

HALLMARK FINANCIAL SERVICES INC  
Form 10-Q  
August 07, 2017

**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 June 30, 2017

Commission file number 001-11252

**Hallmark Financial Services, Inc.**

(Exact name of registrant as specified in its charter)

Nevada 87-0447375  
(State or other jurisdiction of (I.R.S. Employer  
Incorporation or organization) Identification No.)

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777 Main Street, Suite 1000, Fort Worth, Texas 76102  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (817) 348-1600

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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 15(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, par value \$.18 per share –18,176,579 shares outstanding as of August 7, 2017.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

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**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Balance Sheets**

(\$ in thousands, except par value)

	June 30, 2017 (unaudited)	December 31, 2016
<b>ASSETS</b>		
Investments:		
Debt securities, available-for-sale, at fair value (cost: \$605,986 in 2017 and \$597,784 in 2016)	\$ 608,074	\$ 597,457
Equity securities, available-for-sale, at fair value (cost: \$33,220 in 2017 and \$31,449 in 2016)	56,477	51,711
Other investments (cost, \$3,763 in 2017 and 2016)	4,448	4,951
Total investments	668,999	654,119
Cash and cash equivalents	77,448	79,632
Restricted cash	3,458	7,327
Ceded unearned premiums	92,638	81,482
Premiums receivable	107,806	89,715
Accounts receivable	1,756	2,269
Receivable for securities	1,620	3,047
Reinsurance recoverable	164,434	147,821
Deferred policy acquisition costs	19,335	19,193
Goodwill	44,695	44,695
Intangible assets, net	11,257	12,491
Deferred federal income taxes, net	1,621	1,365
Federal income tax recoverable	1,797	3,951
Prepaid expenses	2,256	1,552
Other assets	13,720	13,801
Total assets	\$ 1,212,840	\$ 1,162,460
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Revolving credit facility payable	\$ 30,000	\$ 30,000
Subordinated debt securities (less unamortized debt issuance cost of \$975 in 2017 and \$1,001 in 2016)	55,727	55,701
Reserves for unpaid losses and loss adjustment expenses	505,358	481,567
Unearned premiums	261,893	241,254
Reinsurance balances payable	54,178	46,488
Pension liability	2,100	2,203
Payable for securities	13,257	14,215
Accounts payable and other accrued expenses	24,627	25,296
Total liabilities	\$ 947,140	\$ 896,724

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Commitments and Contingencies (Note 16)

Stockholders' equity:

Common stock, \$.18 par value, authorized 33,333,333; issued 20,872,831 shares in 2017 and 2016	3,757	3,757
Additional paid-in capital	123,110	123,166
Retained earnings	148,663	148,027
Accumulated other comprehensive income	13,933	10,371
Treasury stock (2,637,434 shares in 2017 and 2,260,849 in 2016), at cost	(23,763 )	(19,585 )
Total stockholders' equity	\$ 265,700	\$ 265,736
Total liabilities and stockholders' equity	\$ 1,212,840	\$ 1,162,460

The accompanying notes are an integral part of the consolidated financial statements

**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Operations**

(Unaudited)

(\$ in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Gross premiums written	\$ 162,056	\$ 144,037	\$ 297,168	\$ 272,484
Ceded premiums written	(61,162 )	(48,794 )	(107,755 )	(89,615 )
Net premiums written	100,894	95,243	189,413	182,869
Change in unearned premiums	(10,187 )	(7,545 )	(9,483 )	(10,844 )
Net premiums earned	90,707	87,698	179,930	172,025
Investment income, net of expenses	4,587	3,994	9,066	7,873
Net realized losses	(3,479 )	(2,177 )	(1,419 )	(2,404 )
Finance charges	936	1,348	1,989	2,789
Commission and fees	653	155	725	732
Other income	71	34	132	65
Total revenues	93,475	91,052	190,423	181,080
Losses and loss adjustment expenses	70,704	58,502	132,546	113,897
Other operating expenses	25,879	29,323	53,374	56,219
Interest expense	1,193	1,123	2,349	2,254
Amortization of intangible assets	617	617	1,234	1,234
Total expenses	98,393	89,565	189,503	173,604
(Loss) income before tax	(4,918 )	1,487	920	7,476
Income tax (benefit) expense	(1,568 )	421	284	2,336
Net (loss) income	(3,350 )	1,066	636	5,140
Net (loss) income per share:				
Basic	\$ (0.18 )	\$ 0.06	\$ 0.03	\$ 0.27
Diluted	\$ (0.18 )	\$ 0.06	\$ 0.03	\$ 0.27

The accompanying notes are an integral part of the consolidated financial statements

**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income**

(Unaudited)

(\$ in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net (loss) income	\$ (3,350 )	\$ 1,066	\$ 636	\$ 5,140
Other comprehensive income:				
Change in net actuarial gain	35	29	70	57
Tax effect on change in net actuarial gain	(12 )	(10 )	(24 )	(20 )
Unrealized holding gains arising during the period	2,654	4,358	7,900	5,729
Tax effect on unrealized holding gains arising during the period	(929 )	(1,525 )	(2,765 )	(2,005 )
Reclassification adjustment for losses (gains) included in net income	10	(410 )	(2,491 )	(484 )
Tax effect on reclassification adjustment for losses (gains) included in net income	(3 )	143	872	169
Other comprehensive income, net of tax	1,755	2,585	3,562	3,446
Comprehensive (loss) income	\$ (1,595 )	\$ 3,651	\$ 4,198	\$ 8,586

The accompanying notes are an integral part of the consolidated financial statements

**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Stockholders' Equity**

(Unaudited)

(\$ in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
<b>Common Stock</b>				
Balance, beginning of period	\$3,757	\$3,757	\$3,757	\$3,757
Balance, end of period	3,757	3,757	3,757	3,757
<b>Additional Paid-In Capital</b>				
Balance, beginning of period	123,183	123,619	123,166	123,480
Equity based compensation	19	89	46	228
Shares issued under employee benefit plans	(92 )	(58 )	(102 )	(58 )
Balance, end of period	123,110	123,650	123,110	123,650
<b>Retained Earnings</b>				
Balance, beginning of period	152,013	145,575	148,027	141,501
Net (loss) income	(3,350 )	1,066	636	5,140
Balance, end of period	148,663	146,641	148,663	146,641
<b>Accumulated Other Comprehensive Income</b>				
Balance, beginning of period	12,178	8,279	10,371	7,418
Additional minimum pension liability, net of tax	23	19	46	37
Unrealized holding gains arising during period, net of tax	1,725	2,833	5,135	3,724
Reclassification adjustment for losses (gains) included in net income, net of tax	7	(267 )	(1,619 )	(315 )
Balance, end of period	13,933	10,864	13,933	10,864
<b>Treasury Stock</b>				
Balance, beginning of period	(20,105 )	(15,423 )	(19,585 )	(14,130 )
Acquisition of treasury stock	(3,862 )	(3,452 )	(4,425 )	(4,745 )
Shares issued under employee benefit plans	204	58	247	58
Balance, end of period	(23,763 )	(18,817 )	(23,763 )	(18,817 )
<b>Total Stockholders' Equity</b>	<b>\$265,700</b>	<b>\$266,095</b>	<b>\$265,700</b>	<b>\$266,095</b>

The accompanying notes are an integral part of the consolidated financial statements





**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

(Unaudited)

(\$ in thousands)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	\$ 636	\$ 5,140
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	2,256	1,923
Deferred federal income taxes	(2,174 )	(669 )
Net realized losses	1,419	2,404
Share-based payments expense	46	228
Change in ceded unearned premiums	(11,156 )	(9,516 )
Change in premiums receivable	(18,091 )	(13,683 )
Change in accounts receivable	513	(11 )
Change in deferred policy acquisition costs	(142 )	(258 )
Change in unpaid losses and loss adjustment expenses	23,791	(7,266 )
Change in unearned premiums	20,639	20,360
Change in reinsurance recoverable	(16,613 )	(10,578 )
Change in reinsurance balances payable	7,690	11,314
Change in current federal income tax recoverable	2,154	1,519
Change in all other liabilities	(745 )	1,167
Change in all other assets	2,161	260
Net cash provided by operating activities	12,384	2,334
Cash flows from investing activities:		
Purchases of property and equipment	(1,231 )	(690 )
Net transfers from (into) restricted cash	3,869	(720 )
Purchases of investment securities	(124,366 )	(92,561 )
Maturities, sales and redemptions of investment securities	111,440	73,876
Net cash used in investing activities	(10,288 )	(20,095 )
Cash flows from financing activities:		
Proceeds from exercise of employee stock options	145	-
Purchase of treasury shares	(4,425 )	(4,745 )
Net cash used in financing activities	(4,280 )	(4,745 )

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Decrease in cash and cash equivalents	(2,184	)	(22,506	)
Cash and cash equivalents at beginning of period	79,632		114,446	
Cash and cash equivalents at end of period	\$ 77,448		\$ 91,940	
Supplemental cash flow information:				