ALLEGHANY CORP /DE
Form 10-Q
May 05, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2016

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 1-9371

ALLEGHANY CORPORATION

EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER

DELAWARE

STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION

51-0283071

I.R.S. EMPLOYER IDENTIFICATION NO.

7 TIMES SQUARE TOWER, 17TH FLOOR, NY, NY 10036

ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE

212-752-1356

REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE

NOT APPLICABLE

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 x 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 (SECTION 232.405 OF THIS CHAPTER) DURING THE PRECEDING 12 MONTHS (OR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO SUBMIT AND POST SUCH FILES). YES x 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 THE DEFINITIONS OF LARGE ACCELERATED FILER, ACCELERATED FILER, AND SMALLER REPORTING COMPANY IN RULE 12b-2 OF THE EXCHANGE ACT. (CHECK ONE):

LARGE ACCELERATED FILER x		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 x

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER S CLASSES OF COMMON STOCK, AS OF THE LAST PRACTICABLE DATE.

15,438,632 SHARES, PAR VALUE $1.00 PER SHARE, AS OF MAY 1, 2016

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ALLEGHANY CORPORATION

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Part I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

	March 31, 2016 (unaudited)	December 31, 2015
	(in thousands, except share amounts)	
Assets		
Investments:		
Available-for-sale securities at fair value:		
Equity securities (cost: 2016 $2,637,787; 2015 $2,740,984)	$ 2,889,055	$ 3,005,908
Debt securities (amortized cost: 2016 $13,385,266; 2015 $13,529,923)	13,618,212	13,605,963
Short-term investments	493,614	365,810
	17,000,881	16,977,681
Commercial mortgage loans	279,906	177,947
Other invested assets	694,607	676,811
Total investments	17,975,394	17,832,439
Cash	509,743	475,267
Accrued investment income	114,681	115,313
Premium balances receivable	755,811	752,103
Reinsurance recoverables	1,203,188	1,249,948
Ceded unearned premiums	190,366	190,368
Deferred acquisition costs	449,645	419,448
Property and equipment at cost, net of accumulated depreciation and amortization	99,958	101,306
Goodwill	141,015	141,015
Intangible assets, net of amortization	209,704	212,790
Current taxes receivable	31,030	12,129
Net deferred tax assets	344,294	468,440
Other assets	1,030,514	868,513
Total assets	$ 23,055,343	$ 22,839,079
Liabilities, Redeemable Noncontrolling Interests and Stockholders Equity		
Loss and loss adjustment expenses	$ 10,758,730	$ 10,799,242
Unearned premiums	2,170,059	2,076,061
Senior Notes	1,383,572	1,383,086

Reinsurance payable	88,164	69,297
Other liabilities	857,216	930,967
Total liabilities	15,257,741	15,258,653
Redeemable noncontrolling interests	25,866	25,719
Common stock (shares authorized: 2016 and 2015 22,000,000; shares issued: 2016 and 2015 17,459,961)	17,460	17,460
Contributed capital	3,611,715	3,611,631
Accumulated other comprehensive income	229,376	116,273
Treasury stock, at cost (2016 2,022,329 shares; 2015 1,915,884 shares)	(798,447)	(747,784)
Retained earnings	4,711,632	4,557,127
Total stockholders equity attributable to Alleghany stockholders	7,771,736	7,554,707
Total liabilities, redeemable noncontrolling interest and stockholders equity	$ 23,055,343	$ 22,839,079

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Earnings and Comprehensive Income

(unaudited)

	Three Months Ended March 31, 2016	2015
	(in thousands, except per share amounts)	
Revenues		
Net premiums earned	$ 1,221,565	$ 1,017,171
Net investment income	104,863	113,382
Net realized capital gains	35,893	43,151
Other than temporary impairment losses	(20,759)	(52,281)
Other revenue	137,388	36,200
Total revenues	1,478,950	1,157,623
Costs and Expenses		
Net loss and loss adjustment expenses	664,644	546,916
Commissions, brokerage and other underwriting expenses	406,733	343,609
Other operating expenses	162,164	67,405
Corporate administration	9,734	12,678
Amortization of intangible assets	3,085	(1,660)
Interest expense	20,269	23,092
Total costs and expenses	1,266,629	992,040
Earnings before income taxes	212,321	165,583
Income taxes	57,668	40,163
Net earnings	154,653	125,420
Net earnings attributable to noncontrolling interest	148	211
Net earnings attributable to Alleghany stockholders	$ 154,505	$ 125,209
Net earnings	$ 154,653	$ 125,420
Other comprehensive income:		
Change in unrealized gains, net of deferred taxes of $54,981 and $33,141 for 2016 and 2015, respectively	102,107	61,548
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes of ($5,297) and $3,196 for 2016 and 2015,	(9,837)	5,935

respectively				
Change in unrealized currency translation adjustment, net of deferred taxes of $11,077 and ($5,791) for 2016 and 2015, respectively		20,571		(10,755)
Retirement plans		262		(522)
Comprehensive income		267,756		181,626
Comprehensive income attributable to noncontrolling interest		148		211
Comprehensive income attributable to Alleghany stockholders	$	267,608	$	181,415
Basic earnings per share attributable to Alleghany stockholders	$	10.00	$	7.82
Diluted earnings per share attributable to Alleghany stockholders		9.96		7.82

See accompanying Notes to Unaudited Consolidated Financial Statements.

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ALLEGHANY CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(unaudited)

	Three Months Ended March 31, 2016	2015
	(in thousands)	
Cash flows from operating activities		
Net earnings	$ 154,653	$ 125,420
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	34,905	42,083
Net realized capital (gains) losses	(35,893)	(43,151)
Other than temporary impairment losses	20,759	52,281
(Increase) decrease in reinsurance recoverables, net of reinsurance payable	65,627	215
(Increase) decrease in premium balance receivable	(3,708)	44,282
(Increase) decrease in ceded unearned premiums	2	(12,756)
(Increase) decrease in deferred acquisition costs	(30,197)	(16,662)
(Increase) decrease in unearned premiums	93,998	68,644
(Increase) decrease in loss and loss adjustment expenses	(40,512)	(182,881)
Change in unrealized foreign exchange losses (gains)	45,552	154,741
Other, net	(265,606)	(14,895)
Net adjustments	(115,073)	91,901
Net cash provided by (used in) operating activities	39,580	217,321
Cash flows from investing activities		
Purchases of debt securities	(1,844,101)	(2,122,464)
Purchases of equity securities	(551,815)	(1,385,109)
Sales of debt securities	1,800,873	1,596,406
Maturities and redemptions of debt securities	237,162	353,149
Sales of equity securities	665,994	1,132,816
Net (purchase) sale in short-term investments	(142,622)	230,725
Purchases of property and equipment	(2,088)	(10,609)
Purchase of subsidiary, net of cash acquired	(1,020)	(43,900)
Other, net	(122,288)	1,232
Net cash provided by (used in) investing activities	40,095	(247,754)
Cash flows from financing activities		
Treasury stock acquisitions	(53,288)	(26,632)

Other, net		5,734		7,344
Net cash provided by (used in) financing activities		(47,554)		(19,288)
Effect of exchange rate changes on cash		2,355		(18,053)
Net increase (decrease) in cash		34,476		(67,774)
Cash at beginning of period		475,267		605,259
Cash at end of period	$	509,743	$	537,485
Supplemental disclosures of cash flow information				
Cash paid during period for:				
Interest paid	$	16,115	$	16,406
Income taxes paid (refund received)		11,737		(1,787)

See accompanying Notes to Unaudited Consolidated Financial Statements.

ALLEGHANY CORPORATION AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

1. Summary of Significant Accounting Principles

(a) Principles of Financial Statement Presentation

This Quarterly Report on Form 10-Q (this Form 10-Q) should be read in conjunction with the Annual Report on Form 10-K for the year ended December 31, 2015 (the 2015 10-K) of Alleghany Corporation (Alleghany).

Alleghany, a Delaware corporation, which was initially incorporated in Delaware in 1929, owns and manages certain operating subsidiaries and investments, anchored by a core position in property and casualty reinsurance and insurance. Through its wholly-owned subsidiary Alleghany Insurance Holdings LLC (AIHL) and its subsidiaries, Alleghany is engaged in the property and casualty insurance business. AIHL s insurance operations are principally conducted by its subsidiaries RSUI Group, Inc. (RSUI), CapSpecialty, Inc. (CapSpecialty) and Pacific Compensation Corporation (PacificComp). CapSpecialty has been a subsidiary of AIHL since January 2002, RSUI has been a subsidiary of AIHL since July 2003 and PacificComp has been a subsidiary of AIHL since July 2007. AIHL Re LLC (AIHL Re), a captive reinsurance company which provides reinsurance to Alleghany s insurance operating subsidiaries and affiliates, has been a wholly-owned subsidiary of Alleghany since its formation in May 2006. Alleghany s reinsurance operations commenced on March 6, 2012 when Alleghany consummated a merger with Transatlantic Holdings, Inc. (TransRe), and TransRe became one of Alleghany s wholly-owned subsidiaries. Alleghany s public equity investments, including those held by TransRe s and AIHL s operating subsidiaries, are managed primarily through Alleghany s wholly-owned subsidiary Roundwood Asset Management LLC.

Although Alleghany s primary sources of revenues and earnings are its reinsurance and insurance operations and investments, Alleghany also manages, sources, executes and monitors certain private capital investments primarily through its wholly-owned subsidiary Alleghany Capital Corporation (Alleghany Capital). Alleghany Capital s private capital investments are included in other activities for segment reporting purposes and include: (i) Stranded Oil Resources Corporation (SORC), an exploration and production company focused on enhanced oil recovery, headquartered in Golden, Colorado; (ii) Bourn & Koch, Inc. (Bourn & Koch), a manufacturer and remanufacturer/retrofitter of precision machine tools and supplier of replacement parts, headquartered in Rockford, Illinois; (iii) R.C. Tway Company, LLC (Kentucky Trailer), a manufacturer of custom trailers and truck bodies for the moving and storage industry and other markets, headquartered in Louisville, Kentucky; (iv) IPS-Integrated Project Services, LLC (IPS), a technical service provider focused on the global pharmaceutical and biotechnology industries, headquartered in Blue Bell, Pennsylvania, acquired on October 31, 2015; (v) an approximately 40 percent equity interest in ORX Exploration, Inc. (ORX), a regional oil and gas exploration and production company, headquartered in New Orleans, Louisiana; and (vi) a 30 percent equity interest in Jazwares, LLC (Jazwares), a toy and consumer electronics company, headquartered in Sunrise, Florida. ORX and Jazwares are accounted for under the equity method of accounting. On April 15, 2016, Alleghany Capital acquired an additional 50 percent equity interest in Jazwares, bringing its equity interest in Jazwares to 80 percent, and as of that date, the results of Jazwares will be included in Alleghany s consolidated results. In addition, Alleghany owns and manages properties in the Sacramento, California region through its wholly-owned subsidiary Alleghany Properties Holdings LLC (Alleghany Properties).

Unless the context otherwise requires, references to Alleghany include Alleghany together with its subsidiaries.

The accompanying consolidated financial statements include the results of Alleghany and its wholly-owned and majority-owned subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). All significant inter-company balances and transactions have been eliminated in consolidation. The results of IPS have been included in Alleghany s consolidated results beginning with its acquisition by Alleghany Capital on October 31, 2015.

The portion of stockholders equity, net earnings and accumulated other comprehensive income that is not attributable to Alleghany stockholders is presented on the Consolidated Balance Sheets and the Consolidated Statements of Earnings and Comprehensive Income as noncontrolling interest. Because all noncontrolling interests have the option to sell their interests to Alleghany in the future (generally through 2023), the portion of stockholders equity that is not attributable to Alleghany stockholders is presented on the Consolidated Balance Sheets as redeemable noncontrolling interest for all periods presented. During the first three months of 2016, Bourn & Koch had approximately 12 percent noncontrolling interests outstanding, Kentucky Trailer had approximately 20 percent noncontrolling interests outstanding and IPS had approximately 16 percent noncontrolling interests outstanding.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Alleghany relies on historical experience and on various other assumptions that it believes to be reasonable under the circumstances to make judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from those reported results to the extent that those estimates and assumptions prove to be inaccurate. Changes in estimates are reflected in the consolidated statement of earnings and comprehensive income in the period in which the change is made.

(b) Other Significant Accounting Principles

Alleghany s significant accounting principles can be found in Note 1 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of the 2015 10-K.

(c) Recent Accounting Standards

Recently Adopted

In February 2015, the Financial Accounting Standards Board (the FASB) issued guidance that amended the analysis that must be performed to determine whether an entity should consolidate certain types of legal entities. Under the new guidance, the evaluation of whether limited partnerships and similar entities are variable interest entities or voting interest entities is modified, the presumption that general partners should consolidate limited partnerships is eliminated and the process to determine the primary beneficiary of a variable interest entity is modified. This guidance is effective in the first quarter of 2016. Alleghany adopted this guidance in the first quarter of 2016 and the implementation did not have a material impact on its results of operations and financial condition.

In April 2015, the FASB issued guidance that requires debt issuance costs related to debt liabilities be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, which is consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected. This guidance was effective in the first quarter of 2016. Alleghany adopted this guidance on a retrospective basis in the first quarter of 2016 and the implementation resulted in a reduction of other assets and a corresponding decrease in senior notes of approximately $7 million as of March 31, 2016 and December 31, 2015.

Future Application of Accounting Standards

In May 2014, the FASB, together with the International Accounting Standards Board, issued guidance on the recognition of revenue from contracts with customers. Under the new guidance, revenue is recognized as the transfer of goods and services to customers takes place, and in amounts that reflect the payment or payments that are expected to be received from the customers for those goods and services. The new guidance also requires new disclosures about revenue. Revenues related to insurance and reinsurance are not impacted by this guidance. In July 2015, the FASB decided to delay the effective date of the new revenue standard by a year. This guidance is now effective in the first quarter of 2018 for public entities, with early adoption permitted in 2017. Alleghany will adopt this guidance in the first quarter of 2018 and does not currently believe that the implementation will have a material impact on its results of operations and financial condition.

In May 2015, the FASB issued guidance that requires disclosures related to short-duration insurance contracts. The guidance applies to property and casualty insurance and reinsurance entities, among others, and requires the following annual disclosure related to the liability for loss and loss adjustment expenses (LAE): (i) net incurred and paid claims development information by accident year for up to ten years; (ii) a reconciliation of incurred and paid claims development information to the aggregate carrying amount of the liability for loss and LAE;
(iii) incurred-but-not-reported liabilities by accident year and in total; (iv) a description of reserving methodologies (as well as any changes to those methodologies); (v) quantitative information about claim frequency by accident year; and (vi) the average annual percentage payout of incurred claims by age by accident year. In addition, the guidance requires insurance entities to disclose for annual and interim reporting periods a roll-forward of the liability for loss and LAE. This guidance is effective for annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016, with early adoption permitted. Alleghany will adopt this guidance as of December 31, 2016 and does not currently believe that the implementation will have an impact on its results of

operations and financial condition.

In January 2016, the FASB issued guidance that changes the recognition and measurement of certain financial instruments. The new guidance requires investments in equity securities (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. For equity securities that do not have readily determinable fair values, measurement may be at cost, adjusted for any impairment and changes resulting from observable price changes for a similar investment of the same issuer. The new guidance also changes the presentation and disclosure of financial instruments by: (i) requiring that financial instrument disclosures of fair value use the exit price notion; (ii) requiring separate presentation of financial assets and financial liabilities by measurement category and form, either on the balance sheet or the accompanying notes to the financial statements; (iii) requiring separate presentation in other comprehensive income for the portion of the change in a liability s fair value resulting from instrument-specific credit risk when an election has been made to measure the liability at fair value; and (iv) eliminating the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet. The new guidance is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Except for the change in presentation for instrument-specific credit risk, the new guidance does not permit early adoption. Alleghany will adopt this guidance in the first quarter of 2018. As of January 1, 2018, unrealized gains or losses of equity securities, net of deferred taxes, will be reclassified from accumulated other comprehensive income to retained earnings. Subsequently, all changes in unrealized gains or losses of equity securities, net of deferred taxes, will be presented in the consolidated statement of earnings, rather than the consolidated statement of

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comprehensive income. Alleghany does not currently believe that the implementation will have a material impact on its financial condition.

In February 2016, the FASB issued guidance on leases. Under the new guidance, a lessee is required to recognize assets and liabilities for leases with lease terms of more than one year, whereas under current guidance, a lessee is only required to recognize assets and liabilities for those leases qualifying as capital leases. The new guidance also requires new disclosures about the amount, timing and uncertainty of cash flows arising from leases. The accounting by lessors is to remain largely unchanged. This guidance is effective in the first quarter of 2019 for public entities, with early adoption permitted. Alleghany will adopt this guidance in the first quarter of 2019 and does not currently believe that the implementation will have a material impact on its results of operations and financial condition.

2. Fair Value of Financial Instruments

The carrying values and estimated fair values of Alleghany s consolidated financial instruments as of March 31, 2016 and December 31, 2015 were as follows:

	March 31, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	($ in millions)			
Assets				
Investments (excluding equity method investments and loans)[1]	$ 17,029.3	$ 17,029.3	$ 17,007.6	