

ATLANTIC AMERICAN CORP
Form 10-Q
May 11, 2012

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

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2012

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number 0-3722

ATLANTIC AMERICAN CORPORATION
(Exact name of registrant as specified in its charter)

Georgia
(State or other jurisdiction of incorporation or organization)

58-1027114
(I.R.S. Employer Identification No.)

4370 Peachtree Road, N.E.,
Atlanta, Georgia
(Address of principal executive offices)

30319
(Zip Code)

(404) 266-5500
(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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒ (Do not check if a smaller reporting company)

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 total number of shares of the registrant's Common Stock, \$1 par value, outstanding on May 4, 2012, was 21,274,119.

ATLANTIC AMERICAN CORPORATION

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ATLANTIC AMERICAN CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share data)

ASSETS

	Unaudited March 31, 2012	December 31, 2011
Cash and cash equivalents	\$18,037	\$21,285
Investments:		
Fixed maturities (cost: \$201,314 and \$198,506)	217,217	217,348
Common and non-redeemable preferred stocks (cost: \$7,477 and \$7,477)	8,883	8,348
Other invested assets (cost: \$560 and \$567)	560	567
Policy loans	2,255	2,246
Real estate	38	38
Investment in unconsolidated trusts	1,238	1,238
Total investments	230,191	229,785
Receivables:		
Reinsurance	17,248	15,673
Insurance premiums and other (net of allowance for doubtful accounts: \$394 and \$405)	7,477	8,289
Deferred acquisition costs	24,730	24,259
Other assets	776	706
Goodwill	2,128	2,128
Total assets	\$300,587	\$302,125

LIABILITIES AND SHAREHOLDERS' EQUITY

Insurance reserves and policyholder funds:		
Future policy benefits	\$64,088	\$63,321
Unearned premiums	22,419	23,646
Losses and claims	61,779	57,975
Other policy liabilities	1,596	2,252
Total policy liabilities	149,882	147,194
Accounts payable and accrued expenses	11,054	14,100
Deferred income taxes, net	2,495	3,316
Junior subordinated debenture obligations	41,238	41,238
Total liabilities	204,669	205,848
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock, \$1 par, 4,000,000 shares authorized; Series D preferred, 70,000 shares issued and outstanding; \$7,000 redemption value	70	70
Common stock, \$1 par, 50,000,000 shares authorized; shares issued: 22,400,894; shares outstanding: 21,274,119 and 21,274,241	22,401	22,401
Additional paid-in capital	57,136	57,136

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Retained earnings	7,283	6,179
Accumulated other comprehensive income	10,781	12,244
Treasury stock, at cost: 1,126,775 and 1,126,653 shares	(1,753)	(1,753)
Total shareholders' equity	95,918	96,277
Total liabilities and shareholders' equity	\$ 300,587	\$ 302,125

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

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ATLANTIC AMERICAN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; Dollars in thousands, except per share data)

	Three Months Ended March 31,	
	2012	2011
Revenue:		
Insurance premiums	\$30,681	\$25,422
Investment income	2,883	2,569
Realized investment gains, net	958	1
Other income	29	63
Total revenue	34,551	28,055
Benefits and expenses:		
Insurance benefits and losses incurred	22,672	16,631
Commissions and underwriting expenses	7,033	7,901
Interest expense	657	640
Other	2,469	2,255
Total benefits and expenses	32,831	27,427
Income before income taxes	1,720	628
Income tax expense	63	159
Net income	1,657	469
Preferred stock dividends	(127)	(127)
Net income applicable to common stock	\$1,530	\$342
Net income per common share (basic and diluted)	\$.07	\$.02

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

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ATLANTIC AMERICAN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited; Dollars in thousands)

	Three Months Ended March 31,	
	2012	2011
Net income	\$1,657	\$469
Other comprehensive income (loss):		
Available-for-sale securities:		
Gross unrealized holding loss arising in the period	(1,446)	(1,222)
Related tax benefit	506	428
Less: reclassification adjustment for net realized gains included in net income	958	1
Related tax expense	(336)	-
Net effect on other comprehensive loss	(1,562)	(795)
Derivative financial instrument:		
Fair value adjustment to derivative financial instrument	153	191
Related tax expense	(54)	(67)
Net effect on other comprehensive income	99	124
Total other comprehensive loss, net of tax	(1,463)	(671)
Total comprehensive income (loss)	\$194	\$(202)

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

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ATLANTIC AMERICAN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited; Dollars in thousands)

	Preferred	Common	Additional	Retained	Accumulated Other Comprehensive Income	Treasury	Total
Three Months Ended March 31, 2012	Stock	Stock	Paid-In Capital	Earnings	(Loss)	Stock	
Balance, December 31, 2011	\$ 70	\$ 22,401	\$ 57,136	\$ 6,179	\$ 12,244	\$ (1,753)	\$ 96,277
Net income	-	-	-	1,657	-	-	1,657
Other comprehensive loss, net of tax	-	-	-	-	(1,463)	-	(1,463)
Dividends declared on common stock	-	-	-	(426)	-	-	(426)
Dividends accrued on preferred stock	-	-	-	(127)	-	-	(127)
Purchase of shares for treasury	-	-	-	-	-	-	-
Balance, March 31, 2012	\$ 70	\$ 22,401	\$ 57,136	\$ 7,283	\$ 10,781	\$ (1,753)	\$ 95,918
Three Months Ended March 31, 2011							
Balance, December 31, 2010	\$ 70	\$ 22,374	\$ 57,129	\$ 3,886	\$ (604)	\$ (162)	\$ 82,693
Net income	-	-	-	469	-	-	469
Other comprehensive loss, net of tax	-	-	-	-	(671)	-	(671)
Dividends declared on common stock	-	-	-	(445)	-	-	(445)
Dividends accrued on preferred stock	-	-	-	(127)	-	-	(127)
Purchase of shares for treasury	-	-	-	-	-	(9)	(9)
Balance, March 31, 2011	\$ 70	\$ 22,374	\$ 57,129	\$ 3,783	\$ (1,275)	\$ (171)	\$ 81,910

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

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ATLANTIC AMERICAN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; Dollars in thousands)

	Three Months Ended March 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$1,657	\$469
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of deferred acquisition costs	2,960	2,957
Acquisition costs deferred	(3,431)	(2,850)
Realized investment gains	(958)	(1)
Increase (decrease) in insurance reserves	2,688	(4,009)
Depreciation and amortization	112	93
Deferred income tax (benefit) expense	(33)	144
(Increase) decrease in receivables, net	(761)	753
Decrease in other liabilities	(2,937)	(160)
Other, net	(21)	57
Net cash used in operating activities	(724)	(2,547)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from investments sold, called or matured	16,864	19,575
Investments purchased	(18,808)	(26,596)
Additions to property and equipment	(72)	-
Net cash used in investing activities	(2,016)	(7,021)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment of dividends on Series D Preferred Stock	(508)	-
Purchase of shares for treasury	-	(9)
Net cash used in financing activities	(508)	(9)
Net decrease in cash and cash equivalents	(3,248)	(9,577)
Cash and cash equivalents at beginning of period	21,285	28,325
Cash and cash equivalents at end of period	\$18,037	\$18,748
SUPPLEMENTAL CASH FLOW INFORMATION:		
Cash paid for interest	\$659	\$641
Cash paid for income taxes	\$-	\$-

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

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ATLANTIC AMERICAN CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited; Dollars in thousands, except per share amounts)

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Atlantic American Corporation (the “Parent”) and its subsidiaries (collectively with the Parent, the “Company”). All significant intercompany accounts and transactions have been eliminated in consolidation. The accompanying statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for audited annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. The unaudited condensed consolidated financial statements included herein and these related notes should be read in conjunction with the Company’s consolidated financial statements, and the notes thereto, included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011. The Company’s results of operations for the three month period ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012 or for any other future period.

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Note 2. Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-05, Comprehensive Income (Topic 220): Presentation of Comprehensive Income (“ASU 2011-05”). ASU 2011-05 requires all nonowner changes in stockholders’ equity to be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. If an entity elects the single continuous statement method of presentation, the entity is required to present the components of net income and total net income, the components of other comprehensive income and a total for other comprehensive income, along with the total of comprehensive income in that statement. In the two separate statement approach, an entity is required to present components of net income and total net income in the statement of net income. The statement of other comprehensive income would then immediately follow the statement of net income and would include the components of other comprehensive income and a total for other comprehensive income, along with a total for comprehensive income. Regardless of the presentation an entity chooses, the entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. ASU 2011-05 is to be applied retrospectively and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. In December 2011, the FASB issued ASU No. 2011-12, Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income (“ASU 2011-12”). The amendments in ASU 2011-12 are being made to allow the FASB time to evaluate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. The Company adopted all the requirements in ASU 2011-05 not affected by ASU 2011-12 on January 1, 2012. See Condensed Consolidated Statements of Comprehensive Income.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (“ASU 2011-04”). This guidance resulted in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and International Financial Reporting Standards. While many of the amendments to GAAP are not expected to have a significant effect on practice, this guidance changes some fair value measurement principles and disclosure requirements. ASU 2011-04 is applied prospectively. For public entities, this guidance is effective during the interim and annual periods beginning after December 15, 2011. The Company adopted ASU 2011-04 on January 1, 2012. See Note 10 for expanded disclosures.

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In October 2010, the FASB issued ASU No. 2010-26, Financial Services – Insurance (Topic 944): Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts (“ASU 2010-26”) which specifies which costs relating to the acquisition of new or renewal insurance contracts qualify for deferral. In accordance with ASU 2010-26, incremental direct costs of contract acquisition are capitalized. Advertising costs are included in deferred acquisition costs only if the capitalization criteria in the direct-response advertising guidance in Subtopic 340-20, Other Assets and Deferred Costs – Capitalized Advertising Costs, are met. All other acquisition related costs, including costs incurred by the insurer in soliciting potential customers, market research, training, administration, unsuccessful acquisition or renewal efforts, and product development, are expensed as incurred. If the initial application of ASU 2010-26 results in the capitalization of acquisition costs that had not been capitalized previously, the entity may elect not to capitalize those types of costs. ASU 2010-26 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. ASU 2010-26 was required to be applied prospectively upon adoption; although retrospective application to all prior periods presented upon the date of adoption is also permitted, but not required. The Company adopted ASU 2010-26 on January 1, 2012 on a prospective basis. Adoption of ASU 2010-26 did not have a material impact on the Company’s financial condition or results of operations.

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Note 3.Segment Information

The Company's primary operating subsidiaries, American Southern Insurance Company and American Safety Insurance Company (together known as "American Southern") and Bankers Fidelity Life Insurance Company ("Bankers Fidelity") operate in two principal business units, each focusing on specific products. American Southern operates in the property and casualty insurance market, while Bankers Fidelity operates in the life and health insurance market. Each business unit is managed independently and is evaluated on its individual performance. The following sets forth the revenue and income (loss) before tax for each business unit for the three month periods ended March 31, 2012 and 2011.

Revenues	Three Months Ended	
	March 31,	
	2012	2011
American Southern	\$ 11,264	\$ 10,576
Bankers Fidelity	23,081	17,333
Corporate and Other	206	146
Total revenue	\$ 34,551	\$ 28,055

Income (loss) before income taxes	Three Months Ended	
	March 31,	
	2012	2011
American Southern	\$ 715	\$ 1,328
Bankers Fidelity	2,616	885
Corporate and Other	(1,611)	(1,585)
Income before income taxes	\$ 1,720	\$ 628

Note 4.Credit Arrangements

Bank Debt

At March 31, 2012, the Company had a revolving credit facility (the "Credit Agreement") with Wells Fargo Bank, National Association ("Wells Fargo"), pursuant to which the Company is able to borrow or reborrow up to \$5,000, subject to the terms and conditions thereof. The interest rate on amounts outstanding under the Credit Agreement is, at the option of the Company, equivalent to either (a) the base rate (which equals the higher of the Prime Rate or 0.5% above the Federal Funds Rate, each as defined) or (b) the London Interbank Offered Rate ("LIBOR") determined on an interest period of 1-month, 2-months, 3-months or 6-months, plus 2.00%. Interest on amounts outstanding is payable quarterly. The Credit Agreement requires the Company to comply with certain covenants, including, among others, ratios that relate funded debt to both total capitalization and earnings before interest, taxes, depreciation and amortization, as well as the maintenance of minimum levels of tangible net worth. The Company must also comply with limitations on capital expenditures, certain payments, additional debt obligations, equity repurchases and certain redemptions, as well as minimum risk-based capital levels. Upon the occurrence of an event of default, Wells Fargo may terminate the Credit Agreement and declare all amounts outstanding due and payable in full. During the three month period ended March 31, 2012, there was no balance outstanding under this Credit Agreement and the Company was in compliance with all financial covenants of the Credit Agreement. The termination date of this Credit Agreement is August 31, 2012.

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Junior Subordinated Debentures

The Company has two unconsolidated Connecticut statutory business trusts, which exist for the exclusive purposes of: (i) issuing trust preferred securities (“Trust Preferred Securities”) representing undivided beneficial interests in the assets of the trusts; (ii) investing the gross proceeds of the Trust Preferred Securities in junior subordinated deferrable interest debentures (“Junior Subordinated Debentures”) of Atlantic American; and (iii) engaging in only those activities necessary or incidental thereto.

The financial structure of each of Atlantic American Statutory Trust I and II as of March 31, 2012 was as follows:

	Atlantic American Statutory Trust I	Atlantic American Statutory Trust II
JUNIOR SUBORDINATED DEBENTURES (1) (2)		
Principal amount owed	\$ 18,042	\$ 23,196
Balance March 31, 2012	18,042	23,196
Balance December 31, 2011	18,042	23,196
Coupon rate	LIBOR + 4.00%	LIBOR + 4.10%
Interest payable	Quarterly	Quarterly
Maturity date	December 4, 2032	May 15, 2033
Redeemable by issuer	Yes	Yes
TRUST PREFERRED SECURITIES		
Issuance date	December 4, 2002	May 15, 2003
Securities issued	17,500	22,500
Liquidation preference per security	\$ 1	\$ 1
Liquidation value	17,500	22,500
Coupon rate	LIBOR + 4.00%	LIBOR + 4.10%
Distribution payable	Quarterly	Quarterly
Distribution guaranteed by (3)	Atlantic American Corporation	Atlantic American Corporation

- (1) For each of the respective debentures, the Company has the right at any time, and from time to time, to defer payments of interest on the Junior Subordinated Debentures for a period not exceeding 20 consecutive quarters up to the debentures' respective maturity dates. During any such period, interest will continue to accrue and the Company may not declare or pay any cash dividends or distributions on, or purchase, the Company's common stock nor make any principal, interest or premium payments on or repurchase any debt securities that rank equally with or junior to the Junior Subordinated Debentures. The Company has the right at any time to dissolve each of the trusts and cause the Junior Subordinated Debentures to be distributed to the holders of the Trust Preferred Securities.
- (2) The Junior Subordinated Debentures are unsecured and rank junior and subordinate in right of payment to all senior debt of the Parent and are effectively subordinated to all existing and future liabilities of its subsidiaries.
- (3) The Parent has guaranteed, on a subordinated basis, all of the obligations under the Trust Preferred Securities, including payment of the redemption price and any accumulated and unpaid distributions to the extent of available funds and upon dissolution, winding up or liquidation.

Note 5. Derivative Financial Instruments

On February 21, 2006, the Company entered into a zero cost interest rate collar with Wells Fargo to hedge future interest payments on a portion of the Junior Subordinated Debentures. The notional amount of the collar was \$18,042 with an effective date of March 6, 2006. The collar has a LIBOR floor rate of 4.77% and a LIBOR cap rate of 5.85%,

and adjusts quarterly on the 4th of each March, June, September and December through termination on March 4, 2013. The Company began making payments to Wells Fargo under the zero cost interest rate collar on June 4, 2008. As a result of interest rates remaining below the LIBOR floor rate of 4.77% through March 31, 2012, these payments to Wells Fargo have continued. While the Company may be exposed to counterparty risk should Wells Fargo fail to perform its obligations under this agreement, based on the current level of interest rates coupled with the current macroeconomic outlook, the Company believes that its current exposure to nonperformance risks is minimal.

The estimated fair value and related carrying value of the Company's interest rate collar at March 31, 2012 was a liability of approximately \$723 with a corresponding decrease in accumulated other comprehensive income in shareholders' equity, net of deferred tax.

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Note 6. Earnings Per Common Share

A reconciliation of the numerator and denominator used in the earnings per common share calculations is as follows:

		Three Months Ended March 31, 2012	
	Income	Shares (In thousands)	Per Share Amount
Basic Earnings Per Common Share:			
Net income	\$ 1,657	21,274	
Less preferred stock dividends	(127)		
Net income applicable to common shareholders	1,530	21,274	\$.07
Diluted Earnings Per Common Share:			
Effect of dilutive stock options		77	
Net income applicable to common shareholders	\$ 1,530	21,351	\$.07
		Three Months Ended March 31, 2011	
	Income	Shares (In thousands)	