

HCC INSURANCE HOLDINGS INC/DE/

Form 10-Q

August 07, 2008

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q**

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarter Ended June 30, 2008.**

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 001-13790**

**HCC Insurance Holdings, Inc.**

(Exact name of registrant as specified in its charter)

Delaware

76-0336636

(State or other jurisdiction of  
incorporation or organization)

(IRS Employer  
Identification No.)

13403 Northwest Freeway, Houston, Texas

77040-6094

(Address of principal executive offices)

(Zip Code)

(713) 690-7300

(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 a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

(Do not check if a 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

Indicate the number of shares outstanding of each of the registrant's classes of common stock as of the latest practicable date.

On July 31, 2008, there were approximately 114.7 million shares of common stock, \$1.00 par value outstanding.

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**FORWARD-LOOKING STATEMENTS**

*This Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created by those laws. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements include information about possible or assumed future results of our operations. All statements, other than statements of historical facts, included or incorporated by reference in this Report that address activities, events or developments that we expect or anticipate may occur in the future, including such things as growth of our business and operations, business strategy, competitive strengths, goals, plans, future capital expenditures and references to future successes may be considered forward-looking statements. Also, when we use words such as anticipate, believe, estimate, expect, intend, plan, probably or similar expressions, we are making forward-looking statements.*

*Many risks and uncertainties may impact the matters addressed in these forward-looking statements, which could affect our future financial results and performance, including, among other things:*

*the effects of catastrophic losses;*

*the cyclical nature of the insurance business;*

*inherent uncertainties in the loss estimation process, which can adversely impact the adequacy of loss reserves;*

*the effects of emerging claim and coverage issues;*

*the effects of extensive governmental regulation of the insurance industry;*

*potential credit risk with brokers;*

*our assessment of underwriting risk;*

*our increased retention of risk, which could expose us to greater potential losses;*

*the adequacy of reinsurance protection;*

*the ability or willingness of reinsurers to pay balances due us;*

*the occurrence of terrorist activities;*

*our ability to maintain our competitive position;*

*changes in our assigned financial strength ratings;*

*our ability to raise capital in the future;*

*attraction and retention of qualified employees;*

*fluctuations in securities markets, which may reduce the value of our investment assets;*

*our ability to successfully expand our business through the acquisition of insurance-related companies;*

*impairment of goodwill;*

*the ability of our insurance company subsidiaries to pay dividends in needed amounts;*

*fluctuations in foreign exchange rates;*

*failures of our information technology systems; and*

*change of control.*

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*We describe these risks and uncertainties in greater detail in Item 1A, Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2007.*

*These events or factors could cause our results or performance to differ materially from those we express in our forward-looking statements. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of these assumptions and, therefore, the forward-looking statements based on these assumptions could themselves prove to be inaccurate. In light of the significant uncertainties inherent in the forward-looking statements that are included in this Report, our inclusion of this information is not a representation by us or any other person that our objectives and plans will be achieved.*

*Our forward-looking statements speak only at the date made, and we will not update these forward-looking statements unless the securities laws require us to do so. In light of these risks, uncertainties and assumptions, any forward-looking events discussed in this Report may not occur.*

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HCC Insurance Holdings, Inc. and Subsidiaries  
 Condensed Consolidated Balance Sheets  
 (unaudited, in thousands except per share data)

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Investments:		
Fixed income securities, at fair value (amortized cost: 2008 - \$4,102,100; 2007 - \$3,641,667)	\$ 4,068,023	\$ 3,666,705
Short-term investments, at cost, which approximates fair value	527,086	783,650
Other investments	167,418	221,922
<b>Total investments</b>	<b>4,762,527</b>	<b>4,672,277</b>
Cash	27,129	39,135
Restricted cash and cash investments	188,862	193,151
Premium, claims and other receivables	810,109	763,401
Reinsurance recoverables	1,030,408	956,665
Ceded unearned premium	235,632	244,684
Ceded life and annuity benefits	65,275	66,199
Deferred policy acquisition costs	200,576	192,773
Goodwill	818,329	776,046
Other assets	176,431	170,314
<b>Total assets</b>	<b>\$ 8,315,278</b>	<b>\$ 8,074,645</b>
<b>LIABILITIES</b>		
Loss and loss adjustment expense payable	\$ 3,446,824	\$ 3,227,080
Life and annuity policy benefits	65,275	66,199
Reinsurance balances payable	119,893	129,838
Unearned premium	998,922	943,946
Deferred ceding commissions	60,891	68,968
Premium and claims payable	422,068	497,974
Notes payable	369,714	324,714
Accounts payable and accrued liabilities	267,272	375,561
<b>Total liabilities</b>	<b>5,750,859</b>	<b>5,634,280</b>
<b>SHAREHOLDERS EQUITY</b>		
Common stock, \$1.00 par value; 250.0 million shares authorized (shares issued: 2008 - 115,701; 2007 - 115,069 and outstanding: 2008 - 115,581; 2007 - 115,069)	115,701	115,069

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Additional paid-in capital	847,452	831,419
Retained earnings	1,594,030	1,445,995
Accumulated other comprehensive income	9,819	47,882
Treasury stock, at cost (shares: 2008 - 120)	(2,583)	
<b>Total shareholders equity</b>	<b>2,564,419</b>	<b>2,440,365</b>
<b>Total liabilities and shareholders equity</b>	<b>\$ 8,315,278</b>	<b>\$ 8,074,645</b>

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries  
Condensed Consolidated Statements of Earnings  
(unaudited, in thousands except per share data)

	<b>Six months ended June 30,</b>		<b>Three months ended June</b>	
	<b>2008</b>	<b>2007</b>	<b>30,</b>	<b>2007</b>
			<b>2008</b>	<b>2007</b>
<b>REVENUE</b>				
Net earned premium	\$ 1,000,156	\$ 991,986	\$ 506,610	\$ 494,386
Fee and commission income	61,763	63,261	30,764	31,136
Net investment income	94,870	98,164	47,249	48,697
Net realized investment loss	(1,552)	(624)	(1,720)	(69)
Other operating income	6,001	38,685	10,947	20,100
<b>Total revenue</b>	<b>1,161,238</b>	<b>1,191,472</b>	<b>593,850</b>	<b>594,250</b>
<b>EXPENSE</b>				
Loss and loss adjustment expense, net	595,927	603,763	302,901	303,291
Policy acquisition costs, net	188,113	174,527	95,845	85,428
Other operating expense	116,718	111,108	57,514	53,467
Interest expense	7,767	4,399	3,808	1,096
<b>Total expense</b>	<b>908,525</b>	<b>893,797</b>	<b>460,068</b>	<b>443,282</b>
Earnings before income tax expense	252,713	297,675	133,782	150,968
Income tax expense	79,275	99,813	41,445	49,796
<b>Net earnings</b>	<b>\$ 173,438</b>	<b>\$ 197,862</b>	<b>\$ 92,337</b>	<b>\$ 101,172</b>
<b>Basic earnings per share data:</b>				
Net earnings per share	\$ 1.50	\$ 1.76	\$ 0.80	\$ 0.90
Weighted average shares outstanding	115,363	112,117	115,492	112,273
<b>Diluted earnings per share data:</b>				
Net earnings per share	\$ 1.49	\$ 1.69	\$ 0.80	\$ 0.86

Weighted average shares outstanding	116,218	117,381	116,075	117,728
Cash dividends declared, per share	\$ 0.22	\$ 0.20	\$ 0.11	\$ 0.10

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries  
Condensed Consolidated Statement of Changes in Shareholders' Equity  
Six months ended June 30, 2008  
(unaudited, in thousands except per share data)

	<b>Common stock</b>	<b>Additional paid-in capital</b>	<b>Retained earnings</b>	<b>Accumulated other comprehensive income</b>	<b>Treasury stock</b>	<b>Total shareholders equity</b>
<b>Balance at December 31, 2007</b>	\$ 115,069	\$ 831,419	\$ 1,445,995	\$ 47,882	\$	\$ 2,440,365
Net earnings			173,438			173,438
Other comprehensive loss				(38,063)		(38,063)
Comprehensive income						135,375
Issuance of 546 shares for exercise of options, including tax benefit of \$599	546	9,322				9,868
Stock-based compensation	86	6,711				6,797
Purchase of 120 treasury shares					(2,583)	(2,583)
Cash dividends declared, \$0.22 per share			(25,403)			(25,403)
<b>Balance at June 30, 2008</b>	\$ 115,701	\$ 847,452	\$ 1,594,030	\$ 9,819	\$ (2,583)	\$ 2,564,419

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(unaudited, in thousands)

	<b>Six months ended June</b>		<b>Three months ended June</b>	
	<b>30,</b>		<b>30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Cash flows from operating activities:				
Net earnings	\$ 173,438	\$ 197,862	\$ 92,337	\$ 101,172
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Change in premium, claims and other receivables	(43,624)	30,041	(47,403)	(57,125)
Change in reinsurance recoverables	(73,812)	94,621	(76,483)	(16,646)
Change in ceded unearned premium	9,052	(21,249)	(10,847)	(23,139)
Change in loss and loss adjustment expense payable	219,858	105,937	128,013	89,492
Change in reinsurance balances payable	(9,945)	(873)	(4,184)	7,452
Change in unearned premium	55,022	62,882	71,982	65,504
Change in premium and claims payable, net of restricted cash	(73,868)	(42,100)	(28,419)	44,587
Change in current income taxes payable	(7,310)	(14,690)	(42,975)	(38,013)
Change in trading portfolio	42,574	4,865	33,512	(6,093)
Gain on sales of strategic investments	(9,158)	(21,618)	(9,158)	(10,811)
Stock-based compensation expense	6,797	6,389	3,931	4,178
Depreciation and amortization expense	6,824	7,861	3,434	4,125
Other, net	(65,409)	(9,628)	(19,101)	5,306
<b>Cash provided by operating activities</b>	<b>230,439</b>	<b>400,300</b>	<b>94,639</b>	<b>169,989</b>
Cash flows from investing activities:				
Sales of fixed income securities	236,878	174,718	116,803	146,235
Maturity or call of fixed income securities	182,410	158,121	106,535	87,973
Cost of securities acquired	(925,693)	(736,873)	(469,720)	(369,678)
Change in short-term investments	256,564	(26,014)	128,512	(50,871)
Proceeds from sales of other investments	30,994		11,956	
Proceeds from sales of strategic investments	22,818	39,816	22,818	16,866
Payments for purchase of subsidiaries, net of cash received	(72,369)	(51,681)	(883)	(45,764)
Other, net	(4,685)	(5,356)	(3,015)	(3,188)
<b>Cash used by investing activities</b>	<b>(273,083)</b>	<b>(447,269)</b>	<b>(86,994)</b>	<b>(218,427)</b>
Cash flows from financing activities:				
Advances on line of credit	75,000	62,000	35,000	51,000
Payments on line of credit and notes payable	(30,000)	(12,887)	(30,000)	(1,548)
Sales of common stock	9,868	16,422	5,276	8,382

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Dividends paid	(25,340)	(22,381)	(12,682)	(11,208)
Other, net	1,110	(2,544)	(2,798)	1,251
<b>Cash provided (used) by financing activities</b>	<b>30,638</b>	<b>40,610</b>	<b>(5,204)</b>	<b>47,877</b>
Net increase (decrease) in cash	(12,006)	(6,359)	2,441	(561)
Cash at beginning of period	39,135	48,290	24,688	42,492
<b>Cash at end of period</b>	<b>\$ 27,129</b>	<b>\$ 41,931</b>	<b>\$ 27,129</b>	<b>\$ 41,931</b>

See Notes to Condensed Consolidated Financial Statements.

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HCC Insurance Holdings, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(unaudited, tables in thousands except per share data)

**(1) GENERAL INFORMATION**

HCC Insurance Holdings, Inc. and its subsidiaries (collectively, the Company, we, us or our) include domestic and foreign property and casualty and life insurance companies, underwriting agencies and reinsurance brokers. We provide specialized property and casualty, surety, and group life, accident and health insurance coverages and related agency and reinsurance brokerage services to commercial customers and individuals. We market our products both directly to customers and through a network of independent and affiliated brokers, producers, agents and third party administrators. Our lines of business include diversified financial products (which includes directors and officers liability, professional indemnity, employment practices liability, surety and credit); group life, accident and health; aviation; our London market account (which includes energy, marine, property, and accident and health); and other specialty lines of insurance. We operate primarily in the United States, the United Kingdom, Spain, Bermuda, Belgium and Ireland, although some of our operations have a broader international scope.

**Basis of Presentation**

Our unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (generally accepted accounting principles) and include the accounts of HCC Insurance Holdings, Inc. and its subsidiaries. We have made all adjustments that, in our opinion, are necessary for a fair statement of results of the interim periods, and all such adjustments are of a normal recurring nature. All significant intercompany balances and transactions have been eliminated in consolidation. The condensed consolidated financial statements should be read in conjunction with our annual audited consolidated financial statements and related notes. The condensed consolidated balance sheet at December 31, 2007 was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles.

Management must make estimates and assumptions that affect amounts reported in our condensed consolidated financial statements and in disclosures of contingent assets and liabilities. Ultimate results could differ from those estimates.

**Significant Accounting and Reporting Policies**

We reported Significant Accounting and Reporting Policies in our Annual Report on Form 10-K for the year ended December 31, 2007. The following is a new disclosure related to Reinsurance.

One assumed mortgage guaranty reinsurance contract, which is deemed not to transfer significant underwriting risk, is accounted for using the deposit method of accounting. In catastrophic or unforeseen circumstances, it is possible we could incur financial losses on this contract. We record all consideration received under the contract as a deposit liability, rather than as net earned premium and loss and loss adjustment expense. We use actuarial information to estimate both our liability under the contract and the appropriate rates to decrease the liability over the term of the contract. We report income from this contract, net of any losses, as other operating income in our consolidated statements of income.

**Acquisition and Goodwill**