

Hilltop Holdings Inc.
Form 10-Q
May 04, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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, 2012

OR

- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 1-31987

Hilltop Holdings Inc.

(Exact name of registrant as specified in its charter)

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MARYLAND
(State or other jurisdiction of incorporation or
organization)

84-1477939
(I.R.S. Employer Identification No.)

200 Crescent Court, Suite 1330
Dallas, Texas
(Address of principal executive offices)

75201
(Zip Code)

(214) 855-2177

(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 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 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Non-accelerated filer
(Do not check if a smaller reporting company)

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 number of shares of the Registrant's common stock outstanding at May 4, 2012 was 56,362,273.

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Table of Contents**HILLTOP HOLDINGS INC.****CONSOLIDATED BALANCE SHEETS****AS OF MARCH 31, 2012 AND DECEMBER 31, 2011****(in thousands, except share and per share data)****(unaudited)**

	March 31, 2012	December 31, 2011
Assets		
Investments:		
Fixed maturities		
Available for sale securities, at fair value (amortized cost of \$133,122 and \$135,166, respectively)	\$ 142,850	\$ 144,801
Equity securities		
Available for sale securities, at fair value (cost of \$18,969 and \$16,813, respectively)	20,111	19,022
Other investments		
Notes receivable, at fair value (amortized cost of \$39,082 and \$38,641, respectively)	41,026	38,588
Warrants, at fair value (cost of \$12,068 and \$12,068, respectively)	15,534	21,789
Total investments	219,521	224,200
Cash and cash equivalents	579,639	578,520
Accrued interest and dividends	1,430	1,576
Premiums receivable	25,197	24,390
Deferred acquisition costs	19,395	19,182
Reinsurance recoverable, net of uncollectible amounts	25,932	25,861
Prepaid reinsurance premiums	4,783	5,056
Income taxes receivable	48	77
Deferred income taxes	10,011	8,354
Goodwill	23,988	23,988
Intangible assets, definite life	5,765	6,074
Intangible assets, indefinite life	3,000	3,000
Property and equipment, net	2,139	2,128
Loan origination costs, net	2,426	2,471
Other assets	1,036	548
Total assets	\$ 924,310	\$ 925,425
Liabilities and Stockholders Equity		
Liabilities:		
Reserve for losses and loss adjustment expenses	\$ 47,861	\$ 44,835
Unearned premiums	82,796	80,661
Reinsurance payable	2,830	2,845
Accounts payable and accrued expenses	4,368	8,121
Notes payable	131,450	131,450
Other liabilities	3,708	2,130
Total liabilities	273,013	270,042
Stockholders Equity:		
Common stock, \$0.01 par value, 100,000,000 shares authorized, 56,360,846 and 56,500,828 shares issued and outstanding at March 31, 2012 and December 31, 2011, respectively	564	565

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Additional paid-in capital	917,165	918,192
Accumulated other comprehensive income	10,582	13,983
Accumulated deficit	(277,014)	(277,357)
Total stockholders' equity	651,297	655,383
Total liabilities and stockholders' equity	\$ 924,310	\$ 925,425

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2011

(in thousands, except per share data)

(unaudited)

	Three Months Ended March 31,	
	2012	2011
Revenue:		
Net premiums earned	\$ 35,155	\$ 30,932
Net investment income	3,259	2,081
Other income	1,711	1,625
Net realized gains on investments		
Other realized investment gains, net	21	19
Total realized investment gains, net	21	19
Total revenue	40,146	34,657
Expenses:		
Loss and loss adjustment expenses	22,542	16,004
Policy acquisition and other underwriting expenses	12,915	11,985
General and administrative expenses	1,644	1,873
Depreciation and amortization	360	432
Interest expense	2,139	2,176
Total expenses	39,600	32,470
Income before income tax expense	546	2,187
Income tax expense	(203)	(777)
Net income attributable to common stockholders	\$ 343	\$ 1,410
Income per share attributable to common stockholders		
Basic income per share	\$ 0.01	\$ 0.02
Diluted income per share	\$ 0.01	\$ 0.02
Weighted average share information		
Basic shares outstanding	56,499	56,496
Diluted shares outstanding	56,555	56,496
Other comprehensive loss:		
Unrealized losses on available-for-sale securities	(5,232)	(631)
Income tax benefit	1,831	221
Other comprehensive loss, net of tax	(3,401)	(410)
Comprehensive (loss) income attributable to common stockholders	\$ (3,058)	\$ 1,000

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2012

(in thousands)

(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders Equity
Balance, December 31, 2011	56,501	\$ 565	\$ 918,192	\$ 13,983	\$ (277,357)	\$ 655,383
Net income					343	343
Other comprehensive loss, net of tax benefit of \$1,831				(3,401)		(3,401)
Common stock issued to board members	1		12			12
Repurchase of common stock	(141)	(1)	(1,161)			(1,162)
Stock compensation expense			122			122
Balance, March 31, 2012	56,361	\$ 564	\$ 917,165	\$ 10,582	\$ (277,014)	\$ 651,297

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2012 AND 2011

(in thousands)

(unaudited)

	For the Three Months Ended March 31,	
	2012	2011
Cash flow from operating activities:		
Net income	\$ 343	\$ 1,410
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	360	432
Deferred income taxes	174	837
Increase in unearned premiums	2,135	2,565
Increase in deferred acquisition costs	(213)	(703)
Realized gains on investments	(21)	(19)
Amortization of loan origination costs	45	49
Stock grant compensation expense	134	17
Decrease in payable to related party		(263)
Increase in income taxes payable	29	81
Changes in operating assets and liabilities	(432)	(689)
Net cash provided by operating activities	\$ 2,554	\$ 3,717
Cash flow from investing activities:		
Purchases of fixed assets	(62)	(186)
Purchases of available-for-sale securities	(2,556)	(1,072)
Proceeds from sales of available-for-sale securities	995	1,515
Proceeds from maturities of available-for-sale securities	1,350	3,303
Net cash (used in) provided by investing activities	\$ (273)	\$ 3,560
Cash flow from financing activities:		
Repurchase of common stock	(1,162)	
Net cash used in financing activities	\$ (1,162)	\$
Net increase in cash and cash equivalents	1,119	7,277
Cash and cash equivalents, beginning of period	578,520	649,439
Cash and cash equivalents, end of period	\$ 579,639	\$ 656,716

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2012

(unaudited)

1. Business, Basis of Presentation and Summary of Significant Accounting Policies

Business

Hilltop Holdings Inc. is a holding company that is endeavoring to make opportunistic acquisitions or effect a business combination. In connection with that strategy, we are identifying and evaluating potential targets on an ongoing basis. We also conduct operations in the property and casualty insurance industry through our insurance subsidiaries, National Lloyds Insurance Company, or NLIC, and American Summit Insurance Company, or ASIC. National Lloyds Insurance Company commenced business in 1949 and currently operates in 14 states, with its largest market being the State of Texas. American Summit Insurance Company was formed in 1955 and currently operates in 11 states, with its largest market being the State of Arizona. Both of these insurance companies carry a financial strength rating of A (Excellent) by A.M. Best, which was confirmed on March 30, 2012, and are regulated by the Texas Department of Insurance. Our products include fire and homeowners insurance to low value dwellings and manufactured homes primarily in Texas and other areas of the south, southeastern and southwestern United States.

Our common stock is listed on the New York Stock Exchange under the symbol HTH . We have no public trading history prior to February 12, 2004.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States of America (GAAP), and in conformity with the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP, however, have been condensed or omitted pursuant to Article 10 of Regulation S-X. The consolidated financial statements include the accounts of all wholly-owned subsidiaries of the Company. All significant intercompany accounts and transactions have been eliminated in the consolidated financial statements.

In the opinion of management, these financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments necessary for the fair statement of the Company s financial position, results of operations and cash flows. These adjustments were of a normal, recurring nature. The results of operations for the interim period ended March 31, 2012 may not be indicative of the results that may be expected for the year ended December 31, 2012. These financial statements should be read in conjunction with the

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financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011.

We are required by GAAP to make estimates and assumptions that affect our reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our financial statements and our reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. These estimates and assumptions are particularly important in determining revenue recognition, reserves for losses and loss adjustment expenses, deferred policy acquisition costs, reinsurance receivables and potential impairment of assets.

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HILLTOP HOLDINGS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2012

(unaudited)

Summary of Significant Accounting Policies

Recently Adopted Accounting Pronouncements

In October 2010, the FASB issued ASU-2010-26 to address the diversity in practice for the accounting for costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost must be directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. If application of this guidance would result in the capitalization of acquisition costs that had not previously been capitalized by a reporting entity, the entity may elect not to capitalize those costs. The updated guidance is effective for periods beginning after December 15, 2011. The Company adopted this guidance prospectively in the quarter ended March 31, 2012, and it had no material impact on the Company's financial statements.

In May 2011, the FASB issued ASU-2011-04 to clarify ASC 820 and in some instances changed particular principles or requirements for measuring fair value or disclosing information about fair value measurements. The amendments in this update result in common fair value measurement and disclosure requirements in U.S. GAAP and International Financial Reporting Standards (IFRS). This updated guidance is effective for periods beginning after December 15, 2011. The adoption of this guidance in the quarter ended March 31, 2012 did not have a material impact on the Company's financial statements.

In June 2011, the FASB issued ASU-2011-05, which eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. The new standard allows companies to report net income and other comprehensive income in a single, continuous statement, or in two separate, but consecutive statements. The statement(s) would need to be presented with equal prominence as the other primary financial statements. This updated guidance is effective for periods beginning after December 15, 2011. The adoption of this guidance in the quarter ended March 31, 2012 changed our current presentation of other comprehensive income; however, it did not have a material impact on the Company's financial statements.

In December 2011, the FASB issued ASU-2011-12, which amended ASU-2011-05 and defers guidance related to the presentation of reclassification adjustments out of accumulated other comprehensive income. All other requirements presented in ASU-2011-05 are not affected by this Update. This updated guidance is effective for periods beginning after December 15, 2011. The adoption of this guidance in the quarter ended March 31, 2012 changed our current presentation of other comprehensive income; however, it did not have a material impact on the Company's financial statements.

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The amortized cost (original cost for equity securities), gross unrealized gains and losses, and fair value of available-for-sale and other investments by major security type and class of security at March 31, 2012 and December 31, 2011 were as follows (in thousands).

	March 31, 2012			
	Cost/Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	\$ 27,743	\$ 1,301	\$ (2)	\$ 29,042
Residential mortgage-backed securities	11,112	883		11,995
Commercial mortgage-backed securities	2,174	68		2,242
Corporate debt securities	92,093	7,524	(46)	99,571
	133,122	9,776	(48)	142,850
Equity securities	18,969	1,146	(4)	20,111
	152,091	10,922	(52)	162,961
Other investments:				
Note receivable	39,082	1,944		41,026
Warrants	12,068	3,466		15,534
	\$ 203,241	\$ 16,332	\$ (52)	\$ 219,521

	December 31, 2011			
	Cost/Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	\$ 27,729	\$ 1,439	\$ (3)	\$ 29,165
Residential mortgage-backed securities	11,708	944		12,652
Commercial mortgage-backed securities	2,277	36	(10)	2,303
Corporate debt securities	93,452	7,406	(177)	100,681
	135,166	9,825	(190)	144,801
Equity securities	16,813	2,462	(253)	19,022

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	151,979	12,287	(443)	163,823
Other investments:				
Note receivable	38,641		(53)	38,588
Warrants	12,068	9,721		21,789
	\$ 202,688	\$ 22,008	\$ (496)	\$ 224,200

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The following tables summarize the length of time securities with unrealized losses at March 31, 2012 and December 31, 2011 have been in an unrealized loss position (in thousands).

	Less than 12 Months		March 31, 2012 12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Available-for-sale securities:						
Fixed maturities:						
Government securities	\$ 723	\$ (2)	\$	\$	\$ 723	\$ (2)
Corporate debt securities	2,683	(46)			2,683	(46)
	3,406	(48)			3,406	(48)
Equity securities			95	(4)	95	(4)
	\$ 3,406	\$ (48)	\$ 95	\$ (4)	\$ 3,501	\$ (52)

	Less than 12 Months		December 31, 2011 12 Months or More		Total	
	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses
Available-for-sale securities:						
Fixed maturities:						
Government securities	\$ 1,695	\$ (3)	\$	\$	\$ 1,695	\$ (3)
Commercial mortgage-backed securities	487	(10)			487	(10)
Corporate debt securities	5,254	(177)			5,254	(177)
	7,436	(190)			7,436	(190)
Equity securities	8,476	(253)			8,476	(253)
	\$ 15,912	\$ (443)	\$	\$	\$ 15,912	\$ (443)
Other investments						
Note receivable	38,588	(53)			38,588	(53)
	\$ 54,500	\$ (496)	\$	\$	\$ 54,500	\$ (496)

For the quarter ended March 31, 2012, the Company did not record any other-than-temporary impairments. While all of the investments are monitored for potential other-than-temporary impairment, our analysis and experience indicate that these investments generally do not present a

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greater risk of other-than-temporary impairment, as fair value should recover over time. Factors considered in our analysis include the reasons for the unrealized loss position, the severity and duration of the unrealized loss position, credit worthiness, and forecasted performance of the investee. While some of the securities held in the investment portfolio have decreased in value since the date of acquisition, the severity of loss and the duration of the loss position are not believed to be significant enough to warrant other-than-temporary impairment of the securities. The Company does not intend, nor is it likely that the Company will be required to sell these securities before the recovery of the cost basis; and, therefore, we do not believe any other-than-temporary impairments exist as of March 31, 2012.

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HILLTOP HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2012
(unaudited)

Gross realized investment gains and losses for the three months ended March 31, 2012 and 2011 are summarized as follows (in thousands).

	Three Months Ended March 31,					
	Gross Gains	2012 Gross Losses	Total	Gross Gains	2011 Gross Losses	Total
Fixed maturities	\$ 21	\$	\$ 21	\$ 20	\$ (1)	\$ 19
	\$ 21	\$	\$ 21	\$ 20	\$ (1)	\$ 19

Sales of available-for-sale investment securities resulted in the following during the three months ended March 31, 2012 and 2011 (in thousands).

	Three Months Ended March 31,	
	2012	2011
Proceeds	\$ 995	\$ 1,515
Gross gains	\$ 21	\$ 20
Gross losses	\$	\$ (1)

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Expected maturities may differ from contractual maturities because certain borrowers may have the right to call or prepay obligations with or without penalties. The schedule of fixed maturities of available-for-sale securities and other investments at March 31, 2012 and December 31, 2011, by contractual maturity are as follows (in thousands).

	March 31, 2012	
	Amortized Cost	Fair Value
Available-for-sale fixed maturities:		
Due within one year	\$ 19,065	\$ 19,555
Due after one year through five years	62,583	66,120
Due six years through ten years	37,275	41,993
Due after ten years	914	945
Mortgage-backed securities	13,285	14,237
	\$ 133,122	\$ 142,850
Other investments:		
Due after one year through five years	\$ 51,150	\$ 56,560
	\$ 51,150	\$ 56,560

	December 31, 2011	
	Amortized Cost	Fair Value
Available-for-sale fixed maturities:		
Due within one year	\$ 12,608	\$ 12,942
Due after one year through five years	69,594	73,300
Due six years through ten years	38,065	42,766
Due after ten years	914	838
Mortgage-backed securities	13,985	14,955
	\$ 135,166	\$ 144,801
Other investments:		
Due after one year through five years	\$ 50,709	\$ 60,377
	\$ 50,709	\$ 60,377

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HILLTOP HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2012
(unaudited)

Net investment income for the three months ended March 31, 2012 and 2011 is as follows (in thousands).

	Three Months Ended March 31,				Change
	2012	2011			
Cash equivalents	\$ 183	\$ 617	\$	(434)	
Fixed maturities	1,981	1,436		545	
Equity securities	191	163		28	
Other investments	1,000			1,000	
	3,355	2,216		1,139	
Investment expense	(96)	(135)		39	
Net investment income	\$ 3,259	\$ 2,081	\$	1,178	

At March 31, 2012, the Company had on deposit in custody for various State Insurance Departments investments with carrying values totaling \$9.4 million.

3. Fair Value Measurements

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in ASC 820, *Fair Value Measurements and Disclosures*. The framework is based on the inputs used in valuation and gives the highest priority to quoted prices in active markets. It also requires that observable inputs be used in the valuations, when available. The disclosure of fair value estimates is based on whether the significant inputs into the valuation are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

- Level 1 - Unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access.
- Level 2 - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; or valuations based on models where the significant inputs are observable (e.g., interest rates, yield curves, prepayment speeds,

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default rates, loss severities, etc.) or can be corroborated by observable market data. Based on management's understanding of the methodologies used by our pricing service, all applicable investments have been valued in accordance with GAAP valuation principles.

- Level 3 - Valuations based on models where significant inputs are not observable. The unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use.

If the markets were to worsen, there can be no assurance that we will not experience losses on our investments and reductions to earnings.

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HILLTOP HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2012
(unaudited)

The following tables present the hierarchy used by the Company by asset and liability type to determine their fair value at March 31, 2012 and December 31, 2011 (in thousands).

		As of March 31, 2012		
	Total	Level 1	Level 2	Level 3
Financial assets:				