PICO HOLDINGS INC /NEW
Form 10-Q
May 09, 2011
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

SQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2011
OR
£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 033-36383
PICO HOLDINGS, INC.
(Exact Name of Registrant as Specified in Its Charter)

California (State or other jurisdiction of incorporation)	33-36383 (Commission File Number)	94-2723335 (IRS Employer Identification No.)

875 Prospect Street, Suite 301
La Jolla, California 92037
(Address of principal executive offices) (Zip code)
Registrant's Telephone Number, Including Area Code:
(858) 456-6022

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 S 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 a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	S	Accelerated filer	£
Non-accelerated filer (Do not check if a smaller reporting company)	£	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 S

On May 6, 2011, the registrant had 22,700,004 shares of common stock, $0.001 par value outstanding.

PICO HOLDINGS, INC.

FORM 10-Q
For the Three Months Ended March 31, 2011

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Part I: Financial Information
Item I: Condensed Consolidated Financial Statements

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	March 31, 2011 (Unaudited)	December 31, 2010
ASSETS		
Available for sale investments:		
Fixed maturities	$42,949	$41,010
Equity securities	77,959	110,410
Total available-for-sale investments	120,908	151,420
Other Investments	5,778	7,228
Total investments	126,686	158,648
Cash and cash equivalents	109,443	114,759
Notes and other receivables, net	8,888	9,251
Reinsurance receivables	14,213	14,551
Real estate and water assets, net	371,267	355,570
Property and equipment, net	21,156	12,590
Net deferred income taxes	22,884	20,039
Federal, foreign and state income taxes	971	905
Other assets	6,867	6,189
Total assets	$682,375	$692,502
LIABILITIES AND SHAREHOLDERS' EQUITY		
Reserves for unpaid losses and loss adjustment expenses	$22,279	$22,816
Debt	47,279	45,743
Deferred compensation	35,801	37,879
Other liabilities	11,559	15,340
Total liabilities	116,918	121,778
Commitments and Contingencies		
Common stock, $.001 par value; authorized 100,000 shares, 27,117 issued and 22,700 outstanding at March 31, 2011 and at December 31, 2010	27	27
Additional paid-in capital	543,202	542,072
Retained earnings	86,725	88,830
Accumulated other comprehensive income	11,855	15,327
Treasury stock, at cost (common shares: 4,417 in 2011 and in 2010)	(78,152)	(78,152)
Total PICO Holdings, Inc. shareholders’ equity	563,657	568,104
Noncontrolling interest in subsidiaries	1,800	2,620
Total shareholders' equity	565,457	570,724
Total liabilities and shareholders' equity	$682,375	$692,502

The accompanying notes are an integral part of the condensed consolidated financial statements.

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PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED
(In thousands, except per share data)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Revenues:		
Sale of real estate and water assets	$876	$1,598
Net investment income	1,183	1,389
Net realized gain on sale and impairment of investments	5,251	3,149
Other	368	466
Total revenues	7,678	6,602
Costs and expenses:		
Operating and other costs	9,387	11,288
Cost of real estate and water assets sold	478	1,048
Depreciation and amortization	329	325
Interest	146	503
Total costs and expenses	10,340	13,164
Loss before income taxes	(2,662)	(6,562)
Benefit for federal, foreign, and state income taxes	(1,311)	(2,277)
Equity in loss of unconsolidated affiliate	(1,574)	(558)
Net loss	(2,925)	(4,843)
Net loss attributable to the noncontrolling interests	820	781
Net loss attributable to PICO Holdings, Inc.	$(2,105)	$(4,062)
Net loss per common share – basic and diluted:	$(0.09)	$(0.18)
Weighted average shares outstanding	22,700	22,596

The accompanying notes are an integral part of the condensed consolidated financial statements.

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PICO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY - UNAUDITED
THREE MONTHS ENDED MARCH 31, 2011 AND 2010
(In thousands)

	Total	Comprehensive Loss attributable to PICO Holdings, Inc.	Retained Earnings	Accumulated Other Comprehensive Income	Common Stock	Paid-in Capital	Treasury Stock, at Cost	Non-controlling Interest
Beginning balance, January 1, 2011	$570,724		$88,830	$ 15,327	$27	$542,072	$(78,152)	$2,620
Stock-based compensation expense	1,130					1,130		
Comprehensive loss:								
Net loss	(2,925)	$ (2,105)	(2,105)					(820)
Other comprehensive loss, net of tax:								
Unrealized loss on securities	(2,777)	(2,777)		(2,777)				
Foreign currency translation	(695)	(695)		(695)				
Other comprehensive loss	(3,472)	(3,472)						
Comprehensive loss	(6,397)	$ (5,577)						
Ending balance, March 31, 2011	$565,457		$86,725	$ 11,855	$27	$543,202	$(78,152)	$1,800

	Total	Comprehensive Loss attributable to PICO Holdings, Inc.	Retained Earnings	Accumulated Other Comprehensive Loss	Common Stock	Paid-in Capital	Treasury Stock, at Cost	Non-controlling Interest
Beginning balance, January 1, 2010	$579,695		$100,002	$ 21,094	$27	$539,792	$(78,272)	$(2,948)
Stock-based compensation expense	805					805		
Comprehensive loss:								
Net loss	(4,843)	$ (4,062)	(4,062)					(781)
Other comprehensive loss, net of tax:								
Unrealized loss on securities	(1,188)	(1,188)		(1,188)				
Foreign currency translation	(73)	(73)		(73)				

Other comprehensive loss	(1,261)	(1,261)						
Comprehensive loss	(6,104)	$ (5,323)						
Ending balance, March 31, 2010	$574,396		$95,940	$ 19,833	$27	$540,597	$(78,272)	$(3,729)

The accompanying notes are an integral part of the condensed consolidated financial statements.

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED
(In thousands)

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
OPERATING ACTIVITIES:		
Net cash used in operating activities	$(22,881)	$(31,553)
INVESTING ACTIVITIES:		
Purchases of investments	(5,925)	(11,301)
Proceeds from sale of investments	35,396	9,277
Proceeds from maturity of investments	1,044	1,820
Purchases of property and equipment	(8,462)	(316)
Other investing activities, net	684	
Net cash provided by (used in) investing activities	22,737	(520)
FINANCING ACTIVITIES:		
Repayments of debt	(4,860)	
Net cash used in financing activities	(4,860)	
Effect of exchange rate changes on cash	(312)	422
DECREASE IN CASH AND CASH EQUIVALENTS	(5,316)	(31,651)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	114,759	154,545
CASH AND CASH EQUIVALENTS, END OF PERIOD	$109,443	$122,894
SUPPLEMENTAL CASH FLOW INFORMATION:		
Payment for federal, foreign and state income taxes		$410
Interest paid, net of amounts capitalized	$525	$480
Non-cash investing and financing activities:		
Mortgage incurred to purchase real estate	$6,087	$619

The accompanying notes are an integral part of the condensed consolidated financial statements.

PICO HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of PICO Holdings, Inc. and subsidiaries (collectively, the “Company” or “PICO”) have been prepared in accordance with the interim reporting requirements of Form 10-Q, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America (“U.S. GAAP”) for complete consolidated financial statements.

In the opinion of management, all adjustments and reclassifications considered necessary for a fair and comparable presentation of the financial statements presented have been included and are of a normal recurring nature. Operating results presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

These condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010 filed with the SEC.

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of the Company’s consolidated financial statements relate to the assessment of other-than-temporary impairments and the application of the equity method of accounting, unpaid losses and loss adjustment expenses, real estate and water assets, deferred income taxes, stock-based compensation and contingent liabilities. While management believes that the carrying value of such assets and liabilities are appropriate as of March 31, 2011, and December 31, 2010, it is reasonably possible that actual results could differ from the estimates upon which the carrying values were based.

Stock-Based Compensation:

At March 31, 2011, the Company had one stock-based payment arrangement outstanding:

The PICO Holdings, Inc. 2005 Long Term Incentive Plan (the "Plan"). The Plan provides for the grant or award of various equity incentives to PICO employees, non-employee directors and consultants. A total of 2,654,000 shares of common stock are issuable under the Plan and it provides for the issuance of incentive stock options, non-statutory stock options, free-standing stock-settled stock appreciation rights (“SAR”), restricted stock awards (“RSA”), performance shares, performance units, restricted stock units (“RSU”), deferred compensation awards and other stock-based awards. The Plan allows for broker assisted cashless exercises and net-settlement of income taxes and employee withholding taxes. Upon exercise of a SAR and RSU, the employee will receive newly issued shares of PICO Holdings common stock with a fair value equal to the in-the-money value of the award, less applicable federal, state and local withholding and income taxes (however, the holder of an RSU can elect to pay withholding taxes in cash).

The Company has three different equity incentive awards outstanding under the Plan at March 31, 2011 and during the three months ended March 31, 2011 and 2010, the Company recorded $1.1 million and $805,000 of stock based compensation expense, respectively.
A summary of activity of the RSU and RSA is as follows:

	RSU	RSA

Outstanding at January 1, 2011	594,000	4,200
Granted		146
Outstanding at March 31, 2011	594,000	4,346
Unrecognized compensation cost (in thousands)	$13,327	$18

Stock-Settled Stock Appreciation Rights:
There were no SAR granted or exercised during the three months ended 2011 or 2010. However, 10,000 SAR expired worthless during 2011.

Compensation expense recognized for SAR for the three months ended March 31, 2011 and 2010, was zero and $273,000 respectively. At March 31, 2011, there was no unrecognized compensation cost related to unvested SAR.

A summary of SAR activity is as follows:

	SAR	Weighted Average Exercise Price	Weighted Average Contractual Term
Outstanding at January 1, 2011	1,822,079	$36.15	5.5 years
Expired	(10,000)	$33.76	
Outstanding and exercisable (none unvested) at March 31, 2011	1,812,079	$36.16	5.2 years

At March 31, 2011, none of the outstanding SAR were in-the-money.

Deferred Compensation:

The Company reports the investment returns generated in the deferred compensation accounts within the Company's financial statements (with a corresponding increase in the trust assets) and an expense is reported in operating and other costs for increases in the market value of the assets held with a corresponding increase in the deferred compensation liability (except in the case of PICO stock, which is reported as treasury stock, at cost). In the event the trust assets decline in value, the Company will reverse previously expensed compensation.

At March 31, 2011 and December 31, 2010, the Company had $35.8 million and $37.9 million, respectively, recorded as deferred compensation payable to various members of management and certain non-employee members of the board of directors of the Company. The assets of the plan are held in Rabbi Trust accounts. Such accounts hold various investments that are consistent with the Company's investment policy, and accounted and reported for as available-for-sale securities in the accompanying condensed consolidated balance sheets. Assets of the trust will be distributed according to predetermined payout elections established by each employee or member of the board of directors.

The deferred compensation liability decreased by $2.1 million during the three months ended March 31, 2011 primarily due to $3.3 million in distributions of plan assets to participants offset by an increase in the fair value of the assets of $1.2 million. Included in operating and other costs in the accompanying condensed consolidated statements of operations for the three months ended March 31, 2011 and 2010 is compensation expense of $1.2 million and $2.4 million, respectively.

Real Estate and Water Assets:

All real estate and tangible water assets are classified as held and used until management commits to a plan to sell the assets, the asset is available for sale in its present condition, is being actively marketed for sale, and it is probable that the asset will be sold within the next year. At March 31, 2011 and December 31, 2010, the Company had $15 million and $4.3 million of real estate classified as held for sale.

Notes and Other Receivables:

Notes and other receivables include installment notes from the sale of real estate and water assets. These notes generally have terms ranging from three to ten years, with interest rates from 8% to 10%. The Company records a provision for doubtful accounts to allow for any specific accounts which may be unrecoverable and is based upon an analysis of the Company's prior collection experience, customer creditworthiness, current economic trends and underlying value of the real estate. The notes are typically secured by the assets which allows the Company to recover the underlying property if and when a buyer defaults. No significant provision for bad debts was required on any installment notes from the sale of real estate and water assets during the three months ended March 31, 2011 and 2010.

Operating and Other Costs:

For the three months ended March 31, 2011, and 2010 the Company reported a foreign currency gain of $417,000 and loss of $545,000, respectively. The foreign currency gain or loss results primarily from a Swiss Franc denominated loan from PICO Holdings to one of its subsidiaries.

Provision for Income Taxes:

The Company's provision for income tax expense includes federal, foreign and state income taxes currently payable and those deferred because of temporary differences between the income tax and financial reporting bases of the assets and liabilities. The liability method of accounting for income taxes also requires the Company to reflect the effect of a tax rate change on accumulated deferred income taxes in income in the period in which the change is enacted.

In assessing the realization of deferred income taxes, management considers whether it is more likely than not that any deferred income tax assets will be realized. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the period in which temporary differences become deductible. If it is more likely than not that some or all of the deferred income tax assets will not be realized a valuation allowance is recorded.

The Company recognizes any uncertain income tax positions on income tax returns at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained.

The Company recognizes any interest and penalties related to uncertain tax positions in income tax expense. For the three months ended March 31, 2011 and 2010, the Company recorded approximately $7,000 and $39,000, respectively, in interest related to uncertain tax positions.

The Company reported an income tax benefit of $1.3 million and $2.3 million for the three months ended 2011 and 2010, respectively. The effective income tax rate for the three months ended March 31, 2011, and 2010 was 49%, and 35%, respectively. The effective tax rate differs from the statutory rate primarily due to the recognition or reversal of interest expense and penalties on uncertain tax positions, certain non-deductible compensation expense, and the tax benefit of our share of the loss of our unconsolidated affiliate.

2. Net Loss Per Share

Basic earnings or loss per share is computed by dividing net earnings by the weighted average number of shares outstanding during the period. Diluted earnings or loss per share is computed similarly to basic earnings or loss per share except the weighted average shares outstanding are increased to include additional shares from the assumed exercise of any common stock equivalents using the treasury method, if dilutive. The Company’s free-standing SAR and RSU are considered common stock equivalents for this purpose. The number of additional shares related to these common stock equivalents is calculated using the treasury stock method.

For the three months ended March 31, 2011 and 2010, the Company’s stock-settled SAR and RSU were excluded from the diluted per share calculation because their effect on the loss per share was anti-dilutive.

3. Comprehensive Loss

Comprehensive income or loss, net of income tax is comprised of the following (in thousands):

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Net loss	$(2,925)	$(4,843)
Other comprehensive loss, net of tax:		
Unrealized depreciation on available-for-sale securities	(2,777)	(1,188)
Foreign currency translation	(695)	(73)
Total other comprehensive loss, net of tax	(3,472)	(1,261)

Comprehensive loss	(6,397)	(6,104)
Comprehensive loss attributable to the noncontrolling interest	820	781
Comprehensive loss attributable to PICO Holdings, Inc.	$(5,577)	$(5,323)

Total comprehensive loss for the three months ended March 31, 2011 and 2010 is net of a deferred income tax benefit of $2.8 million and $1.5 million, respectively.

The components of accumulated other comprehensive income are as follows (in thousands):

	March 31, 2011	December 31, 2010
Net unrealized appreciation on available-for-sale investments	$17,331	$20,108
Foreign currency translation	(5,476)	(4,781)
Accumulated other comprehensive income	$11,855	$15,327

The accumulated balance is net of deferred income tax liability of $6.7 million at March 31, 2011 and $8.4 million at December 31, 2010.

The following table reports the cost and carrying value of available for sale investments at March 31, 2011 and December 31, 2010 (in thousands):

March 31, 2011	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
Fixed maturities:				
U.S. Treasury securities	$6,509	$47	$(80)	$6,476
Municipal bonds	3,140	150		3,290
Corporate bonds	28,377	917	(235)	29,059
Government sponsored enterprises	3,987	137		4,124
	42,013	1,251	(315)	42,949
Marketable equity securities	52,695	26,421	(1,157)	77,959
Total	$94,708	$27,672	$(1,472)	$120,908

December 31, 2010	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
Fixed maturities:				
U.S. Treasury securities	$4,911	$56		