

Employers Holdings, Inc.
Form 10-Q
May 01, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

R 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: 001-33245

EMPLOYERS HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction

of incorporation or organization)

04-3850065

(I.R.S. Employer

Identification Number)

10375 Professional Circle, Reno, Nevada 89521

(Address of principal executive offices and zip code)

(888) 682-6671

(Registrant's telephone number, including area code)

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 R No o

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 R 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 definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer R Accelerated filer o Non-accelerated filer o 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 R

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Class

April 24, 2014

Common Stock, \$0.01 par value per share

31,375,759 shares outstanding

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PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Employers Holdings, Inc. and Subsidiaries

Consolidated Balance Sheets

(in thousands, except share data)

	As of March 31, 2014 (unaudited)	As of December 31, 2013
Assets		
Available for sale:		
Fixed maturity securities at fair value (amortized cost \$2,131,381 at March 31, 2014 and \$2,116,064 at December 31, 2013)	\$2,211,159	\$2,182,546
Equity securities at fair value (cost \$92,139 at March 31, 2014 and \$89,689 at December 31, 2013)	163,928	162,312
Total investments	2,375,087	2,344,858
Cash and cash equivalents	51,118	34,503
Restricted cash and cash equivalents	8,935	6,564
Accrued investment income	19,381	20,255
Premiums receivable (less bad debt allowance of \$7,082 at March 31, 2014 and \$7,064 at December 31, 2013)	294,077	279,080
Reinsurance recoverable for:		
Paid losses	8,266	8,412
Unpaid losses, including bad debt allowance of \$389 at March 31, 2014 and December 31, 2013	735,453	742,666
Deferred policy acquisition costs	46,423	43,532
Deferred income taxes, net	54,673	58,062
Property and equipment, net	16,228	16,616
Intangible assets, net	9,517	9,685
Goodwill	36,192	36,192
Contingent commission receivable—LPT Agreement	25,528	25,104
Other assets	18,094	17,920
Total assets	\$3,698,972	\$3,643,449
Liabilities and stockholders' equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	\$2,358,178	\$2,330,491
Unearned premiums	320,678	303,967
Total claims and policy liabilities	2,678,856	2,634,458
Commissions and premium taxes payable	44,531	45,314
Accounts payable and accrued expenses	17,116	18,711
Deferred reinsurance gain—LPT Agreement	245,197	249,072
Notes payable	102,000	102,000
Other liabilities	23,411	25,191
Total liabilities	3,111,111	3,074,746
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.01 par value; 150,000,000 shares authorized; 54,748,733 and 54,672,904 shares issued and 31,375,759 and 31,299,930 shares outstanding at March 31, 2014 and December 31, 2013, respectively	547	547

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Preferred stock, \$0.01 par value; 25,000,000 shares authorized; none issued	—	—
Additional paid-in capital	340,279	338,090
Retained earnings	511,067	502,198
Accumulated other comprehensive income, net	98,518	90,418
Treasury stock, at cost (23,372,974 shares at March 31, 2014 and December 31, 2013)	(362,550	) (362,550)
Total stockholders' equity	587,861	568,703
Total liabilities and stockholders' equity	\$3,698,972	\$3,643,449

See accompanying unaudited notes to the consolidated financial statements.

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Employers Holdings, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
(in thousands, except per share data)

	Three Months Ended March 31,	
	2014	2013
Revenues	(unaudited)	
Net premiums earned	\$167,154	\$147,975
Net investment income	18,013	17,405
Net realized gains on investments	3,259	794
Other income	55	103
Total revenues	188,481	166,277
Expenses		
Losses and loss adjustment expenses	122,256	108,272
Commission expense	20,075	18,393
Underwriting and other operating expenses	33,301	31,540
Interest expense	778	808
Total expenses	176,410	159,013
Net income before income taxes	12,071	7,264
Income tax expense (benefit)	1,318	(226)
Net income	\$10,753	\$7,490
Earnings per common share (Note 9):		
Basic and Diluted	\$0.34	\$0.24
Cash dividends declared per common share	\$0.06	\$0.06
Comprehensive income		
Unrealized gains during the period (net of tax expense of \$5,503 and \$14 for the three months ended March 31, 2014 and 2013, respectively)	\$10,218	\$25
Reclassification adjustment for realized gains in net income (net of taxes of \$1,141 and \$278 for the three months ended March 31, 2014 and 2013, respectively)	(2,118)	(516)
Other comprehensive income (loss), net of tax	8,100	(491)
Total comprehensive income	\$18,853	\$6,999
Net realized gains on investments		
Net realized gains on investments before credit related impairments on fixed maturity securities	\$3,259	\$794
Other than temporary impairment, credit losses recognized in earnings	—	—
Net realized gains on investments	\$3,259	\$794
See accompanying unaudited notes to the consolidated financial statements.		

Employers Holdings, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(in thousands)

	Three Months Ended	
	March 31,	
	2014	2013
Operating activities	(unaudited)	
Net income	\$10,753	\$7,490
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,797	1,393
Stock-based compensation	1,596	2,110
Amortization of premium on investments, net	2,508	2,020
Deferred income tax expense	(973	) (1,154
Net realized gains on investments	(3,259	) (794
Excess tax benefits from stock-based compensation	(1,136	) (170
Other	188	562
Change in operating assets and liabilities:		
Premiums receivable	(15,015	) (30,082
Reinsurance recoverable for paid and unpaid losses	7,359	7,206
Federal income taxes	1,382	855
Unpaid losses and loss adjustment expenses	27,687	26,759
Unearned premiums	16,711	24,168
Accounts payable, accrued expenses and other liabilities	(3,376	) 4,378
Deferred reinsurance gain—LPT Agreement	(3,875	) (3,577
Contingent commission receivable—LPT Agreement	(424	) (385
Other	(3,353	) 808
Net cash provided by operating activities	38,570	41,587
Investing activities		
Purchase of fixed maturity securities	(94,495	) (90,117
Purchase of equity securities	(7,838	) (5,328
Proceeds from sale of fixed maturity securities	35,061	—
Proceeds from sale of equity securities	7,872	5,284
Proceeds from maturities and redemptions of investments	42,418	39,693
Proceeds from sale of fixed assets	—	113
Capital expenditures	(1,447	) (1,355
Restricted cash and cash equivalents (used in) provided by investing activities	(2,371	) 659
Net cash used in investing activities	(20,800	) (51,051
Financing activities		
Cash transactions related to stock-based compensation	(412	) 1,374
Dividends paid to stockholders	(1,879	) (1,852
Excess tax benefits from stock-based compensation	1,136	170
Net cash used in financing activities	(1,155	) (308
Net increase (decrease) in cash and cash equivalents	16,615	(9,772
Cash and cash equivalents at the beginning of the period	34,503	140,661
Cash and cash equivalents at the end of the period	\$51,118	\$130,889
See accompanying unaudited notes to the consolidated financial statements.		

Employers Holdings, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation and Summary of Operations

Employers Holdings, Inc. (EHI) is a Nevada holding company. Through its wholly owned insurance subsidiaries, Employers Insurance Company of Nevada (EICN), Employers Compensation Insurance Company (ECIC), Employers Preferred Insurance Company (EPIC), and Employers Assurance Company (EAC), EHI is engaged in the commercial property and casualty insurance industry, specializing in workers' compensation products and services. Unless otherwise indicated, all references to the "Company" refer to EHI, together with its subsidiaries.

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. 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) necessary for a fair presentation of the Company's consolidated financial position and results of operations for the periods presented have been included. The results of operations for an interim period are not necessarily indicative of the results for an entire year. These financial statements have been prepared consistent with the accounting policies described in the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

The Company considers an operating segment to be any component of its business whose operating results are regularly reviewed by the Company's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance based on discrete financial information. Currently, the Company has one operating segment, workers' compensation insurance and related services.

Use of Estimates

The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the consolidated financial statements, as well as the reported amounts of revenues and expenses during the reporting period. As a result, actual results could differ from these estimates. The most significant areas that require management judgment are the estimate of unpaid losses and loss adjustment expenses (LAE), evaluation of reinsurance recoverables, recognition of premium revenue, deferred income taxes, valuation of investments, and the valuation of goodwill and intangible assets.

Reclassifications

Certain prior period information has been reclassified to conform to the current period presentation.

2. Fair Value of Financial Instruments

The carrying value and the estimated fair value of the Company's financial instruments were as follows:

	March 31, 2014		December 31, 2013	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(in thousands)			
Financial assets				
Investments	\$2,375,087	\$2,375,087	\$2,344,858	\$2,344,858
Cash and cash equivalents	51,118	51,118	34,503	34,503
Restricted cash and cash equivalents	8,935	8,935	6,564	6,564
Financial liabilities				
Notes payable	102,000	105,579	102,000	105,450

The Company's estimates of fair value for financial liabilities are based on a combination of the variable interest rates for the Company's existing line of credit and other notes with similar durations to discount the projection of future payments on notes payable, and have been determined to be Level 2 fair value measurements, as defined below.

Assets and liabilities recorded at fair value on the consolidated balance sheets are categorized based upon the levels of judgment associated with the inputs used to measure their fair value. Level inputs are defined as follows:

Level 1 - Inputs are unadjusted quoted market prices for identical assets or liabilities in active markets at the measurement date.

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Level 2 - Inputs other than Level 1 prices that are observable for similar assets or liabilities through corroboration with market data at the measurement date.

Level 3 - Inputs that are unobservable that reflect management's best estimate of what willing market participants would use in pricing the assets or liabilities at the measurement date.

The following methods and assumptions were used to determine the fair value of each class of assets and liabilities recorded at fair value in the consolidated balance sheets.

Fair value of available-for-sale fixed maturity and equity securities is based on quoted market prices, where available, and is obtained primarily from third-party pricing services, which generally use Level 1 or Level 2 inputs. The Company obtains a quoted price for each security from third party pricing services. The quoted prices are derived through recently reported trades for identical or similar securities. For securities not actively traded, the third party pricing services may use quoted market prices of similar instruments or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include, but are not limited to, broker quotes, benchmark yields, credit spreads, default rates, and prepayment speeds. The Company also performs a quarterly analysis on the prices received from third party pricing services to determine whether the prices are reasonable estimates of fair value, including confirming the fair values of these securities through observable market prices using an alternative pricing source. If differences are noted in this review, the Company may obtain additional information from other pricing services to validate the quoted price.

There were no adjustments to prices obtained from third party pricing services as of March 31, 2014 or December 31, 2013 that were material to the Company's consolidated financial statements.

If quoted market prices and an estimate determined by using objectively verifiable information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or Level 3. The Company bases all of its estimates of fair value for assets on the bid price as it represents what a third-party market participant would be willing to pay in an arm's length transaction.

These methods of valuation will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If objectively verifiable information is not available, the Company would be required to produce an estimate of fair value using some of the same methodologies, making assumptions for market-based inputs that are unavailable.

Estimates of fair value for fixed maturity securities are based on estimates using objectively verifiable information and are included in the amount disclosed in Level 2 of the hierarchy. The Level 3 fair value estimates include the Company's assumptions about risk assessments and market participant assumptions based on the best information available, including quotes from market makers and other broker/dealers recognized as market participants, using standard or trade derived inputs, new issue data, monthly payment information, cash flow generation, prepayment speeds, spread adjustments, or rating updates.

The following table presents the items on the accompanying consolidated balance sheets that are stated at fair value and the corresponding fair value measurements.

	March 31, 2014			December 31, 2013		
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(in thousands)					
Fixed maturity securities						
U.S. Treasuries	\$—	\$174,487	\$—	\$—	\$170,897	\$—
U.S. Agencies	—	58,947	—	—	68,118	—
States and municipalities	—	763,913	—	—	735,180	—
Corporate securities	—	838,859	—	—	833,296	—
Residential mortgage-backed securities	—	261,392	—	—	258,431	—
Commercial mortgage-backed securities	—	64,063	—	—	65,110	—
Asset-backed securities	—	49,498	—	—	51,514	—

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Total fixed maturity securities	—	2,211,159	—	—	2,182,546	—
Equity securities	\$163,928	\$—	\$—	\$162,312	\$—	\$—

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3. Investments

The cost or amortized cost, gross unrealized gains, gross unrealized losses, and estimated fair value of the Company's investments were as follows:

	Cost or Amortized Cost (in thousands)	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At March 31, 2014				
Fixed maturity securities				
U.S. Treasuries	\$167,437	\$7,148	\$(98)	) \$174,487
U.S. Agencies	55,912	3,035	—	) 58,947
States and municipalities	724,093	41,784	(1,964)	) 763,913
Corporate securities	812,448	32,007	(5,596)	) 838,859
Residential mortgage-backed securities	256,573	8,136	(3,317)	) 261,392
Commercial mortgage-backed securities	65,326	317	(1,580)	) 64,063
Asset-backed securities	49,592	38	(132)	) 49,498
Total fixed maturity securities	2,131,381	92,465	(12,687)	) 2,211,159
Equity securities	92,139	72,074	(285)	) 163,928
Total investments	\$2,223,520	\$164,539	\$(12,972)	) \$2,375,087
At December 31, 2013				
Fixed maturity securities				
U.S. Treasuries	\$163,951	\$7,073	\$(127)	) \$170,897
U.S. Agencies	64,985	3,137	(4)	) 68,118
States and municipalities	698,979	40,595	(4,394)	) 735,180
Corporate securities	814,283	28,671	(9,658)	) 833,296
Residential mortgage-backed securities	255,187	7,979	(4,735)	) 258,431
Commercial mortgage-backed securities	67,066	316	(2,272)	) 65,110
Asset-backed securities	51,613	54	(153)	) 51,514
Total fixed maturity securities	2,116,064	87,825	(21,343)	) 2,182,546
Equity securities	89,689	72,844	(221)	) 162,312
Total investments	\$2,205,753	\$160,669	\$(21,564)	) \$2,344,858

The amortized cost and estimated fair value of fixed maturity securities at March 31, 2014, by contractual maturity, are shown below. Expected maturities differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

please sign full name by duly authorized officer.

Signature [PLEASE SIGN WITHIN BOX] Date

Signature (Joint Owners)

Date

**Watson Wyatt & Company Holdings
Annual Meeting of Stockholders**

**Hilton Arlington
950 North Stafford Street
Arlington, Virginia 22203**

**November 11, 2005
9:00 a.m., (EST)**

é FOLD AND DETACH HERE é

**WATSON WYATT & COMPANY HOLDINGS
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS.**

The person(s) signing on the reverse hereof hereby appoints John J. Haley and Walter W. Bardenwerper, and each of them, as his or her proxies, each with full power of substitution and resubstitution, to vote all of his or her shares of capital stock of Watson Wyatt & Company Holdings at the Annual Meeting of Stockholders of the Company to be held on November 11, 2005 at the Hilton Arlington, 950 North Stafford Street, Arlington, Virginia 22203 at 9:00 a.m., (EST) and at any adjournment(s) or postponement(s) thereof, with the same authority as if the stockholder(s) were personally present, as specified on the reverse.

THE PERSON(S) SIGNING THIS PROXY HEREBY REVOKES ANY PROXY HERETOFORE GIVEN AND ACKNOWLEDGES RECEIPT OF THE NOTICE AND PROXY STATEMENT FOR THE ANNUAL MEETING.