

ALLEGHANY CORP /DE
Form 10-Q
May 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014

OR

**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 1-9371

ALLEGHANY CORPORATION
EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER

DELAWARE

STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION

51-0283071

I.R.S. EMPLOYER IDENTIFICATION NO.

7 TIMES SQUARE TOWER, 17TH FLOOR, NY, NY 10036

ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE

212-752-1356

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE

NOT APPLICABLE

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 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 (SECTION 232.405 OF THIS CHAPTER) DURING THE PRECEDING 12 MONTHS (OR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES). YES NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER OR A SMALLER REPORTING COMPANY. SEE 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 ACCELERATED FILER
NON-ACCELERATED FILER (DO NOT CHECK IF A SMALLER SMALLER REPORTING COMPANY
REPORTING COMPANY)

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN
RULE 12B-2 OF THE EXCHANGE ACT). YES NO

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF
COMMON STOCK, AS OF THE LAST PRACTICABLE DATE.

16,464,233 SHARES, PAR VALUE \$1.00 PER SHARE, AS OF APRIL 30, 2014

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	March 31, 2014 (unaudited)	December 31, 2013
(in thousands, except share amounts)		
Assets		
Investments:		
Available-for-sale securities at fair value:		
Equity securities (cost: 2014 \$2,265,027; 2013 \$1,804,698)	\$ 2,637,802	\$ 2,229,453
Debt securities (amortized cost: 2014 \$14,682,684; 2013 \$14,875,750)	14,802,122	14,802,890
Short-term investments	926,674	1,317,895
	18,366,598	18,350,238
Other invested assets	619,674	641,924
Total investments	18,986,272	18,992,162
Cash	481,414	498,315
Accrued investment income	141,820	146,381
Premium balances receivable	788,260	675,255
Reinsurance recoverables	1,354,229	1,363,707
Ceded unearned premiums	185,159	173,148
Deferred acquisition costs	358,398	334,740
Property and equipment at cost, net of accumulated depreciation and amortization	67,777	58,974
Goodwill	99,747	99,747
Intangible assets, net of amortization	129,145	127,284
Current taxes receivable	25,644	13,049
Net deferred tax assets	412,697	469,787
Other assets	463,774	408,539
Total assets	\$ 23,494,336	\$ 23,361,088
Liabilities and Stockholders Equity		
Loss and loss adjustment expenses	\$ 11,864,719	\$ 11,952,541
Unearned premiums	1,857,948	1,765,550
Senior Notes	1,790,041	1,794,407

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Reinsurance payable	107,402	90,562
Other liabilities	736,147	810,507
Total liabilities	16,356,257	16,413,567
Common stock (shares authorized: 2014 and 2013 22,000,000; shares issued: 2014 17,459,961; 2013 17,459,961)	17,460	17,460
Contributed capital	3,611,300	3,613,151
Accumulated other comprehensive income	279,049	186,930
Treasury stock, at cost (2014 924,370 shares; 2013 693,769 shares)	(304,760)	(213,911)
Retained earnings	3,525,007	3,320,127
Total stockholders' equity attributable to Alleghany stockholders	7,128,056	6,923,757
Noncontrolling interest	10,023	23,764
Total stockholders' equity	7,138,079	6,947,521
Total liabilities and stockholders' equity	\$ 23,494,336	\$ 23,361,088

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**ALLEGHANY CORPORATION AND SUBSIDIARIES****Consolidated Statements of Earnings and Comprehensive Income**

(unaudited)

	Three Months Ended March 31,	
	2014	2013
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	\$ 1,053,997	\$ 1,075,013
Net investment income	110,583	118,811
Net realized capital gains	96,836	50,902
Other than temporary impairment losses	(5,220)	(32,312)
Other income	30,446	11,141
Total revenues	1,286,642	1,223,555
Costs and Expenses		
Net loss and loss adjustment expenses	611,159	567,413
Commissions, brokerage and other underwriting expenses	324,236	326,227
Other operating expenses	53,342	30,738
Corporate administration	9,632	12,422
Amortization of intangible assets	(1,861)	11,630
Interest expense	21,811	21,736
Total costs and expenses	1,018,319	970,166
Earnings before income taxes	268,323	253,389
Income taxes	63,682	57,095
Net earnings	204,641	196,294
Net losses attributable to noncontrolling interest	(239)	-
Net earnings attributable to Alleghany stockholders	\$ 204,880	\$ 196,294
Net earnings	\$ 204,641	\$ 196,294
Other comprehensive income:		
Change in unrealized gains, net of deferred taxes of \$81,364 and \$45,877 for 2014 and 2013, respectively	151,104	85,200
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes of (\$32,066) and (\$6,507) for 2014 and 2013, respectively	(59,550)	(12,084)

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Change in unrealized currency translation adjustment, net of deferred taxes of \$233 and (\$5,366) for 2014 and 2013, respectively	432	(9,966)
Retirement plans	133	(154)
Comprehensive income	296,760	259,290
Comprehensive loss attributable to noncontrolling interest	(239)	-
Comprehensive income attributable to Alleghany stockholders	\$ 296,999	\$ 259,290
Basic earnings per share attributable to Alleghany stockholders	\$ 12.28	\$ 11.67
Diluted earnings per share attributable to Alleghany stockholders	12.28	11.67

See accompanying Notes to Unaudited Consolidated Financial Statements.

Table of Contents**ALLEGHANY CORPORATION AND SUBSIDIARIES****Consolidated Statements of Cash Flows**

(unaudited)

	Three Months Ended March 31,	
	2014	2013
	(in thousands)	
Cash flows from operating activities		
Net earnings	\$ 204,641	\$ 196,294
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	34,406	65,199
Net realized capital (gains) losses	(96,836)	(50,902)
Other than temporary impairment losses	5,220	32,312
(Increase) decrease in reinsurance recoverables, net of reinsurance payable	26,318	50,668
(Increase) decrease in premium balances receivable	(113,005)	(87,487)
(Increase) decrease in ceded unearned premiums	(12,011)	(14,029)
(Increase) decrease in deferred acquisition costs	(23,658)	(17,960)
Increase (decrease) in unearned premiums	92,398	18,338
Increase (decrease) in loss and loss adjustment expenses	(87,822)	(188,267)
Change in unrealized foreign exchange (losses) gains	(18,543)	78,955
Other, net	(126,845)	67,433
Net adjustments	(320,378)	(45,740)
Net cash provided by (used in) operating activities	(115,737)	150,554
Cash flows from investing activities		
Purchases of debt securities	(1,744,739)	(1,903,342)
Purchases of equity securities	(704,290)	(1,376,991)
Sales of debt securities	1,668,560	2,178,552
Maturities and redemptions of debt securities	244,451	432,542
Sales of equity securities	314,160	863,175
Net (purchase) sale in short-term investments	418,649	(372,447)
Purchases of property and equipment	(12,019)	(1,557)
Other, net	(1,499)	20,439
Net cash (used in) provided by investing activities	183,273	(159,629)
Cash flows from financing activities		
Treasury stock acquisitions	(94,642)	(31,576)
Other, net	8,929	(8,735)

Net cash provided by (used in) financing activities	(85,713)	(40,311)
Effect of exchange rate changes on cash	1,276	(25,259)
Net (decrease) increase in cash	(16,901)	(74,645)
Cash at beginning of period	498,315	649,524
Cash at end of period	\$ 481,414	\$ 574,879

Supplemental disclosures of cash flow information

Cash paid during the period for:

Interest paid	\$ 8,580	\$ 8,438
Income taxes paid (refunds received)	71,106	(45,366)

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

1. Summary of Significant Accounting Principles

(a) Principles of Financial Statement Presentation

This report should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2013 (the 2013 10-K) of Alleghany Corporation (Alleghany), a Delaware corporation. Unless the context otherwise requires, references to Alleghany include Alleghany together with its subsidiaries.

Alleghany owns and manages operating subsidiaries and investments, anchored by a core position in property and casualty reinsurance and insurance. Alleghany was incorporated in 1984 under the laws of the State of Delaware and in December 1986, it succeeded to the business of its parent company, Alleghany Corporation, which was incorporated in 1929. Prior to March 6, 2012, Alleghany was primarily engaged, through its wholly-owned subsidiary Alleghany Insurance Holdings LLC (AIHL) and its subsidiaries, in the property and casualty insurance business. AIHL s insurance operations are principally conducted by its subsidiaries RSUI Group, Inc. (RSUI), Capitol Transamerica Corporation (Capitol), and Pacific Compensation Corporation (PCC). Capitol has been a subsidiary of AIHL since January 2002, RSUI has been a subsidiary of AIHL since July 2003, and PCC has been a subsidiary of AIHL since July 2007. AIHL Re LLC (AIHL Re) has been a wholly-owned subsidiary of Alleghany since its formation in 2006. AIHL Re is a captive reinsurance company which provides reinsurance to our insurance operating subsidiaries and affiliates. On March 6, 2012, Alleghany consummated a merger transaction with Transatlantic Holdings, Inc. (TransRe), at which time TransRe became one of Alleghany s wholly-owned subsidiaries, and Alleghany s reinsurance operations commenced. Alleghany s public equity investments, including those held by TransRe s and AIHL s operating subsidiaries, are managed primarily by Alleghany s wholly-owned subsidiary Roundwood Asset Management LLC (Roundwood).

Although Alleghany s primary sources of revenues and earnings are its reinsurance and insurance operations and investments, it also conducts other activities. Alleghany manages, sources, executes and monitors its private capital investments primarily through its wholly-owned subsidiary Alleghany Capital Corporation (ACC). ACC s private capital investments include: (i) Stranded Oil Resources Corporation (SORC), an exploration and production company focused on enhanced oil recovery, headquartered in Austin, Texas; (ii) Bourn & Koch, Inc. (BKI), a manufacturer and remanufacturer/retrofitter of precision machine tools and supplier of replacement parts, headquartered in Rockford, Illinois; (iii) R.C. Tway Company, LLC (Kentucky Trailer), a manufacturer of custom trailers and truck bodies for the moving and storage industry and other markets, headquartered in Louisville, Kentucky; and (iv) an approximately 39 percent equity interest in ORX Exploration, Inc. (ORX), a regional oil and gas exploration and production company, headquartered in New Orleans, Louisiana.

Alleghany also owns and manages properties in the Sacramento, California region through its wholly-owned subsidiary Alleghany Properties Holdings LLC (Alleghany Properties).

Alleghany owned a minority stake in Homesite Group Incorporated (Homesite), a national, full-service, mono-line provider of homeowners insurance, until its sale to American Family Insurance Company, a Wisconsin-based mutual insurance company, on December 31, 2013.

The financial statements contained in this Quarterly Report on Form 10-Q are unaudited, but reflect all adjustments that, in the opinion of management, are necessary for a fair statement of results of the interim periods covered thereby. All adjustments are of a normal and recurring nature except as described herein.

The accompanying consolidated financial statements include the results of Alleghany and its wholly-owned and majority-owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the U.S. (GAAP). All significant inter-company balances and transactions have been eliminated in consolidation. The results of Kentucky Trailer have been included in Alleghany s consolidated financial statements beginning August 30, 2013.

The portion of stockholders equity, net earnings and accumulated other comprehensive income that is not attributable to Alleghany stockholders is presented on the Consolidated Balance Sheets and the Consolidated Statements of Earnings and Comprehensive Income as noncontrolling interest.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Alleghany relies on historical experience and on various other assumptions that it believes to be reasonable under the circumstances to make judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may

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differ materially from those reported results to the extent that those estimates and assumptions prove to be inaccurate. Changes in estimates are reflected in the consolidated statement of earnings and comprehensive income in the period in which the change is made. The results of operations for any interim period are not necessarily indicative of results for the full year.

(b) Other Significant Accounting Principles

Alleghany's significant accounting principles can be found in Note 1 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of the 2013 10-K.

(c) Recent Accounting Standards***Future Application of Accounting Standards***

In April 2014, the Financial Accounting Standards Board issued guidance that changed the criteria for reporting discontinued operations. Under the new guidance, only disposals that represent a strategic shift in operations would qualify as discontinued operations. In addition, the new guidance requires expanded disclosures about discontinued operations. This guidance is effective in the first quarter of 2015. Alleghany will adopt this guidance in the 2015 first quarter, and Alleghany does not currently believe that the implementation will have an impact on its results of operations and financial condition.

2. Fair Value of Financial Instruments

The carrying values and estimated fair values of Alleghany's consolidated financial instruments as of March 31, 2014 and December 31, 2013 were as follows:

	March 31, 2014		December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets	(in millions)			
Investments (excluding equity method investments) ⁽¹⁾	\$ 18,633.8	\$ 18,633.8	\$ 18,632.2	\$ 18,632.2
Liabilities				
Senior Notes ⁽²⁾	\$ 1,790.0			