

State Auto Financial CORP
Form 10-Q
August 05, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 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 000-19289

STATE AUTO FINANCIAL CORPORATION

(Exact name of Registrant as specified in its charter)

Ohio 31-1324304
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

518 East Broad Street, Columbus, Ohio 43215-3976
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (614) 464-5000

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 ý 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes ý No "

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated file " Accelerated filer ý Non-accelerated filer "

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes " No ý

On July 25, 2014, the Registrant had 40,943,214 Common Shares outstanding.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

PART I – FINANCIAL STATEMENTS

Item 1. Condensed Consolidated Balance Sheets

(\$ and shares in millions, except per share amounts)	June 30, 2014 (unaudited)	December 31, 2013
Assets		
Fixed maturities, available-for-sale, at fair value (amortized cost \$1,789.2 and \$1,804.0, respectively)	\$ 1,849.3	\$ 1,830.1
Equity securities, available-for-sale, at fair value (cost \$230.0 and \$196.6, respectively)	300.4	265.3
Other invested assets, available-for-sale, at fair value (cost \$49.7 and \$49.5, respectively)	87.3	80.9
Other invested assets	5.3	5.0
Notes receivable from affiliate	70.0	70.0
Total investments	2,312.3	2,251.3
Cash and cash equivalents	71.5	80.3
Accrued investment income and other assets	33.4	33.6
Deferred policy acquisition costs	107.0	96.8
Reinsurance recoverable on losses and loss expenses payable	8.6	9.1
Prepaid reinsurance premiums	5.4	4.7
Due from affiliate	27.0	—
Current federal income taxes	0.5	0.3
Net deferred federal income taxes	4.2	11.9
Property and equipment, at cost	8.2	8.4
Total assets	\$ 2,578.1	\$ 2,496.4
Liabilities and Stockholders' Equity		
Losses and loss expenses payable (affiliates \$437.8 and \$438.0, respectively)	\$ 962.8	\$ 959.9
Unearned premiums (affiliates \$103.1 and \$78.4, respectively)	521.5	491.0
Notes payable (affiliates \$15.5 and \$15.5, respectively)	100.8	100.8
Postretirement and pension benefits	69.5	71.6
Due to affiliate	—	1.3
Other liabilities	79.8	86.8
Total liabilities	1,734.4	1,711.4
Stockholders' equity:		
Class A Preferred stock (nonvoting), without par value. Authorized 2.5 shares; none issued	—	—
Class B Preferred stock, without par value. Authorized 2.5 shares; none issued	—	—
Common stock, without par value. Authorized 100.0 shares; 47.7 and 47.5 shares issued, respectively, at stated value of \$2.50 per share	119.2	118.8
Treasury stock, 6.8 and 6.8 shares, respectively, at cost	(116.0)	(115.9)
Additional paid-in capital	140.5	137.5
Accumulated other comprehensive income	114.4	80.8
Retained earnings	585.6	563.8
Total stockholders' equity	843.7	785.0
Total liabilities and stockholders' equity	\$ 2,578.1	\$ 2,496.4

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Income

(\$ in millions, except per share amounts)

(unaudited)	Three months ended June 30	
	2014	2013
Earned premiums (ceded to affiliates \$216.8 and \$213.1, respectively)	\$ 268.3	\$ 263.5
Net investment income (affiliate \$1.2 and \$1.2, respectively)	20.5	19.7
Net realized gains on investments:		
Total other-than-temporary impairment losses	(0.3	) (2.0
Portion of loss recognized in other comprehensive income	—	—
Other net realized investment gains	5.6	3.5
Total net realized gains on investments	5.3	1.5
Other income from affiliates	0.3	0.6
Total revenues	294.4	285.3
Losses and loss expenses (ceded to affiliates \$143.5 and \$164.4, respectively)	190.4	186.1
Acquisition and operating expenses	97.3	87.0
Interest expense (affiliates \$0.1 and \$0.2, respectively)	1.3	3.8
Other expenses	2.3	2.1
Total expenses	291.3	279.0
Income before federal income taxes	3.1	6.3
Federal income tax expense	0.1	0.1
Net income	\$ 3.0	\$ 6.2
Earnings per common share:		
Basic	\$ 0.07	\$ 0.15
Diluted	\$ 0.07	\$ 0.15
Dividends paid per common share	\$ 0.10	\$ 0.10

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Income

(\$ in millions, except per share amounts)

(unaudited)	Six months ended June 30	
	2014	2013
Earned premiums (ceded to affiliates \$432.2 and \$423.8, respectively)	\$ 530.8	\$ 524.8
Net investment income (affiliate \$2.4 and \$2.4, respectively)	38.1	36.6
Net realized gains on investments:		
Total other-than-temporary impairment losses	(1.2	) (2.3
Portion of loss recognized in other comprehensive income	—	—
Other net realized investment gains	17.2	10.5
Total net realized gains on investments	16.0	8.2
Other income from affiliates	0.8	1.0
Total revenues	585.7	570.6
Losses and loss expenses (ceded to affiliates \$285.7 and \$296.2, respectively)	362.2	359.1
Acquisition and operating expenses	185.8	175.8
Interest expense (affiliates \$0.3 and \$0.4, respectively)	2.6	5.5
Other expenses	4.3	3.9
Total expenses	554.9	544.3
Income before federal income taxes	30.8	26.3
Federal income tax expense	0.7	0.4
Net income	\$ 30.1	\$ 25.9
Earnings per common share:		
Basic	\$ 0.74	\$ 0.64
Diluted	\$ 0.73	\$ 0.64
Dividends paid per common share	\$ 0.20	\$ 0.20

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Statements of Comprehensive Income

(\$ in millions, except per share amounts)

(unaudited)

	Three months ended June 30	
	2014	2013
Net income	\$ 3.0	\$ 6.2
Other comprehensive income (loss), net of tax:		
Net unrealized holding gains (losses) on investments:		
Unrealized holding gains (losses) arising during the period ended	34.9	(67.1)
Reclassification adjustments for gains realized in net income	(5.3	) (1.5)
Income tax (expense) benefit	(3.5	) 7.3
Total net unrealized holding gains (losses) on investments	26.1	(61.3)
Amortization of gain on derivative used in cash flow hedge	—	(0.1)
Net unrecognized benefit plan obligations:		
Net actuarial loss arising during period	(1.6) —
Reclassification adjustments for amortization to statements of income:		
Prior service benefits	(1.4	) (1.4)
Net actuarial loss	2.2	2.3
Total net unrecognized benefit plan obligations	(0.8	) 0.9
Other comprehensive income (loss), net of tax	25.3	(60.5)
Comprehensive income (loss), net of tax	\$ 28.3	\$ (54.3)

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Consolidated Statements of Comprehensive Income

(\$ in millions, except per share amounts)

(unaudited)

	Six months ended June 30	
	2014	2013
Net income	\$ 30.1	\$ 25.9
Other comprehensive income (loss), net of tax:		
Net unrealized holding gains (losses) on investments:		
Unrealized holding gains (losses) arising during the period ended	57.9	(47.7)
Reclassification adjustments for gains realized in net income	(16.0	) (8.2)
Income tax (expense) benefit	(7.7	) 7.6
Total net unrealized holding gains (losses) on investments	34.2	(48.3)
Amortization of gain on derivative used in cash flow hedge	—	(0.1)
Net unrecognized benefit plan obligations:		
Net actuarial loss arising during period	(1.6) —
Reclassification adjustments for amortization to statements of income:		
Prior service benefits	(2.8	) (2.8)
Net actuarial loss	3.8	4.6
Total net unrecognized benefit plan obligations	(0.6	) 1.8
Other comprehensive income (loss), net of tax	33.6	(46.6)
Comprehensive income (loss), net of tax	\$ 63.7	\$ (20.7)

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Condensed Consolidated Statements of Cash Flows

(\$ in millions)

(unaudited)

Cash flows from operating activities:

Net income

Adjustments to reconcile net income to net cash provided by operating activities:

Depreciation and amortization, net

Share-based compensation

Net realized gains on investments

Changes in operating assets and liabilities:

Deferred policy acquisition costs

Accrued investment income and other assets

Postretirement and pension benefits

Other liabilities and due to/from affiliates, net

Reinsurance recoverable on losses and loss expenses payable and prepaid reinsurance premiums

Losses and loss expenses payable

Unearned premiums

Federal income taxes

Net cash provided by operating activities

Cash flows from investing activities:

Purchases of fixed maturities, available-for-sale

Purchases of equity securities, available-for-sale

Purchases of other invested assets

Maturities, calls and pay downs of fixed maturities, available-for-sale

Sales of fixed maturities, available-for-sale

Sales of equity securities, available-for-sale

Sales of other invested assets

Net additions of property and equipment

Net cash (used in) provided by investing activities

Cash flows from financing activities:

Proceeds from issuance of common stock

Payments to acquire treasury stock

Payment of dividends

Net cash used in financing activities

Net (decrease) increase in cash and cash equivalents

Cash and cash equivalents at beginning of period

Cash and cash equivalents at end of period

Supplemental disclosures:

Interest paid (affiliates \$0.3 and \$0.3, respectively)

Federal income taxes paid

Six months ended June 30

2014

2013

\$ 30.1

\$ 25.9

4.4

6.4

2.4

2.5

(16.0

) (8.2

)

(10.2

) (8.7

)

0.4

(2.0

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(2.7

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(0.2

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2.9

13.5

30.5

25.7

(0.2

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4.8

11.6

(226.7

) (144.2

)

(84.9

) (39.5

)

(0.9

) (0.5

)

138.3

86.7

101.8

58.2

64.8

43.2

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0.4

—

0.2

(7.3

) 4.5

2.1

1.6

(0.1

) (0.1

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(8.3

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(6.3

) (6.6

)

(8.8

) 9.5

80.3

59.0

\$ 71.5

\$ 68.5

\$ 2.6

\$ 3.5

\$ 1.0

\$ 0.6

See accompanying notes to condensed consolidated financial statements.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements (Unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of State Auto Financial Corporation and Subsidiaries (“State Auto Financial” or the “Company”) have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. In the opinion of the Company, all adjustments (consisting of normal, recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. The balance sheet at December 31, 2013 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s annual report on Form 10-K for the year ended December 31, 2013 (the “2013 Form 10-K”). Capitalized terms used herein and not otherwise defined shall have the meaning ascribed to them in the 2013 Form 10-K.

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

2. Investments

The following tables set forth the cost or amortized cost and fair value of available-for-sale securities by lot at June 30, 2014 and December 31, 2013:

(\$ millions)

June 30, 2014	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 297.9	\$ 19.5	\$ (3.2)	) \$ 314.2
Obligations of states and political subdivisions	708.7	26.0	(3.1)	) 731.6
Corporate securities	318.7	12.8	(3.2)	) 328.3
U.S. government agencies residential mortgage-backed securities	463.9	13.9	(2.6)	) 475.2
Total fixed maturities	1,789.2	72.2	(12.1)	) 1,849.3
Equity securities:				
Large-cap securities	182.4	53.0	—	235.4
Small-cap securities	47.6	17.4	—	65.0
Total equity securities	230.0	70.4	—	300.4
Other invested assets	49.7	37.6	—	87.3
Total available-for-sale securities	\$ 2,068.9	\$ 180.2	\$ (12.1)	) \$ 2,237.0

(\$ millions)

December 31, 2013	Cost or amortized cost	Gross unrealized holding gains	Gross unrealized holding losses	Fair value
Fixed maturities:				
U.S. treasury securities and obligations of U.S. government agencies	\$ 345.5	\$ 13.4	\$ (6.5)	) \$ 352.4
Obligations of states and political subdivisions	765.3	25.8	(16.9)	) 774.2
Corporate securities	345.0	11.4	(6.7)	) 349.7
U.S. government agencies residential mortgage-backed securities	348.2	9.7	(4.1)	) 353.8
Total fixed maturities	1,804.0	60.3	(34.2)	) 1,830.1
Equity securities:				
Large-cap securities	148.2	46.5	(0.3)	) 194.4
Small-cap securities	48.4	22.5	—	70.9
Total equity securities	196.6	69.0	(0.3)	) 265.3
Other invested assets	49.5	31.4	—	80.9
Total available-for-sale securities	\$ 2,050.1	\$ 160.7	\$ (34.5)) \$ 2,176.3

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STATE AUTO FINANCIAL CORPORATION AND SUBSIDIARIES

(a majority-owned subsidiary of State Automobile Mutual Insurance Company)

Notes to Condensed Consolidated Financial Statements, Continued (Unaudited)

The following tables set forth the Company's gross unrealized losses and fair value on its investments by lot, aggregated by investment category and length of time for individual securities that have been in a continuous unrealized loss position at June 30, 2014 and December 31, 2013:

(\$ millions, except # of positions) June 30, 2014	Less than 12 months			12 months or more			Total		
	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions	Fair value	Unrealized losses	Number of positions
Fixed maturities:									
U.S. treasury securities and obligations of U.S. government agencies	\$ 19.9	\$ (0.8)	4	\$ 45.1	\$ (2.4)	16	\$ 65.0	\$ (3.2)	20
Obligations of states and political subdivisions	33.0	(0.2)	12	158.4	(2.9)	53	191.4	(3.1)	65
Corporate securities	5.0	(0.1)	1	70.6	(3.1)	14	75.6	(3.2)	15