

DIRECT GENERAL CORP

Form 10-Q

September 23, 2003

**Table of Contents**

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 June 30, 2003

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: 000-50360

**DIRECT GENERAL CORPORATION**

(Exact name of registrant as specified in its charter)

Tennessee

62-1564496

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

1281 Murfreesboro Road, Nashville, TN

37217

(Address of principal executive offices)

(Zip Code)

(615) 399-0600

(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 is an accelerated filer (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: 21,350,640 shares of common stock, no par value, at September 22, 2003.

**TABLE OF CONTENTS**

**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Item 4. Controls and Procedures

**PART. II. OTHER INFORMATION**

Item 1. Legal Proceedings

Item 2. Changes in Securities and Use of Proceeds

Item 4. Submission of Matters to a Vote of Security Holders

Item 6. Exhibits and Reports on Form 8-K

**SIGNATURES**

**EX-10.31 STOCK PURCHASE AGREEMENT**

**EX-31.1 302 CERTIFICATION OF THE CEO**

**EX-31.2 302 CERTIFICATION OF THE CFO**

**EX-32.1 906 CERTIFICATION OF THE CEO**

**EX-32.2 906 CERTIFICATION OF THE CFO**

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Table of Contents

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements.

## DIRECT GENERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30	
	2003	2002	2003	2002
(In thousands except per share amounts)				
<b>Revenues</b>				
Premiums earned	\$53,776	\$35,217	\$101,451	\$66,104
Finance income	11,220	8,593	22,447	17,228
Commission and service fee income	7,499	5,724	15,998	13,807
Net investment income	1,550	1,395	2,931	2,608
Net realized gains (losses) on securities	1,655	(1,109)	1,921	(1,151)
<b>Total revenues</b>	<b>75,700</b>	<b>49,820</b>	<b>144,748</b>	<b>98,596</b>
<b>Expenses</b>				
Insurance losses and loss adjustment expenses	40,191	24,507	74,989	47,151
Selling, general and administrative costs	17,651	14,566	34,982	32,390
Interest expense	1,805	1,626	3,372	3,235
<b>Total expenses</b>	<b>59,647</b>	<b>40,699</b>	<b>113,343</b>	<b>82,776</b>
Income before income taxes	16,053	9,121	31,405	15,820
Income tax expense	5,919	3,287	11,461	5,449
<b>Net income</b>	<b>10,134</b>	<b>5,834</b>	<b>19,944</b>	<b>10,371</b>
Preferred stock dividends Series B	141	141	281	281
<b>Net income available to common stockholders</b>	<b>\$ 9,993</b>	<b>\$ 5,693</b>	<b>\$ 19,663</b>	<b>\$ 10,090</b>
<b>Earnings per Share</b>				
Basic earnings per common share	\$ 0.82	\$ 0.42	\$ 1.62	\$ 0.75
Diluted earnings per common share	\$ 0.58	\$ 0.31	\$ 1.14	\$ 0.56

See notes to consolidated financial statements.

**Table of Contents****DIRECT GENERAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

	(Unaudited) June 30, 2003	December 31, 2002
(In thousands)		
<b>Assets</b>		
Investments:		
Debt securities available-for-sale at fair value (amortized cost \$169,754 and \$119,292)	\$ 174,207	\$ 123,576
Short-term investments		2,745
	<u>174,207</u>	<u>126,321</u>
Total investments	174,207	126,321
Cash and cash equivalents	111,372	87,027
Finance receivables, net	203,992	166,935
Reinsurance balances receivable	52,610	50,874
Prepaid reinsurance premiums	102,498	82,648
Deferred policy acquisition costs	8,853	8,165
Deferred income taxes	15,995	12,740
Property and equipment	12,148	12,791
Goodwill, net	7,409	7,409
Other assets	19,395	14,210
	<u>708,479</u>	<u>569,120</u>
Total assets	\$ 708,479	\$ 569,120
<b>Liabilities, Redeemable Preferred Stock and Stockholders Equity</b>		
Loss and loss adjustment expense reserves	\$ 101,456	\$ 86,898
Unearned premiums	215,318	172,971
Reinsurance balances payable and funds held	90,412	76,722
Accounts payable and accrued expenses	12,665	13,629
Income taxes payable	723	3,182
Notes payable	168,895	126,880
Capital lease obligations	4,159	4,310
Other liabilities	30,331	19,648
	<u>623,959</u>	<u>504,240</u>
Total liabilities	623,959	504,240
Redeemable Series A preferred stock, no par; authorized, issued and outstanding shares 2,937.7	5,685	5,685
	<u>5,685</u>	<u>5,685</u>
Stockholders equity		
Series B preferred stock, no par; authorized shares 2,700.0; issued and outstanding shares 2,078.2	9,219	9,219
Preferred stock, no par; authorized shares 4,362.3; no shares issued		
Common stock, no par; authorized shares 100,000.0; issued shares 13,447.5	9,037	9,037
Retained earnings	63,505	43,842
Accumulated other comprehensive income:		
Net unrealized appreciation on investment securities	2,895	2,789
Net loss on cash flow hedge	(1,273)	(1,144)
Treasury stock, at cost; 1,328.4 shares at June 30, 2003 and December 31, 2002	(4,548)	(4,548)
	<u>78,835</u>	<u>59,195</u>
Total stockholders equity	78,835	59,195

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Total liabilities, redeemable preferred stock and stockholders equity	\$ 708,479	\$ 569,120
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See notes to consolidated financial statements.

**Table of Contents****DIRECT GENERAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY  
(Unaudited)**

For the Six Months Ended June 30, 2003 and 2002

	Series B Preferred Stock	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders Equity
(In thousands)						
Balances at January 1, 2003	\$9,219	\$9,037	\$43,842	\$ 1,645	\$(4,548)	\$59,195
Comprehensive income:						
Net income			19,944			19,944
Net unrealized appreciation on securities available-for-sale, net of deferred taxes				106		106
Net change during the period related to cash flow hedge				(129)		(129)
Total comprehensive income						19,921
Dividends on preferred stock			(281)			(281)
Balances at June 30, 2003	\$9,219	\$9,037	\$63,505	\$ 1,622	\$(4,548)	\$78,835
Balances at January 1, 2002	\$9,219	\$9,037	\$13,366	\$ (615)	\$	\$31,007
Comprehensive income:						
Net income			10,371			10,371
Net unrealized appreciation on securities available-for-sale, net of deferred taxes				1,938		1,938
Net change during the period related to cash flow hedge				(535)		(535)
Total comprehensive income						11,774
Dividends on preferred stock			(281)			(281)
Purchase of treasury stock (108.0 shares)					(248)	(248)
Balances at June 30, 2002	\$9,219	\$9,037	\$23,456	\$ 788	\$ (248)	\$42,252

See notes to consolidated financial statements.

**Table of Contents****DIRECT GENERAL CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)**

	<b>Six Months Ended June 30</b>	
	<b>2003</b>	<b>2002</b>
<b>(In thousands)</b>		
<b>Operating activities</b>		
Net income	\$ 19,944	\$ 10,371
Adjustments to reconcile net income to net cash provided by operating activities:		
Net realized (gains) losses on securities	(1,921)	1,151
Depreciation and amortization	2,341	2,470
Deferred income taxes	(4,256)	(2,250)
Changes in operating assets and liabilities:		
Finance receivables	(37,057)	(39,058)
Reinsurance balances receivable	(1,736)	(6,979)
Prepaid reinsurance premiums	(19,850)	(11,804)
Deferred policy acquisition costs	(688)	(2,411)
Income taxes recoverable/payable	(2,459)	5,085
Loss and loss adjustment expense reserves	14,558	7,857
Unearned premiums	42,347	41,045
Reinsurance balances payable and funds held	13,690	11,202
Accounts payable and accrued expenses	(964)	1,772
Other	6,307	47
	<u>30,256</u>	<u>18,498</u>
Net cash provided by operating activities	30,256	18,498
<b>Investing activities</b>		
Proceeds from sales and maturities of debt securities available-for-sale	49,948	7,416
Purchase of debt securities available-for-sale	(98,489)	(21,220)
Net sales (purchases) of short-term investments	2,745	(1,200)
Purchase of property and equipment, net	(1,698)	(1,763)