

HALLMARK FINANCIAL SERVICES INC  
Form 10-Q  
November 05, 2015

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

Quarterly report pursuant to Section 13 or 15(d) of the

Securities Exchange Act of 1934

For the quarterly period ended September 30, 2015

Commission file number 001-11252

**Hallmark Financial Services, Inc.**

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of

Incorporation or organization)

87-0447375  
(I.R.S.  
Employer  
Identification  
No.)

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777 Main Street, Suite 1000, Fort Worth, Texas      76102  
(Address of principal executive offices)      (Zip Code)

Registrant's telephone number, including area code: (817) 348-1600

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 (§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 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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: Common Stock, par value \$.18 per share – 19,144,294 shares outstanding as of November 5, 2015.

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

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**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Balance Sheets**

(\$ in thousands, except par value )

	September 30, 2015 (unaudited)	December 31, 2014
<b>ASSETS</b>		
Investments:		
Debt securities, available-for-sale, at fair value (cost: \$524,908 in 2015 and \$450,770 in 2014)	\$ 519,163	\$ 450,785
Equity securities, available-for-sale, at fair value (cost: \$24,957 in 2015 and \$25,360 in 2014)	48,229	56,444
Total investments	567,392	507,229
Cash and cash equivalents	93,049	130,985
Restricted cash	18,525	11,914
Ceded unearned premiums	64,115	53,376
Premiums receivable	86,877	71,003
Accounts receivable	2,241	3,141
Receivable for securities	2,354	932
Reinsurance recoverable	116,342	109,719
Deferred policy acquisition costs	21,110	20,746
Goodwill	44,695	44,695
Intangible assets, net	15,576	17,427
Deferred federal income taxes, net	2,832	-
Prepaid expenses	2,920	1,823
Other assets	10,632	7,879
Total assets	\$ 1,048,660	\$ 980,869
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities:		
Subordinated debt securities	\$ 56,702	\$ 56,702
Reserves for unpaid losses and loss adjustment expenses	451,383	415,135
Unearned premiums	218,590	196,826
Reinsurance balances payable	32,832	26,403
Pension liability	2,481	2,619
Payable for securities	4,269	1,321
Federal income tax payable	522	968
Deferred federal income taxes, net	-	3,092

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Accounts payable and other accrued expenses	21,089	25,766
Total liabilities	\$ 787,868	\$ 728,832
Commitments and Contingencies (Note 17)		
Stockholders' equity:		
Common stock, \$.18 par value, authorized 33,333,333; issued 20,872,831 shares in 2015 and 2014	3,757	3,757
Additional paid-in capital	123,606	123,194
Retained earnings	138,055	119,638
Accumulated other comprehensive income	8,921	17,801
Treasury stock (1,728,537 shares in 2015 and 1,655,306 in 2014), at cost	(13,547 )	(12,353 )
Total stockholders' equity	260,792	252,037
	\$ 1,048,660	\$ 980,869

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

**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Operations**

(Unaudited)

(\$ in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Gross premiums written	\$ 132,141	\$ 122,723	\$ 390,708	\$ 363,245
Ceded premiums written	(42,217 )	(38,698 )	(116,105 )	(122,596 )
Net premiums written	89,924	84,025	274,603	240,649
Change in unearned premiums	(1,518 )	(6,878 )	(11,025 )	(2,879 )
Net premiums earned	88,406	77,147	263,578	237,770
Investment income, net of expenses	3,495	2,912	10,051	9,139
Net realized gains (losses)	(335 )	(23 )	3,688	(122 )
Finance charges	1,619	1,300	4,400	4,067
Commission and fees	60	71	(41 )	(1,528 )
Other income	439	10	655	36
Total revenues	93,684	81,417	282,331	249,362
Losses and loss adjustment expenses	56,005	50,509	171,820	155,781
Other operating expenses	26,458	24,409	78,818	75,055
Interest expense	769	1,140	3,043	3,435
Amortization of intangible assets	617	631	1,851	1,909
Total expenses	83,849	76,689	255,532	236,180
Income before tax	9,835	4,728	26,799	13,182
Income tax expense	3,137	1,265	8,382	3,520
Net income	6,698	3,463	18,417	9,662
Net income per share:				
Basic	\$0.35	\$0.18	\$0.96	\$0.50
Diluted	\$0.35	\$0.18	\$0.95	\$0.50

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



**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Comprehensive Income (Loss)**

(Unaudited)

(\$ in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	\$ 6,698	\$ 3,463	\$ 18,417	\$ 9,662
Other comprehensive income (loss):				
Change in net actuarial gain	26	40	78	122
Tax effect on change in net actuarial gain	(9 )	(14 )	(27 )	(43 )
Unrealized holding (losses) gains arising during the period	(10,821 )	(221 )	(7,858 )	1,900
Tax effect on unrealized holding (losses) gains arising during the period	3,787	77	2,750	(665 )
Reclassification adjustment for (gains) losses included in net income	(28 )	23	(5,881 )	122
Tax effect on reclassification adjustment for gains (losses) included in net income	10	(8 )	2,058	(43 )
Other comprehensive (loss) income, net of tax	(7,035 )	(103 )	(8,880 )	1,393
Comprehensive (loss) income	\$ (337 )	\$ 3,360	\$ 9,537	\$ 11,055

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



**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Stockholders' Equity**

(Unaudited)

(\$ in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
<b>Common Stock</b>				
Balance, beginning of period	\$3,757	\$3,757	\$3,757	\$3,757
Balance, end of period	3,757	3,757	3,757	3,757
<b>Additional Paid-In Capital</b>				
Balance, beginning of period	123,618	123,048	123,194	122,827
Equity based compensation	(11 )	(135 )	526	87
Shares issued under employee benefit plans	(1 )	-	(114 )	(1 )
Balance, end of period	123,606	122,913	123,606	122,913
<b>Retained Earnings</b>				
Balance, beginning of period	131,357	112,408	119,638	106,209
Net income	6,698	3,463	18,417	9,662
Balance, end of period	138,055	115,871	138,055	115,871
<b>Accumulated Other Comprehensive Income</b>				
Balance, beginning of period	15,956	18,379	17,801	16,883
Additional minimum pension liability, net of tax	17	26	51	79
Unrealized holding (losses) gains arising during period, net of tax	(7,034 )	(144 )	(5,108 )	1,235
Reclassification adjustment for (gains) losses included in net income, net of tax	(18 )	15	(3,823 )	79
Balance, end of period	8,921	18,276	8,921	18,276
<b>Treasury Stock</b>				
Balance, beginning of period	(12,376 )	(12,278 )	(12,353 )	(11,558 )
Acquisition of treasury stock	(1,180 )	(659 )	(1,910 )	(1,395 )
Shares issued under employee benefit plans	9	-	716	16
Balance, end of period	(13,547 )	(12,937 )	(13,547 )	(12,937 )
<b>Total Stockholders' Equity</b>	<b>\$260,792</b>	<b>\$247,880</b>	<b>\$260,792</b>	<b>\$247,880</b>

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



**Hallmark Financial Services, Inc. and Subsidiaries****Consolidated Statements of Cash Flows**

(Unaudited)

(\$ in thousands)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	\$ 18,417	\$ 9,662
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization expense	2,346	2,822
Deferred federal income taxes	(1,311)	(182)
Net realized (gains) losses	(3,688)	122
Share-based payments expense	526	87
Change in ceded unearned premiums	(10,739)	(17,001)
Change in premiums receivable	(15,874)	(11,315)
Change in accounts receivable	900	(372)
Change in deferred policy acquisition costs	(364)	1,921
Change in unpaid losses and loss adjustment expenses	36,248	32,112
Change in unearned premiums	21,764	19,881
Change in reinsurance recoverable	(6,623)	(28,619)
Change in reinsurance balances payable	6,429	12,049
Change in current federal income tax payable	(446)	(1,407)
Change in all other liabilities	(3,599)	941
Change in all other assets	(885)	1,009
Net cash provided by operating activities	43,101	21,710
Cash flows from investing activities:		
Purchases of property and equipment	(2,569)	(809)
Net transfers into restricted cash	(6,611)	(4,692)
Purchases of investment securities	(167,677)	(108,753)
Maturities, sales and redemptions of investment securities	98,344	113,758
Net cash used in investing activities	(78,513)	(496)
Cash flows from financing activities:		
Activity under revolving credit facility, net	-	(1,473)
Payment of contingent consideration	(1,216)	-
Proceeds from exercise of employee stock options	602	15
Purchase of treasury shares	(1,910)	(1,395)

Net cash used in financing activities (2,524 )