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COMMERCE GROUP INC /MA
Form 8-K
July 28, 2003

UNITED STATES
SECURITIES AND EXCHANGE
COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT

Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

Date of Report
(Date of earliest event reported)
July 25, 2003

THE COMMERCE GROUP, INC.
(Exact name of registrant as specified in its charter)

| | | | |
|--|-----------|-----------------------------|---|
| Massachusetts | 001-13672 | 04-2599931 | |
| (State or other jurisdiction of Incorporation) | | (Commission File Number) | (IRS Employer Identification No.) |

211 Main Street, Webster, Massachusetts 01570
(Address of principal executive offices) (Zip Code)

Registrants telephone number, including area code:
(508) 943-9000

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Item 9. REGULATION FD DISCLOSURE

The following information, including the text of the press release attached as an Exhibit to this Form 8-K, is furnished pursuant to Item 9, "Regulation FD Disclosure" and Item 12, "Disclosure of Results of Operations and Financial Condition".

On July 25, 2003, The Commerce Group, Inc. (the "Company") issued a press release announcing its results for the quarter ended June 30, 2003. A copy of the press release is attached as Exhibit 99.1 to this Form 8-K.

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In its press release, the Company presents "operating earnings" and "operating earnings per diluted share", non-GAAP financial measures, as well as net earnings and net earnings per diluted share. As further described in the press release, operating earnings is the measure utilized by the Company in managing corporate operating performance. A reconciliation of net earnings to operating earnings is provided in the tables that are included in the press release. Statutory ratios are presented in accordance with principles prescribed by insurance regulatory authorities.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

THE COMMERCE GROUP, INC.
July 28, 2003

/s/ Randall V. Becker

Randall V. Becker
Treasurer and Chief Accounting Officer

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Exhibit 99.1

Press Release

RELEASE: Immediate (July 25, 2003)

CONTACT: Randall V. Becker
Treasurer
(508) 949-4129

The Commerce Group, Inc.
Announces 2003 Second Quarter Results
and Comparison to Second Quarter 2002 (as restated)

WEBSTER, Mass., July 25, 2003 -- The Commerce Group, Inc. (NYSE:CGI) today reported 2003 second quarter results. Net earnings were \$71.5 million, or \$2.22 per diluted share, compared to a net loss of \$1.3 million or \$0.04 per diluted share for 2002 (as restated).

Operating earnings, a non-GAAP financial measure, were \$22.3 million

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for the second quarter of 2003, or \$0.69 per diluted share, compared to \$21.7 million or \$0.65 per diluted share for 2002 (as restated). Operating earnings consist of net earnings (loss) adjusted to exclude: (1) the after-tax impact of net realized investment gains and losses; and, (2) for 2002 only, the after-tax effect of a required change in accounting principle. The Company believes that operating earnings are a more appropriate measure of an insurance entity's performance because the realization investment of gains and losses tends to distort the analysis of insurance operating results and trends as they are discretionary as to timing as well as impacted by interest rate fluctuations. Previously, the Company excluded the impact of variable stock option treatment in determining operating earnings. Operating earnings, as defined by the Company, may not be comparable to similarly captioned measurements utilized by other property and casualty companies. A reconciliation of net earnings to operating earnings is provided in the tables that follow.

Earned premiums were \$350.3 million for the second quarter of 2003 compared to \$296.4 million for 2002. A schedule of direct written premiums to earned premiums is included in the attached tables.

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CGI 2Q'03 earnings

Net realized investment gains were \$65.9 million, or \$1.53 per diluted share, compared to net realized investment losses of \$31.5 million or \$0.69 per diluted share for 2002. During the second quarter the Company shortened the overall duration of its investment portfolio by reducing its holdings in certain long term fixed income instruments, equities and closed end mutual funds. This change in strategy resulted in the realization of significant investment gains with a minimal adverse impact on future investment income. If market conditions warrant, the Company will continue to reduce the duration of the investment portfolio in order to continue to protect itself from anticipated future increases in overall interest rates. A complete breakdown of this information is included in the attached tables.

The second quarter statutory combined ratio for property and casualty operations was 98.8% compared to 98.9% for 2002. The slight decrease in the combined ratio was primarily the result of an increase in the loss ratio, offset by a decrease in the underwriting ratio. The Company's loss ratio for the second quarter of 2003 increased to 76.1% from 74.7% during the same period last year. The increase was the result of less favorable loss reserve development compared to the second quarter of last year offset by a slight decrease in claim frequency for bodily injury and collision claims.

The Company's statutory underwriting ratio improved to 22.7%, as compared to 24.2% for last year's second quarter, primarily as a result of decreased expenses assumed from the Massachusetts residual market mechanism, commonly know as C.A.R., and higher ceding commissions received on the Company's other than automobile quota-share reinsurance agreement.

As disclosed in the Company's 2002 Form 10-K, in the fourth quarter of

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2002, the Company changed its method of accounting for employee stock options and began applying variable accounting treatment for employee stock options issued in 1999 and 2000. Accordingly, the Company restated its 2002 quarterly results. The impact of the restatement for the three months ended June 30, 2002 resulted in a decrease to net earnings of \$1.1 million or \$0.03 per diluted share. The comparable amount for the three months ended June 30, 2003 resulted in a decrease to net earnings of \$1.0 million or \$0.03 per diluted share.

Cumulative June 30, 2003 Results

Net earnings were \$84.4 million, or \$2.62 per diluted share, compared to \$32.7 million or \$0.98 per diluted share for 2002 (as restated).

Operating earnings were \$41.4 million for the first six months of 2003, or \$1.29 per diluted share, compared to \$46.7 million or \$1.40 per diluted share for 2002 (as restated). As previously noted, a reconciliation of net earnings to operating earnings is provided in the tables that follow.

Earned premiums were \$688.3 million compared to \$577.2 million for 2002. A schedule of direct written premiums to earned premiums is included in the attached tables.

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CGI 2Q'03 earnings

The Company had realized gains on investments of \$60.0 million, or \$1.33 per diluted share, compared to losses of \$35.0 million, or \$0.76 per diluted share for 2002. A complete breakdown of this information is included in the attached tables.

The statutory combined ratio for property and casualty operations was 100.0% for the first six months of 2003 compared to 98.4% for 2002. The increase in the combined ratio was primarily the result of an increase in the loss ratio, offset by a decrease in the underwriting ratio. The Company's loss ratio for the first six months of 2003 increased to 78.7% from 75.8% during the same period last year. The increase was primarily driven by increased claim frequency in the first quarter of this year as a result of the severe winter. The Company's statutory underwriting ratio improved to 21.3%, as compared to 22.6% for 2002, primarily from reduced accrued contingent commissions as a result of the higher loss ratio mentioned previously, decreased expenses assumed from C.A.R., coupled with premium growth exceeding growth in underwriting expenses.

As previously mentioned, in the fourth quarter of 2002 the Company changed its method of accounting for employee stock options and began applying variable accounting treatment for employee stock options issued in 1999 and 2000. The impact of the restatement for the six months ended June 30, 2002 resulted in a decrease to net earnings of \$2.5 million or \$0.07 per diluted share. The comparable amount for the six months ended June 30, 2003 resulted in an increase to net earnings of \$0.6 million or \$0.02 per diluted share.

A complete presentation of June 30, 2003 and 2002 financial statement information, including a breakdown of the components of the combined ratio and realized investment gains and losses, is included in the

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financial statements attached to this press release.

Additional supplemental financial information will be available on the Company's website at www.commerceinsurance.com, under the "Links" section of the "News and Investor Information" area.

At June 30, 2003, the Company had authority to purchase approximately 741,000 additional shares of common stock under the current Board of Directors' stock re-purchase authorization. During the past twelve months, the Company purchased 1,093,600 shares of treasury stock at an average price of \$36.27 per share.

All quarterly figures are unaudited and all results are reported in accordance with accounting principles generally accepted in the United States (GAAP) with the exception of operating earnings and statutory operating ratios.

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CGI 2Q'03 earnings

About The Commerce Group, Inc.

The Commerce Group, Inc. is headquartered in Webster, Massachusetts. Property and casualty insurance subsidiaries include The Commerce Insurance Company and Citation Insurance Company in Massachusetts, Commerce West Insurance Company in California, and American Commerce Insurance Company in Ohio. Through its subsidiaries' combined insurance activities, the Company is ranked as the 22nd largest personal automobile insurance group in the country by Risk Information, Inc., based on 2002 direct written premium information.

Forward Looking Statements

This press release contains some statements that are not historical facts and are considered "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve opinions, assumptions and predictions, and no assurance can be given that the future results will be achieved since events or results may differ materially as a result of risks facing the Company. These include, but are not limited to, those risks and uncertainties in our business, some of which are beyond the control of the Company, that are described in the Company's Forms 10-K and 10-Q, Schedules 13D and 13G, and other documents filed with the SEC, including the possibility of adverse catastrophe experience and severe weather, adverse trends in claim severity or frequency, adverse state and federal regulation and legislation, adverse state judicial decisions, litigation risks, interest rate risk, rate making decisions for private passenger automobile policies in Massachusetts, potential rate filings outside of Massachusetts, adverse impacts related to consolidation activities, heightened competition, concentration of business within Massachusetts, dependence on certain principal employees, as well as the economic, market or regulatory conditions and risks associated with entry into new markets and diversification. The Commerce Group, Inc. is not under any obligation to (and expressly disclaims any such obligations to) update or alter its forward-looking statements, whether as a result of new information, future events or otherwise.

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(Tables Follow)

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CGI 2Q '03 earnings

THE COMMERCE GROUP, INC. (NYSE: CGI - news)
 CONSOLIDATED BALANCE SHEETS
 June 30, 2003 and 2002
 (Thousands of Dollars, Except Per Share Data)
 Unaudited

| ASSETS | June 30, 2003 | June 30 2002 (Restated) |
|---|------------------|-------------------------------|
| Investments | | |
| Fixed maturities, at market | \$ 918,793 | \$ 641,593 |
| Preferred stocks, at market | \$ 349,075 | \$ 288,413 |
| Common stocks, at market | \$ 69,454 | \$ 114,208 |
| Preferred stock mutual funds, at equity | \$ 259,403 | \$ 298,493 |
| Mortgage loans | \$ 19,135 | \$ 34,422 |
| Cash and short-term investments | \$ 111,040 | \$ 147,981 |
| Other investments | \$ 24,749 | \$ 22,855 |
| Total investments | \$ 1,751,649 | \$ 1,547,965 |
| Accrued investment income | \$ 15,820 | \$ 16,321 |
| Premiums receivable | \$ 392,743 | \$ 331,317 |
| Deferred policy acquisition costs | \$ 157,247 | \$ 137,476 |
| Property and equipment | \$ 51,552 | \$ 45,822 |
| Due from reinsurers | \$ 111,679 | \$ 84,978 |
| Residual market receivable | \$ 179,628 | \$ 156,022 |
| Current income taxes | \$ - | \$ 2,324 |
| Deferred income taxes | \$ 34,912 | \$ 27,221 |
| Receivable for securities sold | \$ 21,505 | \$ - |
| Other assets | \$ 12,647 | \$ 13,687 |
| Total assets | \$ 2,729,382 | \$ 2,363,133 |
| Liabilities | | |
| Losses and LAE | \$ 893,248 | \$ 754,893 |
| Unearned premiums | \$ 822,727 | \$ 698,411 |
| Current income taxes | \$ 15,270 | \$ - |
| Deferred income | \$ 7,730 | \$ 8,034 |
| Contingent commissions accrued | \$ 21,192 | \$ 23,332 |
| Payable for securities purchased | \$ 52,361 | \$ 1,577 |
| Other liabilities | \$ 56,700 | \$ 46,186 |

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| | | |
|---|--------------|--------------|
| Total liabilities | \$ 1,869,228 | \$ 1,532,433 |
| Minority interest | \$ 4,228 | \$ 4,449 |
| Stockholders' equity | | |
| Preferred stock | - | - |
| Common stock | \$ 19,178 | \$ 19,108 |
| Paid-in capital | \$ 42,140 | \$ 37,371 |
| Net accumulated other comprehensive income | \$ 32,353 | \$ 26,060 |
| Retained earnings | \$ 941,544 | \$ 883,335 |
| | \$ 1,035,215 | \$ 965,874 |
| Treasury stock | \$ (179,289) | \$ (139,623) |
| Total stockholders' equity | \$ 855,926 | \$ 826,251 |
| Total liabilities, minority interest and stockholders' equity | \$ 2,729,382 | \$ 2,363,133 |
| Common shares outstanding | 31,955,030 | 32,909,423 |
| Stockholders' equity per share | \$ 26.79 | \$ 25.11 |

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CGI 2Q '03 earnings

THE COMMERCE GROUP, INC. (NYSE: CGI - news)
CONSOLIDATED STATEMENTS OF EARNINGS
Three and Six Months Ended June 30, 2003 and 2002
(Thousands of Dollars, Except Per Share Data)
Unaudited

| | Three Months Ended June 30, | |
|---|--------------------------------|--------------------|
| | 2003 | 2002 (Restated) |
| Revenues: | | |
| Earned premiums | \$ 350,269 | \$ 296,410 |
| Net investment income | \$ 23,108 | \$ 24,858 |
| Premium finance and service fees | \$ 6,915 | \$ 5,065 |
| Net realized investment gains (losses) | \$ 65,864 | \$ (31,545) |
| Other income | \$ - | \$ - |
| TOTAL REVENUES | \$ 446,156 | \$ 294,788 |
| Expenses: | | |
| Losses and LAE | \$ 269,211 | \$ 222,975 |
| Policy acquisition costs | \$ 86,268 | \$ 77,053 |
| TOTAL EXPENSES | \$ 355,479 | \$ 300,028 |
| Earnings (loss) before income taxes (benefits), change in accounting principle and minority interest | \$ 90,677 | \$ (5,240) |

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| | | | | |
|--|----|--------|----|---------|
| Income taxes (benefit) | \$ | 19,080 | \$ | (3,787) |
| Change in accounting principle, net of taxes | \$ | - | \$ | - |
| Earnings (loss) before minority interest | \$ | 71,597 | \$ | (1,453) |
| (Less) plus the (income) loss in minority interest in subsidiary | \$ | (124) | \$ | 153 |
| NET EARNINGS (LOSS) | \$ | 71,473 | \$ | (1,300) |
| COMPREHENSIVE INCOME | \$ | 75,057 | \$ | 8,242 |
| EARNINGS (LOSS) PER COMMON SHARE: | | | | |
| BASIC | \$ | 2.24 | \$ | (0.04) |
| DILUTED | \$ | 2.22 | \$ | (0.04) |

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CGI 2Q '03 earnings

THE COMMERCE GROUP, INC. (NYSE: CGI - news)
CONSOLIDATED STATEMENTS OF EARNINGS
Three and Six Months Ended June 30, 2003 and 2002
(Thousands of Dollars, Except Per Share Data)
Unaudited

(Continued)

| | Three Months Ended | | | |
|---|--------------------|------------|----|------|
| | June 30, | | | |
| | 2003 | 2002 | 20 | |
| | | (Restated) | | |
| Net earnings per share excluding the after-tax impact of net realized investment gains (losses) and change in accounting principle: | | | | |
| BASIC | \$ | 0.70 | \$ | 0.66 |
| DILUTED | \$ | 0.69 | \$ | 0.65 |
| Weighted average shares outstanding: | | | | |
| BASIC | 31,930,507 | 32,968,368 | | |
| DILUTED | 32,156,738 | 33,334,199 | | |

CGI 2Q '03 earnings

THE COMMERCE GROUP, INC. (NYSE: CGI - news)
 ADDITIONAL EARNINGS INFORMATION
 Three and Six Months Ended June 30, 2003 and 2002
 (Thousands of Dollars, Except Per Share Data)
 Unaudited

| | Three Months Ended June 30, | |
|---|--------------------------------|--------------------|
| | 2003 | 2002 (Restated) |
| ADDITIONAL EARNINGS INFORMATION: | | |
| Direct written premiums to earned premiums reconciliation: | | |
| Direct written premiums | \$ 415,787 | \$ 348,212 |
| Assumed premiums | \$ 29,769 | \$ 34,898 |
| Ceded premiums | \$ (60,081) | \$ (48,614) |
| Net written premiums | \$ 385,475 | \$ 334,496 |
| Increase in unearned premiums | \$ (35,206) | \$ (38,086) |
| Earned premiums | \$ 350,269 | \$ 296,410 |
| Statutory operating ratios for insurance subsidiaries: | | |
| Loss ratio | 76.1% | 74.7% |
| Underwriting ratio | 22.7% | 24.2% |
| Combined ratio | 98.8% | 98.9% |
| Reconciliation of net earnings (loss) to operating earnings: | | |
| Net earnings (loss) | \$ 71,473 | \$ (1,300) |
| Plus net realized losses, minus net realized gains, net of tax | \$ (49,128) | \$ 23,007 |
| Less SFAS 142 change in accounting principle, net of tax | \$ - | \$ - |
| Operating earnings | \$ 22,345 | \$ 21,707 |
| Reconciliation of net earnings to operating earnings per diluted share: | | |
| Net earnings (loss) per diluted share | \$ 2.22 | \$ (0.04) |
| Plus net realized losses, minus net realized gains, net of tax | \$ (1.53) | \$ 0.69 |
| Less SFAS 142 change in accounting principle, net of tax | \$ - | \$ - |
| Operating earnings per diluted share | \$ 0.69 | \$ 0.65 |
| Breakdown of net realized investment gains (losses) | | |
| Fixed maturities | \$ 12,652 | \$ (760) |
| Preferred stocks | \$ 8,131 | \$ (4) |
| Common stocks | \$ 13,485 | \$ (158) |

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CGI 2Q '03 earnings

THE COMMERCE GROUP, INC. (NYSE: CGI - news)
 ADDITIONAL EARNINGS INFORMATION
 Three and Six Months Ended June 30, 2003 and 2002
 (Thousands of Dollars, Except Per Share Data)
 Unaudited

(Continued)

| | Three Months Ended | |
|---|--------------------|-------------|
| | June 30, | |
| | 2003 | 2002 |
| | | (Restated) |
| Preferred stock mutual funds: | | |
| Due to increase (decrease) in NAV | \$ 34,136 | \$ (18,085) |
| Due to sales | \$ (1,524) | \$ 308 |
| Venture capital fund investments | \$ (463) | \$ (1,043) |
| Other | \$ (60) | \$ (69) |
| Other than temporary writedowns | \$ (493) | \$ (11,734) |
| Net realized investment gains (losses) before tax | \$ 65,864 | \$ (31,545) |
| Income tax (benefit) at 35% | \$ 23,052 | \$ (11,041) |
| Net realized investment gains (losses) after tax and before impact of valuation allowance | \$ 42,812 | \$ (20,504) |
| Impact of valuation allowance | \$ 6,316 | \$ (2,503) |
| Net realized investment gains (losses) after tax and after tax impact of valuation allowance | \$ 49,128 | \$ (23,007) |
| Per diluted share net realized gains (losses) after tax and after tax impact of valuation allowance | \$ 1.53 | \$ (0.69) |