PROFESSIONALS DIRECT INC
Form 10QSB
August 14, 2007

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

FORM 10-QSB

(MARK ONE)
[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 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 July 31, 2007.

Transitional Small Business Disclosure Format (check one): Yes ____ No__X__.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

June 30,	**2007 (000)**
Assets	
Fixed maturities held to maturity, at amortized cost	**$ 7,014**
Fixed maturities available for sale, at fair value	**31,341**
Other invested asset, at cost which approximates fair value	**277**
Total investments	**38,632**
Cash and cash equivalents	**5,528**
Receivables:	
Amounts due from reinsurers	**14,367**
Other	**1,968**
Prepaid reinsurance premiums	**3,568**
Deferred acquisition costs	**1,585**
Net deferred federal income taxes	**1,326**
Other assets	**1,685**
Total Assets	**$ 68,659**
Liabilities and Shareholders' Equity	
Liabilities	
Loss and loss adjustment expense reserves	**$ 32,398**
Unearned premiums	**12,709**
Amounts due to reinsurers	**1,931**
Other liabilities	**2,216**
Accrued interest	**1,003**
Surplus certificates	**1,343**
Trust preferred securities	**5,000**
Total Liabilities	**56,600**
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	**9,192**
Accumulated other comprehensive loss	**(337)**
Total Shareholders' Equity	**12,059**

Total Liabilities and Shareholders' Equity	**$ 68,659**

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007 (000)	2006 (000)	**2007 (000)**	2006 (000)
Revenues				
Net premiums earned	**$ 4,079**	$ 4,015	**$ 8,037**	$ 8,019
Fees and commissions	**256**	232	**512**	444
Net investment income	**404**	368	**807**	727
Finance and other income, including unusual gains	**46**	91	**170**	251
Total revenues	**4,785**	4,706	**9,526**	9,441
Expenses				
Losses and loss adjustment expenses	**4,458**	3,135	**7,245**	5,970
Operating and administrative	**1,034**	1,128	**2,257**	2,076
Strategic alternatives	**274**	-	**274**	-
Interest	**129**	142	**257**	281
Total expenses	**5,895**	4,405	**10,033**	8,327
Income (loss) before federal income taxes	**(1,110)**	301	**(507)**	1,114
Federal income taxes (benefit)	**(430)**	66	**(272)**	316
Net income (loss)	**(680)**	235	**(235)**	798
Other comprehensive loss (Net of tax benefit of $50, $26, $16 and $88, respectively)	**(97)**	(50)	**(31)**	(171)
Comprehensive income (loss)	**$ (777)**	$ 185	**$ (266)**	$ 627
Per share of common stock (not in thousands):				
Basic and diluted net income (loss) per share	**$ (2.04)**	$ .70	**$ (.71)**	$ 2.39
Basic and diluted comprehensive income (loss) per share	**(2.33)**	.55	**(.80)**	1.88

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended June 30, **2007** (000)	Six Months Ended June 30, 2006 (000)
Operating activities		
Net income (loss)	**$ (235)**	$ 798
Adjustments to reconcile net income to net cash from operating activities:		
Deferred federal income taxes	**(72)**	119
Gain from redemption of surplus certificates	**(82)**	(157)
Loss on disposal of assets	**15**	-
Depreciation and amortization	**310**	328
Changes in operating assets and liabilities:		
Amounts due from reinsurers	**2,014**	(5,210)
Other receivables	**80**	44
Prepaid reinsurance premiums	**551**	86
Federal income taxes recoverable	**(400)**	(466)
Deferred acquisition costs	**(169)**	(33)
Other assets	**(69)**	(99)
Loss and loss adjustment expense reserves	**(478)**	4,458
Amounts due to reinsurers	**201**	292
Unearned premiums	**924**	(118)
Other liabilities	**(531)**	880
Accrued interest	**(142)**	(318)
Net cash from operating activities	**1,917**	604
Investing activities		
Cost of fixed maturities acquired	**(6,173)**	(9,692)
Proceeds from sales or maturities of fixed maturities	**4,479**	5,093
Cost of property and equipment acquired	**(59)**	(309)
Net cash for investing activities	**(1,753)**	(4,908)
Financing activities		
Repayments of surplus certificates	**(178)**	(425)
Net repayments under lines of credit	**-**	(170)
Net cash for financing activities	**(178)**	(595)
Net decrease in cash and cash equivalents	**(14)**	(4,899)
Cash and cash equivalents, beginning of period	**5,542**	9,309
Cash and cash equivalents, end of period	**$ 5,528**	$ 4,410
Supplemental disclosures of cash flow information		

Federal income tax payments	**$ 214**	$ 663
Interest payments	**299**	599

See accompanying notes to condensed consolidated financial statements.

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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, 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 they are not consolidated because the Company is not the primary beneficiary.

The condensed consolidated financial statements and notes as of and for the three and six-month periods ended June 30, 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. Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (“SFAS No. 157”) which 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 believes SFAS No. 157, which we will adopt effective January 1, 2008, will not materially impact, if at all, its financial condition or results of operations.

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 the 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 Company believes SFAS No. 159, which we will adopt effective January 1, 2008, will not materially impact, if at all, its financial condition or results of operations.

3. 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 and six months ended June 30, 2007, and 333,500 for the three and six months ended June 30, 2006). Diluted income per share is equal to basic income per share as there are no stock options or other dilutive instruments outstanding.

4. Unusual Gains

Other income includes unusual gains of $0 and $82,000 for the three and six months ended June 30, 2007, respectively, and $44,000 and $157,000 for the three and six months ended June 30, 2006, respectively, from principal forgiven by surplus certificate holders in return for early redemption.

5. Sale of Company

On June 25, 2007, Professionals Direct, Inc. executed a merger agreement under which it agreed to be acquired by Hanover Acquisition Corp. (“Purchaser”), a wholly-owned subsidiary of The Hanover Insurance Group, Inc. of Worcester, Massachusetts (NYSE: THG) (“Hanover”). The purchase price is $23.2 million, or $69.61 per share, payable in cash after closing of the merger. The closing is subject to a variety of conditions, including approval by shareholders and the Commissioner of Insurance of the State of Michigan and the Office of Financial and Insurance Services of the Michigan Department of Labor and Economic Growth (“OFIS”). If the merger is approved, closing will occur late in the third quarter or early in the fourth quarter of 2007.

On August 7, 2007, OFIS issued an order stating that the acquisition of control of the Company by Hanover in accordance with the Merger Agreement is approved, contingent upon approval of holders of a majority of the common stock of the Company, and satisfactory review of fingerprint results for all of Purchaser’s officers and directors.

Item 2. Management's Discussion and Analysis

The following discussion and analysis for the six months ended June 30, 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 increased nominally in 2007 from 2006. Losses and loss adjustment expenses increased in 2006 because adverse development was greater in the first half of 2007 than in 2006. Operating and administrative expenses also increased. As a result, the first six months of 2007 is a net loss when compared to last year's net income. The following table and discussion compares year-to-date financial results for 2007 and 2006:

	Six Months Ended June 30,			
	2007	2006	Change	Percent Change
	(in thousands of dollars, except for per share data)			
Revenues:				
Net premiums earned	$ 8,037	$ 8,019	$ 18	0.2%
Fees and commissions	512	444	68	15.3%
Net investment income	807	727	80	11.0%
Finance and other income	170	251	(81)	(32.3%)
Total revenues	9,526	9,441	85	0.9%
Expenses:				
Losses and loss adjustment expenses	7,245	5,970	1,275	21.4%
Operating and administrative	2,257	2,076	181	8.7%
Strategic alternatives	274	-	274	-
Interest	257	281	(24)	(8.5%)
Total expenses	10,033	8,327	1,706	20.5%
Income (loss) before federal income taxes	(507)	1,114	(1,621)	(145.5%)
Federal income taxes (benefit)	(272)	316	(588)	(186.1%)
Net income (loss)	$ (235)	$ 798	$ (1,033)	(129.4%)
Selected Balance Sheet Data: (at end of period)				
Total investments and cash	$ 44,160	$ 42,641	$ 1,519	3.6%
Total assets	68,659	76,220	(7,561)	(9.9%)
Total liabilities	56,600	64,992	(8,392)	(12.9%)
Total shareholders' equity	12,059	11,228	831	7.4%
Per Share Data:				
Net income (loss)	$ (.71)	$ 2.39	$ (3.10)	(129.7%)
Shareholders' equity	$ 36.18	$ 33.67	$ 2.51	7.5%

Results of Operations (000 omitted):

Following is a summary and analysis of the material revenue and expense components of our operational results for the first six months and second quarter of 2007 with comparisons to 2006.

Net Premiums Earned. Net premiums earned is equal to direct premiums earned (premiums earned for policies written) less ceded premiums earned (amounts ceded to reinsurers) and is our primary source of revenue. Net unearned premiums increased consistent with increases in direct and net premiums written in 2007 compared to 2006.

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

	Six Months Ended June 30,			
	2007	2006	Change	Percent Change
	(in thousands of dollars)			
Beginning gross unearned premium	$ 11,785	$ 11,776	$ 9	0.1%
Beginning ceded unearned premium	(4,118)	(4,175)	57	1.4%
Beginning net unearned premium	7,667	7,601	66	0.9%
Direct premiums written	13,826	12,479	1,347	10.8%
Ceded premiums written	(4,315)	(4,492)	177	3.9%
Net premiums written	9,511	7,987	1,524	19.1%
Ending gross unearned premium	12,709	11,658	1,051	9.0%
Ending ceded unearned premium	(3,568)	(4,089)	521	12.7%
Ending net unearned premium	9,141	7,569	1,572	20.8%
Net premiums earned	$ 8,037	$ 8,019	$ 18	0.2%

During the first half of 2007, direct and net premiums written increased. These increases resulted from increased new business ($2,912 compared to $1,402 for 2006) plus rate increases partially offset by lower renewal rates in Michigan and Florida. The percentage increase in net premiums written exceeded that of direct premiums written principally because policies are being written at lower limits in 2007 which increases the percentage we retain. Additionally, we nominally increased 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 from two primary sources. First are membership fees, which are earned by Lawyers Direct Risk Purchasing Group ("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 half of 2007 were $512, $68 more than in the first half of 2006. Commission income accounted for $66 of the increase; Lawyers Direct accounted for $2.

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 $80 or 11% in the first six 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 64 basis points from a year ago and is now almost 5%.

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 $7 lower for the first six months of 2007 as compared to 2006. During the first six months of 2007 and 2006, PDIC redeemed 260 and 254 surplus certificates, respectively, as part of a redemption program. This redemption resulted in unusual gains of $82 and $157 in 2007 and 2006, respectively, from principal forgiven by surplus certificate holders in return for early redemption. The decrease in these gains primarily caused 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 six months of 2007, PDIC recorded losses and LAE of $7,245 of which $5,692 was for claims made and reported in 2007 and $1,553 was for claims made and reported in prior years. During the first six months of 2006, PDIC recorded losses and LAE of $5,970 of which $5,585 was for claims made and reported in 2006 and $385 was for claims made and reported in prior years. The increase in 2007 losses attributed to prior years resulted from unanticipated development on a number of claims primarily from the 2005 report year. The increase in 2006 losses attributed to prior years resulted from small changes to the loss ratio assumptions to reflect then current experience. Loss ratios are the sum of the losses and loss adjustment expenses incurred expressed as a percentage of net premiums earned. The loss ratio for the first six months of 2007 was 90.1% compared to 74.4% in 2006. In the first half of 2007, the increase in estimate of prior years' claims increased the loss ratio by 19.3% as contrasted to 2006, when the increase in estimate of prior years' claims increased the loss ratio by 4.8%.

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. The June 30, 2007 and 2006 loss and LAE reserves have been evaluated by our outside actuary. 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:

Incurred development method
Paid development method
Case development method
Hindsight outstanding method
Pure premium method
Incurred Bornhuetter-Ferguson method
Paid Bornhuetter-Ferguson 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 June 30, 2007 were 43.0%. 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 six months of 2007 compared to the same period for 2006 increased $181 or 8.7%. This increase is the result of reduced ceding commissions earned in 2007 compared to 2006 and increased compensation costs and insurance assessments. Ceding commissions have declined consistent with decreases in ceded premium and account for $72 of the increase. Compensation costs and insurance assessments account equally for the remainder of the increase.

Strategic Alternatives. Strategic alternatives represent fees attributable to the pending sale of the Company and include principally legal and valuation fees.

Interest Expense. Interest expense for the first six months of 2007 decreased $24 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 (benefit) rate for 2007 and 2006 is (53.6%) and 28.4%, respectively. The effective rates for both years differ from 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. The management fees paid by PDIC are pre-approved by the Office of Financial and Insurance Services, the regulatory body in Michigan responsible for the oversight of the insurance subsidiary. Under the terms of the plan that governed the Company’s conversion from a mutual insurance company to a stock insurance company, PDIC is prohibited from making any dividend payments to Professionals Direct, Inc. until such time as the surplus certificates are repaid in full. The management fees paid by the remaining subsidiaries are determined from time-to-time by the Board of Directors. The payment of management fees and dividends by the other subsidiaries is 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 June 30, 2007, cash and cash equivalents totaled $5,528. 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 six months of 2007 was $1,917 compared to $604 for the first six months of 2006, an increase of $1,313. Cash flow from operations was generated primarily by a decrease in the amount due from reinsurers. Cash flow for both periods was invested in fixed maturities and used to repay lines of credit and redeem 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 June 30, 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 June 30, 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”, “forecasts”, “intends”, “judgment”, “objective”, “plans”, “predict
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 effect of the Company’s entering into an Agreement and Plan of Merger on June 25, 2007, with The Hanover Insurance Group, Inc., a Delaware corporation, and Hanover Acquisition Corp., a Michigan corporation;

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. 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 5. Other Information.

On June 25, 2007, the Company executed a merger agreement under which it agreed to be acquired by Hanover Acquisition Corp. (“Purchaser”), a wholly-owned subsidiary of The Hanover Insurance Group, Inc. of Worcester, Massachusetts (“Hanover”). The merger consideration is approximately $23.2 million, or $69.61 per share, payable in cash after closing of the merger. The closing is subject to a variety of conditions, including approval by the Company’s shareholders and approval by the Commissioner of Insurance of the State of Michigan and the Office of Financial and Insurance Services of the Michigan Department of Labor and Economic Growth (“OFIS”). If the merger is approved, we expect that the closing would occur in the late third or early fourth quarter of 2007.

On August 10, 2007, the Company was informed that OFIS issued an order dated August 6, 2007, stating that the acquisition of control of the Company by Hanover in accordance with the Merger Agreement is approved, contingent upon approval of holders of a majority of the common stock of the Company, and satisfactory review of fingerprint results for all of Purchaser’s officers and directors.

The Company expects to hold a special meeting of its shareholders on Friday, September 7, 2007, to consider and approve the merger with Hanover. In connection with that meeting, the Company filed its proxy statement with the SEC on August 1, 2007, and began mailing the proxy statement to its shareholders on August 3, 2007. Shareholders and other interested parties can obtain free copies of the proxy statement as well as other documents filed with the SEC that contain information about the Company on the SEC’s website at www.sec.gov. Free copies of the SEC filings are also available from the Company.

Item 6. Exhibits

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

Exhibit No.	Document
2.1	Agreement and Plan of Merger, dated June 25, 2007, among Professionals Direct, Inc., The Hanover Insurance Group, Inc., and Hanover Acquisition Corp. Previously filed as an exhibit to the Company’s Current Report on Form 8-K filed on June 26, 2007. Here incorporated by reference.
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.

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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: August 14, 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)

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EXHIBIT INDEX

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