applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. The Company does not believe the adoption will have a material impact on its financial condition or results of operations, if any, of adopting SFAS No. 157 which becomes effective in 2008.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159") which provides reporting entities an option to report selected financial assets, including investment securities designated as available for sale, and liabilities, including most insurance contracts, at fair value. SFAS No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The standard also requires additional information to aid financial statement users' understanding of a reporting entity's choice to use fair value on its earnings and also requires entities to display on the face of the balance sheet the fair value of those assets and liabilities for which the reporting entity has chosen to measure at fair value. SFAS No. 159 is effective as of the beginning of a reporting entity's first fiscal year beginning after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of SFAS No. 157. Because application of the standard is optional, any impacts are limited to those financial assets and liabilities to which SFAS No. 159 would be applied, which has yet to be determined. The Company will adopt the standard in fiscal 2008.

Item 2. Management's Discussion and Analysis

The following discussion and analysis for the three months ended March 31, 2007 should be read in conjunction with the condensed consolidated financial statements and the notes thereto included elsewhere in this report. The following discussion of our financial condition and results of operations contains certain forward-looking statements. A discussion of the limitations of forward-looking statements appears at the end of this section.

Introduction

Revenues decreased nominally in 2007 from 2006. The decrease in losses and loss adjustment expenses approximated the slight decrease in net premiums earned. Operating and administrative expenses increased. As a result, net income this year is down when compared to last year. The following table and discussion compares the year-to-date financial results for 2007 and 2006:

| | Three Months Ended March 31, | | | |
|-------------------------------------|---|---------------|-----------------|-----------------------|
| | 2007 | 2006 | Change | Percent Change |
| | (in thousands of dollars, except for per share data) | | | |
| Revenues: | | | | |
| Net premiums earned | \$ 3,958 | \$ 4,004 | \$ (46) | (1.1%) |
| Fees and commissions | 256 | 212 | 44 | 20.8% |
| Net investment income | 403 | 359 | 44 | 12.3% |
| Finance and other income | 124 | 160 | (36) | (22.5%) |
| Total revenues | 4,741 | 4,735 | 6 | 0.1% |
| Expenses: | | | | |
| Losses and loss adjustment expenses | 2,787 | 2,835 | (48) | (1.7%) |
| Operating and administrative | 1,223 | 948 | 275 | 29.0% |
| Interest | 128 | 139 | (11) | (7.9%) |
| Total expenses | 4,138 | 3,922 | 216 | 5.5% |
| Income before federal income taxes | 603 | 813 | (210) | (25.8%) |
| Federal income taxes | 158 | 250 | (92) | (36.8%) |
| Net income | \$ 445 | \$ 563 | \$ (118) | (21.0%) |
| Selected Balance Sheet Data: | | | | |
| (at end of period) | | | | |
| Total investments and cash | \$ 42,834 | \$ 43,611 | \$ (777) | (1.8%) |
| Total assets | 69,465 | 71,859 | (2,394) | (3.3%) |
| Total liabilities | 56,630 | 60,815 | (4,185) | (6.9%) |
| Total shareholders' equity | 12,835 | 11,044 | 1,791 | 16.2% |
| Per Share Data: | | | | |
| Net income | \$ 1.33 | \$ 1.69 | \$ (0.36) | (21.3%) |
| Shareholders' equity | 38.51 | 33.12 | 5.39 | 16.3% |

Results of Operations (000 omitted):

The following is an analysis of the material revenue and expense components of our operational results for the first quarter of 2007 with comparisons to the first quarter of 2006.

Net Premiums Earned. Net premiums earned equal direct premiums earned (premiums earned on policies written) less ceded premiums earned (amounts ceded to reinsurers) and is our primary source of revenue. The decrease in net premiums earned is the result of higher net premiums written offset by higher ending net unearned premiums. The increase in net unearned premiums is consistent with the increase in both direct and net premiums written in 2007 when compared to 2006.

The effects of these changes are reflected in the table below:

| | Three Months Ended March 31, | | | Percent Change |
|-----------------------------------|------------------------------|-----------|---------|-------------------|
| | 2007 | 2006 | Change | |
| | (in thousands of dollars) | | | |
| Beginning gross unearned premiums | \$ 11,785 | \$ 11,776 | \$ 9 | 0.1% |
| Beginning ceded unearned premiums | (4,118) | (4,175) | 57 | 1.4% |
| Beginning net unearned premiums | 7,667 | 7,601 | 66 | 0.9% |
| Direct premiums written | 6,855 | 5,944 | 911 | 15.3% |
| Ceded premiums written | (2,029) | (2,115) | 86 | 4.1% |
| Net premiums written | 4,826 | 3,829 | 997 | 26.0% |
| Ending gross unearned premiums | 12,218 | 11,407 | 811 | 7.1% |
| Ending ceded unearned premiums | (3,683) | (3,981) | 298 | 7.5% |
| Ending net unearned premiums | 8,535 | 7,426 | 1,109 | 14.9% |
| Net premiums earned | \$ 3,958 | \$ 4,004 | \$ (46) | (1.1%) |

During the first quarter of 2007, direct and net premiums written increased. These increases resulted from increased new business and rate increases offset by lower renewal rates in Michigan and Florida. New business for 2007 was \$1,586 compared to \$811 for 2006. The percentage increase in net premiums written exceeded that of direct premiums written because policies are being written at lower limits in 2007 and as a result of the slight increase in our reinsurance retention beginning January 1, 2007.

For policies with 2007 effective dates, PDIC's maximum retention increased slightly from \$250 in 2006 to \$275 in 2007. Decisions on the appropriate level of reinsurance are impacted by a variety of factors from pricing, to availability and credit quality of reinsurers, and our level of surplus. As such, reinsurance retentions can vary from year to year. After analyzing our surplus and given market conditions, we decided to increase our retention level for 2007.

Fees and Commissions. Fees and commissions originate primarily from two sources. First are membership fees, which are earned by Lawyers Direct Risk Purchasing Group, Inc. ("Lawyers Direct"), an affiliate organized and managed by Services, as part of the Lawyers Direct® program for one to five person law firms. Second are commissions, which are earned from placing insurance with unrelated third parties and performing management services. Fees and commissions earned in the first quarter of 2007 were \$256, \$44 more than the first quarter of 2006. Commission income accounted for \$37 of the

increase and fees from Lawyers Direct accounted for \$7. These increases resulted from writing more business with other carriers and through Lawyers Direct.

Net Investment Income. Net investment income is comprised of interest on fixed maturity investments, short-term investments and realized investment gains and losses. The net investment income increase of \$44 or 12.3% in the first three months of 2007 as compared to 2006 is primarily attributable to an improvement in average yield resulting from an increase in interest rates. The tax equivalent book yield on the portfolio increased 63 basis points from a year ago and is now over 4.6%.

Finance and Other Income. Income generated from premium financing incidental to the sale of PDIC's insurance policies in Michigan and selected other states was \$3 lower in 2007 than 2006. During the first quarter of 2007 and 2006, PDIC redeemed 260 and 254 surplus certificates, respectively, as part of a redemption program. This redemption resulted in an unusual gain of \$82 and \$113 in 2007 and 2006, respectively, the portion of principal surplus certificate holders forgave in return for early redemption. The decrease in the gain is the primary reason for the decrease in finance and other income.

Losses and Loss Adjustment Expenses ("LAE"). Overall profitability is materially influenced by the loss estimate for current year claims, plus the favorable or adverse development related to estimates for prior years' claims. During the first three months of 2007, PDIC recorded losses and LAE of \$2,787 for claims made and reported in 2007. During the first three months of 2006, PDIC recorded losses and LAE of \$2,835 for claims made and reported in 2006. First quarter loss and LAE is determined based on the application of the five-year weighted average historic loss ratio for PDIC applied to the current quarter net earned premium. Use of an average loss ratio is appropriate as there has been insufficient time to assess the reported 2007 claims.

Loss ratios are the sum of incurred losses and LAE expressed as a percentage of net premiums earned. The loss ratio for the first three months of 2007 was 70.4% compared to 70.8% in 2006. There was no development in the first quarter of either 2007 or 2006 related to prior years' claims.

PDIC establishes reserves for payment of losses and LAE related to our insurance contracts. Reserves are the estimated ultimate cost for reported claims and for claims incurred but not reported arising from policies that have been issued. PDIC provides for the estimated ultimate cost of those claims without regard to how long it takes to settle them or the time value of money.

PDIC issues only "claims-made" contracts. Claims-made contracts are commonly used for lawyers professional liability policies and provide coverage for claims related to covered events described in the insurance contract that are made against the insured during the term of the contract and reported to the insurer during a period provided for in the contract.

The determination of reserves involves actuarial and statistical projections of expected costs of the ultimate settlement and administration of such claims based on facts and circumstances then known, estimates of future trends in claim severity, and other variable factors such as inflation and changing judicial theories of liability.

Management estimates of the loss reserve liability are reviewed by independent actuaries twice each year. Several variables and methodologies are used to calculate the appropriate amount of the loss reserve liability that should be recorded. Key variables utilized to develop the loss reserve estimate include:

Loss reporting patterns

Payment patterns

Loss severity trend rates

Application of Michigan loss patterns and loss to premium relationships to non-Michigan business

Case reserve setting patterns

The key actuarial methodologies used include:

Historical development method on an incurred, paid and case reserve basis
Bornhuetter-Ferguson ("B-F") method on both a paid and incurred basis
Loss ratio method
Frequency/severity method

Small changes to any of the assumptions regarding the key variables can significantly alter the outcome of the actuarial analysis. Because of the number of factors considered, it is neither practical nor meaningful to isolate a single variable and calculate the impact of changing that item.

An in-depth review of loss reserves is undertaken on a semi-annual basis. However, management continually reviews and updates the data underlying the estimation of its loss reserves and makes adjustments when we believe the emerging data supports a change. Any adjustments necessary are reflected in current operations. As a result of the variety of variables and methodologies that are considered, there is a significant risk that actual incurred losses will develop differently from these estimates.

In the years after a claim is reported, there is a significant amount of uncertainty over what the ultimate loss will be. Therefore, the estimate of future loss costs for claims recently reported tends to be less accurate. As claims get older, the estimate of future loss costs may be less inaccurate, but are still subject to material fluctuations until the claims are paid or otherwise closed. Eventually, all claims in a particular year are paid or closed and no additional development, favorable or adverse, will be experienced because the amount of the loss is certain.

Another factor that impacts incurred losses is development related to claims reported in prior years. Favorable or adverse development occurs when subsequent estimates of the loss change. A subsequent decrease in estimate results in favorable development; a subsequent increase in estimate results in adverse development. Favorable or adverse development is reflected as a decrease or increase in the current year's losses and loss adjustment expenses.

The estimation of ultimate liability for losses and loss adjustment expenses is an inherently uncertain process and does not represent an exact calculation of that liability. Claims may not be brought until several years after the acts or omissions that gave rise to the claim occurred. Ultimate loss costs, even for similar events, vary significantly depending upon many factors. Professional liability claims are typically resolved over an extended period of time, often three years or more. The combination of changing conditions and the extended time required for claim resolution results in a loss cost estimation process that requires actuarial expertise and the application of significant judgment. Such estimates require periodic revision. PDIC's current reserve policy recognizes this uncertainty by maintaining case supplement reserves (*commonly referred to as IBNR reserves*) to provide for the possibility that actual results may be less favorable compared to the estimated costs as developed during the normal case reserve estimation process. The case supplement reserve is determined by estimating the ultimate liability for all claims which have been made and reported and then subtracting the case reserves. Case supplement reserves as a percentage of total reserves at March 31, 2007 were 39.1%. PDIC does not discount its reserves to recognize the time value of money.

When a claim is reported to PDIC, claims personnel establish a case reserve for the estimated amount of the ultimate payment. This estimate reflects an informed judgment based upon general insurance reserving practices and on the experience and knowledge of the estimator regarding the nature and value of the specific claim, the severity of injury or damage, and the policy provisions relating to the type of loss. The claims staff periodically adjusts the loss estimate as more information becomes available.

Each quarter, PDIC computes its estimated liability using appropriate principles and procedures. Because the establishment of loss reserves is an inherently uncertain process, however, there can be no assurance that losses will not exceed reserves. Adjustments in aggregate reserves, if any, are reflected in the operating results of the period during which such adjustments are made. As required by insurance regulatory authorities, PDIC annually receives a statement of opinion from its appointed actuary concerning the reasonableness of its reserves.

Operating and Administrative Expenses. Operating and administrative expenses for the first three months of 2007 compared to the same period for 2006 increased \$275 or 29.0%. This increase occurred in multiple areas, some of which were timing differences or non-recurring items. For example, acquisition costs increased \$88 from changes in PDIC's sources of business; compensation increased \$65 from increases in personnel, salaries and bonuses; professional fees were \$55 higher because we were billed earlier, not more, in 2007 than in 2006; and outsourced programming, a non-recurring expense, was \$20.

Interest Expense. Interest expense for the first three months of 2007 decreased \$11 from the same period in 2006 primarily as a result of the reduction in the number of surplus certificates.

Income Taxes. The effective federal income tax rate for 2007 and 2006 is 26.2% and 30.7%, respectively. The effective rates for both years are less than the statutory rate of 34% because of tax-exempt interest income.

Financial Condition, Liquidity, and Capital Resources (000 omitted):

Professionals Direct, Inc. is a legal entity separate and distinct from its subsidiaries. Because the parent holding company has no other business operations, management fees and dividends from its subsidiaries represent the principal source of funds for its obligations, including debt service. Management fees paid by PDIC must be pre-approved by the Office of Financial and Insurance Services, the regulatory body in Michigan responsible for the oversight of PDIC. Under terms of the plan that governed the Company's conversion, PDIC is prohibited from making any dividend payments to the Company until such time as the surplus certificates are redeemed. Management fees paid by the remaining subsidiaries are determined from time-to-time by the Board of Directors. Payment of management fees and dividends by our other subsidiaries are limited only by solvency requirements.

The primary sources of liquidity, on both a short-term and long-term basis, are funds provided by insurance premiums collected, net investment income, recoveries from reinsurance, and proceeds from the maturity or sale of invested assets. The primary uses of cash, on both a short-term and long-term basis, are losses, loss adjustment expenses, operating expenses, reinsurance premiums, taxes, debt repayment and acquisition of investments.

Trends or uncertainties that may have an impact on short-term or long-term liquidity include the impact that hard or soft market conditions may have on premium rates we can charge, changes in the cost and availability of reinsurance and changes in interest rates effecting both investment income and interest expense. As the costs of obtaining reinsurance change in the future, we intend to adjust the rates we charge our customers. However, such rate changes may be limited by competition or regulation and we may need to increase our retention levels which may impact our underwriting results. We believe that we will be able to manage reinsurance costs so the impact on overall liquidity is minimized.

When interest rates decline, the cost of borrowing decreases and the market value of our investment portfolio, which primarily consists of debt securities, increases and the overall yield on new investments decreases. When interest rates increase, the opposite effects are realized. Because interest rates have recovered from their historic lows, we believe it is unlikely that material gains will be realized on portfolio assets or be a source of liquidity during 2007.

At March 31, 2007, cash and cash equivalents totaled \$4,425. This represents that portion of total assets necessary to be kept liquid to meet demand for operating, loss and reinsurance payments. It is expected that this level of cash and short term investments will be maintained to meet cash flow needs throughout 2007.

Our net cash flow from operations for the first quarter of 2007 was \$341 compared to \$1,028 for the first quarter of 2006, a decrease of \$687. The decrease in cash from operations is largely the result of the timing of payments received from reinsurers on ceded losses. Cash flow for both quarters was invested in fixed maturities and net repayments on the lines of credit and surplus certificates.

To provide additional liquidity, we have two lines of credit available from a bank. The first line is a \$1,800 revolving line used by Finance to finance insurance premiums and bears interest at .5% over the bank's prime rate. The second line for \$1,000 can be used for general corporate purposes and bears interest at 1% over the bank's prime rate. Neither of the lines had outstanding balances as of March 31, 2007. These lines of credit require, among other things, that we maintain a minimum tangible net worth of \$7,500, that PDIC maintain a minimum surplus of not less than 240% of the Authorized Control Level Risk Based Capital (as defined by the National Association of Insurance Commissioners), and that we deliver periodic financial reports to the bank. The Company was in compliance with all covenants as of March 31, 2007. Debt under these lines is secured by substantially all assets of the Company, Services and Finance, including shares of PDIC subject to the rights of policyholders under insurance laws and the authority of insurance regulators.

Based on historical trends, market conditions and our business plans, we believe that our existing resources and sources of funds will be sufficient to meet our short-term and long-term liquidity needs over the next year and beyond. Because economic, market and regulatory conditions may change, however, there can be no assurance that our funds will be sufficient to meet these liquidity needs. In addition, competition, pricing, the frequency and severity of losses and interest rates could significantly affect our short-term and long-term liquidity needs.

Critical Accounting Estimates and Judgments:

The Company's significant accounting policies are presented on pages 6 through 9 of Exhibit 20.1 to the Company's Annual Report on Form 10-KSB filed on March 30, 2007. Certain of these policies are important to the portrayal of the Company's financial condition, because they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain.

The condensed consolidated financial statements include certain amounts, based upon informed estimates and judgments made by management, for transactions not yet complete or for which the ultimate resolution is not certain. Such estimates and judgments affect the reported amounts in the financial statements. Although management believes that they are making the best decisions based upon information then available, it is possible that as conditions and experience develop, these estimates may change and may be materially different from originally reported in the financial statements. Our reserves for unpaid losses and loss adjustment expenses, the related amounts due from reinsurers, investment valuation and deferred taxes represent the most critical estimates present within the financial statements. Amounts recoverable from reinsurers are estimated in a manner consistent with the provisions of the reinsurance agreement and the establishment of the liability for loss and loss adjustment expenses.

Forward-Looking Statements:

This report contains forward-looking statements, including, but not limited to, statements relating to the Company's business objectives and strategy. Such forward-looking statements are based on current expectations, management beliefs, certain assumptions made by the Company's management, and estimates and projections about the Company's industry. Words such as "believes", "estimates",

“expects”, “judgment”, “objective”, “plans”, “projects”, and variations of such words and similar expressions are intended to identify such forward-looking statements. Determination of loss and loss adjustment expense reserves and amounts due from reinsurers are based substantially on estimates and the amounts so determined are inherently forward-looking.

Forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict with respect to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may differ materially from those expressed, forecasted, or contemplated by any such forward-looking statements. Other factors, some of which are listed below, also influence our results of operations, financial condition and business of the Company and its subsidiaries:

Future economic conditions and the legal and regulatory environment in the markets served by the Company’s subsidiaries;

Reinsurance market conditions, including changes in pricing and availability of reinsurance;

Financial market conditions, including, but not limited to, changes in interest rates and the values of investments;

Inflation;

Credit worthiness of the issuers of investment securities, reinsurers and others with whom the Company and its subsidiaries do business;

Estimates of loss reserves and trends in losses and loss adjustment expenses;

Changing competition;

The Company’s ability to execute its business plan;

The effects of war and terrorism on investment and reinsurance markets;

The effects of hurricanes, earthquakes and other natural disasters on investment and reinsurance markets;

Changes in financial ratings issued by independent organizations, including A.M. Best, Standard & Poors and Moody’s;

The Company’s ability to enter new markets successfully and capitalize on growth opportunities;

The results of the activities of the Special Committee of the Company’s Board of Directors that was established to explore strategic alternatives to enhance shareholder value which could include, but are not limited to, a possible sale or merger, recapitalization, strategic alliance or joint venture (although there can be no assurance that the exploration of strategic alternatives will result in any transaction);

The Company’s ability to comply with internal control audit requirements that are expected to become effective in 2007; and

Changes in the laws, rules and regulations governing insurance holding companies and insurance companies, as well as applicable tax and accounting matters.

Changes in any of these factors, or others, could have an adverse affect on the business or results of operations of the Company or its subsidiaries. Unless required by law, the Company undertakes no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

Item 3. Controls and Procedures

The Company's Chief Executive Officer and Vice President of Finance, after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Sections 13a-15(e) and 15d-15(e) of the regulations promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the most recent fiscal quarter covered by this quarterly report (the "Evaluation Date"), have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and are designed to ensure that information required to be disclosed in those reports is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. Other than as related to the ceded premium issue previously disclosed in our Form 10-K for the year ended December 31, 2006 and resolved during the first quarter of 2007, there were no changes in the Company's internal control over financial reporting identified in connection with the Company's evaluation of controls that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

Item 6. Exhibits

Exhibits. The following documents are filed as exhibits to this report on Form 10-QSB:

| Exhibit No. | Document |
|-------------|---|
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Vice President of Finance pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This exhibit, except for those portions expressly incorporated by reference in this filing, is furnished for the information of the Commission and is not deemed "filed" as part of this filing. |

SIGNATURES

In accordance with the requirements of the Exchange Act, the Company caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PROFESSIONALS DIRECT, INC.

Date: May 11, 2007

/s/ Stephen M. Tuuk
Stephen M. Tuuk, President and Chief
Executive
Officer (authorized to sign on behalf of
Company)

/s/ Stephen M. Westfield
Stephen M. Westfield, Vice President of
Finance
(principal financial and accounting officer)

EXHIBIT INDEX

| Exhibit No. | Document |
|-------------|---|
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Vice President of Finance pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32 | Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. This exhibit, except for those portions expressly incorporated by reference in this filing, is furnished for the information of the Commission and is not deemed “filed” as part of this filing. |