PROASSURANCE CORP
Form 10-Q
May 07, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 31, 2008 or __________

o **[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________

Commission file number 0-16533
ProAssurance Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware	63-1261433
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
100 Brookwood Place, Birmingham, AL	35209
(Address of Principal Executive Offices)	(Zip Code)

(205) 877-4400
(Registrant s Telephone Number, Including Area Code)
(Former Name, Former Address, and Former Fiscal Year, if Changed Since Last Report)

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 þ No o

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. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of April 25, 2008 there were 32,055,510 shares of the registrant s common stock outstanding.

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FORWARD-LOOKING STATEMENTS

Any statements in this Form 10Q that are not historical facts are specifically identified as forward-looking statements. These statements are based upon our estimates and anticipation of future events and are subject to certain risks and uncertainties that could cause actual results to vary materially from the expected results described in the forward-looking statements. Forward-looking statements are identified by words such as, but not limited to, anticipate , believe , estimate , expect , hope , hopeful , intend , may , optimistic , preliminary , potential , project analogous expressions. There are numerous factors that could cause our actual results to differ materially from those in the forward-looking statements. Thus, sentences and phrases that we use to convey our view of future events and trends are expressly designated as forward-looking statements as are sections of this Form 10Q that are identified as giving our outlook on future business.

Forward-looking statements relating to our business include among other things: statements concerning liquidity and capital requirements, return on equity, financial ratios, net income, premiums, losses and loss reserves, premium rates and retention of current business, competition and market conditions, the expansion of product lines, the development or acquisition of business in new geographical areas, the availability of acceptable reinsurance, actions by regulators and rating agencies, court actions, legislative actions, payment or performance of obligations under indebtedness, payment of dividends, and other matters.

These forward-looking statements are subject to significant risks, assumptions and uncertainties, including, among other things, the following factors that could affect the actual outcome of future events:

general economic conditions, either nationally or in our market area, that are different than anticipated;

regulatory, legislative and judicial actions or decisions that affect our business plans or operations;

inflation, particularly in loss costs trends;

changes in the interest rate environment;

performance of financial markets affecting the fair value of our investments or making it difficult to determine the value of our investments;

changes in laws or government regulations affecting medical professional liability insurance;

changes to our ratings assigned by rating agencies;

the effects of changes in the health care delivery system;

uncertainties inherent in the estimate of loss and loss adjustment expense reserves and reinsurance, and changes in the availability, cost, quality, or collectibility of insurance/reinsurance;

the results of litigation, including pre-or-post-trial motions, trials and/or appeals we undertake;

bad faith litigation which may arise from our handling of any particular claim, including failure to settle;

changes in competition among insurance providers and related pricing weaknesses in our markets;

loss of independent agents;

our ability to purchase reinsurance and collect payments from our reinsurers;

increases in guaranty fund assessments;

our ability to achieve continued growth through expansion into other states or through acquisitions or business combinations;

the expected benefits from acquisitions may not be achieved or may be delayed longer than expected due to, among other reasons, business disruption, loss of customers and employees, increased operating costs or inability to achieve cost savings, and assumption of greater than expected liabilities;

changes in accounting policies and practices that may be adopted by our regulatory agencies, the Financial Accounting Standards Board, or the Securities and Exchange Commission;

changes in our organization, compensation and benefit plans; and

our ability to retain and recruit senior management.

Our results may differ materially from those we expect and discuss in any forward-looking statements. The principal risk factors that may cause these differences are described in Item 1A, Risk Factors in our annual report on Form 10K and other documents we file with the Securities and Exchange Commission, such as our current reports on Form 8-K, and our regular reports on Forms 10-Q and 10-K.

We caution readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and advise readers that the factors listed above could affect our financial performance and could cause actual results for future periods to differ materially from any opinions or statements expressed with respect to future periods in any current statements. Except as required by law or regulations, we do not undertake and specifically decline any obligation to publicly release the result of any revisions that may be made to any forward-looking statements to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

(In thousands, except share data)	**March 31 2008 (Unaudited)**	December 31 2007
Assets		
Investments		
Fixed maturities available for sale, at fair value	**$3,241,680**	$3,244,593
Equity securities, available for sale, at fair value	**8,683**	7,597
Equity securities, trading, at fair value	**15,111**	14,173
Short-term investments	**273,141**	220,029
Business owned life insurance	**62,121**	61,509
Investment in unconsolidated subsidiaries	**45,781**	26,767
Other	**52,591**	54,939
Total Investments	**3,699,108**	3,629,607
Cash and cash equivalents	**10,688**	39,090
Premiums receivable	**105,986**	98,693
Receivable from reinsurers on unpaid losses and loss adjustment expenses	**329,768**	327,111
Prepaid reinsurance premiums	**15,245**	14,835
Deferred taxes	**93,627**	103,105
Real estate, net	**24,146**	24,004
Other assets	**195,396**	203,391
Total Assets	**$4,473,964**	$4,439,836
Liabilities and Stockholders Equity		
Liabilities		
Policy liabilities and accruals:		
Reserve for losses and loss adjustment expenses	**$2,555,403**	$2,559,707
Unearned premiums	**246,022**	218,028
Reinsurance premiums payable	**123,906**	128,582
Total Policy Liabilities	**2,925,331**	2,906,317
Other liabilities	**108,509**	114,291
Long-term debt	**164,269**	164,158
Total Liabilities	**3,198,109**	3,184,766
Commitments and contingencies		
Stockholders Equity		
Common stock, par value $0.01 per share 100,000,000 shares authorized, 33,631,672 and 33,570,685 shares issued, respectively	**337**	336
Additional paid-in capital	**511,616**	505,923
	12,561	9,902

Accumulated other comprehensive income (loss), net of deferred tax expense (benefit) of $6,766 and $5,334, respectively		
Retained earnings	**829,034**	793,166
	1,353,548	1,309,327
Treasury stock, at cost, 1,573,324 shares and 1,128,111 shares, respectively	**(77,693)**	(54,257)
Total Stockholders Equity	**1,275,855**	1,255,070
Total Liabilities and Stockholders Equity	**$4,473,964**	$4,439,836

See accompanying notes

ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Changes in Capital (Unaudited)

(In thousands)	**Total**	**Accumulated Other Comprehensive Income (Loss)**	**Retained Earnings**	**Other Capital Accounts**
Balance at December 31, 2007	**$1,255,070**	**$ 9,902**	**$793,166**	**$452,002**
Net income	**35,868**		**35,868**	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	**2,659**	**2,659**		
Purchase of treasury stock	**(23,436)**			**(23,436)**
Common shares issued as compensation	**3,238**			**3,238**
Share-based compensation	**2,440**			**2,440**
Net effect of stock options exercised	**16**			**16**
Balance at March 31, 2008	**$1,275,855**	**$ 12,561**	**$829,034**	**$434,260**

(In thousands)	Total	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Other Capital Accounts
Balance at December 31, 2006	$1,118,547	$ 111	$622,310	$496,126
Cumulative effect of accounting change	2,670		2,670	
Net income	36,090		36,090	
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	1,494	1,494		
Common shares issued as compensation	2,736			2,736
Share-based compensation	2,253			2,253
Net effect of stock options exercised	184			184
Balance at March 31, 2007	$1,163,974	$ 1,605	$661,070	$501,299

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Income (Unaudited)

(In thousands, except per share data)	Three Months Ended March 31 **2008**	2007
Revenues:		
Gross premiums written	**$160,266**	$185,302
Net premiums written	**$148,415**	$171,459
Premiums earned	**$132,018**	$150,685
Premiums ceded	**(11,441)**	(13,508)
Net premiums earned	**120,577**	137,177
Net investment income	**41,059**	42,571
Equity in earnings (loss) of unconsolidated subsidiaries	**(1,946)**	867
Net realized investment gains (losses)	**(1,426)**	(3,162)
Other income	**1,362**	1,424
Total revenues	**159,626**	178,877
Expenses:		
Losses and loss adjustment expenses	**90,579**	129,601
Reinsurance recoveries	**(8,897)**	(30,554)
Net losses and loss adjustment expenses	**81,682**	99,047
Underwriting, acquisition and insurance expenses	**26,243**	26,827
Interest expense	**2,422**	2,959
Total expenses	**110,347**	128,833
Income before income taxes	**49,279**	50,044
Provision for income taxes:		
Current expense (benefit)	**5,365**	11,598
Deferred expense (benefit)	**8,046**	2,356
	13,411	13,954
Net income	**$ 35,868**	$ 36,090
Earnings per share:		
Basic	**$ 1.11**	$ 1.08

Diluted	**$ 1.04**	$ 1.02
Weighted average number of common shares outstanding:		
Basic	**32,182**	33,294
Diluted	**35,068**	36,157

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)

	Three Months Ended March 31	
(In thousands)	**2008**	2007
Comprehensive income:		
Net income	**$35,868**	$36,090
Change in net unrealized gains (losses) on investments, after tax, net of reclassification adjustments	**2,659**	1,494
Comprehensive income	**$38,527**	$37,584

See accompanying notes

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ProAssurance Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)

(In thousands)	Three Months Ended March 31 2008	2007
Operating Activities		
Net Income	**$ 35,868**	$ 36,090
Depreciation and amortization	**3,756**	3,923
Net realized investment (gains) losses	**1,426**	3,162
Net sales (purchases) of trading portfolio securities	**(1,825)**	(270)
Share-based compensation	**2,440**	2,253
Deferred income taxes	**8,046**	2,356
Changes in assets and liabilities:		
Premiums receivable	**(7,293)**	(10,181)
Reserve for losses and loss adjustment expenses	**(4,304)**	26,477
Unearned premiums	**27,994**	35,222
Reinsurance related assets and liabilities	**(7,743)**	1,756
Other	**1,135**	(13,766)
Net cash provided by operating activities	**59,500**	87,022
Investing Activities		
Purchases of:		
Fixed maturities available for sale	**(276,176)**	(378,214)
Equity securities available for sale	**(2,346)**	(95)
Other investments	**(277)**	(71)
Cash invested in unconsolidated subsidiaries	**(20,960)**	(1,500)
Proceeds from sale or maturities of:		
Fixed maturities available for sale	**282,155**	400,546
Equity securities available for sale	**196**	315
Other investments	**1,886**	53
Net (increase) decrease in short-term investments	**(53,112)**	(142,331)
Other	**4,144**	6,481
Net cash provided (used) by investing activities	**(64,490)**	(114,816)
Financing Activities		
Repurchase of treasury shares	**(23,436)**	
Other	**24**	125
Net cash provided (used) by financing activities	**(23,412)**	125
Increase (decrease) in cash and cash equivalents	**(28,402)**	(27,669)

Cash and cash equivalents at beginning of period	**39,090**	29,146
Cash and cash equivalents at end of period	**$ 10,688**	$ 1,477
Significant Non-cash Transactions:		
Fixed maturity securities transferred, at fair value, to other investments	**$**	$ 34,732

See accompanying notes

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2008

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of ProAssurance Corporation and its consolidated subsidiaries (ProAssurance). The financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes contained in ProAssurance s December 31, 2007 report on Form 10-K.

Accounting Changes

In September 2006, the FASB issued Statement of Financial Accounting Standards 157, *Fair Value Measurements* (SFAS 157). The standard establishes a revised definition of fair value: fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 also establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. SFAS 157 is applicable to other accounting pronouncements that require or permit fair value measurements but does not establish new guidance regarding the assets and liabilities required or allowed to be measured at fair value. The statement is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. ProAssurance adopted SFAS 157 on January 1, 2008. ProAssurance did not recognize any cumulative effect related to the adoption of SFAS 157 and adoption did not have a significant effect on ProAssurance s results of operations or financial condition.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits many financial assets and liabilities to be reported at fair value that are not otherwise required under GAAP to be measured at fair value. Under SFAS 159 guidance, the election of fair value treatment is specific to individual assets and liabilities, with changes in fair value recognized in earnings as they occur. The election of fair value measurement is generally irrevocable. SFAS 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. ProAssurance adopted SFAS 159 on January 1, 2008 but did not elect fair value measurement for any financial assets or liabilities that were not otherwise required to be measured at fair value.

Recent Accounting Developments

In December 2007 the FASB issued SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS 160 amends Accounting Research Bulletin 51 to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The Statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. ProAssurance will adopt the Statement on its effective date. Adoption is not expected to have an effect on ProAssurance s results of operations or financial position.

In December 2007 the FASB issued SFAS 141 (Revised 2007) *Business Combinations. SFAS 141R* replaces FASB Statement No. 141, *Business Combinations,* but retains the fundamental requirement in SFAS 141 that the acquisition method (referred to as the *purchase* method in SFAS 141) of accounting be used for all business combinations. SFAS 141R provides new or additional guidance with respect to business combinations including: defining the acquirer in a transaction, the valuation of assets and liabilities when noncontrolling interests exist, the treatment of contingent consideration, the treatment of costs incurred to effect the acquisition, the treatment of reorganization costs, and the valuation of assets and liabilities when the purchase price is below the net fair value of assets acquired. SFAS 141R applies prospectively to business combinations for which the acquisition

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2008

1. Basis of Presentation (continued)

date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. ProAssurance will adopt the Statement on its effective date.

Reclassifications

Several amounts have been reclassified within the 2007 Statement of Cash Flow in order to conform to the 2008 presentation. The reclassifications did not change the total cash provided by (used by) operating, investing or financing activities.

2. Fair Value Measurement

Effective January 1, 2008 ProAssurance adopted SFAS 157 which establishes a framework for measuring fair value and requires specific disclosures regarding assets and liabilities that are measured at fair value.

As defined in SFAS 157, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 ranks the quality and reliability of the information used to determine fair values into three broad categories, with the highest priority given to Level 1 inputs and the lowest priority to Level 3 inputs. Hierarchy levels are defined by SFAS 157 as follows:

Level 1:	quoted (unadjusted) market prices in active markets for identical assets and liabilities. For ProAssurance, Level 1 inputs are generally quotes for debt or equity securities actively traded in exchange or over-the-counter markets.
Level 2:	market data obtained from sources independent of the reporting entity (observable inputs). For ProAssurance, Level 2 inputs generally include quoted prices in markets that are not active, quoted prices for similar assets/liabilities, and other observable inputs such as interest rates and yield curves that are generally available at commonly quoted intervals.
Level 3:	the reporting entity s own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). For ProAssurance, Level 3 inputs are used in situations where little or no Level 1 or 2 inputs are available or are inappropriate given the particular circumstances. Level 3 inputs include results from pricing models and discounted cash flow methodologies as well as adjustments to externally quoted prices that are based on management judgment or estimation.

The following tables present information about ProAssurance s assets measured at fair value on a recurring basis as of March 31, 2008, and indicate the fair value hierarchy of the valuation techniques utilized to determine such value. No liabilities are measured at fair value at March 31, 2008. For some assets, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. When this is the case, the asset is categorized in the table based on the lowest level input that is significant to the fair value measurement in its entirety. ProAssurance s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the assets being valued.

ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2008

2. Fair Value Measurement (continued)

Assets measured at fair value on a recurring basis as of March 31, 2008 are as follows:

	March 31, 2008 Fair Value Measurements Using			Total
(in thousands)	Level 1	Level 2	Level 3	Fair Value
Assets				
Fixed maturities, available for sale				
Government-sponsored enterprises	$	$ 281,473	$	$ 281,473
Asset-backed securities		925,053	4,290	929,343
Corporate bonds	13,089	548,559	64,703	626,351
State and municipal bonds		1,388,892	15,621	1,404,513
Equity securities, available-for-sale	7,943		740	8,683
Equity securities, trading	15,111			15,111
Other investments			19,740	19,740
Short-term investments		273,141		273,141
Total assets	$36,143	$3,417,118	$105,094	$3,558,355

Level 3 assets in the above table consists primarily of asset-backed securities (as shown in the table), private placement senior notes and bank loans (included in Corporate bonds), auction rate municipal bonds (included in State and Municipal bonds), and a beneficial interest in asset-backed securities held in a private investment fund (included in Other investments).

The private placement senior notes are unconditionally guaranteed by large regional banks rated A or better. The asset-backed securities have a weighted average rating of A , and are collateralized by a timber trust, timeshare receivables, and Fannie Mae mortgage backed securities. The auction rate municipal bonds are rated AA. The fair value of these assets are primarily derived using pricing models that may require multiple market input parameters as is considered appropriate for the asset being valued.

The Level 3 bank loans are rated B to BB and are valued by a broker dealer quote or, when quotes are not available, a pricing model. The asset-backed securities held in a private investment fund are rated BB- and are valued using a broker dealer quote.

The following table presents additional information about assets measured at fair value using Level 3 inputs for the three months ended March 31, 2008:

	Fair Value Measurements					
(in thousands)	Asset-backed Securities	Corporate Bonds	State and Municipal Bonds	Equity Securities	Other Invested Assets	Total
Balance January 1, 2008	$ 33,283	$ 86,969	$ 7,183	$	$20,981	$148,416
Total gains or (losses) (realized/unrealized) :						
		(80)				(80)

Included in earnings, as a part of net realized investment gains/(losses)						
Included in other comprehensive income	(1,949)	(970)	25		(774)	(3,668)
Purchases, sales or settlements	(386)	7,980	2,417	740	(467)	10,284
Transfers in and/or out of Level 3	(26,658)	(29,196)	5,996			(49,858)
Balance March 31, 2008	$ 4,290	$ 64,703	$ 15,621	$ 740	$ 19,740	$ 105,094
Unrealized gains (losses) included in other comprehensive income for the period, related to assets still held at March 31, 2008	$ (38)	$ (1,167)	$ 28	$	$ (774)	$ (1,951)

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ProAssurance Corporation and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
March 31, 2008

2. Fair Value Measurement (continued)

The transfers out of Level 3 to Level 2 consists of $29 million of bank loans previously valued using a pricing model that are now valued using multiple broker dealer quotes and $22 million of AAA agency and non-subprime mortgage backed securities previously valued using a single broker dealer quote that are now valued using multiple observable inputs including broker dealer quotes.

3. Investments

The amortized cost and estimated fair value of available-for-sale fixed maturities and equity securities are as follows: