

SELECTIVE INSURANCE GROUP INC
Form 10-Q
April 30, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended: March 31, 2015
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: 001-33067

SELECTIVE INSURANCE GROUP, INC.
(Exact Name of Registrant as Specified in Its Charter)

New Jersey 22-2168890
(State or Other Jurisdiction of Incorporation or (I.R.S. Employer Identification No.)
Organization)

40 Wantage Avenue 07890
Branchville, New Jersey (Zip Code)
(Address of Principal Executive Offices)

(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 reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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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.

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

As of April 15, 2015, there were 56,948,239 shares of common stock, par value \$2.00 per share, outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

SELECTIVE INSURANCE GROUP, INC.
CONSOLIDATED BALANCE SHEETS

	Unaudited	
	March 31, 2015	December 31, 2014
(\$ in thousands, except share amounts)		
ASSETS		
Investments:		
Fixed income securities, held-to-maturity – at carrying value (fair value: \$311,093 – 2015; \$333,961 – 2014)	\$296,557	318,137
Fixed income securities, available-for-sale – at fair value (amortized cost: \$4,059,034 – 2015; \$3,975,786 – 2014)	4,174,242	4,066,122
Equity securities, available-for-sale – at fair value (cost: \$199,617 – 2015; \$159,011 – 2014)	211,571	191,400
Short-term investments (at cost which approximates fair value)	124,376	131,972
Other investments	95,020	99,203
Total investments (Note 4)	4,901,766	4,806,834
Cash	14,804	23,959
Interest and dividends due or accrued	38,416	38,901
Premiums receivable, net of allowance for uncollectible accounts of: \$4,201 – 2015; \$4,137 – 2014	596,888	558,778
Reinsurance recoverables, net	574,982	581,548
Prepaid reinsurance premiums	141,941	146,993
Deferred federal income tax	92,061	98,449
Property and equipment – at cost, net of accumulated depreciation and amortization of: \$175,896 – 2015; \$172,183 – 2014	61,855	59,416
Deferred policy acquisition costs	191,956	185,608
Goodwill	7,849	7,849
Other assets	78,627	73,215
Total assets	\$6,701,145	6,581,550
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Reserve for loss and loss expenses	\$3,516,268	3,477,870
Unearned premiums	1,132,733	1,095,819
Notes payable	394,301	379,297
Current federal income tax	10,627	3,921
Accrued salaries and benefits	142,092	158,382
Other liabilities	189,186	190,675
Total liabilities	\$5,385,207	5,305,964
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: 100,430,480 – 2015; 99,947,933 – 2014	200,861	199,896

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Additional paid-in capital	312,930	305,385
Retained earnings	1,345,035	1,313,440
Accumulated other comprehensive income (Note 10)	23,615	19,788
Treasury stock – at cost (shares: 43,482,438 – 2015; 43,353,181 – 2014)	(566,503	) (562,923)
Total stockholders' equity	1,315,938	1,275,586
Commitments and contingencies		
Total liabilities and stockholders' equity	\$6,701,145	6,581,550

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)	Quarter ended	
	March 31, 2015	2014
Revenues:		
Net premiums earned	\$476,123	456,495
Net investment income earned	26,917	35,534
Net realized gains:		
Net realized investment gains	20,977	8,181
Other-than-temporary impairments	(2,094	) (963
Other-than-temporary impairments on fixed income securities recognized in other comprehensive income	—	—
Total net realized gains	18,883	7,218
Other income	1,969	9,824
Total revenues	523,892	509,071
Expenses:		
Loss and loss expense incurred	284,999	320,546
Policy acquisition costs	164,723	149,266
Interest expense	5,479	5,561
Other expenses	12,401	8,614
Total expenses	467,602	483,987
Income before federal income tax	56,290	25,084
Federal income tax expense:		
Current	12,254	6,538
Deferred	4,328	572
Total federal income tax expense	16,582	7,110
Net income	\$39,708	17,974
Earnings per share:		
Basic net income	\$0.70	0.32
Diluted net income	\$0.69	0.31
Dividends to stockholders	\$0.14	0.13

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 COMPREHENSIVE INCOME (\$ in thousands)	Quarter ended March 31,		
	2015	2014	
Net income	\$39,708	17,974	
Other comprehensive income, net of tax:			
Unrealized gains on investment securities:			
Unrealized holding gains arising during period	15,586	21,426	
Amount reclassified into net income:			
Held-to-maturity securities	(170) (296)
Non-credit other-than-temporary impairments	232	—	
Realized gains on available for sale securities	(12,932) (4,699)
Total unrealized gains on investment securities	2,716	16,431	
Defined benefit pension and post-retirement plans:			
Amounts reclassified into net income:			
Net actuarial loss	1,111	247	
Total defined benefit pension and post-retirement plans	1,111	247	
Other comprehensive income	3,827	16,678	
Comprehensive income	\$43,535	34,652	

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

Quarter ended March 31,

(\$ in thousands)	2015	2014
Common stock:		
Beginning of year	\$199,896	198,240
Dividend reinvestment plan (shares: 13,533 – 2015; 15,283 – 2014)	27	31
Stock purchase and compensation plans (shares: 469,014 – 2015; 401,179 – 2014)	938	802
End of period	200,861	199,073
Additional paid-in capital:		
Beginning of year	305,385	288,182
Dividend reinvestment plan	346	320
Stock purchase and compensation plans	7,199	5,863
End of period	312,930	294,365
Retained earnings:		
Beginning of year	1,313,440	1,202,015
Net income	39,708	17,974
Dividends to stockholders (\$0.14 per share – 2015; \$0.13 per share – 2014)	(8,113)	(7,412)
End of period	1,345,035	1,212,577
Accumulated other comprehensive income:		
Beginning of year	19,788	24,851
Other comprehensive income	3,827	16,678
End of period	23,615	41,529
Treasury stock:		
Beginning of year	(562,923)	(559,360)
Acquisition of treasury stock (shares: 129,257 – 2015; 118,876 – 2014)	(3,580)	(2,653)
End of period	(566,503)	(562,013)
Total stockholders' equity	\$1,315,938	1,185,531

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)	Quarter ended March 31,	
	2015	2014
Operating Activities		
Net income	\$39,708	17,974
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,041	10,578
Sale of renewal rights	—	(8,000)
Stock-based compensation expense	3,681	4,176
Undistributed losses (gains) of equity method investments	3,541	(33)
Net realized gains	(18,883)	(7,218)
Changes in assets and liabilities:		
Increase in reserve for loss and loss expenses, net of reinsurance recoverables	44,964	58,938
Increase in unearned premiums, net of prepaid reinsurance	41,966	20,254
Decrease in net federal income taxes	11,034	4,332
Increase in premiums receivable	(38,110)	(29,042)
Increase in deferred policy acquisition costs	(6,348)	(4,697)
Decrease in interest and dividends due or accrued	510	414
Decrease in accrued salaries and benefits	(16,290)	(21,869)
Decrease in accrued insurance expenses	(24,255)	(26,957)
Increase in other assets and other liabilities	5,015	16,914
Net adjustments	20,866	17,790
Net cash provided by operating activities	60,574	35,764
Investing Activities		
Purchase of fixed income securities, available-for-sale	(238,000)	(182,809)
Purchase of equity securities, available-for-sale	(150,500)	(61,360)
Purchase of other investments	(1,724)	(4,615)
Purchase of short-term investments	(333,550)	(398,348)
Sale of fixed income securities, available-for-sale	9,305	1,302
Sale of short-term investments	341,146	434,865
Redemption and maturities of fixed income securities, held-to-maturity	20,720	9,396
Redemption and maturities of fixed income securities, available-for-sale	145,661	104,358
Sale of equity securities, available-for-sale	129,052	61,523
Distributions from other investments	5,845	5,704
Purchase of property and equipment	(4,064)	(5,699)
Sale of renewal rights	—	8,000
Net cash used in investing activities	(76,109)	(27,683)
Financing Activities		
Dividends to stockholders	(7,591)	(6,948)
Acquisition of treasury stock	(3,580)	(2,653)
Net proceeds from stock purchase and compensation plans	2,271	1,261
Proceeds from borrowings	15,000	—
Excess tax benefits from share-based payment arrangements	1,398	770
Repayments of capital lease obligations	(1,118)	(459)
Net cash provided by (used in) financing activities	6,380	(8,029)

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Net (decrease) increase in cash	(9,155) 52
Cash, beginning of year	23,959	193
Cash, end of period	\$14,804	245

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. Basis of Presentation

As used herein, the "Company," "we," "us," or "our" refers to Selective Insurance Group, Inc. (the "Parent"), and its subsidiaries, except as expressly indicated or unless the context otherwise requires. Our interim unaudited consolidated financial statements ("Financial Statements") have been prepared by us in conformity with: (i) U.S. generally accepted accounting principles ("GAAP"); and (ii) the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") regarding interim financial reporting. The preparation of the Financial Statements in conformity with GAAP requires us 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 the Parent and its subsidiaries are eliminated in consolidation.

Certain amounts in the prior years' Financial Statements and related notes have been reclassified to conform to the 2015 presentation. Such reclassifications had no effect on our net income, stockholders' equity, or cash flows.

Our Financial Statements reflect all adjustments that, in our opinion, are normal, recurring, and necessary for a fair presentation of our results of operations and financial condition. Our Financial Statements cover the first quarters ended March 31, 2015 ("First Quarter 2015") and March 31, 2014 ("First Quarter 2014") and do not include all of the information and disclosures required by GAAP and the SEC for audited annual financial statements. Results of operations for any interim period are not necessarily indicative of results for a full year. Consequently, our Financial Statements should be read in conjunction with the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2014 ("2014 Annual Report") filed with the SEC.

NOTE 2. Accounting Pronouncements

In June 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period ("ASU 2014-12"). ASU 2014-12 requires that performance targets that affect vesting and could be achieved after the requisite service period be treated as performance conditions. The effective date for ASU 2014-12 is for interim and annual periods beginning after December 15, 2015. The adoption of ASU 2014-12 will not affect us, as we are currently recording expense consistent with the requirements of this accounting update.

In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern ("ASU 2014-15"). ASU 2014-15 provides guidance about: (i) management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern; and (ii) the content of related footnote disclosures. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods beginning in 2017. Early application is permitted. The adoption of this ASU is not expected to impact the Company.

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis ("ASU 2015-02"). ASU 2015-02 amends the current consolidation guidance, focusing mainly on the investment management industry, although entities across all industries will be impacted. The main provisions in this update affect the following areas: (i) limited partnerships and similar legal entities; (ii) the evaluation of fees paid to a decision maker or a service provider as a variable interest; (iii) the effect of fee arrangements on the primary beneficiary determination; (iv) the effect of related parties on the primary beneficiary determination; and (v) certain investment funds. ASU 2015-02 is effective for interim and annual reporting periods beginning after December 15, 2015. While we are currently evaluating ASU 2015-02, we do not expect a material impact on our financial condition or results of operations from the adoption of this guidance.

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NOTE 3. Statements of Cash Flow

Supplemental cash flow information for First Quarter 2015 and First Quarter 2014 is as follows:

(\$ in thousands)	Quarter ended March 31,	
	2015	2014
Cash paid during the period for:		
Interest	\$2,887	2,973
Federal income tax	4,000	2,000

Non-cash items:

Tax-free exchange of fixed income securities, available-for-sale ("AFS")	8,586	—
Tax-free exchange of fixed income securities, held-to-maturity ("HTM")	—	15
Corporate actions related to equity securities, AFS ¹	389	—
Assets acquired under capital lease arrangements	2,428	1,419

¹Examples of such corporate actions include non-cash acquisitions and stock splits.

Included in "Other assets" on the Consolidated Balance Sheet was \$6.0 million at March 31, 2015 and \$6.1 million at March 31, 2014 of cash received from the National Flood Insurance Program ("NFIP"), which is restricted to pay flood claims under the Write Your Own ("WYO") program.

NOTE 4. Investments

(a) The amortized cost, net unrealized gains and losses, carrying value, unrecognized holding gains and losses, and fair value of HTM fixed income securities as of March 31, 2015 and December 31, 2014 were as follows:

March 31, 2015

(\$ in thousands)	Amortized Cost	Net Unrealized Gains (Losses)	Carrying Value	Unrecognized Holding Gains	Unrecognized Holding Losses	Fair Value
Foreign government	\$5,292	25	5,317	21	—	5,338
Obligations of states and political subdivisions	264,788	1,706	266,494	10,536	—	277,030
Corporate securities	18,532	(269)	18,263	2,936	—	21,199
Asset-backed securities ("ABS")	2,483	(378)	2,105	375	—	2,480
Commercial mortgage-backed securities ("CMBS")	4,764	(386)	4,378	668	—	5,046
Total HTM fixed income securities	\$295,859	698	296,557	14,536	—	311,093

December 31, 2014

(\$ in thousands)	Amortized Cost	Net Unrealized Gains (Losses)	Carrying Value	Unrecognized Holding Gains	Unrecognized Holding Losses	Fair Value
Foreign government	\$5,292	47	5,339	55	—	5,394
Obligations of states and political subdivisions	285,301	2,071	287,372	11,760	—	299,132

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Corporate securities	18,899	(273)	18,626	2,796	—	21,422
ABS	2,818	(455)	2,363	460	—	2,823
CMBS	4,869	(432	)	4,437	753	—	5,190
Total HTM fixed income securities	\$317,179	958		318,137	15,824	—	333,961

Unrecognized holding gains and losses of HTM securities are not reflected in the Financial Statements, as they represent fair value fluctuations from the later of: (i) the date a security is designated as HTM; or (ii) the date that an other-than-temporary impairment (“OTTI”) charge is recognized on an HTM security, through the date of the balance sheet. Our HTM securities had an average duration of 1.7 years as of March 31, 2015.

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(b) The cost/amortized cost, unrealized gains and losses, and fair value of AFS securities as of March 31, 2015 and December 31, 2014 were as follows:

March 31, 2015

(\$ in thousands)	Cost/ Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agencies	\$112,146	7,342	(2	) 119,486
Foreign government	27,030	885	—	27,915
Obligations of states and political subdivisions	1,254,037	40,872	(534	) 1,294,375
Corporate securities	1,770,747	55,057	(1,539	) 1,824,265
ABS	184,278	1,214	(105	) 185,387
CMBS ¹	197,304	3,335	(128	) 200,511
Residential mortgage-backed securities (“RMBS ²)	513,492	9,991	(1,180	) 522,303
AFS fixed income securities	4,059,034	118,696	(3,488	) 4,174,242
AFS equity securities	199,617	15,223	(3,269	) 211,571
Total AFS securities	\$4,258,651	133,919	(6,757	) 4,385,813

December 31, 2014

(\$ in thousands)	Cost/ Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
U.S. government and government agencies	\$116,666	7,592	(128	) 124,130
Foreign government	27,035	796	—	27,831
Obligations of states and political subdivisions	1,208,776	38,217	(729	) 1,246,264
Corporate securities	1,763,427	42,188	(5,809	) 1,799,806
ABS	176,837	760		