

PROFESSIONALS DIRECT INC
Form 10QSB
August 14, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

(MARK ONE)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2007

TRANSITION REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File Number: **000-49786**

PROFESSIONALS DIRECT, INC.
(Exact Name of Small Business Issuer as Specified in its Charter)

Michigan **38-3324634**
(State or Other Jurisdiction of Incorporation or (I.R.S. Employer Identification No.)
Organization)

5211 Cascade Road, S.E. **(616) 456-8899**
Grand Rapids, Michigan 49546 (Issuer's Telephone Number,
(Address of Principal Executive Offices) 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 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 X No ___

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

There were 333,300 shares of Common Stock outstanding as of July 31, 2007.

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

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements**

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEET
(Unaudited)

<i>June 30,</i>	2007 (000)
Assets	
Fixed maturities held to maturity, at amortized cost	\$ 7,014
Fixed maturities available for sale, at fair value	31,341
Other invested asset, at cost which approximates fair value	277
Total investments	38,632
Cash and cash equivalents	5,528
Receivables:	
Amounts due from reinsurers	14,367
Other	1,968
Prepaid reinsurance premiums	3,568
Deferred acquisition costs	1,585
Net deferred federal income taxes	1,326
Other assets	1,685
Total Assets	\$ 68,659
Liabilities and Shareholders' Equity	
Liabilities	
Loss and loss adjustment expense reserves	\$ 32,398
Unearned premiums	12,709
Amounts due to reinsurers	1,931
Other liabilities	2,216
Accrued interest	1,003
Surplus certificates	1,343
Trust preferred securities	5,000
Total Liabilities	56,600
Shareholders' Equity	
Preferred stock, no par (500,000 shares authorized, no shares issued)	-
Common stock, no par (5,000,000 shares authorized, 333,300 shares issued and outstanding)	3,204
Retained earnings	9,192
Accumulated other comprehensive loss	(337)
Total Shareholders' Equity	12,059

Total Liabilities and Shareholders' Equity	\$ 68,659
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See accompanying notes to condensed consolidated financial statements.

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (LOSS)
AND COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007 (000)	2006 (000)	2007 (000)	2006 (000)
Revenues				
Net premiums earned	\$ 4,079	\$ 4,015	\$ 8,037	\$ 8,019
Fees and commissions	256	232	512	444
Net investment income	404	368	807	727
Finance and other income, including unusual gains	46	91	170	251
Total revenues	4,785	4,706	9,526	9,441
Expenses				
Losses and loss adjustment expenses	4,458	3,135	7,245	5,970
Operating and administrative	1,034	1,128	2,257	2,076
Strategic alternatives	274	-	274	-
Interest	129	142	257	281
Total expenses	5,895	4,405	10,033	8,327
Income (loss) before federal income taxes	(1,110)	301	(507)	1,114
Federal income taxes (benefit)	(430)	66	(272)	316
Net income (loss)	(680)	235	(235)	798
Other comprehensive loss (Net of tax benefit of \$50, \$26, \$16 and \$88, respectively)	(97)	(50)	(31)	(171)
Comprehensive income (loss)	\$ (777)	\$ 185	\$ (266)	\$ 627
Per share of common stock (not in thousands):				
Basic and diluted net income (loss) per share	\$ (2.04)	\$.70	\$ (.71)	\$ 2.39
Basic and diluted comprehensive income (loss) per share	(2.33)	.55	(.80)	1.88

See accompanying notes to condensed consolidated financial statements.

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2007	2006
	(000)	(000)
Operating activities		
Net income (loss)	\$ (235)	\$ 798
Adjustments to reconcile net income to net cash from operating activities:		
Deferred federal income taxes	(72)	119
Gain from redemption of surplus certificates	(82)	(157)
Loss on disposal of assets	15	-
Depreciation and amortization	310	328
Changes in operating assets and liabilities:		
Amounts due from reinsurers	2,014	(5,210)
Other receivables	80	44
Prepaid reinsurance premiums	551	86
Federal income taxes recoverable	(400)	(466)
Deferred acquisition costs	(169)	(33)
Other assets	(69)	(99)
Loss and loss adjustment expense reserves	(478)	4,458
Amounts due to reinsurers	201	292
Unearned premiums	924	(118)
Other liabilities	(531)	880
Accrued interest	(142)	(318)
Net cash from operating activities	1,917	604
Investing activities		
Cost of fixed maturities acquired	(6,173)	(9,692)
Proceeds from sales or maturities of fixed maturities	4,479	5,093
Cost of property and equipment acquired	(59)	(309)
Net cash for investing activities	(1,753)	(4,908)
Financing activities		
Repayments of surplus certificates	(178)	(425)
Net repayments under lines of credit	-	(170)
Net cash for financing activities	(178)	(595)
Net decrease in cash and cash equivalents	(14)	(4,899)
Cash and cash equivalents, beginning of period	5,542	9,309
Cash and cash equivalents, end of period	\$ 5,528	\$ 4,410
Supplemental disclosures of cash flow information		

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Federal income tax payments	\$	214	\$	663
Interest payments		299		599

See accompanying notes to condensed consolidated financial statements.

PROFESSIONALS DIRECT, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries (Professionals Direct Insurance Company (PDIC), a property and casualty insurance company providing professional liability insurance to attorneys; Professionals Direct Employer Organization, Inc., an inactive Michigan professional employer organization; Professionals Direct Finance, Inc. (Finance), a premium finance company; and Professionals Direct Insurance Services, Inc. (Services), a company providing underwriting, claims, accounting, information technology services and selling professionals liability and other insurance) plus Lawyers Direct Risk Purchasing Group, which the Company controls. Professionals Direct Statutory Trust I and Professionals Direct Statutory Trust II are accounted for under the equity method in the accompanying financial statements and they are not consolidated because the Company is not the primary beneficiary.

The condensed consolidated financial statements and notes as of and for the three and six-month periods ended June 30, 2007 and 2006 are unaudited. The condensed consolidated financial statements reflect all adjustments (consisting of normal recurring accruals) that are, in the opinion of management, necessary for the fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the interim periods should not be considered indicative of results to be expected for the full year.

2. Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157") which defines fair value, establishes a framework for measuring fair value in GAAP, and enhances disclosures about fair value measurements. SFAS No. 157 applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. The Company believes SFAS No. 157, which we will adopt effective January 1, 2008, will not materially impact, if at all, its financial condition or results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS No. 159") which provides reporting entities the option to report selected financial assets, including investment securities designated as available for sale, and liabilities, including most insurance contracts, at fair value. SFAS No. 159 establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The Company believes SFAS No. 159, which we will adopt effective January 1, 2008, will not materially impact, if at all, its financial condition or results of operations.

3. Income per Share

Basic income per share is computed by dividing net income by the weighted average number of shares of common stock outstanding for the period (333,300 for the three and six months ended June 30, 2007, and 333,500 for the three and six months ended June 30, 2006). Diluted income per share is equal to basic income per share as there are no stock options or other dilutive instruments outstanding.

4. Unusual Gains

Other income includes unusual gains of \$0 and \$82,000 for the three and six months ended June 30, 2007, respectively, and \$44,000 and \$157,000 for the three and six months ended June 30, 2006, respectively, from principal forgiven by surplus certificate holders in return for early redemption.

5. Sale of Company

On June 25, 2007, Professionals Direct, Inc. executed a merger agreement under which it agreed to be acquired by Hanover Acquisition Corp. (“Purchaser”), a wholly-owned subsidiary of The Hanover Insurance Group, Inc. of Worcester, Massachusetts (NYSE: THG) (“Hanover”). The purchase price is \$23.2 million, or \$69.61 per share, payable in cash after closing of the merger. The closing is subject to a variety of conditions, including approval by shareholders and the Commissioner of Insurance of the State of Michigan and the Office of Financial and Insurance Services of the Michigan Department of Labor and Economic Growth (“OFIS”). If the merger is approved, closing will occur late in the third quarter or early in the fourth quarter of 2007.

On August 7, 2007, OFIS issued an order stating that the acquisition of control of the Company by Hanover in accordance with the Merger Agreement is approved, contingent upon approval of holders of a majority of the common stock of the Company, and satisfactory review of fingerprint results for all of Purchaser’s officers and directors.

Item 2. Management's Discussion and Analysis

The following discussion and analysis for the six months ended June 30, 2007 should be read in conjunction with the condensed consolidated financial statements and the notes thereto included elsewhere in this report. The following discussion of our financial condition and results of operations contains certain forward-looking statements. A discussion of the limitations of forward-looking statements appears at the end of this section.

Introduction

Revenues increased nominally in 2007 from 2006. Losses and loss adjustment expenses increased in 2006 because adverse development was greater in the first half of 2007 than in 2006. Operating and administrative expenses also increased. As a result, the first six months of 2007 is a net loss when compared to last year's net income. The following table and discussion compares year-to-date financial results for 2007 and 2006:

	Six Months Ended June 30,			
	2007	2006	Change	Percent Change
	(in thousands of dollars, except for per share data)			
Revenues:				
Net premiums earned	\$ 8,037	\$ 8,019	\$ 18	0.2%
Fees and commissions	512	444	68	15.3%
Net investment income	807	727	80	11.0%
Finance and other income	170	251	(81)	(32.3%)
Total revenues	9,526	9,441	85	0.9%
Expenses:				
Losses and loss adjustment expenses	7,245	5,970	1,275	21.4%
Operating and administrative	2,257	2,076	181	8.7%
Strategic alternatives	274	-	274	-
Interest	257	281	(24)	(8.5%)
Total expenses	10,033	8,327	1,706	20.5%
Income (loss) before federal income taxes	(507)	1,114	(1,621)	(145.5%)
Federal income taxes (benefit)	(272)	316	(588)	(186.1%)
Net income (loss)	\$ (235)	\$ 798	\$ (1,033)	(129.4%)
Selected Balance Sheet Data:				
(at end of period)				
Total investments and cash	\$ 44,160	\$ 42,641	\$ 1,519	3.6%
Total assets	68,659	76,220	(7,561)	(9.9%)
Total liabilities	56,600	64,992	(8,392)	(12.9%)
Total shareholders' equity	12,059	11,228	831	7.4%
Per Share Data:				
Net income (loss)	\$ (.71)	\$ 2.39	\$ (3.10)	(129.7%)
Shareholders' equity	\$ 36.18	\$ 33.67	\$ 2.51	7.5%

Results of Operations (000 omitted):

Following is a summary and analysis of the material revenue and expense components of our operational results for the first six months and second quarter of 2007 with comparisons to 2006.

Net Premiums Earned. Net premiums earned is equal to direct premiums earned (premiums earned for policies written) less ceded premiums earned (amounts ceded to reinsurers) and is our primary source of revenue. Net unearned premiums increased consistent with increases in direct and net premiums written in 2007 compared to 2006.

The effects of these changes are reflected in the table below:

	Six Months Ended June 30,			Percent Change
	2007	2006	Change	
	(in thousands of dollars)			
Beginning gross unearned premium	\$ 11,785	\$ 11,776	\$ 9	0.1%
Beginning ceded unearned premium	(4,118)	(4,175)	57	1.4%
Beginning net unearned premium	7,667	7,601	66	0.9%
Direct premiums written	13,826	12,479	1,347	10.8%
Ceded premiums written	(4,315)	(4,492)	177	