

MEADOWBROOK INSURANCE GROUP INC
Form 10-Q
May 10, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

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 1-14094

Meadowbrook Insurance Group, Inc.
(Exact name of Registrant as specified in its charter)

Michigan
(State of Incorporation)

38-2626206
(IRS Employer Identification No.)

26255 American Drive, Southfield, Michigan 48034
(Address, zip code of principal executive offices)

(248) 358-1100
(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 ☒ No ☐

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, 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 ☒ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller 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 ☒

The aggregate number of shares of the Registrant's Common Stock, \$.01 par value, outstanding on May 1, 2013, was 49,887,200.

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PART 1 - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME

For the Three Months Ended March 31,

| | 2013 | 2012 |
|---|-----------------------------------|------------|
| | (Unaudited) | |
| | (In thousands, except share data) | |
| Revenues | | |
| Premiums earned | | |
| Gross | \$ 264,342 | \$ 227,447 |
| Ceded | (93,754) | (34,632) |
| Net earned premiums | 170,588 | 192,815 |
| Net commissions and fees | 9,634 | 8,965 |
| Net investment income | 11,140 | 13,732 |
| Realized gains (losses): | | |
| Total other-than-temporary impairments on securities | - | - |
| Portion of loss recognized in other comprehensive income | - | - |
| Net other-than-temporary impairments on securities recognized in earnings | - | - |
| Net realized gains excluding other-than-temporary impairments on securities | 316 | 732 |
| Net realized gains | 316 | 732 |
| Total revenues | 191,678 | 216,244 |
| Expenses | | |
| Losses and loss adjustment expenses | 191,974 | 161,519 |
| Reinsurance recoveries | (70,158) | (28,772) |
| Net losses and loss adjustment expenses | 121,816 | 132,747 |
| Policy acquisition and other underwriting expenses | 50,605 | 63,113 |
| General, selling and administrative expenses | 6,023 | 6,339 |
| General corporate expenses | 1,516 | 1,373 |
| Amortization expense | 1,071 | 1,416 |
| Interest expense | 2,197 | 1,977 |
| Total expenses | 183,228 | 206,965 |
| Income before taxes and equity earnings | 8,450 | 9,279 |
| Federal and state income tax expense | 1,836 | 1,855 |
| Equity earnings of affiliates, net of tax | 438 | 688 |
| Equity earnings (losses) of unconsolidated subsidiaries, net of tax | 30 | (8) |
| Net income | \$ 7,082 | \$ 8,104 |
| Earnings Per Share | | |
| Basic | \$ 0.14 | \$ 0.16 |
| Diluted | \$ 0.14 | \$ 0.16 |
| Weighted average number of common shares | | |
| Basic | 49,823,882 | 50,915,145 |
| Diluted | 49,845,023 | 50,921,465 |

| | | |
|---------------------------------|---------|---------|
| Dividends paid per common share | \$ 0.02 | \$ 0.05 |
|---------------------------------|---------|---------|

The accompanying notes are an integral part of the Consolidated Financial Statements.

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MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Three Months Ended March 31,

| | 2013 | 2012 |
|--|----------------|---------|
| | (Unaudited) | |
| | (In thousands) | |
| Net income | \$7,082 | \$8,104 |
| Other comprehensive loss, net of tax: | | |
| Unrealized losses on securities | (2,782) | (417) |
| Unrealized gains in affiliates and unconsolidated subsidiaries | 12 | 149 |
| Increase on non-credit other-than-temporary impairments on securities | - | 258 |
| Net deferred derivative gains - hedging activity | 805 | 300 |
| Less reclassification adjustment for investment gains included in net income | (187) | (462) |
| Other comprehensive losses, net of tax | (2,152) | (172) |
| Comprehensive income | \$4,930 | \$7,932 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

Table of ContentsMEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED BALANCE SHEETS

| | March 31, 2013 (Unaudited) | December 31, 2012 |
|---|----------------------------------|----------------------|
| (In thousands, except share data) | | |
| ASSETS | | |
| Investments | | |
| Debt securities available for sale, at fair value (amortized cost of \$1,430,000 and \$1,211,794) | \$ 1,496,953 | \$ 1,286,807 |
| Equity securities available for sale, at fair value (cost of \$70,073 and \$20,389) | 75,690 | 22,661 |
| Cash and cash equivalents | 158,678 | 342,124 |
| Accrued investment income | 14,284 | 11,167 |
| Premiums and agent balances receivable, net | 214,146 | 208,743 |
| Reinsurance recoverable on: | | |
| Paid losses | 24,827 | 13,612 |
| Unpaid losses | 419,864 | 381,905 |
| Prepaid reinsurance premiums | 122,276 | 143,180 |
| Deferred policy acquisition costs | 51,967 | 45,417 |
| Deferred income taxes, net | 11,821 | 10,929 |
| Goodwill | 121,041 | 121,041 |
| Other intangible assets | 27,193 | 28,264 |
| Other assets | 118,965 | 97,424 |
| Total assets | \$ 2,857,705 | \$ 2,713,274 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities | | |
| Losses and loss adjustment expenses | \$ 1,487,905 | \$ 1,455,980 |
| Unearned premiums | 442,741 | 439,418 |
| Debt | 164,110 | 78,500 |
| Debentures | 80,930 | 80,930 |
| Accounts payable and accrued expenses | 27,543 | 29,190 |
| Funds held and reinsurance balances payable | 49,687 | 49,622 |
| Payable to insurance companies | 2,342 | 5,641 |
| Other liabilities | 36,984 | 15,714 |
| Total liabilities | 2,292,242 | 2,154,995 |
| Shareholders' Equity | | |
| Common stock, \$0.01 par value; authorized 75,000,000 shares; 49,887,200 and 49,776,011 shares issued and outstanding | 506 | 505 |
| Additional paid-in capital | 275,716 | 272,472 |
| Retained earnings | 243,435 | 237,351 |
| Note receivable from officer | (730) | (737) |
| Accumulated other comprehensive income | 46,536 | 48,688 |
| Total shareholders' equity | 565,463 | 558,279 |
| Total liabilities and shareholders' equity | \$ 2,857,705 | \$ 2,713,274 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

Table of ContentsMEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

| | Common Stock | Additional Paid- In Capital | Retained Earnings (Unaudited, In thousands) | Note Receivable from Officer | Accumulated Other Comprehensive Income | Total Shareholders' Equity |
|--|-----------------|-----------------------------------|---|---------------------------------------|---|----------------------------------|
| Balances December 31, 2012 | \$505 | \$ 272,472 | \$237,351 | \$ (737) | \$ 48,688 | \$ 558,279 |
| Net income | - | - | 7,082 | - | - | 7,082 |
| Dividends declared | - | - | (998) | - | - | (998) |
| Change in unrealized gain or loss on available for sale securities, net of tax | - | - | - | - | (3,157) | (3,157) |
| Change in valuation allowance on deferred tax assets | - | - | - | - | 188 | 188 |
| Net deferred derivative gain - hedging activity | - | - | - | - | 805 | 805 |
| Stock award | 1 | 107 | - | - | - | 108 |
| Long term incentive plan; stock award for 2012 and 2013 plan years | - | 114 | - | - | - | 114 |
| Change in investment of affiliates, net of tax | - | - | - | - | (9) | (9) |
| Change in investment of unconsolidated subsidiaries | - | - | - | - | 21 | 21 |
| Stock warrant issuance | - | 3,023 | - | - | - | 3,023 |
| Note receivable from officer | - | - | - | 7 | - | 7 |
| Balances March 31, 2013 | \$506 | \$ 275,716 | \$243,435 | \$ (730) | \$ 46,536 | \$ 565,463 |

The accompanying notes are an integral part of the Consolidated Financial Statements.

Table of ContentsMEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Three Months Ended March 31,

| | 2013 | 2012 |
|---|----------------|------------|
| | (Unaudited) | |
| | (In thousands) | |
| Cash Flows From Operating Activities | | |
| Net income | \$7,082 | \$8,104 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of other intangible assets | 1,071 | 1,416 |
| Amortization of deferred debenture issuance costs | 31 | 31 |
| Depreciation of furniture, equipment, and building | 1,189 | 1,400 |
| Net amortization of discount and premiums on bonds | 2,249 | 1,467 |
| Accretion of issued debt/original issue discount | 51 | - |
| Amortization of capitalized convertible note fees | 14 | - |
| Gain on sale of investments | (288) | (711) |
| Gain on sale of fixed assets | (22) | (21) |
| Long-term incentive plan expense | 114 | 53 |
| Stock award | 107 | 109 |
| Equity earnings of affiliates, net of taxes | (438) | (688) |
| Equity (earnings) losses of unconsolidated subsidiaries, net of tax | (30) | 8 |
| Deferred income tax expense (benefit) | 424 | (427) |
| Changes in operating assets and liabilities: | | |
| (Increase) decrease in: | | |
| Premiums and agent balances receivable | (5,403) | (15,445) |
| Reinsurance recoverable on paid and unpaid losses | (49,174) | (17,715) |
| Prepaid reinsurance premiums | 20,904 | (4,349) |
| Deferred policy acquisition costs | (6,550) | (5,236) |
| Other assets | (10,432) | (2,661) |
| Increase (decrease) in: | | |
| Losses and loss adjustment expenses | 31,925 | 40,234 |
| Unearned premiums | 3,323 | 30,508 |
| Payable to insurance companies | (3,299) | (907) |
| Funds held and reinsurance balances payable | 65 | 1,644 |
| Other liabilities | 9,707 | 1,437 |
| Total adjustments | (4,462) | 30,147 |
| Net cash provided by operating activities | 2,620 | 38,251 |
| Cash Flows From Investing Activities | | |
| Purchase of debt securities available for sale | (239,603) | (111,769) |
| Proceeds from sales and maturities of debt securities available for sale | 17,718 | 35,676 |
| Purchase of equity securities available for sale | (54,351) | - |
| Proceeds from sales of equity securities available for sale | 4,934 | 275 |
| Capital expenditures | (467) | (483) |
| Other investing activities | 90 | (2,608) |
| Net cash used in investing activities | (271,679) | (78,909) |
| Cash Flows From Financing Activities | | |
| Proceeds from line of credit | - | 5,000 |

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| | | |
|---|------------|-----------|
| Proceeds from FHLB advance | - | 20,000 |
| Payments on term loan | (1,500) | (3,688) |
| Proceeds from convertible senior notes | 96,423 | - |
| Payments for convertible senior notes hedge | (12,942) | - |
| Proceeds from issuance of warrants | 3,023 | - |
| Book overdrafts | 601 | (247) |
| Dividends paid on common stock (1) | - | - |
| Share repurchases | - | (5,002) |
| Other financing activities | 8 | 8 |
| Net cash provided by financing activities | 85,613 | 16,071 |
| Net decrease in cash and cash equivalents | (183,446) | (24,587) |
| Cash and cash equivalents, beginning of period | 342,124 | 101,757 |
| Cash and cash equivalents, end of period | \$158,678 | \$77,170 |
| Supplemental Disclosure of Cash Flow Information: | | |
| Interest paid | \$1,808 | \$1,831 |
| Net income taxes paid (2) | \$(3,067) | \$(421) |
| Supplemental Disclosure of Non-Cash Investing and Financing Activities: | | |
| Stock-based employee compensation | \$107 | \$109 |

(1)Dividends of \$998 and \$2,532 were paid on April 4, 2013 and April 5, 2012, respectively.

(2)Tax return refunds were received in first quarter of 2013 and 2012 for \$3,067 and \$475, respectively.

The accompanying notes are an integral part of the Consolidated Financial Statements.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – Summary of Significant Accounting Policies

Basis of Presentation and Management Representation

The consolidated financial statements include accounts, after elimination of intercompany accounts and transactions, of Meadowbrook Insurance Group, Inc. (the “Company” or “Meadowbrook”), its wholly owned subsidiary Star Insurance Company (“Star”), and Star’s wholly owned subsidiaries, Savers Property and Casualty Insurance Company (“Savers”), Williamsburg National Insurance Company (“Williamsburg”), and Ameritrust Insurance Corporation (“Ameritrust”). The consolidated financial statements also include Meadowbrook, Inc., Crest Financial Corporation, and their respective subsidiaries. In addition, the consolidated financial statements also include ProCentury Corporation (“ProCentury”) and its wholly owned subsidiaries. ProCentury’s wholly owned subsidiaries consist of Century Surety Company (“Century”) and its wholly owned subsidiary ProCentury Insurance Company (“PIC”). In addition, ProCentury Risk Partners Insurance Company, Ltd., is a wholly owned subsidiary of ProCentury. Star, Savers, Williamsburg, Ameritrust, Century, and PIC are collectively referred to as the Insurance Company Subsidiaries.

In the opinion of management, the consolidated financial statements reflect all normal recurring adjustments necessary to present a fair statement of the results for the interim period. Preparation of financial statements under generally accepted accounting principles (“GAAP”) requires management to make estimates. Actual results could differ from those estimates. The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results expected for the full year. In addition, certain amounts in the 2012 financial statements have been reclassified to conform to the 2013 presentation as a result of adopting the new Accumulated Other Comprehensive guidance noted below.

These financial statements and the notes thereto should be read in conjunction with the Company’s audited financial statements and accompanying notes included in its Annual Report on Form 10-K, as filed with the United States Securities and Exchange Commission, for the fiscal year ended December 31, 2012.

Revenue Recognition

Premiums written, which include direct, assumed and ceded amounts are recognized as earned on a pro rata basis over the life of the policy term. Unearned premiums represent the portion of premiums written that are applicable to the unexpired terms of policies in force. Provisions for unearned premiums on reinsurance assumed from others are made on the basis of ceding reports when received and actuarial estimates.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Assumed premium estimates include business where the company accepts a portion of the risk from a ceding carrier as well as the mandatory assumed pool business from the National Council on Compensation Insurance ("NCCI"), or residual market business. The majority of the assumed premium is from an established book of workers' compensation business produced by a ceding company in which the Company has an equity stake.

Fee income, which includes risk management consulting, loss control, and claims services, is recognized during the period the services are provided. Depending on the terms of the contract, claims processing fees are recognized as revenue over the estimated life of the claims, or the estimated life of the contract. For those contracts that provide services beyond the expiration or termination of the contract, fees are deferred in an amount equal to management's estimate of the Company's obligation to continue to provide services in the future.

Commission income, which includes reinsurance placement, is recorded on the later of the effective date or the billing date of the policies on which they were earned. Commission income is reported net of any sub-producer commission expense. Commission adjustments that occur subsequent to the issuance of the policy because of cancellation, typically are recognized when the policy is effectively cancelled. Profit sharing commissions from insurance companies are recognized when determinable, which is when such commissions are received.

Income Taxes

As of March 31, 2013 and December 31, 2012, the Company did not have any unrecognized tax benefits. As of March 31, 2013 and December 31, 2012, the Company had no accrued interest or penalties related to uncertain tax positions.

Recent Accounting Pronouncements

Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive

In February 2013, the FASB issued guidance to improve the reporting of reclassifications out of accumulated other comprehensive income. The guidance requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under GAAP to be reclassified in its entirety to net income. For other amounts that are not required under GAAP to be reclassified in their entirety to net income in the same reporting period, an entity is required to cross-reference other disclosures required under GAAP that provide additional detail about those amounts. The guidance is to be applied prospectively for reporting periods beginning after December 15, 2012. The Company adopted this new guidance on January 1, 2013 and included the required disclosures in note 10 ~ Accumulated Other Comprehensive Income.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 2 – Investments

The cost or amortized cost, gross unrealized gains, losses, non-credit other-than-temporary impairments (“OTTI”) and estimated fair value of investments in securities classified as available for sale at March 31, 2013 and December 31, 2012 were as follows (in thousands):

| | Cost or Amortized Cost | Gains | March 31, 2013 Gross Unrealized Losses | Non-Credit OTTI | Estimated Fair Value |
|---|------------------------------|-----------|--|--------------------|-------------------------|
| Debt Securities: | | | | | |
| U.S. Government and agencies | \$ 25,213 | \$ 859 | \$ (28) | \$ - | \$ 26,044 |
| Obligations of states and political subs | 686,729 | 40,264 | (3,537) | - | 723,456 |
| Corporate securities | 528,670 | 24,628 | (1,577) | - | 551,721 |
| Redeemable preferred stocks | 1,461 | 422 | - | - | 1,883 |
| Residential mortgage-backed securities | 141,574 | 3,888 | (480) | - | 144,982 |
| Commercial mortgage-backed securities | 35,675 | 1,593 | (122) | - | 37,146 |
| Other asset-backed securities | 10,678 | 1,048 | (5) | - | 11,721 |
| Total debt securities available for sale | 1,430,000 | 72,702 | (5,749) | - | 1,496,953 |
| Equity Securities: | | | | | |
| Perpetual preferred stock | 6,422 | 1,666 | - | - | 8,088 |
| Common stock | 63,651 | 4,376 | (425) | - | 67,602 |
| Total equity securities available for sale | 70,073 | 6,042 | (425) | - | 75,690 |
| Total securities available for sale | \$ 1,500,073 | \$ 78,744 | \$ (6,174) | \$ - | \$ 1,572,643 |

| | Cost or Amortized Cost | Gains | December 31, 2012 Gross Unrealized Losses | Non-Credit OTTI | Estimated Fair Value |
|--|------------------------------|--------|---|--------------------|-------------------------|
| Debt Securities: | | | | | |
| U.S. Government and agencies | \$26,788 | \$918 | \$ (22) | \$ - | \$27,684 |
| Obligations of states and political subs | 587,276 | 43,124 | (1,427) | - | 628,973 |
| Corporate securities | 482,290 | 25,569 | (858) | - | 507,001 |
| Redeemable preferred stocks | 1,743 | 436 | - | - | 2,179 |
| Residential mortgage-backed securities | 73,530 | 4,393 | (41) | - | 77,882 |
| Commercial mortgage-backed securities | 33,732 | 1,800 | - | - | 35,532 |
| Other asset-backed securities | 6,435 | 1,125 | (4) | - | 7,556 |
| Total debt securities available for sale | 1,211,794 | 77,365 | (2,352) | - | 1,286,807 |

Equity Securities:

| | | | | | |
|--|-------------|----------|------------|-----|-------------|
| Perpetual preferred stock | 6,930 | 1,578 | - | - | 8,508 |
| Common stock | 13,459 | 901 | (207) | - | 14,153 |
| Total equity securities available for sale | 20,389 | 2,479 | (207) | - | 22,661 |
| Total securities available for sale | \$1,232,183 | \$79,844 | \$(2,559) | \$- | \$1,309,468 |

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Gross unrealized gains, losses, and non-credit OTTI on available for sale securities as of March 31, 2013 and December 31, 2012 were as follows (in thousands):

| | March 31, 2013 | December 31, 2012 |
|---|-------------------|----------------------|
| Unrealized gains | \$ 78,744 | \$ 79,844 |
| Unrealized losses | (6,174) | (2,559) |
| Non-credit OTTI | - | - |
| Net unrealized gains | 72,570 | 77,285 |
| Deferred federal income tax expense | (25,399) | (26,957) |
| Net unrealized gains on investments, net of deferred federal income taxes | \$ 47,171 | \$ 50,328 |

Net realized gains (losses including OTTI) on securities, for the three months ended March 31, 2013 and 2012 were as follows (in thousands):

| | For the Three Months Ended March 31, | |
|--|---|--------|
| | 2013 | 2012 |
| Realized gains (losses): | | |
| Debt securities: | | |
| Gross realized gains | \$ 30 | \$ 666 |
| Gross realized losses | (9) | (12) |
| Total debt securities | 21 | 654 |
| Equity Securities: | | |
| Gross realized gains | 275 | 57 |
| Gross realized losses | (8) | - |
| Total equity securities | 267 | 57 |
| Net realized gains (losses) | \$ 288 | \$ 711 |
| OTTI included in realized losses on securities above | \$ - | \$ - |

Proceeds from the sales of debt and equity securities available for sale were \$6.5 million and \$10.8 million for the three months ended March 31, 2013 and 2012, respectively.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

At March 31, 2013, the amortized cost and estimated fair value of available for sale debt securities by contractual maturity are shown below. Expected maturities may differ from contractual maturities, because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

| | Available for Sale | |
|---|--------------------|-------------------------|
| | Amortized Cost | Estimated Fair Value |
| Due in one year or less | \$ 46,685 | \$ 47,239 |
| Due after one year through five years | 365,358 | 383,453 |
| Due after five years through ten years | 600,492 | 639,123 |
| Due after ten years | 229,538 | 233,289 |
| Mortgage-backed securities, collateralized obligations and asset-backed securities | 187,927 | 193,849 |
| | \$ 1,430,000 | \$ 1,496,953 |

Net investment income for the three months ended March 31, 2013 and 2012 was as follows (in thousands):

| | For the Three Months Ended March 31, | |
|------------------------------------|---|-----------|
| | 2013 | 2012 |
| Net Investment Income Earned From: | | |
| Debt securities | \$ 10,688 | \$ 13,293 |
| Equity securities | 620 | 505 |
| Cash and cash equivalents | 194 | 275 |
| Total gross investment income | 11,502 | 14,073 |
| Less investment expenses | 362 | 341 |
| Net investment income | \$ 11,140 | \$ 13,732 |

Other-Than-Temporary Impairments of Securities and Unrealized Losses on Investments

Available for sale securities are reviewed for declines in fair value, excluding other-than-temporary declines. For a debt security, if the Company intends to sell a security and it is more likely than not that the Company will be required to sell a debt security before recovery of its amortized cost basis and the fair value of the debt security is below amortized cost, the Company concludes that an OTTI has occurred and the amortized cost is written down to current fair value, with a corresponding charge to realized loss in the Consolidated Statements of Income. If the Company does not intend to sell a debt security and it is not more likely than not that the Company will be required to sell a debt security before recovery of its amortized cost basis, but the present value of the cash flows expected to be collected is less than the amortized cost of the debt security (referred to as the credit loss), the Company concludes that an OTTI has occurred. In this instance, accounting guidance requires the bifurcation of the total OTTI into the amount related to the credit loss, which is recognized in earnings, and the non-credit OTTI, which is recorded in Other Comprehensive Income as an unrealized non-credit OTTI in the Consolidated Statements of Comprehensive Income.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

When assessing the Company's intent to sell a debt security, if it is more likely than not that the Company will be required to sell a debt security before recovery of its cost basis, facts and circumstances such as, but not limited to, decisions to reposition the security portfolio, sales of securities to meet cash flow needs and sales of securities to capitalize on favorable pricing, are evaluated. In order to determine the amount of the credit loss for a debt security, the Company calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows expected to be recovered. The discount rate is the effective interest rate implicit in the underlying debt security upon issuance. The effective interest rate is the original yield or the coupon if the debt security was previously impaired. If an OTTI exists and there is not sufficient cash flows or other information to determine a recovery value of the security, the Company concludes the entire OTTI is credit-related and the amortized cost for the security is written down to current fair value with a corresponding charge to realized loss in the Consolidated Statements of Income.

To determine the recovery period of a debt security, the Company considers the facts and circumstances surrounding the underlying issuer including, but not limited to, the following:

- Historical and implied volatility of the security;
- Length of time and extent to which the fair value has been less than amortized cost;
- Conditions specifically related to the security such as default rates, loss severities, loan to value ratios, current levels of subordination, third party guarantees, and vintage;
 - Specific conditions in an industry or geographic area;
 - Any changes to the rating of the security by a rating agency;
 - Failure, if any, of the issuer of the security to make scheduled payments; and/or
 - Recoveries or additional declines in fair value subsequent to the balance sheet date.

In periods subsequent to the recognition of an OTTI, the security is accounted for as if it had been purchased on the measurement date of the OTTI. Therefore, for a fixed maturity security, the discount or reduced premium is reflected in net investment income over the contractual term of the investment in a manner that produces a constant effective yield.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

For an equity security, if the Company does not have the ability and intent to hold the security for a sufficient period of time to allow for a recovery of the cost of the security in value, the Company concludes that an OTTI has occurred, and the cost of the equity security is written down to the current fair value, with a corresponding charge to realized loss within the Consolidated Statements of Income. When assessing the Company's ability and intent to hold the equity security to recovery of the cost of the security, the Company considers, among other things, the severity and duration of the decline in fair value of the equity security, as well as the cause of decline, a fundamental analysis of the liquidity, business prospects and overall financial condition of the issuer.

The Company reviewed its investment portfolio in relation to its OTTI policy and determined that the Company did not record a credit related OTTI loss or recognize a non-credit related OTTI loss in other comprehensive income for the three months ended March 31, 2013 and 2012.

The fair value and amount of unrealized losses segregated by the time period the investment has been in an unrealized loss position were as follows (in thousands):

| | | March 31, 2013 | | | | | | | | |
|--|------------------|--|--------------------------------------|------------------|--|--------------------------------------|------------------|--|--------------------------------------|--|
| | | Less than 12 months | | | Greater than 12 months | | | Total | | |
| | Number of Issues | Fair Value of Investments with Unrealized Losses | Gross Unrealized and Non-Credit OTTI | Number of Issues | Fair Value of Investments with Unrealized Losses | Gross Unrealized and Non-Credit OTTI | Number of Issues | Fair Value of Investments with Unrealized Losses | Gross Unrealized and Non-Credit OTTI | |
| Debt Securities: | | | | | | | | | | |
| U.S. Government and agencies | 3 | \$ 3,494 | \$ (28) | - | \$ - | \$ - | 3 | \$ 3,494 | \$ (28) | |
| Obligations of states and political subs | 56 | 195,938 | (3,537) | - | - | - | 56 | 195,938 | (3,537) | |
| Corporate securities | 58 | 136,362 | (1,577) | - | - | - | 58 | 136,362 | (1,577) | |
| Redeemable preferred stocks | - | - | - | - | - | - | - | - | - | |
| Residential mortgage-backed securities | 5 | 33,379 | (479) | 1 | 24 | (1) | 6 | 33,403 | (480) | |
| Commercial mortgage-backed securities | 3 | 8,045 | (122) | - | - | - | 3 | 8,045 | (122) | |
| Other asset-backed securities | 3 | 5,197 | (4) | 1 | 11 | (1) | 4 | 5,208 | (5) | |
| Total debt securities | 128 | 382,415 | (5,747) | 2 | 35 | (2) | 130 | 382,450 | (5,749) | |
| Equity Securities: | | | | | | | | | | |
| Perpetual preferred stock | - | - | - | - | - | - | - | - | - | |
| Common stock | 6 | 4,204 | (173) | 2 | 4,557 | (252) | 8 | 8,761 | (425) | |

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| | | | | | | | |
|--------------|---|-------|--------|---|-------|--------|---------|
| Total equity | | | | | | | |
| securities | 6 | 4,204 | (173) | 2 | 4,557 | (252) | 8 8,761 |