PENN AMERICA GROUP INC
Form 10-Q
May 11, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

(x) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2001

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 0-22316

Penn-America Group, Inc.
(Exact name of registrant as specified in its charter)

Pennsylvania	23-2731409
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

420 South York Road, Hatboro, Pennsylvania 19040
(Address of principal executive offices, including zip code)

(215) 443-3600
(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 other 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 X No .

At May 11, 2001, 7,592,525 shares of the registrant's common stock, $.01 par value, were outstanding.

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PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(In thousands, except per share data)

	March 200
ASSETS	(Unaudi
Investments:	
Fixed maturities:	
Available for sale, at fair value (amortized cost 2001, $127,309; 2000, $123,873)	$ 130
Held to maturity, at amortized cost (fair value 2001, $17,619; 2000, $17,441)	17
Equity securities, at fair value (cost 2001, $29,389; 2000, $27,324)	25
Total investments	173
Cash	5

Accrued investment income	1
Premiums receivable, net	10
Reinsurance recoverable	24
Prepaid reinsurance premiums	4
Deferred policy acquisition costs	9
Capital lease	1
Deferred income taxes	4
Income tax recoverable	2
Other assets	
Total assets	$ 239
LIABILITIES AND STOCKHOLDERS' EQUITY	
Liabilities:	
Unpaid losses and loss adjustment expenses	$ 115
Unearned premiums	40
Accounts payable and accrued expenses	2
Capitalized lease obligation	1
Other liabilities	3
Total liabilities	163
Stockholders' equity:	
Preferred stock, $.01 par value; authorized 2,000,000 shares; None issued	
Common stock, $.01 par value; authorized 20,000,000 shares; issued 2001 and 2000, 10,086,525 and 10,076,025 shares, respectively; outstanding 2001 and 2000, 7,586,525 and 7,576,025 shares, respectively	
Additional paid-in capital	70
Accumulated other comprehensive loss	
Retained earnings	30
Treasury stock, 2,500,000 shares in 2001 and 2000 at cost	(24
Officers' stock loans	
Unearned compensation from restricted stock awards	
Total stockholders' equity	75
Total liabilities and stockholders' equity	$ 239

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Operations
(Unaudited)

For the three months ended March 31, 2001 and 2000
(In thousands, except per share data)

	Three months ended March 31,	
	2001	2000
Revenues		
Premiums earned	$ 23,042	$ 21,546

Net investment income	2,850	2,400
Net realized investment gain (loss)	102	(13)
Total revenues	25,994	23,933
Losses and expenses		
Losses and loss adjustment expenses	16,734	13,905
Amortization of deferred policy acquisition costs	6,224	6,239
Other underwriting expenses	1,534	1,430
Corporate expenses	162	220
Interest expense	40	36
Total losses and expenses	24,694	21,830
Income before income tax	1,300	2,103
Income tax expense	333	520
Net income	$ 967	$ 1,583
Net income per share, basic and diluted	$ 0.13	$ 0.20

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Consolidated Statement of Stockholders' Equity
(Unaudited)

For the three months ended March 31, 2001
(In thousands, except per share data)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Treasury Stock	Officers Stock Loans
Balance at December 31, 2000	$ 101	$ 70,164	$ (811)	$ 29,583	$ (24,161)	$ (546
Net income	--	--	--	967	--	--
Other comprehensive income: unrealized gains on investments, net of tax and reclassification adjustment	--	--	667	--	--	--

Comprehensive income						
Issuance of common stock	--	62	--	--	--	--
Officers' stock loans	--	--	--	--	--	(109
Amortization of compensation expense from restricted stock awards issued	--	--	--	--	--	--
Cash dividends paid ($0.0525 per share)	--	--	--	(398)	--	--
Balance at March 31, 2001	$ 101	$ 70,226	$ (144)	$ 30,152	$ (24,161)	$ (655

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(Unaudited)

For the three months ended March 31, 2001 and 2000
(In thousands)

	Three m
	2001
Cash flows from operating activities:	
Net income	$ 9
Adjustments to reconcile net income to net cash provided (used) by Operating activities:	
Amortization and depreciation expense	(
Net realized investment (gains) losses	(1
Deferred income tax (benefit) expense	(1
Net decrease in premiums receivable, prepaid reinsurance premiums and unearned premiums	(2,9
Net increase (decrease) in unpaid losses and loss adjustment expenses and reinsurance recoverable	2
Accrued investment income	2
Deferred policy acquisition costs	6
Income tax recoverable	5
Other assets	(
Accounts payable and accrued expenses	2
Other liabilities	3
Net cash provided (used) by operating activities	(1
Cash flows from investing activities:	
Purchases of equity securities	(2,0
Purchases of fixed maturities available for sale	(9,9
Purchases of fixed maturities held to maturity	
Proceeds from sales of equity securities	
Proceeds from sales and maturities of fixed maturities available for sale	6,6
Proceeds from maturities and calls of fixed maturities held to maturity	
Change in short-term investments	

Net cash used by investing activities	(5,3
Cash flows from financing activities:	
Issuance of common stock	
Purchase of treasury stock	
Officers' stock loans	(1
Principal payments on capital lease obligations	(
Dividends paid	(3
Net cash used by financing activities	(4
Decrease in cash	(6,0
Cash, beginning of period	11,4
Cash, end of period	$ 5,4
Supplemental disclosure of cash flow information:	
Interest paid	$
Taxes recovered	

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

Note 1 - Organization and Basis of Presentation

Penn-America Group, Inc. ("PAGI" or the "Company") is an insurance holding company. Approximately 41% of the outstanding common stock of the Company was owned by Penn Independent Corporation ("Penn Independent") at March 31, 2001. The accompanying financial statements include the accounts of the Company and its wholly owned subsidiary, Penn-America Insurance Company ("Penn-America") and its wholly owned subsidiary, Penn-Star Insurance Company ("Penn-Star").

Penn-America and Penn-Star underwrite commercial property and general liability insurance and multi-peril insurance, generally referred to as "property and casualty" insurance. The companies write their business on an excess and surplus lines, or non-standard, basis as well as on an admitted basis. Penn-America and Penn-Star can write business in all 50 states and the District of Columbia. The companies write business on both an admitted and excess and surplus lines basis in 33 states, on an admitted basis only in 5 states and on an excess and surplus lines basis only in 13 states.

The accompanying condensed unaudited consolidated financial statements and notes 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 and recurring adjustments) considered necessary for a fair presentation of results for the interim periods have been included. All significant intercompany accounts and transactions have been eliminated in consolidation. It is suggested that these condensed unaudited consolidated financial statements and notes be read in conjunction with the financial statements and notes in the Company's 2000 Annual Report which was incorporated by reference into the Company's Form 10-K for the year ended December 31, 2000. The Company's results of operations for interim periods are not necessarily indicative of the results to be expected for the entire year.

Note 2 - Reinsurance

Premiums earned are presented net of amounts ceded to reinsurers of $3.0 million and $2.6 million for the three months ended March 31, 2001 and 2000, respectively. Losses and loss adjustment expenses are presented net of amounts ceded to reinsurers of $2.7 million and $1.9 million for the three months ended March 31, 2001 and 2000, respectively.

Note 3 - Comprehensive Income

Accumulated other comprehensive income (loss) of the Company consists solely of unrealized gains or losses on investment securities net of applicable income tax expense or benefit and reclassification adjustments.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

Note 4 - Income Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted income per share computations:

(in thousands, except per share data)	Three months ended March 31, 2001	2000
Basic per share computation:		
Net income	$ 967	$1,583
Weighted average common shares outstanding	7,579	7,972
Basic net income per share	$ 0.13	$ 0.20
Diluted per share computation:		
Net income	$ 967	$1,583
Weighted average common shares outstanding	7,579	7,972
Additional shares outstanding after the assumed exercise of stock options by applying the treasury stock method	56	38

Total shares	7,635	8,010
Diluted net income per share	$ 0.13	$ 0.20

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

Note 5- Segment Information

The Company has two reportable segments: non-standard personal automobile and commercial lines. The Company announced in April 1999 that it would run-off its remaining portfolio of the personal lines automobile business, which was underwritten through a single agent in California. This followed a decision earlier in 1999 to eliminate the remainder of the Company's non-standard personal automobile business in nine other states. The Company will continue to report on this segment separately until the amounts relating to the non-standard personal automobile business become immaterial to the financial statements presented. These segments are managed separately because they have different customers, pricing and expense structures. The Company does not allocate assets between segments because assets are reviewed in total by management for decision-making purposes.

The accounting policies of the segments are the same as those more fully described in the summary of significant accounting policies in Note 1 of the Company's 2000 Annual Report, which was incorporated by reference into the Company's 2000 Form 10-K. The Company evaluates segment profit based on profit or loss from operating activities. Segment profits or losses from operations are pre-tax and do not include unallocated expenses but do include investment income attributable to insurance transactions. Segment profit or loss therefore excludes federal income taxes, unallocated expenses and investment income attributable to equity as opposed to investment income attributable to insurance transactions.

The following is a summary of the Company's segment revenues, expenses and profit:

(in thousands) Three months ended March 31, 2

	Commercial	Personal Automobile
Premiums earned	$ 23,026	$ 16
Net investment income from insurance operations	1,866	84
Total segment revenues	24,892	100
Segment losses and loss adjustment expenses	17,930	(1,196)
Segment expenses	6,591	5
Total segment expenses	24,521	(1,191)
Segment income	$ 371	$ 1,291
Unallocated items:		
Net investment income from equity		
Unallocated expenses		
Income tax expense		
Net income		

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements
(continued)

Note 5- Segment Information (Continued)

(in thousands)	Three months ended March 31, 2000		
	Commercial	Personal Automobile	Tota
Premiums earned	$19,776	$ 1,770	$21
Net investment income from insurance operations	1,197	156	1
Total segment revenues	20,973	1,926	22
Segment losses and loss adjustment expenses	12,753	1,152	13
Segment expenses	6,055	645	6

Total segment expenses	18,808	1,797	20
Segment income	$ 2,165	$ 129	$ 2
Unallocated items:			
Net investment income from equity			1
Unallocated expenses			(1
Income tax expense			
Net income			$1

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Three Months Ended March 31, 2001 and 2000

Premiums earned increased 6.9% to $23.0 million for the three months ended March 31, 2001 from $21.5 million for the three months ended March 31, 2000, due to a 16.4% increase in commercial earned premiums, partially offset by a 99.1% decline in non-standard personal automobile earned premiums. The Company announced in 1999 that it is running off its non-standard personal automobile business.

Gross written premiums decreased 9.3% for the three months ended March 31, 2001 to $23.8 million compared to $26.3 million for the three months ended March 31, 2000, due to a 4.0% decrease in commercial gross written premiums and a 99.9% decline in non-standard personal automobile premiums.

Net written premiums decreased 10.0% for the three months ended March 31, 2001 to $21.1 million compared to $23.4 million for the three months ended March 31, 2000, due to a 4.1% decrease in commercial net written premiums and a 99.9% decline in non-standard personal lines.

Net investment income increased 18.8% to $2.9 million for the three months ended March 31, 2001, from $2.4 million for the three months ended March 31, 2000. This increase resulted principally from an increase in the investment yield of the fixed income investment portfolio and the growth in invested assets.

Losses and loss adjustment expenses increased 20.3% to $16.7 million for the three months ended March 31, 2001, from $13.9 million for the three months ended March 31, 2000.

Amortization of deferred policy acquisition costs ("DAC") remained unchanged at $6.2 million for the three months ended March 31, 2001 and March 31, 2000. Although earned premiums increased as discussed above, DAC amortization remained flat due to a reduction in commission rates.

Other underwriting expenses increased 7.3% to $1.5 million for the three months ended March 31, 2001, from $1.4 million for the three months ended March 31, 2000.

The overall statutory combined ratio for the Company increased to 106.9 for the three months ended March 31, 2001, from 99.8 for the three months ended March 31, 2000, primarily due to the increase in the loss ratio to 72.6 in 2001, compared to 64.5 in 2000. The expense ratio decreased to 34.3 for the three months ended March 31, 2001, compared to 35.3 for the three months ended March 31, 2000, due in part to the aforementioned commission reduction.

As a result of the factors described above, net income for the three months ended March 31, 2001 was $1.0 million or $0.13 per share (basic and diluted), compared to net income of $1.6 million or $0.20 per share (basic and diluted) for the three months ended March 31, 2000.

Liquidity and Capital Resources

PAGI is a holding company, the principal asset of which is the common stock of Penn-America. The principal source of cash for the payment of dividends to PAGI's stockholders, PAGI operating expenses and repurchase of PAGI stock is dividends from Penn-America and Penn-Star. Penn-America's principal sources of funds are operations, investment income and proceeds from sales and redemptions of investments. Funds are used by Penn-America and Penn-Star principally to pay claims and operating expenses, to purchase investments and to make dividend and other payments to PAGI.

Penn-America is required by law to maintain a certain minimum surplus on a statutory basis and is subject to risk-based capital requirements and regulations under which payment of dividends from statutory surplus may require prior approval from the Pennsylvania Insurance Department. Penn-America may pay dividends to PAGI without advance regulatory approval only from unassigned surplus and only to the extent that all dividends in the past twelve months do not exceed the greater of 10% of total statutory surplus, or statutory net income for the prior year. Using this criteria, the available ordinary dividend for 2001 is $5.5 million. No ordinary dividends were paid to PAGI in 2000. In 2000, Penn-America paid a $6.4 million return of capital to PAGI, after receiving approval from the Pennsylvania Insurance Department, which PAGI used to repurchase stock and to pay dividends and PAGI operating expenses. Penn-America paid a $0.6 million dividend to PAGI on May 9, 2001.

Net cash used by operating activities was $0.2 million for the three months ended March 31, 2001, compared to $3.4 million provided by operating activities for the three months ended March 31, 2000.

Net cash used by investing activities was $5.3 million for the three months ended March 31, 2001, compared to $4.6 million for the three months ended March 31, 2000.

Net cash used by financing activities was $0.5 million for the three months ended March 31, 2001, compared to $3.6 million for the three months ended March 31, 2000. In 2000, $2.6 million was used to purchase treasury stock, and no such purchases were made in 2001.

Statutory surplus as of March 31, 2001 increased to $58.7 million from $55.5 million as of March 31, 2000, due primarily to a $2.7 million net positive impact of adopting the standard set of statutory accounting principles known as "codification".

The Company believes it has sufficient liquidity to meet its anticipated insurance obligations and operating and capital expenditure needs. The Company's investment strategy emphasizes quality, liquidity and diversification, as well as total return. With respect to liquidity, the Company considers liability durations, specifically related to loss reserves, when determining desired investment maturities. In addition, maturities have been staggered to produce cash flows for loss payments and reinvestment opportunities.

The Company's fixed maturity portfolio of $148.0 million was 85.2% of the total investment portfolio as of March 31, 2001. Approximately 95% of these securities were rated "A" or better by Standard & Poor's or Moody's. The average duration of the fixed maturity portfolio as of March 31, 2001 was approximately

3.53 years. Equity securities, the majority of which consist of preferred stocks and exchange traded funds, were $25.8 million or 14.8% of total investments as of March 31, 2001.

As of March 31, 2001, the investment portfolio contained $46.9 million of mortgage/asset-backed obligations, which represents 27.0% of the total investments as of March 31, 2001. All of these securities were "AA"-rated or better and 73.8% were "AAA"-rated by Standard & Poor's or Moody's. These securities, which were issued by government, government-related agencies or publicly held corporations, are publicly traded, and have market values obtained from an independent pricing service. Changes in estimated cash flows due to changes in prepayment assumptions from the original purchase assumptions are revised based on current interest rates and the economic environment. The Company had no derivative financial instruments, real estate or mortgages in the investment portfolio as of March 31, 2001.

PENN-AMERICA GROUP, INC. AND SUBSIDIARIES

PART II. OTHER INFORMATION

Item 1. Legal Proceedings - None

Item 2. Changes in Securities - None

Item 3. Default Upon Senior Securities - None

Item 4. Submission of Matters to a Vote by Security Holders - None

Item 5. Other Information - None

Item 6. Exhibits and Reports on Form 8-K

On April 3, 2001, the Company filed a current report on Form 8-K announcing the availability of annual statements of its insurance subsidiaries, Penn-America Insurance Company and Penn-Star Insurance Company, on the Company's website, in hard copy from the Company, or from the Pennsylvania Insurance Department. This filing was made relative to Regulation FD requirements only.

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SIGNATURE

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

Penn-America Group, Inc.

Date: May 11, 2001 By: /s/ Jon S. Saltzman

Jon S. Saltzman
President and
Chief Executive Officer

By: /s/ Joseph F. Morris

Joseph F. Morris
Senior Vice President and
Chief Financial Officer