SELECTIVE INSURANCE GROUP INC
Form 10-Q
May 02, 2007

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

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended: March 31, 2007

or

o **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: 0-8641
SELECTIVE INSURANCE GROUP, INC.
(Exact name of registrant as specified in its charter)

New Jersey	22-2168890
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
40 Wantage Avenue Branchville, New Jersey	07890
(Address of Principal Executive Offices)	(Zip Code)

(973) 948-3000
(Registrant s Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report)

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 report), 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 large accelerated filer, an accelerated filer, or non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated file þ Accelerated file o Non-accelerated filer 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

As of March 31, 2007, there were 54,857,753 shares of common stock, par value $2.00, outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
SELECTIVE INSURANCE GROUP, INC.

(in thousands, except share amounts)	Unaudited March 31, 2007	December 31, 2006
ASSETS		
Investments:		
Fixed maturity securities, held-to-maturity - at amortized cost (fair value of: $9,871 - 2007; $10,073 - 2006)	**$ 9,653**	9,822
Fixed maturity securities, available-for-sale - at fair value (amortized cost of: $2,927,958 - 2007; $2,916,884 - 2006)	**2,949,798**	2,937,100
Equity securities, available-for-sale - at fair value (cost of: $168,993 - 2007; $157,864 - 2006)	**310,534**	307,376
Short-term investments - (at cost which approximates fair value)	**156,899**	197,019
Other investments	**165,131**	144,785
Total investments	**3,592,015**	3,596,102
Cash and cash equivalents	**3,877**	6,443
Interest and dividends due or accrued	**34,036**	34,846
Premiums receivable, net of allowance for uncollectible accounts of: $3,930 - 2007; $3,229 - 2006	**495,615**	458,452
Other trade receivables, net of allowance for uncollectible accounts of: $174 - 2007; $255 - 2006	**19,755**	21,388
Reinsurance recoverable on paid losses and loss expenses	**3,710**	4,693
Reinsurance recoverable on unpaid losses and loss expenses	**200,450**	199,738
Prepaid reinsurance premiums (Note 5)	**70,592**	69,935
Current federal income tax		468
Deferred federal income tax	**20,798**	15,445
Property and equipment - at cost, net of accumulated depreciation and amortization of: $107,133- 2007; $103,660 - 2006	**57,663**	59,004
Deferred policy acquisition costs	**226,759**	218,103
Goodwill	**33,637**	33,637
Other assets	**43,558**	49,451
Total assets	**$ 4,802,465**	4,767,705
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Reserve for losses	**$ 2,013,230**	1,959,485
Reserve for loss expenses	**339,270**	329,285
Unearned premiums	**829,369**	791,540
Senior convertible notes	**57,413**	57,413
Notes payable	**304,431**	304,424
Current federal income tax	**12,738**	
Commissions payable	**30,411**	54,814
Accrued salaries and benefits	**74,917**	94,560
Other liabilities	**101,822**	98,957

Total liabilities	**3,763,601**	3,690,478
Stockholders Equity:		
Preferred stock of $0 par value per share:		
Authorized shares: 5,000,000; no shares issued or outstanding Common stock of $2 par value per share:		
Authorized shares: 360,000,000		
Issued: 92,275,103 - 2007; 91,562,266 - 2006	**184,550**	183,124
Additional paid-in capital	**164,541**	153,246
Retained earnings	**1,016,427**	986,017
Accumulated other comprehensive income	**97,462**	100,601
Treasury stock - at cost (shares: 37,417,350 - 2007; 34,289,974 - 2006)	**(424,116)**	(345,761)
Total stockholders equity (Note 9)	**1,038,864**	1,077,227
Commitments and contingencies (Note 10)		
Total liabilities and stockholders equity	**$ 4,802,465**	4,767,705

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

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SELECTIVE INSURANCE GROUP, INC. **UNAUDITED CONSOLIDATED STATEMENTS OF INCOME** (in thousands, except per share amounts)	**Quarters ended March 31,** **2007**	 **2006**
Revenues:		
Net premiums written	**$ 417,185**	431,989
Net increase in unearned premiums and prepaid reinsurance premiums	**(37,172)**	(61,832)
Net premiums earned	**380,013**	370,157
Net investment income earned	**39,863**	36,002
Net realized gains	**11,243**	7,367
Diversified Insurance Services revenue	**29,178**	27,278
Other income	**1,812**	1,862
Total revenues	**462,109**	442,666
Expenses:		
Losses incurred	**203,310**	191,363
Loss expenses incurred	**42,983**	42,337
Policy acquisition costs	**122,918**	115,478
Dividends to policyholders	**1,487**	1,208
Interest expense	**6,331**	5,518
Diversified Insurance Services expenses	**24,811**	23,746
Other expenses	**11,070**	8,744
Total expenses	**412,910**	388,394
Income before federal income tax	**49,199**	54,272
Federal income tax expense (benefit):		
Current	**15,611**	16,698
Deferred	**(3,664)**	(2,404)
Total federal income tax expense	**11,947**	14,294
Net income	**37,252**	39,978
Earnings per share:		
Basic net income	**$ 0.68**	0.75
Diluted net income	**$ 0.62**	0.64

Dividends to stockholders	**$ 0.12**	0.11

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

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SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

($ in thousands, except per share amounts)	Quarters ended March 31, 2007		2006	
Common stock:				
Beginning of year	$ **183,124**		173,085	
Dividend reinvestment plan (shares: 18,764 2007; 15,964 2006)	**38**		32	
Convertible debentures (shares: 107,344 2007; 2,824 2006)	**215**		6	
Stock purchase and compensation plans (shares: 586,729 2007; 483,956 2006)	**1,173**		967	
End of period	**184,550**		174,090	
Additional paid-in capital:				
Beginning of year	**153,246**		71,638	
Dividend reinvestment plan	**422**		408	
Convertible debentures	**171**		4	
Stock purchase and compensation plans	**10,702**		9,985	
End of period	**164,541**		82,035	
Retained earnings:				
Beginning of year	**986,017**		847,687	
Net income	**37,252**	**37,252**	39,978	39,978
Cash dividends to stockholders ($0.12 per share 2007; $0.11 per share 2006)	**(6,842)**		(6,161)	
End of period	**1,016,427**		881,504	
Accumulated other comprehensive income:				
Beginning of year	**100,601**		118,121	
Other comprehensive (loss) income:				
Decrease in net unrealized gains on investment securities, net of deferred income tax effect of: $(1,740) 2007; $(6,769) 2006	**(3,232)**	**(3,232)**	(12,571)	(12,571)
Increase in defined benefit pension plans, net of deferred income tax effect of $51 2007	**93**	**93**		
End of period	**97,462**		105,550	
Comprehensive income		**34,113**		27,407

Treasury stock:		
Beginning of year	**(345,761)**	(229,407)
Acquisition of treasury stock (shares: 3,127,376 2007; 2,064,856 2006)	**(78,355)**	(56,531)
End of period	**(424,116)**	(285,938)
Total stockholders equity	$ **1,038,864**	957,241

Selective Insurance Group, Inc. also has authorized, but not issued, 5,000,000 shares of preferred stock without par value of which 300,000 shares have been designated Series A junior preferred stock without par value.

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

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SELECTIVE INSURANCE GROUP, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOW
(in thousands)

	Quarters ended March 31, 2007	2006
Operating Activities		
Net income	$ **37,252**	39,978
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**6,975**	5,915
Share-based compensation expense	**8,630**	6,935
Net realized gains	**(11,243)**	(7,367)
Deferred tax	**(3,664)**	(2,404)
Changes in assets and liabilities:		
Increase in reserves for losses and loss expenses, net of reinsurance recoverable on unpaid losses and loss expenses	**63,053**	59,297
Increase in unearned premiums, net of prepaid reinsurance and advance premiums	**38,107**	61,864
Increase in net federal income tax payable	**13,206**	11,843
Increase in premiums receivable	**(37,163)**	(11,907)
Decrease in other trade receivables	**1,633**	810
Increase in deferred policy acquisition costs	**(8,656)**	(15,721)
Decrease in interest and dividends due or accrued	**822**	617
Decrease (increase) in reinsurance recoverable on paid losses and loss expenses	**983**	(1,471)
Decrease in accrued salaries and benefits	**(20,874)**	(16,120)
Decrease in accrued insurance expenses	**(24,887)**	(53,902)
Other-net	**11,030**	1,297
Net adjustments	**37,952**	39,686
Net cash provided by operating activities	**75,204**	79,664
Investing Activities		
Purchase of fixed maturity securities, available-for-sale	**(89,915)**	(167,352)
Purchase of equity securities, available-for-sale	**(31,550)**	(17,277)
Purchase of other investments	**(20,228)**	(15,091)
Purchase of short-term investments	**(285,836)**	(571,473)
Net proceeds from sale of subsidiary		376
Sale of fixed maturity securities, available-for-sale	**8,351**	96,880
Sale of short-term investments	**325,948**	573,336
Redemption and maturities of fixed maturity securities, held-to-maturity	**172**	765
Redemption and maturities of fixed maturity securities, available-for-sale	**63,004**	55,033
Sale of equity securities, available-for-sale	**32,149**	21,435
Proceeds from other investments	**2,578**	948
Purchase of property and equipment	**(2,292)**	(3,865)
Net cash provided by (used in) investing activities	**2,381**	(26,285)

Financing Activities		
Dividends to stockholders	**(6,262)**	(5,548)
Acquisition of treasury stock	**(78,355)**	(56,531)
Net proceeds from stock purchase and compensation plans	**1,980**	3,382
Excess tax benefits from share-based payment arrangements	**2,486**	2,920
Net cash used in financing activities	**(80,151)**	(55,777)
Net decrease in short-term investments and cash	**(2,566)**	(2,398)
Cash and cash equivalents, beginning of year	**6,443**	2,983
Cash and cash equivalents, end of period	**$ 3,877**	585
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest	**$ 3,095**	2,464
Federal income tax	**400**	1,935
Supplemental schedule of non-cash financing activity:		
Conversion of convertible debentures	**380**	10

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

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NOTES TO UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. Organization

Selective Insurance Group, Inc., through its subsidiaries, (collectively known as Selective) offers property and casualty insurance products and diversified insurance services and products. Selective Insurance Group, Inc. was incorporated in New Jersey in 1977 and its main offices are located in Branchville, New Jersey. Selective Insurance Group, Inc. s Common Stock is publicly traded on the NASDAQ Global Select MarketÒ under the symbol, SIGI.

Selective classifies its business into three operating segments:

- Insurance Operations, which sells property and casualty insurance products and services primarily in 20 states in the Eastern and Midwestern United States, and has at least one company licensed to do business in each of the 50 states;

- Investments; and

- Diversified Insurance Services, which provides human resource administration outsourcing products and services, and federal flood insurance administrative services.

NOTE 2. Basis of Presentation

These interim unaudited consolidated financial statements (Financial Statements) include the accounts of Selective Insurance Group, Inc. and its subsidiaries, and have been prepared in conformity with (i) accounting principles generally accepted in the United States of America (GAAP) and (ii) the rules and regulations of the United States Securities and Exchange Commission (SEC) regarding interim financial reporting. The preparation of Financial Statements in conformity with GAAP 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 from those estimates. All significant intercompany accounts and transactions between Selective Insurance Group, Inc. and its subsidiaries are eliminated in consolidation.

These Financial Statements reflect all adjustments that, in the opinion of management, are normal, recurring, and necessary for a fair presentation of Selective s results of operations and financial condition. These Financial Statements cover the first quarters ended March 31, 2007 (First Quarter 2007) and March 31, 2006 (First Quarter 2006). These Financial Statements do not include all of the information and disclosures required by GAAP and the SEC for audited financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, these Financial Statements should be read in conjunction with the consolidated financial statements contained in Selective s Annual Report on Form 10-K for the year ended December 31, 2006 (2006 Annual Report).

NOTE 3. Statement of Cash Flow

At December 31, 2006, Selective changed its definition of cash equivalents for presentation in the Statements of Cash Flow. Accordingly, the First Quarter 2006 Statement of Cash Flow has been restated to conform with this policy change. In addition, certain amounts in the Statement of Cash Flow for First Quarter 2006 have been reclassified to conform to reclassifications made to the balance sheet in the prior year. These reclassifications resulted in immaterial changes to individual line items in the operating activities and investing activities sections of the Statements of Cash Flow, but had no impact on total cash flows from operating activities or investing activities. Neither the policy change nor the reclassifications had any effect on Selective s net income or stockholders equity. For additional information, refer to Item 8. Financial Statements and Supplementary Data, Note 2 of Selective s 2006 Annual Report.

NOTE 4. Adoption of Accounting Pronouncements

On January 1, 2007, Selective adopted Financial Accounting Standards No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140* (FAS 155). Under the guidance contained in FAS 155, companies are required to evaluate interests in securitized financial assets to identify whether such interests are freestanding derivatives or hybrid financial instruments that contain an embedded derivative. During the fourth quarter of 2006, the Financial Accounting Standards Board (FASB) recommended a narrow scope exception for securitized interests if: (i) the securitized interest itself has no embedded derivative (including interest rate related derivatives) that would be required to be accounted for separately other than an embedded derivative that results solely from the embedded call options in the underlying financial assets; and (ii) the investor does not control the right to accelerate the settlement. The adoption of FAS 155 did not have a material impact on the results of operations or financial condition of Selective during First Quarter 2007.

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On January 1, 2007, Selective adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 calls for a two-step process to evaluate tax positions based on the recognition, derecognition, and measurement of benefits related to income taxes. The process begins with an initial assessment of whether a tax position, based on its technical merits and applicability to the facts and circumstances, will more-likely-than-not be sustained upon examination, including related appeals or litigation. The more-likely-than-not threshold is defined as having greater than a 50% chance of being realized upon settlement. Tax positions that are more-likely-than-not sustainable are then measured to determine how much of the benefit should be recorded in the financial statements. This determination is made by considering the probabilities of the amounts that could be realized upon ultimate settlement. Each tax position is evaluated individually and must continue to meet the threshold in each subsequent reporting period or the benefit will be derecognized. A position that initially failed to meet the more-likely-than-not threshold should be recognized in a subsequent period if: (i) a change in facts and circumstances results in the position s ability to meet the threshold; (ii) the issue is settled with the taxing authority; or (iii) the statute of limitations expires. FIN 48 is effective for fiscal years beginning after December 15, 2006. Selective has analyzed its tax positions in all federal and state jurisdictions in which it is required to file income tax returns for all open tax years. The open tax years for the federal returns are 2003 though 2006. The Internal Revenue Service completed a limited scope examination of tax year 2003 and 2004 that resulted in a favorable adjustment. Selective did not have any unrecognized tax benefits as of January 1, 2007. Selective believes its tax positions will be sustained on audit and does not anticipate any adjustments that will result in a material change to its financial position. As a result, there was no material change in Selective s liability for unrecognized tax benefits.

In February 2007, the FASB issued Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (FAS 159), which provides companies with an option to report selected financial assets and liabilities at fair value. FAS 159 requires companies to provide additional information that will help investors and other users of financial statements to more easily understand the effect of the company s choice to use fair value on its earnings. FAS 159 also requires companies to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. We are currently evaluating the impact FAS 159 may have on our financial statements.

NOTE 5. Reinsurance

The following table summarizes the direct, assumed, and ceded reinsurance amounts by income statement caption. For more information concerning reinsurance, refer to Note 7, Reinsurance in Item 8. Financial Statements and Supplementary Data in Selective s 2006 Annual Report.

	Unaudited Quarter ended March 31,	
($ in thousands)	**2007**	**2006**