

ALLEGHANY CORP /DE
Form 10-Q
May 03, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 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, 2018**

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.

1411 BROADWAY, 34TH FLOOR, NY, NY 10018

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 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 NO

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A LARGE ACCELERATED FILER, AN ACCELERATED FILER, A NON-ACCELERATED FILER, A SMALLER REPORTING COMPANY, OR AN EMERGING GROWTH COMPANY. SEE THE DEFINITIONS OF LARGE ACCELERATED FILER, ACCELERATED FILER, SMALLER REPORTING COMPANY, AND EMERGING GROWTH COMPANY IN RULE 12b-2 OF THE EXCHANGE ACT.

LARGE ACCELERATED FILER

ACCELERATED FILER

EMERGING GROWTH COMPANY

NON-ACCELERATED FILER

SMALLER REPORTING COMPANY

IF AN EMERGING GROWTH COMPANY, INDICATE BY CHECK MARK IF THE REGISTRANT HAS ELECTED NOT TO USE THE EXTENDED TRANSITION PERIOD FOR COMPLYING WITH ANY NEW OR REVISED FINANCIAL ACCOUNTING STANDARDS PROVIDED PURSUANT TO SECTION 13(A) OF THE

EXCHANGE ACT.

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS A SHELL COMPANY (AS DEFINED IN RULE 12b-2 OF THE ACT). YES NO

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

15,289,793 SHARES, PAR VALUE \$1.00 PER SHARE, AS OF APRIL 23, 2018

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ALLEGHANY CORPORATION

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	March 31, 2018 (unaudited)	December 31, 2017
(\$ in thousands, except share amounts)		
Assets		
Investments:		
Securities at fair value:		
Equity securities (cost: 2018 \$3,721,932; 2017 \$3,170,673)	\$ 4,545,899	\$ 4,099,467
Debt securities (amortized cost: 2018 \$12,065,159; 2017 \$12,536,772)	12,066,223	12,721,399
Short-term investments	611,655	578,054
	17,223,777	17,398,920
Commercial mortgage loans	663,933	658,364
Other invested assets	601,555	743,358
Total investments	18,489,265	18,800,642
Cash	711,040	838,375
Accrued investment income	97,998	105,877
Premium balances receivable	856,078	797,346
Reinsurance recoverables	1,653,758	1,746,488
Ceded unearned premiums	204,640	190,252
Deferred acquisition costs	467,524	453,346
Property and equipment at cost, net of accumulated depreciation and amortization	198,707	125,337
Goodwill	345,306	334,905
Intangible assets, net of amortization	467,475	459,037
Current taxes receivable	63,568	31,085
Net deferred tax assets	123,944	136,489
Funds held under reinsurance agreements	705,433	706,042
Other assets	712,520	659,096
Total assets	\$ 25,097,256	\$ 25,384,317
Liabilities, Redeemable Noncontrolling Interests and Stockholders Equity		
Loss and loss adjustment expenses	\$ 11,714,269	\$ 11,871,250

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Unearned premiums	2,251,593	2,182,294
Senior Notes and other debt	1,540,865	1,484,897
Reinsurance payable	160,228	156,376
Other liabilities	919,270	1,068,907
Total liabilities	16,586,225	16,763,724

Redeemable noncontrolling interests	137,631	106,530
Common stock (shares authorized: 2018 and 2017 22,000,000; shares issued: 2018 and 2017 17,459,961)	17,460	17,460
Contributed capital	3,613,630	3,612,109
Accumulated other comprehensive (loss) income	(123,620)	618,118
Treasury stock, at cost (2018 2,097,820 shares; 2017 2,069,461 shares)	(843,497)	(824,906)
Retained earnings	5,709,427	5,091,282
Total stockholders' equity attributable to Alleghany stockholders	8,373,400	8,514,063
Total liabilities, redeemable noncontrolling interest and stockholders' equity	\$ 25,097,256	\$ 25,384,317

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,	
	2018	2017
	(\$ in thousands, except per share amounts)	
Revenues		
Net premiums earned	\$ 1,207,856	\$ 1,209,188
Net investment income	124,126	115,538
Change in the fair value of equity securities	(42,649)	-
Net realized capital gains	44,505	59,651
Other than temporary impairment losses	(511)	(3,217)
Noninsurance revenue	251,627	151,292
 Total revenues	 1,584,954	 1,532,452
Costs and Expenses		
Net loss and loss adjustment expenses	670,578	699,305
Commissions, brokerage and other underwriting expenses	406,295	408,515
Other operating expenses	264,897	175,138
Corporate administration	7,785	16,885
Amortization of intangible assets	5,264	3,764
Interest expense	21,531	20,935
 Total costs and expenses	 1,376,350	 1,324,542
 Earnings before income taxes	 208,604	 207,910
Income taxes	37,422	58,550
 Net earnings	 171,182	 149,360
Net earnings attributable to noncontrolling interest	(393)	184
 Net earnings attributable to Alleghany stockholders	 \$ 171,575	 \$ 149,176
 Net earnings	 \$ 171,182	 \$ 149,360
Other comprehensive income:		
Change in unrealized gains (losses), net of deferred taxes of (\$38,905) and \$67,270 for 2018 and 2017, respectively	(146,358)	124,929
Less: reclassification for net realized capital gains and other than temporary impairment losses, net of taxes of \$366 and (\$19,752) for 2018 and 2017, respectively	1,379	(36,682)

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Change in unrealized currency translation adjustment, net of deferred taxes of \$1,356 and \$2,719 for 2018 and 2017, respectively	5,100	5,049
Retirement plans	(1,322)	(395)
Comprehensive income	29,981	242,261
Comprehensive income attributable to noncontrolling interest	(393)	184
Comprehensive income attributable to Alleghany stockholders	\$ 30,374	\$ 242,077
Basic earnings per share attributable to Alleghany stockholders	\$ 11.15	\$ 9.68
Diluted earnings per share attributable to Alleghany stockholders	11.04	9.67
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,	
	2018	2017
	(\$ in thousands)	
Cash flows from operating activities		
Net earnings	\$ 171,182	\$ 149,360
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	33,107	35,663
Change in the fair value of equity securities	42,649	-
Net realized capital (gains) losses	(44,505)	(59,651)
Other than temporary impairment losses	511	3,217
(Increase) decrease in reinsurance recoverables, net of reinsurance payable	96,582	34,196
(Increase) decrease in premium balances receivable	(58,732)	(62,971)
(Increase) decrease in ceded unearned premiums	(14,388)	(17,874)
(Increase) decrease in deferred acquisition costs	(14,178)	(6,488)
(Increase) decrease in funds held under reinsurance agreements	609	(23,885)
Increase (decrease) in unearned premiums	69,299	39,448
Increase (decrease) in loss and loss adjustment expenses	(156,981)	(97,254)
Change in unrealized foreign exchange losses (gains)	(35,143)	(19,971)
Other, net	(95,181)	(16,322)
Net adjustments	(176,351)	(191,892)
Net cash provided by (used in) operating activities	(5,169)	(42,532)
Cash flows from investing activities		
Purchases of debt securities	(989,813)	(1,811,566)
Purchases of equity securities	(451,519)	(304,343)
Sales of debt securities	1,014,024	1,349,608
Maturities and redemptions of debt securities	466,457	443,960
Sales of equity securities	172,819	1,363,269
Net (purchases) sales of short-term investments	(33,634)	(949,847)
Net (purchases) sales and maturities of commercial mortgage loans	(5,569)	(24,803)
(Purchases) sales of property and equipment	(11,057)	(4,480)
Purchases of affiliates and subsidiaries, net of cash acquired	(105,386)	-
Other, net	(23,951)	29,388

Net cash provided by (used in) investing activities	32,371	91,186
Cash flows from financing activities		
Treasury stock acquisitions	(21,268)	-
Increase (decrease) in other debt	9,957	(5,509)
Cash dividends paid	(153,967)	-
Other, net	4,654	(13,057)
Net cash provided by (used in) financing activities	(160,624)	(18,566)
Effect of exchange rate changes on cash	6,087	266
Net increase (decrease) in cash	(127,335)	30,354
Cash at beginning of period	838,375	594,091
Cash at end of period	\$ 711,040	\$ 624,445

Supplemental disclosures of cash flow information

Cash paid during period for:

Interest paid	\$ 16,942	\$ 16,359
Income taxes paid (refund received)	20,275	5,949

See accompanying Notes to Unaudited Consolidated Financial Statements.

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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, 2017 (the 2017 Form 10-K) of Alleghany Corporation (Alleghany).

Alleghany Corporation, a Delaware corporation, 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 TransRe, Alleghany is engaged in the property and casualty reinsurance business. TransRe has been Alleghany's wholly-owned subsidiary since March 2012. 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, prior to December 31, 2017, Pacific Compensation Corporation (PacificComp). CapSpecialty has been a subsidiary of AIHL since January 2002 and RSUI has been a subsidiary of AIHL since July 2003. AIHL Re LLC (AIHL Re), a captive reinsurance company which provides reinsurance to Alleghany's current and former insurance operating subsidiaries and affiliates, has been a wholly-owned subsidiary of Alleghany since its formation in May 2006.

On September 12, 2017, AIHL signed a definitive agreement to sell PacificComp to CopperPoint Mutual Insurance Company (CopperPoint) for total cash consideration of approximately \$158 million. The transaction closed on December 31, 2017, at which time: (i) approximately \$442 million of PacificComp assets, consisting primarily of debt securities, and approximately \$316 million of PacificComp liabilities, consisting primarily of loss and loss adjustment expenses (LAE) reserves, were transferred; and (ii) AIHL recorded an after-tax gain of approximately \$16 million, which included a tax benefit. In connection with the transaction, AIHL Re will continue to provide adverse development reinsurance coverage on PacificComp's pre-acquisition claims, subject to certain terms and conditions. AIHL Re's obligations, which are guaranteed by Alleghany, are subject to: (i) an aggregate limit of \$150.0 million; and (ii) a final commutation and settlement as of December 31, 2024.

Although Alleghany's primary sources of revenues and earnings are its reinsurance and insurance operations and investments, Alleghany also sources, executes, manages and monitors certain private investments primarily through its wholly-owned subsidiary Alleghany Capital Corporation (Alleghany Capital). Alleghany Capital's investments include:

Bourn & Koch, Inc. (Bourn & Koch), a manufacturer/remanufacturer of specialty machine tools and supplier of replacement parts, accessories and services for a variety of cutting technologies, headquartered in Rockford, Illinois;

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;

IPS-Integrated Project Services, LLC (IPS), a technical engineering-focused service provider focused on the global pharmaceutical and biotechnology industries, headquartered in Blue Bell, Pennsylvania;

Jazwares, LLC (together with its affiliates, Jazwares), a global toy, entertainment and musical instrument company, headquartered in Sunrise, Florida;

WWSC Holdings, LLC (W&WIAFCO Steel), a structural steel fabricator and erector, headquartered in Oklahoma City, Oklahoma; and

a 45 percent equity interest in Wilbert Funeral Services, Inc. (Wilbert), a provider of products and services for the funeral and cemetery industries and precast concrete markets, headquartered in Overland Park, Kansas.

The results of W&WIAFCO Steel have been included in Alleghany's consolidated results beginning with its acquisition by Alleghany Capital on April 28, 2017. On February 7, 2018, W&WIAFCO Steel acquired Hirschfeld Holdings, LP (Hirschfeld).

Wilbert is accounted for under the equity method of accounting and is included in other invested assets. The results of Wilbert have been included in Alleghany's consolidated results beginning with its acquisition by Alleghany Capital on August 1, 2017.

In addition, Alleghany owns certain other holding-company investments. Stranded Oil Resources Corporation (SORC) is an exploration and production company focused on enhanced oil recovery, headquartered in Golden, Colorado. Alleghany also owns and manages properties in the Sacramento, California region through its wholly-owned subsidiary Alleghany Properties Holdings LLC (Alleghany Properties). Alleghany's public equity investments are managed primarily through Alleghany's wholly-owned subsidiary Roundwood Asset Management LLC.

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

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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 U.S. (GAAP). All material inter-company balances and transactions have been eliminated in consolidation.

The portion of stockholders' equity, net earnings and 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 interests. Because all noncontrolling interests have the option to sell their ownership interests to Alleghany in the future (generally through 2024), the portion of stockholders' equity that is not attributable to Alleghany stockholders is presented on the Consolidated Balance Sheets as redeemable noncontrolling interests for all periods presented. During the first three months of 2018, the approximate noncontrolling interests outstanding were as follows: Bourn & Koch - 11 percent; Kentucky Trailer - 21 percent; IPS - 16 percent; Jazwares - 23 percent; and W&WIAFCO Steel - 20 percent.

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 Statements of Earnings and Comprehensive Income in the period in which the changes are 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 2017 Form 10-K.

(c) Recent Accounting Standards

Recently Adopted

In February 2018, the Financial Accounting Standards Board (the FASB) issued guidance on certain tax effects caused by the Tax Cuts and Jobs Act of 2017 (the Tax Act), which was signed into law on December 22, 2017. The Tax Act reduced the corporate federal income tax rate from 35.0 percent to 21.0 percent, effective January 1, 2018 for the 2018 tax year, among other provisions. Under such circumstances, GAAP requires that the value of deferred tax assets and liabilities be reduced through tax expense. The new guidance provides an option to reclassify any stranded tax amounts that remain in accumulated other comprehensive income to retained earnings, either retrospectively or at the beginning of the period in which the adoption is elected. This guidance became effective in the first quarter of 2018 for public entities, with early adoption permitted in 2017. Alleghany adopted this new guidance in the first quarter of 2018, and has elected to reclassify stranded tax amounts that remain in accumulated other comprehensive income, in the amount of approximately \$135 million, to retained earnings as of January 1, 2018. See Note 7(b) of this Form 10-Q for further information on accumulated other comprehensive income, and see Note 9 to Notes to Consolidated Financial Statements set forth in Part II, Item 8, Financial Statements and Supplementary Data of the 2017 Form 10-K for additional information on the Tax Act and its impact on Alleghany.

In March 2017, the FASB issued guidance that reduces the amortization period for the premium on certain purchased callable debt securities to the earliest call date. The guidance applies specifically to noncontingent call features that are callable at a predetermined and fixed price and date. The accounting for purchased callable debt securities held at a

discount is not affecte