

Hilltop Holdings Inc.
Form 10-Q
August 05, 2011
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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 June 30, 2011

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

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of shares of the Registrant's common stock outstanding at August 4, 2011 was 56,499,204.

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FORM 10-Q

FOR THE QUARTER ENDED JUNE 30, 2011

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Table of Contents**HILLTOP HOLDINGS INC.****CONSOLIDATED BALANCE SHEETS****AS OF JUNE 30, 2011 AND DECEMBER 31, 2010****(in thousands, except share and per share data)****(unaudited)**

	June 30, 2011	December 31, 2010
Assets		
Investments		
Fixed maturities		
Available for sale securities, at fair value (amortized cost of \$124,976 and \$115,344, respectively)	\$ 133,031	\$ 123,162
Held-to-maturity securities, at amortized cost (fair value of \$18,102 and \$18,059 respectively)	17,062	17,035
Equity securities		
Available for sale securities, at fair value (cost of \$8,800 and \$8,478, respectively)	9,141	8,768
Total investments	159,234	148,965
Cash and cash equivalents	639,160	649,439
Accrued interest and dividends	1,593	1,519
Premiums receivable	25,593	22,490
Deferred acquisition costs	19,617	17,237
Reinsurance recoverable, net of uncollectible amounts	41,921	45,655
Prepaid reinsurance premiums	4,878	4,898
Deferred income taxes	15,334	9,115
Goodwill	23,988	23,988
Intangible assets, definite life	6,831	7,599
Intangible assets, indefinite life	3,000	3,000
Property and equipment, net	2,173	2,021
Loan origination costs, net	2,773	2,871
Other assets	1,357	844
Total assets	\$ 947,452	\$ 939,641
Liabilities and Stockholders Equity		
Liabilities		
Reserve for losses and loss adjustment expenses	\$ 68,616	\$ 58,882
Unearned premiums	82,118	72,814
Reinsurance payable	5,979	5,666
Accounts payable and accrued expenses	8,147	8,600
Income taxes payable	99	78
Notes payable	138,350	138,350
Other liabilities	2,690	2,196
Total liabilities	305,999	286,586
Stockholders Equity		
Common stock, \$.01 par value, 100,000,000 shares authorized, 56,497,840 and 56,495,410 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively	565	565
Additional paid-in capital	918,080	918,046

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Accumulated other comprehensive income	5,457	5,270
Accumulated deficit	(282,649)	(270,826)
Total stockholders' equity	641,453	653,055
Total liabilities and stockholders' equity	\$ 947,452	\$ 939,641

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

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HILLTOP HOLDINGS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2011 AND 2010

(in thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Revenue:				
Net premiums earned	\$ 32,568	\$ 29,301	\$ 63,500	\$ 57,432
Net investment income	2,229	1,855	4,310	3,490
Other income	1,723	1,765	3,348	3,545
Net realized (losses) gains on investments				
Other-than-temporary impairments on fixed maturity securities		(65)		(65)
Other realized investment gains, net	12	14	31	123
Total realized investment gains (losses), net	12	(51)	31	58
Total revenue	36,532	32,870	71,189	64,525
Expenses:				
Loss and loss adjustment expenses	41,101	20,534	57,105	35,834
Policy acquisition and other underwriting expenses	11,597	11,556	23,582	22,680
General and administrative expenses	1,612	2,063	3,485	3,893
Depreciation and amortization	426	450	858	913
Interest expense	2,245	2,254	4,421	4,436
Total expenses	56,981	36,857	89,451	67,756
Loss before income tax benefit	(20,449)	(3,987)	(18,262)	(3,231)
Income tax benefit	7,216	1,358	6,439	1,093
Net loss	(13,233)	(2,629)	(11,823)	(2,138)
Preferred stock dividend		(2,578)		(5,156)
Net loss attributable to common stockholders	\$ (13,233)	\$ (5,207)	\$ (11,823)	\$ (7,294)
Loss per share attributable to common stockholders				
Basic loss per share	\$ (0.23)	\$ (0.09)	\$ (0.21)	\$ (0.13)
Diluted loss per share	\$ (0.23)	\$ (0.09)	\$ (0.21)	\$ (0.13)
Weighted average share information				
Basic shares outstanding	56,498	56,491	56,497	56,490
Diluted shares outstanding	56,498	56,491	56,497	56,490

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 SIX MONTHS ENDED JUNE 30, 2011

(in thousands)

(unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders Equity
Balance, January 1, 2011	56,495	\$ 565	\$ 918,046	\$ 5,270	\$ (270,826)	\$ 653,055
Net loss					(11,823)	(11,823)
Other comprehensive gain, net of tax of \$101				187		187
Total comprehensive loss						(11,636)
Common stock issued to board members	3		24			24
Stock compensation expense			10			10
Balance, June 30, 2011	56,498	\$ 565	\$ 918,080	\$ 5,457	\$ (282,649)	\$ 641,453

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 SIX MONTHS ENDED JUNE 30, 2011 AND 2010

(in thousands)

(unaudited)

	For the Six Months Ended June 30,	
	2011	2010
Cash flow from operating activities:		
Net loss	\$ (11,823)	\$ (2,138)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	858	913
(Increase) decrease in deferred income taxes	(6,320)	1,299
Increase in unearned premiums	9,304	5,636
Increase in deferred acquisition costs	(2,380)	(1,484)
Realized gains on investments	(31)	(58)
Amortization of loan origination costs	98	98
Stock grant compensation expense	34	94
Decrease in payable to related party	(263)	(3,769)
Increase in income taxes payable	21	
Decrease in income taxes receivable		202
Increase in premium and agent balances	(3,103)	(2,485)
Decrease (increase) in reinsurance recoverables	3,734	(1,896)
Increase in loss and loss adjustment expense reserves	9,734	2,966
Changes in other operating assets and liabilities	226	1,373
Net cash provided by operating activities	\$ 89	\$ 751
Cash flow from investing activities:		
Purchases of available-for-sale securities	(16,321)	(25,284)
Purchases of held-to-maturity securities		(1,606)
Proceeds from sales of available-for-sale securities	2,392	14,636
Proceeds from maturities of available-for-sale securities	3,803	4,751
Proceeds from maturities of held-to-maturity securities		1,600
Purchases of fixed assets	(242)	(153)
Net cash used in investing activities	\$ (10,368)	\$ (6,056)
Cash flow from financing activities:		
Payment of preferred dividends		(5,156)
Net cash used in financing activities	\$ (10,279)	\$ (10,461)
Net decrease in cash and cash equivalents		(10,461)
Cash and cash equivalents, beginning of period	649,439	790,013
Cash and cash equivalents, end of period	\$ 639,160	\$ 779,552
Supplemental cash flow information:		
Cash paid for interest	\$ 4,386	\$ 4,376
Dividends declared but unpaid	\$	\$ 1,719

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

JUNE 30, 2011

(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. On July 29, 2011, we made a \$50 million investment in SWS Group, Inc.

We also conduct operations in the property and casualty insurance industry through our wholly-owned property and casualty insurance holding company, NLASCO Inc., or NLASCO. NLASCO operates through its wholly-owned subsidiaries, National Lloyds Insurance Company (NLIC) and American Summit Insurance Company (ASIC). NLIC commenced business in 1949 and currently operates in 15 states, with its largest market being the State of Texas. ASIC was formed in 1955 and currently operates in 12 states, 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 and are regulated by the Texas Department of Insurance.

Our common stock is listed on the New York Stock Exchange under the symbol HTH .

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

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adjustments were of a normal, recurring nature. The results of operations for the interim period ended June 30, 2011 may not be indicative of the results that may be expected for the year ended December 31, 2011. These financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010.

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.

Summary of Significant Accounting Policies

Recently Adopted Accounting Pronouncements

In December 2010, the Financial Accounting Standards Board, or FASB, issued ASU-2010-29 to address diversity in practice relating to the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The amendments in the update specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a

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description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments in this update are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The adoption of this guidance in the quarter ended March 31, 2011 did not have a material impact on the Company's financial statements.

In December 2010, the FASB issued ASU-2010-28 to modify Step 1 of the goodwill impairment test. The guidance affects all entities that have recognized goodwill and have one or more reporting units whose carrying amount for purposes of performing Step 1 of the goodwill impairment test is zero or negative. The amendments in this update modify Step 1 so that for those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with existing guidance, which requires that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The amendments in this update are effective for fiscal years beginning after December 15, 2010. The adoption of this guidance in the quarter ended March 31, 2011 did not have a material impact on the Company's financial statements.

Recently Issued 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 adoption of this guidance is not expected to have a 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 is not expected to 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 will change our current presentation of other comprehensive income; however, it is not expected to have a material impact on the Company's financial statements.

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The amortized cost (original cost for equity securities), gross unrealized holding gains and losses, and fair value of available-for-sale and held-to-maturity securities by major security type and class of security at June 30, 2011 and December 31, 2010 were as follows (in thousands).

	June 30, 2011			
	Cost and Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	\$ 14,901	\$ 1,057		\$ 15,958
Residential mortgage-backed securities	10,410	1,045		11,455
Commercial mortgage-backed securities	2,367	62	(8)	2,421
Corporate debt securities	97,298	5,910	(11)	103,197
	124,976	8,074	(19)	133,031
Equity securities	8,800	343	(2)	9,141
	133,776	8,417	(21)	142,172
Held-to-maturity securities:				
Fixed maturities:				
Government securities	17,062	1,040		18,102
	\$ 150,838	\$ 9,457	\$ (21)	\$ 160,274

	December 31, 2010			
	Cost and Amortized Cost	Gross Unrealized Holding Gains	Gross Unrealized Holding Losses	Fair Value
Available-for-sale securities:				
Fixed maturities:				
Government securities	\$ 14,883	\$ 1,118		\$ 16,001
Residential mortgage-backed securities	12,563	1,078		13,641
Commercial mortgage-backed securities	2,496	98		2,594
Corporate debt securities	85,402	5,564	(40)	90,926
	115,344	7,858	(40)	123,162
Equity securities	8,478	290		8,768
	123,822	8,148	(40)	131,930
Held-to-maturity securities:				
Fixed maturities:				
Government securities	17,035	1,024		18,059
	\$ 140,857	\$ 9,172	\$ (40)	\$ 149,989

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The following tables summarize the length of time securities with unrealized losses at June 30, 2011 and December 31, 2010 have been in an unrealized loss position (in thousands).

	Less than 12 Months		June 30, 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:						
Commercial						
mortgage-backed securities	\$ 489	\$ (8)	\$	\$	\$ 489	\$ (8)
Corporate debt securities	2,678	(11)			2,678	(11)
	3,167	(19)			3,167	(19)
Equity securities	97	(2)			97	(2)
	\$ 3,264	\$ (21)	\$	\$	\$ 3,264	\$ (21)

	Less than 12 Months		December 31, 2010 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:						
Corporate debt securities	\$ 4,976	\$ (40)	\$	\$	\$ 4,976	\$ (40)
	4,976	(40)			4,976	(40)
Equity securities	56				56	
	\$ 5,032	\$ (40)	\$	\$	\$ 5,032	\$ (40)

For the quarter and six months ended June 30, 2011, 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 great 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 June 30, 2011.

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Gross realized investment gains and losses for the three and six months ended June 30, 2011 and 2010 are summarized as follows (in thousands).

	2011		Three Months Ended June 30,		2010		Total
	Gross Gains	Gross Losses	Total	Gross Gains	Gross Losses		
Fixed maturities	\$ 13	\$ (1)	\$ 12	\$ 14	\$ (65)	\$ (51)	
	\$ 13	\$ (1)	\$ 12	\$ 14	\$ (65)	\$ (51)	

	2011		Six Months Ended June 30,		2010		Total
	Gross Gains	Gross Losses	Total	Gross Gains	Gross Losses		
Fixed maturities	\$ 33	\$ (2)	\$ 31	\$ 158	\$ (100)	\$ 58	
	\$ 33	\$ (2)	\$ 31	\$ 158	\$ (100)	\$ 58	

Sale of available-for-sale investment securities resulted in the following during the three and six months ended June 30, 2011 and 2010 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Proceeds	\$ 877	\$ 12,912	\$ 2,392	\$ 14,636
Gross gains	\$ 13	\$ 14	\$ 33	\$ 158
Gross losses	\$ (1)	\$ (65)	\$ (2)	\$ (100)

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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 and held-to-maturity securities at June 30, 2011 and December 31, 2010, by contractual maturity are as follows (in thousands).

	June 30, 2011	
	Amortized Cost	Fair Value
Available-for-sale fixed maturities:		
Due within one year	\$ 6,079	\$ 6,211
Due after one year through five years	69,944	73,759
Due six years through ten years	35,262	38,270
Due after ten years	914	915
Mortgage-backed securities	12,777	13,876
	\$ 124,976	\$ 133,031

Held-to-maturity debt securities:		
Due within one year	\$ 595	\$ 601
Due after one year through five years	11,817	12,341
Due six years through ten years	4,650	5,160
	\$ 17,062	\$ 18,102

	December 31, 2010	
	Amortized Cost	Fair Value
Available-for-sale fixed maturities:		
Due within one year	\$ 8,228	\$ 8,420
Due after one year through five years	58,959	62,339
Due six years through ten years		