Amtrust Financial Services, Inc.
Form 10-Q
August 04, 2011

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2011

¨ 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. 001-33143

AmTrust Financial Services, Inc.
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	04-3106389 (IRS Employer Identification No.)
59 Maiden Lane, 6th Floor, New York, New York (Address of principal executive offices)	10038 (Zip Code)

(212) 220-7120
(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 x 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 x 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ¨ Accelerated filer x

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 Securities Exchange Act). Yes ¨ No x

As of July 29, 2011, the Registrant had one class of Common Stock ($.01 par value), of which 59,930,452 shares were issued and outstanding.

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PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

AMTRUST FINANCIAL SERVICES, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(in thousands, except par value)

(Amounts in Thousands)	June 30, 2011 (Unaudited)	December 31, 2010 (Audited)
ASSETS		
Investments:		
Fixed maturities, available-for-sale, at market value (amortized cost $1,191,390; $1,192,844)	$ 1,222,419	$ 1,208,813
Equity securities, available-for-sale, at market value (cost $19,204; $18,577)	19,367	17,412
Short-term investments	98,480	32,137
Equity investment in unconsolidated subsidiary – related party	86,633	77,136
Other investments	22,008	21,514
Total investments	1,448,907	1,357,012
Cash and cash equivalents	256,446	201,949
Accrued interest and dividends	10,050	7,979
Premiums receivable, net	877,047	727,561
Reinsurance recoverable (related party $426,930; $386,932)	1,006,410	775,432
Prepaid reinsurance premium (related party $320,720; $283,899)	507,999	484,960
Prepaid expenses and other assets	495,296	163,905
Federal income tax receivable	2,009	10,269
Deferred policy acquisition costs	258,557	224,671
Property and equipment, net	44,779	30,889
Goodwill	107,731	106,220
Intangible assets	120,366	91,606
	$ 5,135,597	$ 4,182,453
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Loss and loss expense reserves	$ 1,688,737	$ 1,263,537
Unearned premiums	1,212,703	1,024,965
Ceded reinsurance premiums payable (related party $152,869; $95,629)	310,894	266,314
Reinsurance payable on paid losses	10,855	11,343
Funds held under reinsurance treaties	55,324	3,217
Securities sold but not yet purchased, at market	141	8,847
Securities sold under agreements to repurchase, at contract value	211,867	347,617
Accrued expenses and other current liabilities	296,406	195,060
Deferred income taxes	67,428	9,883
Note payable on collateral loan – related party	167,975	167,975
Revolving credit facility	98,200	—
Secured term loan	10,413	—
Non-interest bearing note payable – net of unamortized discount of $303; $600	7,197	14,400
Term loan	—	6,667
Junior subordinated debt	123,714	123,714

Total liabilities	4,261,854	3,443,539
Commitments and contingencies		
Redeemable non-controlling interest	600	600
Stockholders' equity:		
Common stock, $.01 par value; 100,000 shares authorized, 84,713 and 84,314 issued in 2011 and 2010, respectively; 59,913 and 59,565 outstanding in 2011 and 2010, respectively	847	844
Preferred stock, $.01 par value; 10,000 shares authorized	—	—
Additional paid-in capital	554,994	548,731
Treasury stock at cost; 24,800 and 24,816 shares in 2011 and 2010, respectively	(300,365)	(300,489)
Accumulated other comprehensive income (loss)	16,404	(266)
Retained earnings	553,478	467,694
Total AmTrust Financial Services, Inc. equity	825,358	716,514
Non-controlling interest	47,785	21,800
Total stockholders' equity	873,143	738,314
	$ 5,135,597	$ 4,182,453

See accompanying notes to unaudited condensed consolidated statements.

AmTrust Financial Services, Inc.
Condensed Consolidated Statements of Income
(Unaudited)
(in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenues:				
Premium income:				
Net written premium	$ 375,681	$ 196,394	$ 609,700	$ 385,808
Change in unearned premium	(127,399)	(133)	(161,080)	(41,447)
Net earned premium	248,282	196,261	448,620	344,361
Ceding commission – primarily related party	35,414	32,958	71,098	65,206
Service and fee income (related parties – three months $4,459; $2,880 and six months $7,898; $5,548)	24,542	9,121	49,731	17,087
Net investment income	13,167	14,686	27,359	28,285
Net realized gain (loss) on investments	616	(6,544)	1,031	(4,759)
Total revenues	322,021	246,482	597,839	450,180
Expenses:				
Loss and loss adjustment expense	170,008	121,510	298,704	211,331
Acquisition costs and other underwriting expenses	89,580	79,579	170,814	140,925
Other	18,564	9,336	38,760	15,570
Total expenses	278,152	210,425	508,278	367,826
Income before other income (expense), income taxes and equity in earnings of unconsolidated subsidiaries	43,869	36,057	89,561	82,354
Other income (expense):				
Foreign currency gain	2,520	755	2,236	38
Interest expense	(4,334)	(3,063)	(8,088)	(6,635)
Net gain on investment in life settlement contracts	22,638	—	41,524	—
Total other income (expense)	20,824	(2,308)	35,672	(6,597)
Income before income taxes and equity in earnings of unconsolidated subsidiaries	64,693	33,749	125,233	75,757
Provision for income taxes	12,126	8,839	24,468	24,007
Income before equity earnings of unconsolidated subsidiaries and non-controlling interest	52,567	24,910	100,765	51,750
Equity in earnings of unconsolidated subsidiaries – related parties	4,077	5,913	7,200	17,773
Net income	56,644	30,823	107,965	69,523
Net income attributable to non-controlling interest of subsidiaries	(6,482)	—	(12,620)	—
Net income attributable to AmTrust Financial Services, Inc.	50,162	30,823	95,345	69,523
Earnings per common share:				
Basic earnings per common share	$ 0.84	$ 0.52	$ 1.60	$ 1.17
Diluted earnings per common share	$ 0.81	$ 0.51	$ 1.55	$ 1.15
Dividends declared per common share	$ 0.08	$ 0.07	$ 0.16	$ 0.14

Net realized gain (loss) on investments:				
Total other-than-temporary impairment loss	$ (345)	$ (12,007)	$ (345)	$ (17,145)
Portion of loss recognized in other comprehensive income	—	—	—	—
Net impairment losses recognized in earnings	(345)	(12,007)	(345)	(17,145)
Other net realized gain on investments	961	5,463	1,376	12,386
Net realized investment gain (loss)	$ 616	$ (6,544)	$ 1,031	$ (4,759)

See accompanying notes to unaudited condensed consolidated financial statements.

AmTrust Financial Services, Inc.
Consolidated Statements of Cash Flows
(Unaudited)
(in thousands)

	Six Months Ended June 30, 2011	2010
Cash flows from operating activities:		
Net income	$ 107,965	$ 69,523
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31,764	7,945
Equity earnings and gain on investment in unconsolidated subsidiaries	(7,200)	(17,773)
Gain on investment in life settlement contracts	(41,524)	—
Realized gain marketable securities	(1,376)	(12,386)
Non-cash write-down of marketable securities	345	17,145
Discount on notes payable	298	450
Stock compensation expense	2,827	1,860
Bad debt expense	4,167	3,510
Foreign currency (gain) loss	(2,236)	(38)
Changes in assets - (increase) decrease:		
Premiums and note receivables	(130,990)	(162,419)
Reinsurance recoverable	(82,829)	(53,216)
Deferred policy acquisition costs, net	(33,886)	(42,340)
Prepaid reinsurance premiums	(23,039)	(35,907)
Prepaid expenses and other assets	(35,908)	(739)
Changes in liabilities - increase (decrease):		
Reinsurance premium payable	44,580	94,480
Loss and loss expense reserve	57,179	62,671
Unearned premiums	165,925	88,653
Funds held under reinsurance treaties	52,107	(70)
Deferred tax liability, net	(20,344)	(4,170)
Accrued expenses and other current liabilities	87,070	(10,896)
Net cash provided in operating activities	174,895	6,283
Cash flows from investing activities:		
Net (purchases) sales of securities with fixed maturities and short term investments	(72,409)	95,734
Net (purchases) sales of equity securities	(176)	4,502
Net (purchases) sales of other investments	(451)	(577)
Investment in ACAC	—	(53,055)
Acquisition of and capitalized premiums for life settlement contracts	(26,504)	—
Acquisition of subsidiaries, net of cash obtained	30,874	(3,553)
Purchase of property and equipment	(18,315)	(1,677)
Net cash (used in) provided by investing activities	(86,981)	41,374
Cash flows from financing activities:		
Repurchase agreements, net	(135,750)	65,478
Revolving credit facility borrowings	98,200	—
Secured loan agreement borrowings	10,800	—
Secured loan agreement repayment	(387)	—

Term loan payment		(6,667)		(6,667)
Capital contribution to subsidiary		12,515		—
Stock option exercise and other		3,563		790
Dividends distributed on common stock		(9,551)		(7,713)
Non-interest bearing note payment		(7,500)		(7,500)
Debt financing fees		(1,394)		—
Net cash (used in) provided by financing activities		(36,171)		44,388
Effect of exchange rate changes on cash		2,754		(9,446)
Net increase in cash and cash equivalents		54,497		82,599
Cash and cash equivalents, beginning of the period		201,949		233,810
Cash and cash equivalents, end of the period	$	256,446	$	316,409
Supplemental Cash Flow Information				
Income tax payments	$	6,280	$	7,258
Interest payments on debt		6,566		8,434

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements
(Unaudited)
(dollars in thousands, except share data)

1. Basis of Reporting

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by GAAP for complete financial statements. These interim statements should be read in conjunction with the financial statements and notes thereto included in the AmTrust Financial Services, Inc. ("AmTrust" or the "Company") Annual Report on Form 10-K for the year ended December 31, 2010, previously filed with the Securities and Exchange Commission ("SEC") on March 15, 2011. The balance sheet at December 31, 2010 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

These interim consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim period and all such adjustments are of a normal recurring nature. The results of operations for the interim period are not necessarily indicative, if annualized, of those to be expected for the full year. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

A detailed description of the Company's significant accounting policies and management judgments is located in the audited consolidated financial statements for the year ended December 31, 2010, included in the Company's Form 10-K filed with the SEC.

All significant inter-company transactions and accounts have been eliminated in the consolidated financial statements. To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation. There was no effect on net income from the change in presentation.

2. Recent Accounting Pronouncements

With the exception of those discussed below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the six months ended June 30, 2011, as compared to those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, that are of significance, or potential significance, to the Company.

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-05 Comprehensive Income (Topic 220). This update requires that all non-owner charges in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-step approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The updated guidance is effective for fiscal years and interim periods beginning on or after December 15, 2011 and is to be applied on a retrospective basis to the beginning of the annual period of adoption. Early adoption is permitted and the amendment does not require any transition disclosure. The Company is currently assessing the impact of the adoption of this guidance, but does not anticipate any material impact on its results of operations, financial position or liquidity.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement (Topic 820). The ASU generally aligns the principles for fair value measurements and the related disclosure requirements under GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements, particularly for Level 3 fair value measurements. The amendment is effective on a prospective basis for interim and annual reporting periods beginning after December 15, 2011 and early adoption is not permitted. The Company is currently assessing the impact of the adoption of this guidance, but does not anticipate any material impact on its results of operations, financial position or liquidity.

On April 29, 2011, the FASB amended its guidance on accounting for repurchase agreements. The amendments eliminate the criteria to assess whether a transferor must have the ability to repurchase or redeem the financial assets in order to demonstrate effective control over the transferred asset. Under the amended guidance, a transferor maintains effective control over transferred financial assets (and thus accounts for the transfer as a secured borrowing) if there is an agreement that both entitles and obligates the transferor to repurchase the financial assets before maturity and if all of the following conditions previously required are met: (i) financial assets to be repurchased or redeemed are the same or substantially the same as those transferred; (ii) repurchase or redemption date before maturity at a fixed or determinable price; and (iii) the agreement is entered into contemporaneously with, or in contemplation of, the transfer. As a result, more arrangements could be accounted for as secured borrowings rather than sales. The updated guidance is effective on a prospective basis for interim and annual reporting periods beginning on or after December 15, 2011, and early adoption is prohibited. The Company is currently evaluating the impact of the adoption of this new guidance on its consolidated results of operations and financial condition.

In April 2011, the FASB issued updated guidance to clarify whether a modification or restructuring of a receivable is considered a troubled debt restructuring, i.e., whether the creditor has granted a concession and whether the debtor is experiencing financial difficulties. A modification or restructuring that is considered a troubled debt restructuring will result in the creditor having to account for the receivable as being impaired and will also result in additional disclosure of the creditors' troubled debt restructuring activities. The updated guidance is effective for the first interim period beginning on or after June 15, 2011 and is to be applied on a retrospective basis to the beginning of the annual period of adoption. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or liquidity.

In December 2010, the FASB issued authoritative guidance on disclosure of supplementary pro forma information for business combinations. The new guidance specifies that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. The new guidance became effective for the Company on January 1, 2011. The adoption of this guidance is not expected to have a material impact on the Company's results of operations, financial position or liquidity.

In October 2010, the FASB issued updated guidance to address the diversity in practice for the accounting for costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost must be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. If application of this guidance would result in the capitalization of acquisition costs that had not previously been capitalized by a reporting entity, the entity may elect not to capitalize those costs. The updated guidance is effective on either a retrospective or prospective basis for interim and annual reporting periods beginning after December 15, 2011, with early adoption permitted as of the beginning of a company's annual period. The Company is currently evaluating the impact of the adoption of this new guidance on its consolidated results of operations and financial condition.

3. Investments

(a) Available-for-Sale Securities

The original cost, estimated market value and gross unrealized appreciation and depreciation of available-for-sale securities as of June 30, 2011, are presented in the table below:

(Amounts in Thousands)	Original or amortized cost	Gross unrealized gains	Gross unrealized losses	Market value
Preferred stock	$ 6,029	$ 357	$ 42	$ 6,344
Common stock	13,175	1,456	1,608	13,023
U.S. treasury securities	92,204	1,928	328	93,804
U.S. government agencies	18,224			