ASSURANCEAMERICA CORP
Form 10QSB
May 15, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-QSB

(Mark one)

þ **QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2006

o **TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE EXCHANGE ACT OF 1934**

for the transition period from __________ to __________

Commission File Number: 0-06334

AssuranceAmerica Corporation

(Exact name of small business issuer as specified in its charter)

Nevada	**87-0281240**
(State of Incorporation)	(IRS Employer ID Number)
5500 Interstate North Parkway, Suite 600	**30328**
(Address of principal executive offices)	(Zip Code)

(770) 952-0200

(Issuer s telephone number, including area code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or 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 þ NO o

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

There were 51,767,321 shares of the Registrant s $.01 par value Common Stock outstanding as of May 1, 2006, and 1,266,000 shares of the Registrant s $.01 par value Series A Convertible Preferred Stock (Preferred Stock) outstanding as of May 1, 2006.

Transitional Small Business Disclosure Format (check one): Yes o No þ

ASSURANCEAMERICA CORPORATION
Index to Form 10-QSB

Table of Contents

PART I FINANCIAL INFORMATION
Item 1. Financial Statements

ASSURANCEAMERICA CORPORATION
(Unaudited) CONSOLIDATED BALANCE SHEETS
March 31, 2006 and December 31, 2005

	March 31, 2006	December 31, 2005
Assets		
Cash and cash equivalents	$ 5,998,721	$ 8,668,827
Short term investments and other invested assets	893,598	120,000
Long term investments, available for sale at fair value	8,582,075	8,419,835
Investment income due and accrued	126,713	81,150
Receivable from insured	15,751,597	13,821,477
Reinsurance recoverable (including $4,630,131 and $4,213,187 on paid losses)	17,915,842	14,790,099
Prepaid reinsurance premiums	13,556,616	11,211,270
Deferred acquisition costs	707,395	798,539
Property and equipment (net of accumulated depreciation of $1,725,741 and $1,606,200)	1,807,580	1,400,667
Other receivables	5,364,115	1,674,184
Prepaid expenses	235,451	161,415
Intangibles (net of accumulated amortization of $1,495,787 and $1,398,244)	11,016,417	7,359,850
Security deposits	107,241	75,072
Deferred tax assets	1,139,069	
Other assets	375,593	378,758
Total assets	$ 83,578,023	$ 68,961,143
Liabilities and Stockholders Equity		
Accounts payable and accrued expenses	$ 6,202,496	$ 4,802,223
Unearned premium	20,108,264	16,574,473
Unpaid losses and loss adjustment expenses	18,979,587	15,109,874
Reinsurance payable	12,008,046	10,238,081
Provisional commission reserve	2,066,428	1,704,379
Notes payable	7,107,401	5,568,535
Dividends payable	126,600	
Income taxes payable	956,899	
Debentures payable	4,801,852	4,800,185
Capital lease obligations	208,261	220,155
Total liabilities	72,565,834	59,017,905
Stockholders equity		
Common stock, .01 par value (authorized 80,000,000, outstanding 51,767,321 and 51,167,321)	517,673	511,673
Preferred stock, .01 par value (authorized 5,000,000, outstanding 1,266,000 and 1,266,000)	12,660	12,660

Surplus-paid in		16,091,165		15,678,015
Accumulated deficit		(5,589,139)		(6,259,110)
Accumulated other comprehensive (loss) income:				
Net unrealized (loss) gain on investment securities		(20,170)		
Total stockholders equity		11,012,189		9,943,238
Total liabilities and stockholders equity	$	83,578,023	$	68,961,143

See accompanying notes to consolidated financial statements.

3

Table of Contents

ASSURANCEAMERICA CORPORATION
(Unaudited) CONSOLIDATED STATEMENTS OF OPERATIONS
For the Three Months Ended March 31, 2006 and 2005

	Three Months	
	2006	**2005**
Revenue:		
Gross premiums written	$ 19,460,734	$ 10,764,245
Gross premiums ceded	(13,165,429)	(7,331,914)
Net premiums written	6,295,305	3,432,331
Increase in unearned premiums, net of prepaid reinsurance premiums	(1,188,445)	(834,021)
Net premiums earned	5,106,860	2,598,310
Commission income	7,367,806	3,867,879
Managing general agent fees	2,546,505	1,068,735
Net investment income	151,015	13,191
Other fee income	204,764	258,835
Total revenue	15,376,950	7,806,950
Expenses:		
Losses and loss adjustment expenses	3,978,178	1,701,776
Selling, general and administrative expenses	9,698,877	5,118,723
Depreciation and amortization expense	217,084	92,242
Interest expense	284,658	149,499
Total operating expenses	14,178,797	7,062,240
Income before provision for income tax expense	1,198,153	744,710
Income tax provision	401,582	
Net income	796,571	744,710
Dividends on preferred stock	126,600	46,600
Net income attributable to common stockholders	$ 669,971	$ 698,110
Earnings per common share		
Basic	0.013	0.014
Diluted	0.010	0.013
Weighted average shares outstanding-basic	51,647,321	49,681,287
Weighted average shares outstanding-diluted	65,029,221	54,704,718

See accompanying notes to consolidated financial statements.

Table of Contents

ASSURANCEAMERICA CORPORATION
(Unaudited) CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Three Months Ended March 31, 2006 and 2005

	2006	2005
Cash flows from operating activities:		
Net income	$ 796,571	$ 744,710
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	217,084	92,242
Changes in assets and liabilities:		
Receivables	(5,620,051)	(1,576,059)
Prepaid expenses and other assets	(103,040)	(73,336)
Unearned premiums and other payables	3,533,791	2,706,986
Unpaid loss and loss adjustment expenses	3,869,713	763,023
Ceded reinsurance payable	1,769,965	1,203,245
Reinsurance recoverable	(3,125,743)	(973,998)
Prepaid reinsurance premiums	(2,345,346)	(1,872,965)
Accounts payable and accrued expenses	1,400,273	658,259
Income taxes payable	(182,170)	
Equity-based compensation	70,400	
Deferred acquisition costs	91,144	(42,464)
Provisional commission reserve	362,049	200,336
Net cash provided by operating activities	734,640	1,829,979
Cash flows from investing activities:		
Purchases of property and equipment	(526,454)	(115,650)
Acquisitions of agencies	(3,754,110)	
Purchases of investments and accrued investment income	(1,001,571)	(250,192)
Net cash used by investing activities	(5,282,135)	(365,842)
Cash flows from financing activities:		
Proceeds from debt, net	1,540,533	22,440
Preferred dividends paid		(46,600)
Repayments on capital lease obligation	(11,894)	
Stock issued	348,750	200,000
Net cash provided by financing activities	1,877,389	175,840
Net (decrease) increase in cash and cash equivalents	(2,670,106)	1,639,977
Cash and cash equivalents, beginning of period	8,668,827	7,059,188
Cash and cash equivalents, end of period	$ 5,998,721	$ 8,699,165

See accompanying notes to consolidated financial statements.

Table of Contents

ASSURANCEAMERICA CORPORATION AND SUBSIDIARIES
Notes to Consolidated Financial Statements

(1) Description of Business

AssuranceAmerica Corporation, a Nevada corporation (the Company) is an insurance holding company comprised of AssuranceAmerica Insurance Company (AAIC), AssuranceAmerica Managing General Agency, LLC (MGA), TrustWay Insurance Agencies, LLC (TrustWay) and AssuranceAmerica Capital Trust I, each wholly-owned. The Company primarily solicits and underwrites nonstandard private passenger automobile insurance. The Company is headquartered in Atlanta, Georgia.

(2) Summary of Significant Accounting Policies

Basis of Consolidation and Presentation

The accompanying consolidated financial statements include the accounts and operations of the Company. All material intercompany accounts and transactions have been eliminated. The consolidated financial statements have been prepared in conformity with generally accepted accounting principles (GAAP). The preparation of the financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known that could impact the amounts reported and the actual results could differ from these estimates.

Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported financial statement balances as well as the disclosure of contingent assets and liabilities. Actual results could differ materially from those estimates used.

The Company s liability for unpaid losses and loss adjustment expenses (an estimate of the ultimate cost to settle claims both reported and unreported), although supported by actuarial projections and other data, is ultimately based on management s reasoned expectations of future events. Although considerable variability is inherent in these estimates, management believes that this liability is adequate. Estimates are reviewed regularly and adjusted as necessary. Such adjustments are reflected in current operations.

In addition, the realization of the Company s deferred income tax assets is dependent on generating sufficient future taxable income. It is reasonably possible that the expectations associated with these accounts could change in the near term and that the effect of such changes could be material to the consolidated financial statements.

Recognition of Revenues

Insurance premiums are recognized pro rata over the terms of the policies. The unearned portion of premiums is included in the Consolidated Balance Sheet as a liability for unearned premium. Commission income is recognized in the period the insurance policy is written and is reduced by an estimate of future cancellations. Installment and other fees are recognized in the periods the services are rendered.

Fair Value of Financial Instruments

The carrying amounts of the Company s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, approximate fair value because of their short maturities. The carrying amounts of the Company s capital lease obligations approximate fair value because of these obligations based upon management s best estimates of interest rates that would be available for similar debt obligations as of March 31, 2006 and December 31, 2005.

Deferred Acquisition Costs

Deferred acquisition costs (DAC) include premium taxes and commissions incurred in connection with the production of new and renewal business, less ceding commissions allowed by reinsurers. These costs are deferred and amortized over the period in which the related premiums are earned. The Company does not consider anticipated investment income in determining the recoverability of these costs. Based on current indications, management believes that these costs will be fully recoverable and, accordingly, no reduction in DAC has been recognized.

Table of Contents

Contingencies

In the normal course of business, the Company is named as a defendant in lawsuits related to claims and other insurance policy issues. Some of the actions request extra-contractual and/or punitive damages. These actions are vigorously defended unless a reasonable settlement appears appropriate. In the opinion of management, the ultimate outcome of litigation is not expected to be material to the Company s financial condition, results of operations, or cash flows.

Start-Up Costs

Start-up costs are expensed when incurred.

Cash and Cash Equivalents

Cash and cash equivalents include cash demand deposits, money market accounts and bank certificates of deposit with a maturity of less than three months.

Leased Property Under Capital Lease

Leased property under a capital lease is recorded as a capital asset and amortized on a straight-line basis over the estimated useful life of the property. The property and the related lease obligation are disclosed on the balance sheet.

Property and Equipment

Property and equipment is recorded at cost and depreciated on a straight-line basis. The estimated useful lives used for depreciation purposes are: Furniture and fixtures 5 to 7 years; equipment 3 to 5 years; software currently in service 3 to 5 years; leasehold improvements over the remaining life of the lease, including options. Improvements, additions and major renewals which extend the life of an asset are capitalized. Repairs are expensed in the year incurred. Depreciation expense was $119,541 and $59,743 for the three months ended March 31, 2006 and 2005, respectively.

A summary of property and equipment is as follows:

	March 31, 2006	December 31, 2005
Furniture and equipment	$ 978,000	$ 886,837
Computer equipment	1,353,803	1,097,942
Computer software	501,446	477,524
Leasehold improvements	700,072	544,564
Less: accumulated depreciation	(1,725,741)	(1,606,200)
	$ 1,807,580	$ 1,400,667

Amortization of Intangible Assets

Intangible assets consist of non-competition agreements, renewal lists, restrictive covenants and goodwill. Intangible assets are stated at cost. Effective January 1, 2002, the Company adopted the Financial Accounting Standards Board s (FASB) Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. SFAS requires that goodwill and certain intangibles with indefinite lives no longer be amortized, but instead tested for impairment at least annually. The non-competition agreements were amortized on a straight-line basis varying from 2 1/2 years to 5 years. Amortization expense was $97,543 and $32,499 for the three months ended March 31, 2006 and 2005, respectively**.**

Intangible Assets include the following:

	March 31, 2006	December 31, 2005
Goodwill	$ 8,546,554	$ 6,388,094
Non-compete clause	980,000	980,000
Renewal list	2,765,650	1,170,000
Restrictive covenants	220,000	220,000
	12,512,204	8,758,094

Less: Accumulated amortization		(1,495,787)		(1,398,244)
	$	11,016,417	$	7,359,850

Based upon its most recent analysis, the Company believes that no impairment of goodwill exists at December 31, 2005.

Advertising

Advertising costs are expensed as incurred. Advertising expenses for the three months ended March 31, 2006 and 2005 were $304,984 and $193,379, respectively.

Table of Contents

Stock Options

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-based payment (SFAS 123R). The provisions of SFAS 123R require companies to expense the estimated fair value of stock options awarded after the effective date in their financial statements. The Company adopted this statement using the modified prospective application. For options granted and vested prior to the effective date, the Company continues to follow the intrinsic value method set forth in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25), but disclose the pro forma effects on net income had the fair value of these options been expensed. The disclosure provisions required by SFAS No 123R are provided in Note 8.

(3) Investments

All of the Company s long-term investment securities have been classified as available-for-sale because all of the Company s long-term securities are available to be sold in response to the Company s liquidity needs, changes in market interest rates and asset-liability management strategies, among other economic factors. Investments available-for-sale are stated at fair value on the balance sheet. Unrealized gains and losses are excluded from earnings and are reported as a component of other comprehensive income within shareholders equity, net of related deferred income taxes.

A decline in the fair value of an available-for-sale security below cost that is deemed other than temporary results in a charge to income, resulting in the establishment of a new cost basis for the security. Unrealized losses for the three months ended March 31, 2006 and 2005 were $32,272 and $0, respectively.

Premiums and discounts are amortized or accreted, respectively, over the life of the related fixed maturity security as an adjustment to yield using a method that approximates the effective interest method. Dividends and interest income are recognized when earned. Realized gains and losses are included in earnings and are derived using the specific-identification method for determining the cost of securities sold.

At March 31, 2006, long-term investments carried at market value of $1,507,875 and short term investments of approximately $893,598 were pledged by one of the Company s subsidiaries under requirements of regulatory authorities.

A summary of investments is as follows as of:

	March 31, 2006	December 31, 2005
Short term bank certificates of deposit	$ 120,127	$ 120,000
U.S. Treasury securities and obligations of U.S. government corporations and agencies	7,247,449	6,300,740
Obligations of states and political subdivisions	533,473	528,915
Corporate debt securities	1,574,624	1,590,179
Total	$ 9,475,673	$ 8,539,835

The amortized cost, fair value and gross unrealized gain or loss of debt securities available-for-sale at March 31, 2006, by contractual maturity, is shown below:

	Gross	Gross

Years to Maturity	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Within one year	$	$	$	$
One to five years	3,244,757	4,731	7,855	3,241,633
Five to ten years	1,304,772		8,703	1,296,069
Over ten years	4,064,818	1,968	22,413	4,044,373
Total	$ 8,614,347	$ 6,699	$ 38,971	$ 8,582,075

As of March 31, 2006, the Company has determined that all of the unrealized losses in the table above were temporary. There were no fundamental issues with any of these securities and the Company has the ability and intent to hold the securities until there is a recovery in fair value. There were no securities with unrealized losses of greater than 10% of book value.

(4) Losses and Loss Adjustment Expenses

The estimated liabilities for losses and loss adjustment expenses (LAE) include the accumulation of estimates for losses for claims reported prior to the balance sheet dates (case reserves), estimates (based upon actuarial analysis of historical data) of losses for claims incurred but not reported and for the development of case reserves to ultimate values, and estimates of expenses for investigating, adjusting and settling all incurred claims. Amounts reported are estimates of the ultimate costs of settlement, net of estimated salvage and subrogation. These estimated liabilities are subject to the outcome of future events,

Table of Contents

such as changes in medical and repair costs as well as economic and social conditions that impact the settlement of claims. Management believes that, given the inherent variability in any such estimates, the aggregate reserves are within a reasonable and acceptable range of adequacy. The methods of making such estimates and for establishing the resulting reserves are reviewed and updated quarterly and any resulting adjustments are reflected in current operations.

A summary of unpaid losses and loss adjustment expenses, net of reinsurance ceded, is as follows:

	March 31, 2006	December 31, 2005
Case basis	$ 2,579,260	$ 1,784,824
IBNR	3,114,617	2,748,138
Total	$ 5,693,877	$ 4,532,962

(5) Reinsurance

In the normal course of business, the Company seeks to reduce its overall risk levels by obtaining reinsurance from other insurance enterprises or reinsurers. Reinsurance premiums and reserves on reinsured business are accounted for on a basis consistent with those used in accounting for the original policies issued and the terms of the reinsurance contracts.

Reinsurance contracts do not relieve the Company from its obligations to policyholders. The Company periodically reviews the financial condition of its reinsurers to minimize its exposure to losses from reinsurer insolvencies.

Reinsurance assets include balances due from other insurance companies under the terms of reinsurance agreements. Amounts applicable to ceded unearned premiums, ceded loss payments and ceded claims liabilities are reported as assets in the accompanying balance sheets. The Company believes the fair value of its reinsurance recoverables approximates their carrying amounts.

The impact of reinsurance on the statements of operations for the period ended March 31 is as follows:

	2006	2005
Premiums written:		
Direct	$ 19,289,626	$ 10,764,245
Assumed	171,108	
Ceded	13,165,429	7,331,914
Net	**6,295,305**	**3,423,331**
Premiums earned:		
Direct	15,858,513	8,057,259
Assumed	68,430	
Ceded	10,820,083	5,458,949
Net	**5,106,860**	**2,598,310**
Losses and loss adjustment expenses incurred:		
Direct	13,286,350	5,672,586
Assumed		

Ceded	9,308,172	3,970,810
Net	**$ 3,978,178**	$ **1,701,776**

The impact of reinsurance on the balance sheets as of March 31 is as follows:

	March 31, 2006	December 31, 2005
Unpaid losses and loss adjustment expense:		
Direct	$ 18,979,587	$ 15,109,874
Assumed		
Ceded	13,285,710	10,576,912
Net	**5,693,877**	**4,532,962**
Unearned premiums:		
Direct	19,873,614	16,442,501
Assumed	234,650	131,972
Ceded	13,556,616	11,211,270
Net	**$ 6,551,648**	**$ 5,363,203**

The Company received $3,423,011 in commissions on premiums ceded during the three month period ended March 31, 2006.

Had all of the Company s reinsurance agreements been cancelled at March 31, 2006, the Company would have returned $3,524,720 in reinsurance commissions to its reinsurers and its reinsurers would have returned $13,556,616 in unearned premiums to the Company.

Contingent Reinsurance Commission and Provisional Commission Reserve

The Company s reinsurance contract provides ceding commissions for premiums written which are subject to adjustment. The amount of ceding commissions, net of adjustments, is determined by the loss experience for the reinsurance agreement term. The reinsurers provide commissions on a sliding scale with maximum and minimum achievable levels. The reinsurers pay the Company with the provisional commissions, before adjustment. The Company adjusts the commissions based on the current loss experience for the policy year premiums. This results in establishing a liability for the excess of provisional commissions retained compared to amounts recognized, which is subject to variation until the ultimate loss experience is determinable.

(6) Long-Term Debt

Notes Payable, Related Party

The Company has various notes payable to related parties totaling to $5,252,992 at March 31, 2006. This Notes Payable debt consists primarily of unsecured promissory notes payable to its Chairman and its Chief Executive Officer. The promissory notes provide for the repayment of principal beginning in December 2004 in an amount equal to the greater of $1.1 million or an amount equal to 25% of the Company s net income after tax, plus non-cash items, less working capital. However, the promissory notes also permit the Company to postpone any and all payments under the promissory notes without obtaining the consent of, and without giving notice or paying additional consideration. As a result of the acquisition of a Georgia insurance agency in 2004, the Company has an unsecured promissory note payable to a Senior Vice President of the Company. The promissory note carries an interest rate of 8% and provides for the repayment of principal in three equal installments beginning August 2005.

Other Notes Payable

As a result of the acquisitions of a two Florida insurance agencies in 2006, the Company has unsecured promissory notes payable to the former owners. The first promissory note, executed in connection with the acquisition of The Insurance Center, Inc. effective January 1, 2006, carries an interest rate of 8%. This note provides for the payment of interest in quarterly installments beginning April 1, 2006 and the repayment of principal in one installment on July 1, 2008. Amounts due under this note, as of March 31, 2006, total $1,571,076. The second promissory note, executed in connection with the acquisition of the assets of Tampa No-Fault Insurance Agency, Inc. effective January 16, 2006, carries an interest rate of 8%. The note provides for the payment of interest in quarterly installments beginning on March 31, 2006 and the repayment of principal in two equal installments on January 16, 2007 and January 16, 2008. Amounts due under this note, as of March 31, 2006 totaled $283,333.

Debentures Payable

On December 22, 2005, the Company, through a newly-formed Delaware statutory trust, AssuranceAmerica Capital Trust I (the Trust), consummated the private placement of 5,000 of the Trust s floating rate Capital Securities, with a liquidation amount of $1,000 per capital security (the Capital Securities). In connection with the Trust s issuance and sale of the Capital Securities, the Company purchased from the Trust 155 of the Trust s floating rate Common Securities, with a liquidation amount of $1,000 per common security (the Common Securities). The Trust used the proceeds from the issuance and sale of the Capital Securities and the Common

Securities to purchase $5,155,000 in aggregate principal amount of the floating rate junior subordinated debentures of the Company (the Debentures). The Capital Securities mature on December 31, 2035, but may be redeemed at par beginning December 31, 2010 if and to the extent the Company exercises its right to redeem the Debentures. The Capital Securities require quarterly distributions by the Trust to the holders of the Capital Securities, at a floating rate of three-month LIBOR plus 5.75% per annum, reset quarterly. Distributions are cumulative and will accrue from the date of original issuance but may be deferred for a period of up to 20 consecutive quarterly interest payment periods if the Company exercises its right under the Indenture to defer the payment of interest on the Debentures. The Company has guaranteed the obligations of the Trust.

Scheduled Maturities

The aggregate annual maturities of payments due on debt outstanding as of March 31 are as follows:

	Amount
2006	$ 1,310,560
2007	1,592,192
2008	2,732,186
2009	1,000,000
2010 and after	472,463
Total	$ 7,107,401

(7) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are established for temporary differences between the financial reporting bases and the tax bases of assets and liabilities, at the enacted tax rates expected to be in effect when the temporary differences are expected to be recovered or settled. The principal assets and liabilities that generate these temporary differences are unearned premiums, loss and loss adjustment expense reserves, deferred policy acquisition costs, operating loss and tax-credit carry forwards and non-deductible provisions for unearned revenue. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company has established a valuation allowance for some portion of its net deferred tax assets due to the uncertainty regarding the realization of these deferred income tax assets.

The Company has loss carry-forwards that may be offset against future taxable income and tax credits that may be used against future income taxes. If not used, the carry-forwards will expire in varying amounts between the year 2015 and December 31, 2024. The loss carry-forwards at December 31, 2004 were approximately $4,121,000. Utilization of part of the net operating losses carried forward will be limited under Section 382 of the Internal Revenue Code as the Company experienced an ownership change greater than 50% effective April 1, 2003. Accordingly, certain net operating losses may not be realizable in future years due to this limitation.