

Edgar Filing: Employers Holdings, Inc. - Form 10-Q

Employers Holdings, Inc.
Form 10-Q
July 26, 2018

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 June 30, 2018

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 04-3850065

(State or other jurisdiction (I.R.S. Employer
of incorporation or organization) 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 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 definitions of "large accelerated filer," "accelerated filer," "non-accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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 13(a) of the Exchange Act.

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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

Class

July 19, 2018

Common Stock, \$0.01 par value per share 32,759,375 shares outstanding

TABLE OF CONTENTS

	Page No.
<u>PART 1 – FINANCIAL INFORMATION</u>	
<u>Item 1 Consolidated Financial Statements</u>	
<u>Consolidated Balance Sheets as of June 30, 2018 (Unaudited) and December 31, 2017</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2018 and 2017 (Unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Stockholders' Equity for the Six Months Ended June 30, 2018 and 2017 (Unaudited)</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017 (Unaudited)</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	<u>8</u>
<u>Item 2 Management’s Discussion and Analysis of Consolidated Financial Condition and Results of Operations</u>	<u>20</u>
<u>Item 3 Quantitative and Qualitative Disclosures About Market Risk</u>	<u>30</u>
<u>Item 4 Controls and Procedures</u>	<u>30</u>
 <u>PART II – OTHER INFORMATION</u>	
<u>Item 1 Legal Proceedings</u>	<u>31</u>
<u>Item 1A Risk Factors</u>	<u>31</u>
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>31</u>
<u>Item 3 Defaults Upon Senior Securities</u>	<u>31</u>
<u>Item 4 Mine Safety Disclosures</u>	<u>31</u>
<u>Item 5 Other Information</u>	<u>31</u>
<u>Item 6 Exhibits</u>	<u>32</u>
 <u>Signatures</u>	 <u>33</u>

PART I – FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Employers Holdings, Inc. and Subsidiaries

Consolidated Balance Sheets

(in millions, except share data)

	As of June 30, 2018 (unaudited)	As of December 31, 2017
Assets		
Investments:		
Fixed maturity securities at fair value (amortized cost \$2,418.0 at June 30, 2018 and \$2,421.0 at December 31, 2017)	\$ 2,401.2	\$ 2,463.4
Equity securities at fair value (cost \$113.5 at June 30, 2018 and \$116.7 at December 31, 2017)	197.7	210.3
Equity securities at cost	6.4	—
Short-term investments at fair value (amortized cost \$4.0 at December 31, 2017)	—	4.0
Total investments	2,605.3	2,677.7
Cash and cash equivalents	146.3	73.3
Restricted cash and cash equivalents	1.0	1.0
Accrued investment income	18.6	19.6
Premiums receivable (less bad debt allowance of \$7.5 at June 30, 2018 and \$10.0 at December 31, 2017)	355.6	326.7
Reinsurance recoverable for:		
Paid losses	7.6	7.2
Unpaid losses	512.5	537.0
Deferred policy acquisition costs	51.7	45.8
Deferred income taxes, net	24.4	28.7
Property and equipment, net	20.3	13.9
Intangible assets, net	7.8	7.9
Goodwill	36.2	36.2
Contingent commission receivable—LPT Agreement	32.0	31.4
Other assets	49.2	33.7
Total assets	\$ 3,868.5	\$ 3,840.1
Liabilities and stockholders' equity		
Claims and policy liabilities:		
Unpaid losses and loss adjustment expenses	\$ 2,227.9	\$ 2,266.1
Unearned premiums	360.2	318.3
Total claims and policy liabilities	2,588.1	2,584.4
Commissions and premium taxes payable	58.9	55.3
Accounts payable and accrued expenses	23.4	23.7
Deferred reinsurance gain—LPT Agreement	154.7	163.6
Notes payable	20.0	20.0
Other liabilities	66.9	45.4
Total liabilities	\$ 2,912.0	\$ 2,892.4
Commitments and contingencies		
Stockholders' equity:		
Common stock, \$0.01 par value; 150,000,000 shares authorized; 56,866,727 and 56,695,174 shares issued and 32,759,575 and 32,597,819 shares outstanding at June 30,	\$ 0.6	\$ 0.6

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2018 and December 31, 2017, respectively

Preferred stock, \$0.01 par value; 25,000,000 shares authorized; none issued	—	—
Additional paid-in capital	382.4	381.2
Retained earnings	970.8	842.2
Accumulated other comprehensive (loss) income, net of tax	(13.3) 107.4
Treasury stock, at cost (24,107,152 shares at June 30, 2018 and 24,097,355 shares at December 31, 2017)	(384.0) (383.7)
Total stockholders' equity	956.5	947.7
Total liabilities and stockholders' equity	\$ 3,868.5	\$ 3,840.1

See accompanying unaudited notes to the consolidated financial statements.

3

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(unaudited)		(unaudited)	
Revenues				
Net premiums earned	\$ 178.0	\$ 171.7	\$ 354.6	\$ 347.1
Net investment income	20.3	18.2	39.7	36.9
Net realized and unrealized gains (losses) on investments	5.7	1.1	(2.4)	3.3
Gain on redemption of notes payable	—	2.1	—	2.1
Other income	0.1	0.1	0.1	0.1
Total revenues	204.1	193.2	392.0	389.5
Expenses				
Losses and loss adjustment expenses	87.8	106.1	183.2	215.0
Commission expense	24.5	21.5	48.2	43.0
Underwriting and other operating expenses	40.1	32.6	79.2	68.6
Interest and financing expenses	0.4	0.4	0.7	0.8
Total expenses	152.8	160.6	311.3	327.4
Net income before income taxes	51.3	32.6	80.7	62.1
Income tax expense	8.8	7.8	12.6	14.1
Net income	\$ 42.5	\$ 24.8	\$ 68.1	\$ 48.0
Comprehensive income				
Unrealized AFS investment (losses) gains arising during the period (net of taxes of \$(3.0) and \$4.5 for the three months ended June 30, 2018 and 2017, respectively, and \$(12.6) and \$9.7	\$ (11.3)	\$ 8.4	\$ (47.1)	\$ 17.9

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for the six months ended June 30, 2018 and 2017, respectively)				
Reclassification adjustment for realized AFS investment losses (gains) in net income (net of taxes of \$(0.4) for the three months ended June 30, 2017, and \$0.1 and \$(1.2) for the six months ended June 30, 2018 and 2017, respectively)	—	(0.7)	0.4
				(2.1
)
Other comprehensive (loss) income, net of tax	(11.3)	7.7	(46.7
)
15.8				
Total comprehensive income	\$ 31.2	\$ 32.5	\$ 21.4	\$ 63.8
Net realized and unrealized gains (losses) on investments				
Net realized and unrealized gains (losses) on investments before impairments	\$ 5.7	\$ 1.1	\$ (0.4)
				\$ 3.5
Other than temporary impairment recognized in earnings	—	—	(2.0)
				(0.2
)
Net realized and unrealized gains (losses) on investments	\$ 5.7	\$ 1.1	\$ (2.4)
				\$ 3.3
Earnings per common share (Note 12):				
Basic	\$ 1.29	\$ 0.76	\$ 2.07	\$ 1.48
Diluted	\$ 1.28	\$ 0.75	\$ 2.05	\$ 1.46
	\$ 0.20	\$ 0.15	\$ 0.40	\$ 0.30

Cash dividends
declared per
common share and
eligible RSUs and
PSUs

See accompanying unaudited notes to the consolidated financial statements.

4

Employers Holdings, Inc. and Subsidiaries
Consolidated Statements of Stockholders' Equity
For the Six Months Ended June 30, 2018 and 2017
(Unaudited)

	Common Stock Shares Issued	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net	Treasury Stock at Cost	Total Stockholders' Equity
	(in millions, except share data)						
Balance, January 1, 2018	56,695,174	\$ 0.6	\$ 381.2	\$ 842.2	\$ 107.4	\$(383.7)	\$ 947.7
Stock-based obligations	—	—	3.9	—	—	—	3.9
Stock options exercised	13,800	—	0.2	—	—	—	0.2
Vesting of RSUs and PSUs, net of shares withheld to satisfy tax withholdings	157,753	—	(2.9)	—	—	—	(2.9)
Acquisition of common stock	—	—	—	—	—	(0.3)	(0.3)
Dividends declared	—	—	—	(13.3)	—	—	(13.3)
Net income for the period	—	—	—	68.1	—	—	68.1
Reclassification adjustment for adoption of ASU No. 2016-01	—	—	—	74.0	(74.0)	—	—
Change in net unrealized losses on investments, net of taxes of \$12.5	—	—	—	—	(46.7)	—	(46.7)
Balance, June 30, 2018	56,866,727	\$ 0.6	\$ 382.4	\$ 970.8	\$ (13.3)	\$(384.0)	\$ 956.5
Balance, January 1, 2017	56,226,277	\$ 0.6	\$ 372.0	\$ 777.2	\$ 74.5	\$(383.7)	\$ 840.6
Stock-based obligations	—	—	3.2	—	—	—	3.2
Stock options exercised	167,026	—	3.3	—	—	—	3.3
Vesting of RSUs and PSUs, net of shares withheld to satisfy tax withholdings	117,049	—	(1.9)	—	—	—	(1.9)
Dividends declared	—	—	—	(9.8)	—	—	(9.8)
Net income for the period	—	—	—	48.0	—	—	48.0
Change in net unrealized gains on investments, net of taxes of \$8.5	—	—	—	—	15.8	—	15.8
Balance, June 30, 2017	56,510,352	\$ 0.6	\$ 376.6	\$ 815.4	\$ 90.3	\$(383.7)	\$ 899.2

See accompanying unaudited notes to the consolidated financial statements.

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

	Six Months Ended June 30,	
	2018	2017
	(unaudited)	
Operating activities	\$68.1	\$48.0
Net income		
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3.8	4.2
Stock-based compensation	3.8	3.1
Amortization of premium on investments, net	4.4	7.5
Allowance for doubtful accounts	(2.5)	0.1
Deferred income tax (benefit) expense	16.8	6.0
Net realized and unrealized losses (gains) on investments	2.4	(3.3)
Gain on redemption of notes payable	—	(2.1)
Change in operating assets and liabilities:		
Premiums receivable	(26.5)	(28.5)
Reinsurance recoverable on paid and unpaid losses	24.1	20.5
Current federal income taxes	(7.1)	(6.9)
Unpaid losses and loss adjustment expenses	(38.2)	(16.1)
Unearned premiums	41.9	30.8
Accounts payable, accrued expenses and other liabilities	4.0	(7.1)
Deferred reinsurance gain—LPT Agreement	(8.9)	(6.0)
Other	0.1	(7.6)
Net cash provided by operating activities	86.2	42.6
Investing activities		
Purchases of fixed maturity securities	(358.1)	(202.1)
Purchases of equity securities	(19.9)	(10.7)
Purchases of short-term investments	(34.9)	(8.1)
Proceeds from sale of fixed maturity securities	168.4	43.0
Proceeds from sale of equity securities	24.0	11.4
Proceeds from maturities and redemptions of fixed maturity securities	187.7	96.8
Proceeds from maturities of short-term investments	38.9	18.6
Net change in unsettled investment purchases and sales	7.2	5.0
Capital expenditures and other	(10.1)	(5.9)
Net cash provided by (used in) investing activities	3.2	(52.0)
Financing activities		
Acquisition of common stock	(0.3)	—
Cash transactions related to stock-based compensation	(2.7)	1.4
Dividends paid to stockholders	(13.3)	(9.8)
Redemption of notes payable	—	(9.9)
Payments on capital leases	(0.1)	(0.1)
Net cash used in financing activities	(16.4)	(18.4)
Net increase (decrease) in cash, cash equivalents and restricted cash	73.0	(27.8)
Cash, cash equivalents and restricted cash at the beginning of the period	74.3	70.8
Cash, cash equivalents and restricted cash at the end of the period	\$147.3	\$43.0

The following table presents our cash, cash equivalents and restricted cash by category within the Consolidated Balance Sheets:

	As of June 30, 2018	As of December 31, 2017
	(in millions)	
Cash and cash equivalents	\$146.3	\$ 73.3
Restricted cash and cash equivalents supporting reinsurance obligations	1.0	1.0
Total cash, cash equivalents and restricted cash	\$147.3	\$ 74.3

See accompanying unaudited notes to the consolidated financial statements.

7

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.

In 1999, the Nevada State Industrial Insurance System (the Fund) entered into a retroactive 100% quota share reinsurance agreement (the LPT Agreement) through a loss portfolio transfer transaction with third party reinsurers. The LPT Agreement commenced on June 30, 1999 and will remain in effect until all claims under the covered policies have closed, the LPT Agreement is commuted or terminated, upon the mutual agreement of the parties, or the reinsurers' aggregate maximum limit of liability is exhausted, whichever occurs first. The LPT Agreement does not provide for any additional termination terms. On January 1, 2000, EICN assumed all of the assets, liabilities and operations of the Fund, including the Fund's rights and obligations associated with the LPT Agreement (See Note 8). The Company accounts for the LPT Agreement as retroactive reinsurance. Upon entry into the LPT Agreement, an initial deferred reinsurance gain (the Deferred Gain) was recorded as a liability on the Company's Consolidated Balance Sheets. The Company is entitled to receive a contingent profit commission under the LPT Agreement. The contingent profit commission is estimated based on both actual paid results to date and projections of expected paid losses under the LPT Agreement and is recorded as an asset on the Company's Consolidated Balance Sheets.

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 Form 10-K for the year ended December 31, 2017 (Annual Report).

The Company operates as a single operating segment, workers' compensation insurance, through its wholly owned subsidiaries. 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.

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 and 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, recoverability of deferred income taxes, and valuation of investments.

Reclassifications

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

Pending Acquisition

On August 11, 2017, the Company entered into, and on May 23, 2018, the Company amended, a stock purchase agreement (Purchase Agreement) with Partner Reinsurance Company of the U.S. (PRUS) with respect to the acquisition (Acquisition) of all of the outstanding shares of capital stock of PartnerRe Insurance Company of New York (PRNY). The purchase price is equal to the sum of: (i) the amount of statutory capital and surplus of PRNY at

closing (which is currently estimated to be approximately \$40.0 million); and (ii) \$5.8 million. The Company expects to fund the Acquisition with cash on hand.

Pursuant to the Purchase Agreement, all liabilities and obligations of PRNY existing as of the closing date, whether known or unknown, will be indemnified by PRUS. In addition, PartnerRe Ltd., the parent company of PRUS, has provided the Company

8

with a Guaranty that unconditionally, absolutely and irrevocably guarantees the full and prompt payment and performance by PRUS of all of its obligations, liabilities, and indemnities under the Purchase Agreement and the transactions contemplated thereby.

The Company will not be acquiring any employees or ongoing business operations pursuant to the Acquisition. The Acquisition is subject to certain closing conditions, including, among other things, approval from the Department of Financial Services of the State of New York.

2. Change in Estimates

The Company reduced its estimated loss and LAE reserves ceded under the Loss Portfolio Transfer Agreement (LPT Reserve Adjustment) as a result of the determination that an adjustment was necessary to reflect observed favorable paid loss trends during the second quarter of 2018. The following table shows the financial statement impact related to the LPT Reserve Adjustment.

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
	(in millions, except per share data)	
LPT Reserve Adjustment	\$(6.3)	\$(6.3)
Cumulative adjustment to the Deferred Gain ⁽¹⁾	(2.2)	(2.2)
Net income impact from this change in estimate	2.2	2.2
Earnings per common share impact from this change in estimate:		
Basic and Diluted	0.07	0.07

The cumulative adjustment to the Deferred reinsurance gain–LPT Agreement (Deferred Gain) was also recognized in losses and LAE incurred in the Company's Consolidated Statement of Comprehensive Income, so that the (1) Deferred Gain reflects the balance that would have existed had the revised loss and LAE reserves been recognized at the inception of the LPT Agreement.

The Company increased its estimate of Contingent commission receivable – LPT Agreement (LPT Contingent Commission Adjustment) as a result of the determination that an adjustment was necessary to reflect observed favorable paid loss trends during the second quarter of 2018. The following table shows the financial statement impact related to the LPT Contingent Commission Adjustment.

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
	(in millions, except per share data)	
LPT Contingent Commission Adjustment	\$0.5	\$ 0.5
Net income impact from this change in estimate	0.5	0.5
Earnings per common share impact from this change in estimate:		
Basic and Diluted	0.02	0.02

3. New Accounting Standards

Recently Issued Accounting Standards

In February 2016, the FASB issued ASU Number 2016-02, Leases (Topic 842). This update provides guidance on a new lease model that includes the recognition of assets and liabilities arising from lease transactions on the balance sheet. Additionally, the update provides clarity on the definition of a lease and the distinction between finance and operating leases. Furthermore, the update requires certain qualitative and quantitative disclosures pertaining to the amounts recorded in the financial statements. This update becomes effective for annual reporting periods, including interim periods within those annual periods, beginning after December 15, 2018 and early adoption is permitted. The Company has determined that the impact of this new standard will be equal to the present value of the Company's lease obligations under various non-cancellable operating lease contracts, which amounted to approximately \$23.0 million at June 30, 2018, and will be recognized as lease assets and liabilities on the Company's Balance Sheets upon adoption.

Recently Adopted Accounting Standards

In March 2018, the FASB issued ASU Number 2018-05, Income Taxes (Topic 740). This update provides guidance regarding the application of ASC Topic 740 for the income tax effects of the Tax Cuts and Jobs Act. This update allowed companies to report provisional amounts of the effects of the Tax Cuts and Jobs Act in their financial statements in the first reporting period they are able to determine a reasonable estimate and any adjustments to provisional amounts should be included in income from continuing operations as an adjustment to tax expense or benefit in the reporting period the amounts are determined. The Company adopted this update in the fourth quarter of 2017 and included an estimate of the income tax effects in its financial statements for the year

ended December 31, 2017. The Company does not expect the amounts of any future income tax adjustments related to the effects of the Tax Cuts and Jobs Act to be material.

In January 2016, the FASB issued ASU Number 2016-01, Financial Instruments - Overall (Subtopic 825-10). This update replaces the guidance to classify equity securities with readily determinable fair values into different categories (trading or available-for-sale) and requires those equity securities to be measured at fair value with changes in fair value recognized through net income. Additionally, this update eliminates the disclosure of the method and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost. It requires financial instruments to be measured at fair value using the exit price notion. Furthermore, this update clarifies that an evaluation of deferred tax assets related to available-for-sale securities is needed, in combination with an evaluation of other deferred tax assets, to determine if a valuation allowance is required.

This update did not apply to the Company's investment in Federal Home Loan Bank (FHLB) stock. Rather, it specified that FHLB stock shall be carried at cost and evaluated periodically for impairment; furthermore, it specified that, beginning January 1, 2018, FHLB stock shall not be shown with securities accounted for under ASC 321, which provides detailed guidance on, among other things, accounting and reporting of investments in equity securities that have readily determinable fair values. As a result, the Company's investment in FHLB stock is presented within Equity securities at cost on the Company's Consolidated Balance Sheet at March 31, 2018. In all periods prior to January 1, 2018, the Company's investment in FHLB stock is presented within Equity securities at fair value on the Company's Consolidated Balance Sheets.

This update became effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted this update effective January 1, 2018. Adoption of this accounting standard resulted in a \$74.0 million reclassification adjustment, net of tax, from accumulated other comprehensive income to retained earnings.

4. Fair Value of Financial Instruments

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

	June 30, 2018		December 31, 2017	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
	(in millions)			
Financial assets				
Total investments at fair value	\$2,598.9	\$2,598.9	\$2,677.7	\$2,677.7
Cash and cash equivalents	146.3	146.3	73.3	73.3
Restricted cash and cash equivalents	1.0	1.0	1.0	1.0
Financial liabilities				
Notes payable	\$20.0	\$23.5	\$20.0	\$23.6

Assets and liabilities recorded at fair value on the Company's 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.

• 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 Company uses third party pricing services to assist it with its investment accounting function. The ultimate pricing source varies depending on the investment security and pricing service used, but investment securities valued on the basis of observable inputs (Levels 1 and 2) are generally assigned values on the basis of actual transactions. Securities valued on the basis of pricing models with significant unobservable inputs or non-binding broker quotes are classified as Level 3. The Company performs quarterly analyses on the prices it receives from third parties 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, as it is ultimately management's responsibility to ensure that the fair values reflected in the Company's consolidated financial statements are appropriate. If differences are noted in these analyses, the Company may obtain additional information from other pricing services to validate the quoted price.

The Company bases all of its estimates of fair value for assets on the bid prices, when available, as they represent what a third-party market participant would be willing to pay in an arm's length transaction.

For securities not actively traded, 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 speed assumptions. There were no material adjustments made to the prices obtained from third party pricing services as of June 30, 2018 and December 31, 2017.

These methods of valuation only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. When objectively verifiable information is not available, the Company produces an estimate of fair value using some of the same methodologies, making assumptions for market-based inputs that are unavailable. The Company's estimates of fair value for its notes payable are based on a combination of the variable interest rates for notes with similar durations to discount the projection of future payments on notes payable. The fair value measurements for notes payable have been determined to be Level 2 at each of the periods presented.

Each of the Company's insurance operating subsidiaries is a member of the FHLB of San Francisco. Members are required to purchase stock in FHLB in addition to maintaining collateral deposits that back any funds advanced. The Company's investment in FHLB stock is recorded at cost, as purchases and sales of these securities are at par value with the issuer. FHLB stock is considered a restricted security and is periodically evaluated by the Company for impairment based on the ultimate recovery of par value.

The following table presents the Company's investments at fair value and the corresponding fair value measurements.

	June 30, 2018		December 31, 2017			
	Level 1	Level 2	Level 3	Level 1	Level 2	Level 3
	(in millions)					
Fixed maturity securities:						
U.S. Treasuries	\$—	\$119.4	\$—	\$—	\$137.0	\$—
U.S. Agencies	—	11.5	—	—	11.8	—
States and municipalities	—	568.7	—	—	642.5	—
Corporate securities	—	1,079.5	—	—	1,118.0	—
Residential mortgage-backed securities	—	433.1	—	—	389.3	—
Commercial mortgage-backed securities	—	104.0	—	—	106.0	—
Asset-backed securities	—	67.3	—	—	58.8	—
Other securities	—	17.7	—	—	—	—
Total fixed maturity securities	\$—	\$2,401.2	\$—	\$—	\$2,463.4	\$—
Equity securities at fair value:						
Industrial and miscellaneous	\$172.6	\$—	\$—	\$—	\$—	\$—
Non-redeemable preferred stock (FHLB)	—	—	—	—	—	4.7
Other	25.1	—	—	23.9	—	—
Total equity securities at fair value	197.7	—	—	205.6	—	4.7
Short-term investments	—	—	—	—	4.0	—
Total investments at fair value	\$197.7	\$2,401.2	\$—	\$—	\$2,467.4	\$4.7

Certain cash equivalents, principally money market securities, are measured at fair value using the net asset value (NAV) per share. The following table presents cash equivalents at NAV and total cash and cash equivalents carried at fair value on the Company's Consolidated Balance Sheets.

	June 30, 2018	December 31, 2017
	(in millions)	
Cash and cash equivalents at fair value	\$61.3	\$34.3
Cash equivalents measured at NAV, which approximates fair value	85.0	39.0
Total cash and cash equivalents	\$146.3	\$73.3

The following table provides a reconciliation of the beginning and ending balances of investments that are recorded at fair value and are measured using Level 3 inputs for the six months ended June 30, 2018 and 2017.

	Level 3 Securities	
	2018	2017
	(in millions)	
Beginning balance, January 1	\$4.7	\$11.9
Transfers out of Level 3 ⁽¹⁾	(4.7)	(7.0)
Purchases and sales, net	—	(0.2)
Ending balance, June 30	\$—	\$4.7

The transfer during the six months ended June 30, 2018 was the result of adoption of ASU 2016-01, which (1) specified that FHLB stock shall be carried at cost and is no longer measured at fair value. Transfers during the six months ended June 30, 2017 were from Level 3 to Level 2 as observable market data became available for these securities.

5. Investments

The Company's investments in fixed maturity securities, equity securities at fair value (prior to 2018), and short-term investments are classified as available-for-sale (AFS) that are reported at fair value with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of deferred taxes, in Accumulated other comprehensive (loss) income (AOCI) on the Company's Consolidated Balance Sheets. Beginning in 2018, with the adoption of ASU 2016-01, the Company's investments in equity securities at fair value are no longer classified as AFS and changes in fair value are included in Net realized and unrealized (losses) gains on investments on the Company's Consolidated Statements of Comprehensive Income. Effective January 1, 2018, the Company's investment in FHLB stock is presented within Equity securities at cost on the Company's Consolidated Balance Sheets. Other securities within fixed maturity securities consist of bank loans, which are classified as AFS and are reported at fair value.

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

	Cost or Amortized Cost (in millions)	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
At June 30, 2018				
Fixed maturity securities				
U.S. Treasuries	\$120.4	\$ 0.9	\$ (1.9)	\$119.4
U.S. Agencies	11.3	0.3	(0.1)	11.5
States and municipalities	555.0	14.9	(1.2)	568.7
Corporate securities	1,095.9	6.5	(22.9)	1,079.5
Residential mortgage-backed securities	442.9	2.0	(11.8)	433.1
Commercial mortgage-backed securities	107.1	—	(3.1)	104.0
Asset-backed securities	67.6	0.2	(0.5)	67.3
Other securities	17.8	—	(0.1)	17.7
Total fixed maturity securities	2,418.0	24.8	(41.6)	2,401.2
Total AFS investments	\$2,418.0	\$ 24.8	\$ (41.6)	\$2,401.2
At December 31, 2017				
Fixed maturity securities				
U.S. Treasuries	\$135.8	\$2.0	\$(0.8)	\$137.0
U.S. Agencies	11.3	0.5	—	11.8
States and municipalities	617.0	25.5	—	642.5
Corporate securities	1,103.4	18.0	(3.4)	1,118.0
Residential mortgage-backed securities	388.3	3.6	(2.6)	389.3
Commercial mortgage-backed securities	106.5	0.4	(0.9)	106.0
Asset-backed securities	58.7	0.3	(0.2)	58.8
Total fixed maturity securities	2,421.0	50.3	(7.9)	2,463.4
Equity securities at fair value				
Industrial and miscellaneous	100.8	81.5	(0.6)	181.7
Non-redeemable preferred stock (FHLB)	4.7	—	—	4.7
Other	11.2	12.7	—	23.9
Total equity securities at fair value	116.7	94.2	(0.6)	210.3
Short-term investments	4.0	—	—	4.0
Total AFS investments	\$2,541.7	\$144.5	\$(8.5)	\$2,677.7

The cost and estimated fair value of the Company's equity securities recorded at fair value at June 30, 2018 were as follows:

	Cost	Estimated Fair Value (in millions)
At June 30, 2018		
Equity securities at fair value		
Industrial and miscellaneous	\$99.4	\$ 172.6
Other	14.1	25.1
Total equity securities at fair value	\$113.5	\$ 197.7

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The amortized cost and estimated fair value of the Company's fixed maturity securities at June 30, 2018, 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.

	Amortized Cost	Estimated Fair Value
	(in millions)	
Due in one year or less	\$177.8	\$178.3
Due after one year through five years	761.7	763.6
Due after five years through ten years	730.0	720.6
Due after ten years	130.9	134.3
Mortgage and asset-backed securities	617.6	604.4
Total	\$2,418.0	\$2,401.2

The following is a summary of AFS investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or greater as of June 30, 2018 and December 31, 2017.

	June 30, 2018			December 31, 2017		
	Estimated Fair Value	Gross Unrealized Losses	Number of Issues	Estimated Fair Value	Gross Unrealized Losses	Number of Issues
	(in millions, except number of issues data)					
Less than 12 months:						
Fixed maturity securities						
U.S. Treasuries	\$82.0	\$ (1.6)	27	\$86.0	\$ (0.5)	28
U.S. Agencies	3.7	(0.1)	2	—	—	—
States and municipalities	84.0	(1.2)	24	—	—	—
Corporate securities	811.5	(21.0)	265	307.6	(2.3)	113
Residential mortgage-backed securities	310.0	(8.1)	93	165.0	(0.8)	45
Commercial mortgage-backed securities	75.4	(2.0)	34	41.8	(0.2)	19
Asset-backed securities	53.1	(0.5)	37	29.3	(0.2)	25
Other securities	16.1	(0.1)	23	—	—	—
Total less than 12 months	\$1,435.8	\$ (34.6)	505	\$629.7	\$ (4.0)	230
12 months or greater:						
Fixed maturity securities						
U.S. Treasuries	\$17.7	\$ (0.3)	9	\$23.4	\$ (0.3)	10
Corporate securities	36.1	(1.9)	15	53.2	(1.1)	17
Residential mortgage-backed securities	69.7	(3.7)	32	77.1	(1.8)	32
Commercial mortgage-backed securities	20.2	(1.1)	8	25.1	(0.7)	8
Total 12 months or greater	\$143.7	\$ (7.0)	64	\$178.8	\$ (3.9)	67

At December 31, 2017, the Company also had \$0.6 million of gross unrealized losses on 24 equity securities that were in a continuous loss position for less than 12 months.

The Company recognized impairments on fixed maturity securities of \$2.0 million (consisting of 57 securities) during the six months ended June 30, 2018 as a result of the Company's intent to sell these securities. There were no other-than-temporary impairments on fixed maturity securities recognized during the six months ended June 30, 2017. The Company determined that the remaining unrealized losses on fixed maturity securities for the six months ended June 30, 2018 were primarily the result of changes in prevailing interest rates and not the credit quality of the issuers. The fixed maturity securities whose total fair value was less than amortized cost were not determined to be other-than-temporarily impaired given the lack of severity and duration of the impairment, the credit quality of the

issuers, the Company's intent to not sell the securities, and a determination that it is not more likely than not that the Company will be required to sell the securities at an amount less than their amortized cost.

The adoption of ASU 2016-01 removed the impairment assessment for equity securities at fair value, and, beginning in 2018, changes in fair value are included in Net realized and unrealized (losses) gains on investments on the Company's Consolidated Statements of Comprehensive Income. Prior to the adoption of this standard, the Company recognized an impairment on equity securities of \$0.2 million (consisting of one security) during the six months ended June 30, 2017. The other-than-temporary impairment recognized during this period was the result of the severity and duration of the change in fair value of this security.

Certain unrealized losses on equity securities during the six months ended June 30, 2017 were not considered to be other-than-temporary due to the financial condition and near-term prospects of the issuers, and the Company's intent to hold the securities until fair value recovers to above cost.

Realized gains and losses on investments include the gain or loss on a security at the time of sale compared to its original or adjusted cost (equity securities) or amortized cost (fixed maturity securities). Realized losses on fixed maturity securities are also recognized when securities are written down as a result of an other-than-temporary impairment.

Net realized gains on investments and the change in unrealized gains (losses) on the Company's investments recorded at fair value are determined on a specific-identification basis and were as follows:

	Gross Realized Gains	Gross Realized Losses	Change in Net Unrealized Gains (Losses)	Changes in Fair Value Reflected in Earnings	Changes in Fair Value Reflected in AOCI, before tax
(in millions)					
Three Months Ended June 30, 2018					
Fixed maturity securities	\$ 0.3	\$(0.3)	\$ (14.3)	\$ —	\$ (14.3)
Equity securities	2.6	(0.4)	3.5	5.7	—
Total investments	\$ 2.9	\$(0.7)	\$ (10.8)	\$ 5.7	\$ (14.3)
Six Months Ended June 30, 2018					
Fixed maturity securities	\$ 2.1	\$(2.6)	\$ (59.2)	\$ (0.5)	\$ (59.2)
Equity securities	8.1	(0.6)	(9.4)	(1.9)	—
Total investments	\$ 10.2	\$(3.2)	\$ (68.6)	\$ (2.4)	\$ (59.2)
Three Months Ended June 30, 2017					
Fixed maturity securities	\$—	\$—	\$12.5	\$—	\$12.5
Equity securities	1.1	—	(0.7)	1.1	(0.7)
Total investments	\$1.1	\$—	\$11.8	\$1.1	\$11.8
Six Months Ended June 30, 2017					
Fixed maturity securities	\$0.5	\$(0.1)	\$18.9	\$0.4	\$18.9
Equity securities	3.1	(0.2)	5.4	2.9	5.4
Total investments	\$3.6	\$(0.3)	\$24.3	\$3.3	\$24.3

Net investment income was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
(in millions)				
Fixed maturity securities	\$19.2	\$17.3	\$37.7	\$35.0
Equity securities	1.7	1.7	3.3	3.5
Cash equivalents and restricted cash	0.3	0.1	0.5	0.2
Gross investment income	21.2	19.1	41.5	38.7
Investment expenses	(0.9)	(0.9)	(1.8)	(1.8)
Net investment income	\$20.3	\$18.2	\$39.7	\$36.9

The Company is required by various state laws and regulations to hold securities or letters of credit in depository accounts with certain states in which it does business. These laws and regulations govern not only the amount but also the types of securities that are eligible for deposit. As of June 30, 2018 and December 31, 2017, securities having a

fair value of \$954.4 million and \$1,009.7 million, respectively, were on deposit. Additionally, standby letters of credit from the FHLB were in place in lieu of \$140.0 million of securities on deposit as of June 30, 2018 (See Note 9). Certain reinsurance contracts require the Company's funds to be held in trust for the benefit of the ceding reinsurer to secure the outstanding liabilities assumed by the Company. The fair value of fixed maturity securities and restricted cash and cash equivalents held in trust for the benefit of ceding reinsurers at June 30, 2018 and December 31, 2017 was \$22.9 million and \$24.5 million, respectively.

6. Income Taxes

Income tax expense for interim periods is measured using an estimated effective tax rate for the annual period. The Company's effective tax rates were 17.2% and 15.6% for the three and six months ended June 30, 2018, respectively, compared to 23.9% and 22.7% for the same periods of 2017. Tax-advantaged investment income, Deferred Gain amortization, LPT Reserve Adjustments, LPT Contingent Commission Adjustments, and certain other adjustments reduced the Company's effective income tax rate below the U.S. statutory rates of 21% and 35% for periods in 2018 and 2017, respectively.

7. Liability for Unpaid Losses and Loss Adjustment Expenses

The following table represents a reconciliation of changes in the liability for unpaid losses and LAE.

	Three Months Ended		Six Months Ended	
	June 30, 2018	2017	June 30, 2018	2017
	(in millions)			
Unpaid losses and LAE at beginning of period	\$2,258.1	\$2,298.2	\$2,266.1	\$2,301.0
Less reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	531.1	572.9	537.0	580.0
Net unpaid losses and LAE at beginning of period	1,727.0	1,725.3	1,729.1	1,721.0
Losses and LAE, net of reinsurance, incurred during the period related to:				
Current period	111.2	109.4	221.6	221.3
Prior periods	(16.5)	(0.3)	(28.9)	(0.3)
Total net losses and LAE incurred during the period	94.7	109.1	192.7	221.0
Paid losses and LAE, net of reinsurance, related to:				
Current period	20.0	17.0	25.9	21.7
Prior periods	86.3	92.3	180.5	195.2
Total net paid losses and LAE during the period	106.3	109.3	206.4	216.9
Ending unpaid losses and LAE, net of reinsurance	1,715.4	1,725.1	1,715.4	1,725.1
Reinsurance recoverable, excluding bad debt allowance, on unpaid losses and LAE	512.5	559.8	512.5	559.8
Unpaid losses and LAE at end of period	\$2,227.9	\$2,284.9	\$2,227.9	\$2,284.9

Total net losses and LAE included in the above table exclude amortization of the deferred reinsurance gain—LPT Agreement, LPT Reserve Adjustments, and LPT Contingent Commission Adjustments, which totaled \$6.9 million and \$3.1 million for the three months ended June 30, 2018 and 2017, respectively, and \$9.5 million and \$6.0 million for the six months ended June 30, 2018 and 2017, respectively (See Note 8).

The change in incurred losses and LAE attributable to prior periods included \$16.5 million and \$28.5 million of favorable development on the Company's voluntary risk business for the three and six months ended June 30, 2018, respectively, and \$0.4 million of favorable development on the Company's assigned risk business for the six months ended June 30, 2018. The favorable prior accident year loss development on voluntary business during the three and six months ended June 30, 2018 was the result of the Company's determination that adjustments were necessary to reflect observed favorable paid loss trends. Paid loss trends have been impacted by cost savings associated with accelerated claims settlement activity that began in 2014 and continued in 2018.

8. LPT Agreement

The Company is party to the LPT Agreement under which \$1.5 billion in liabilities for losses and LAE related to claims incurred by the Fund prior to July 1, 1995 were reinsured for consideration of \$775.0 million. The LPT Agreement provides coverage up to \$2.0 billion. The Company records its estimate of contingent profit commission in the accompanying Consolidated Balance Sheets as Contingent commission receivable—LPT Agreement and a corresponding liability is recorded in the accompanying Consolidated Balance Sheets in Deferred reinsurance gain—LPT Agreement. The Deferred Gain is being amortized using the recovery method. Amortization is determined by the proportion of actual reinsurance recoveries to total estimated recoveries over the life of the LPT Agreement, except for the contingent profit commission, which is amortized through June 30, 2024, the date through which the

Company is entitled to receive a contingent profit commission under the LPT Agreement. The amortization is recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income. Any adjustments

16

to the Deferred Gain are recorded in losses and LAE incurred in the accompanying consolidated statements of comprehensive income.

The Company amortized \$4.2 million and \$3.1 million of the Deferred Gain for the three months ended June 30, 2018 and 2017, respectively, and \$6.8 million and \$6.0 million for the six months ended June 30, 2018 and 2017, respectively. Additionally, the Deferred Gain was further reduced by \$2.2 million for the three and six months ended June 30, 2018 due to a favorable LPT Reserve Adjustment and by \$0.5 million of amortization for the three and six months ended June 30, 2018 due to a favorable LPT Contingent Commission Adjustment (see Note 2). The remaining Deferred Gain was \$154.7 million and \$163.6 million as of June 30, 2018 and December 31, 2017, respectively. The estimated remaining liabilities subject to the LPT Agreement were \$420.3 million and \$438.9 million as of June 30, 2018 and December 31, 2017, respectively. Losses and LAE paid with respect to the LPT Agreement totaled \$761.6 million and \$749.3 million from inception through June 30, 2018 and December 31, 2017, respectively.

9. Notes Payable and Other Financing Arrangements

Notes payable is comprised of the following:

	June 30,	December 31,
	2018	2017
	(in millions)	
Dekania Surplus Note, due April 29, 2034	\$ 10.0	\$ 10.0
Alesco Surplus Note, due December 15, 2034	10.0	10.0
Total	\$ 20.0	\$ 20.0

EPIC has a \$10.0 million surplus note to Dekania CDO II, Ltd. issued as part of a pooled transaction. The note matures in 2034 and became callable by the Company in 2009. The terms of the note provide for quarterly interest payments at a rate 425 basis points in excess of the 90-day LIBOR. Both the payment of interest and repayment of the principal under this note and the surplus note described in the following paragraph are subject to the prior approval of the Florida Department of Financial Services.

EPIC has a \$10.0 million surplus note to Alesco Preferred Funding V, LTD issued as part of a pooled transaction. The note matures in 2034 and became callable by the Company in 2009. The terms of the note provide for quarterly interest payments at a rate 405 basis points in excess of the 90-day LIBOR.

Other financing arrangements is comprised of the following:

Each of the Company's insurance subsidiaries is a member of the FHLB. Membership allows the insurance subsidiaries access to collateralized advances, which may be used to support and enhance liquidity management. The amount of advances that may be taken is dependent on statutory admitted assets on a per company basis. Currently, none of the Company's insurance subsidiaries has advances outstanding under the FHLB facility.

FHLB membership also allows the Company's insurance subsidiaries access to standby letters of credit. On March 9, 2018, ECIC, EPIC, and EAC entered into standby Letter of Credit Reimbursement Agreements (Letter of Credit Agreements) with the FHLB. The Letter of Credit Agreements are between FHLB and each of EAC, in the amount of \$40.0 million, ECIC, in the amount of \$50.0 million, and EPIC, in the amount of \$50.0 million. The Letter of Credit Agreements became effective March 9, 2018 and expire March 31, 2019; however, the Letter of Credit Agreements will remain evergreen with automatic one-year extensions unless the FHLB notifies the beneficiary at least 60 days prior to the then applicable expiration date of its election not to renew. The Letter of Credit Agreements may only be used to satisfy, in whole or in part, insurance deposit requirements with the State of California and are fully secured with eligible collateral at all times. The Letter of Credit Agreements are subject to annual maintenance charges and a fee of 15 basis points on issued amounts. As of June 30, 2018, letters of credit totaling \$140.0 million were issued in lieu of securities on deposit with the State of California under these Letter of Credit Agreements.

As of June 30, 2018, investment securities having a fair value of \$258.7 million were pledged to FHLB by the Company's insurance subsidiaries in support of the collateralized advance facility and the Letter of Credit Agreements.

10. Accumulated Other Comprehensive Income

Accumulated other comprehensive income is comprised of unrealized (losses) gains on investments classified as AFS, net of deferred tax expense. Beginning in 2018, with the adoption of ASU No. 2016-01, the Company's investments in equity securities at fair value are no longer considered to be AFS and are reported at fair value with unrealized gains and losses included in Net realized and unrealized (losses) gains on investments on the Company's Consolidated Statements of Comprehensive Income. Prior to 2018, investments in equity securities at fair value were classified as AFS and changes in fair value were excluded from earnings and reported in accumulated other comprehensive income. The following table summarizes the components of accumulated other comprehensive (loss) income:

	June 30, December 31,	
	2018	2017
	(in millions)	
Net unrealized (losses) gains on investments, before taxes	\$(16.8)	\$ 136.0
Deferred tax benefit (expense) on net unrealized (losses) gains	3.5	(28.6)
Total accumulated other comprehensive (loss) income	\$(13.3)	\$ 107.4

11. Stock-Based Compensation

The Company awarded restricted stock units (RSUs) and performance share units (PSUs) to certain employees and non-employee Directors of the Company as follows:

	Number Awarded	Weighted Average Fair Value on Date of Grant	Aggregate Fair Value on Date of Grant (in millions)
March 2018			
RSUs ⁽¹⁾	71,400	\$ 40.30	\$ 2.9
RSUs ⁽²⁾	736	40.50	—
PSUs ⁽³⁾	96,940	40.30	3.9

May 2018

RSUs ⁽⁴⁾	13,347	\$ 39.65	\$ 0.5
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(1) The RSUs awarded in March 2018 were awarded to certain employees of the Company and vest 25% on March 15, 2019, and each of the subsequent three anniversaries of that date. The RSUs are subject to accelerated vesting in certain circumstances, including but not limited to: death, disability, retirement, or in connection with a change of control of the Company.

(2) The RSUs awarded in March 2018 were awarded to non-employee Directors of the Company and vested in full on May 25, 2018.

(3) The PSUs awarded in March 2018 were awarded to certain employees of the Company and have a performance period of two years followed by an additional one year vesting period. The PSU awards are subject to certain performance goals with payouts that range from 0% to 200% of the target awards. The value shown in the table represents the aggregate number of PSUs awarded at the target level.

(4) The RSUs awarded in May 2018 were awarded to non-employee Directors of the Company and vest in full on May 24, 2019.

Employees who were awarded RSUs and PSUs are entitled to receive dividend equivalents for eligible awards, payable in cash, when the underlying award vests and becomes payable. If the underlying award does not vest or is forfeited, any dividend equivalents with respect to the underlying award will also fail to become payable and will be forfeited.

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Stock options exercised totaled 13,800 for the six months ended June 30, 2018, 167,026 for the six months ended June 30, 2017, and 307,076 for the year ended December 31, 2017.

As of June 30, 2018, the Company had 233,547 options, 313,426 RSUs, and 266,535 PSUs (based on target number awarded) outstanding.

12. Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding for the period. Diluted earnings per share reflects the potential dilutive impact of all common stock equivalents on earnings per share. Diluted earnings per share includes shares that are assumed to be issued under the “treasury stock method,” which reflects the potential dilution that would occur if outstanding RSUs and PSUs had vested and options were to be exercised.

Commencing in 2017, certain stock-based compensation awards are eligible to receive dividend equivalents on awards that fully vest or become payable. The dividend equivalents are reflected in the Company's net income; therefore, these awards are not considered participating securities for the purposes of determining earnings per share.

The following table presents the net income and the weighted average number of shares outstanding used in the earnings per common share calculations.

	Three Months Ended June 30, 2018 2017		Six Months Ended June 30, 2018 2017	
	(in millions, except share data)			
Net income—basic and diluted	\$42.5	\$ 24.8	\$68.1	\$ 48.0
Weighted average number of shares outstanding—basic	32,880,322	32,469,137	32,843,321	32,898,858
Effect of dilutive securities:				
PSUs	202,142	235,617	253,098	272,754
Stock options	100,352	230,049	100,632	227,856
RSUs	40,177	57,795	62,578	83,460
Dilutive potential shares	342,685	523,461	416,315	584,070
Weighted average number of shares outstanding—diluted	33,222,371	33,092,598	33,259,375	33,982,928

Item 2. Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with our consolidated financial statements and the related notes thereto included in Item 1 of Part I. Unless otherwise indicated, all references to "we," "us," "our," "the Company," or similar terms refer to EHI, together with its subsidiaries. The information contained in this quarterly report is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this quarterly report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report.

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements if accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those discussed. You should not place undue reliance on these statements, which speak only as of the date of this report. Forward-looking statements include those related to our expected financial position, business, financing plans, litigation, future premiums, revenues, earnings, pricing, investments, business relationships, strategic initiatives, expected losses, accident year loss estimates, loss experience, loss reserves, acquisitions, competition, the impact of changes in interest rates, rate increases with respect to our business, and the insurance industry in general. Statements including words such as "expect," "intend," "plan," "believe," "estimate," "may," "anticipate," or similar statements of a future or forward-looking nature identify forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. All forward-looking statements address matters that involve risks and uncertainties that could cause actual results to differ materially from historical or anticipated results, depending on a number of factors. These risks and uncertainties include, but are not limited to, those described in our Annual Report and other documents that we have filed with the SEC.

Overview

We are a Nevada holding company. Through our insurance subsidiaries, we provide workers' compensation insurance coverage to select, small businesses in low to medium hazard industries. Workers' compensation insurance is provided under a statutory system wherein most employers are required to provide coverage for their employees' medical, disability, vocational rehabilitation, and/or death benefit costs for work-related injuries or illnesses. We provide workers' compensation insurance in 42 states and the District of Columbia, with a concentration in California, where over one-half of our business is generated. Our revenues are primarily comprised of net premiums earned, net investment income, and net realized and unrealized gains on investments.

We target small businesses, as we believe that this market is traditionally characterized by fewer competitors, more attractive pricing, and stronger persistency when compared to the U.S. workers' compensation insurance industry in general. We believe we are able to price our policies at levels that are competitive and profitable over the long-term given our expertise in underwriting this market segment. Our underwriting approach is to consistently underwrite small business accounts at appropriate and competitive prices without sacrificing long-term profitability and stability for short-term top-line revenue growth.

Our strategy is to pursue profitable growth opportunities across market cycles and maximize total investment returns within the constraints of prudent portfolio management. We pursue profitable growth opportunities by focusing on disciplined underwriting and claims management, utilizing medical provider networks designed to produce superior medical and indemnity outcomes, establishing and maintaining strong, long-term relationships with independent insurance agencies, development and implementation of new technologies, and developing important alternative distribution channels. We continue to execute a number of ongoing business initiatives, including: focusing on internal and customer-facing business process excellence; accelerating the settlement of open claims; diversifying our risk exposure across geographic markets; utilizing a multi-company pricing platform; utilizing territory-specific pricing; and leveraging data-driven strategies to target, price, and underwrite profitable classes of business across all of our markets.

The insurance industry is highly competitive, and there is significant competition in the national workers' compensation industry that is based on price and quality of services. We compete with other specialty workers' compensation carriers, state agencies, multi-line insurance companies, professional employer organizations, self-insurance funds, and state insurance pools.

Pricing on our renewals showed an overall price decrease of 9.7% versus the rate level in effect on such business a year earlier for each of the three and six months ended June 30, 2018. We believe that we can continue to write attractive business due to favorable loss costs and frequency trends and the success of our accelerated claims initiatives, despite the competitive market conditions we currently face. Given the strength of our balance sheet and the execution of our underwriting, claims, and investment strategies, we believe that we are well positioned for the current market cycle.

On August 11, 2017, we entered into, and on May 23, 2018, we amended, a Purchase Agreement with PRUS with respect to the Acquisition of all of the outstanding shares of capital stock of PRNY. The purchase price is equal to the sum of: (i) the amount of

statutory capital and surplus of PRNY at closing (which is currently estimated to be approximately \$40.0 million); and (ii) \$5.8 million. We expect to fund the Acquisition with cash on hand.

Pursuant to the Purchase Agreement, all liabilities and obligations of PRNY existing as of the closing date, whether known or unknown, will be indemnified by PRUS. In addition, PartnerRe Ltd., the parent company of PRUS, has provided us with a Guaranty that unconditionally, absolutely and irrevocably guarantees the full and prompt payment and performance by PRUS of all of its obligations, liabilities and indemnities under the Purchase Agreement and the transactions contemplated thereby.

We will not be acquiring any employees or ongoing business operations pursuant to the Acquisition. The Acquisition is subject to certain closing conditions, including, among other things, approval from the Department of Financial Services of the State of New York.

Results of Operations

A primary measure of our performance is our ability to increase Adjusted stockholders' equity over the long-term. We believe that this measure is important to our investors, analysts, and other interested parties who benefit from having an objective and consistent basis for comparison with other companies within our industry. The following table shows a reconciliation of our Stockholders' equity on a GAAP basis to our Adjusted stockholders' equity.

	June 30,	December 31,
	2018	2017
	(in millions)	
GAAP stockholders' equity	\$ 956.5	