MEADOWBROOK INSURANCE GROUP INC
Form 10-Q
August 09, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2012
or
o 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 1-14094

Meadowbrook Insurance Group, Inc.
(Exact name of Registrant as specified in its charter)

Michigan	38-2626206
(State of Incorporation)	(IRS Employer Identification No.)

26255 American Drive, Southfield, Michigan 48034
(Address, zip code of principal executive offices)

(248) 358-1100
(Registrant's telephone number, including area code)

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 o

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, 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 x No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or 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 o Accelerated filer x Non-accelerated filer o Smaller Reporting Company o

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

The aggregate number of shares of the Registrant's Common Stock, $.01 par value, outstanding on August 2, 2012, was 49,776,011.

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PART 1 - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME

For the Three Months Ended June 30,

	2012	As Adjusted 2011
	(Unaudited) (In thousands, except share data)	
Revenues		
Premiums earned		
Gross	$ 248,581	$ 209,676
Ceded	(37,278)	(28,206)
Net earned premiums	211,303	181,470
Net commissions and fees	8,552	7,897
Net investment income	13,683	13,765
Realized gains (losses):		
Total other-than-temporary impairments on securities	-	-
Portion of loss recognized in other comprehensive income	-	-
Net other-than-temporary impairments on securities recognized in earnings	-	-
Net realized gains excluding other-than-temporary impairments on securities	1,567	1,094
Net realized gains	1,567	1,094
Total revenues	235,105	204,226
Expenses		
Losses and loss adjustment expenses	196,976	141,356
Reinsurance recoveries	(31,218)	(19,953)
Net losses and loss adjustment expenses	165,758	121,403
Policy acquisition and other underwriting expenses	68,993	62,694
General, selling and administrative expenses	6,327	5,631
General corporate expenses	758	(719)
Amortization expense	1,307	1,206
Interest expense	2,033	2,082
Total expenses	245,176	192,297
(Loss) income before taxes and equity earnings	(10,071)	11,929
Federal and state income tax (benefit) expense	(1,782)	2,323
Equity earnings of affiliates, net of tax	562	173
Equity (losses) earnings of unconsolidated subsidiaries, net of tax	(5)	1
Net (loss) income	$ (7,732)	$ 9,780
(Losses) Earnings Per Share		
Basic	$ (0.15)	$ 0.18
Diluted	$ (0.15)	$ 0.18
Weighted average number of common shares		
Basic	50,251,591	53,100,479

Diluted	50,251,591	53,248,573
Dividends paid per common share	$ 0.05	$ 0.04

The accompanying notes are an integral part of the Consolidated Financial Statements.

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MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF INCOME

For the Six Months Ended June 30,

	2012	As Adjusted 2011
	(Unaudited)	
	(In thousands, except share data)	
Revenues		
Premiums earned		
Gross	$ 476,027	$ 410,362
Ceded	(71,909)	(58,234)
Net earned premiums	404,118	352,128
Net commissions and fees	17,517	16,335
Net investment income	27,415	27,337
Realized gains (losses):		
Total other-than-temporary impairments on securities	-	(84)
Portion of loss recognized in other comprehensive income	-	-
Net other-than-temporary impairments on securities recognized in earnings	-	(84)
Net realized gains excluding other-than-temporary impairments on securities	2,299	1,990
Net realized gains	2,299	1,906
Total revenues	451,349	397,706
Expenses		
Losses and loss adjustment expenses	358,495	270,079
Reinsurance recoveries	(59,990)	(43,414)
Net losses and loss adjustment expenses	298,505	226,665
Policy acquisition and other underwriting expenses	132,106	120,851
General, selling and administrative expenses	12,666	11,875
General corporate expenses	2,131	636
Amortization expense	2,723	2,438
Interest expense	4,010	4,254
Total expenses	452,141	366,719
(Loss) income before taxes and equity earnings	(792)	30,987
Federal and state income tax expense	73	7,782
Equity earnings of affiliates, net of tax	1,250	1,246
Equity losses of unconsolidated subsidiaries, net of tax	(13)	(22)
Net income	$ 372	$ 24,429
Earnings Per Share		
Basic	$ 0.01	$ 0.46
Diluted	$ 0.01	$ 0.46
Weighted average number of common shares		
Basic	50,583,368	53,175,824
Diluted	50,583,368	53,323,802
Dividends paid per common share	$ 0.10	$ 0.08

The accompanying notes are an integral part of the Consolidated Financial Statements.

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MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Three Months Ended June 30,

	2012	As Adjusted 2011
	(Unaudited) (In thousands)	
Net (loss) income	$(7,732)	$ 9,780
Other comprehensive (loss) income, net of tax:		
Unrealized gain on securities	7,900	13,528
Unrealized gains in affiliates and unconsolidated subsidiaries	16	50
Increase (decrease) on non-credit other-than-temporary impairments on securities	34	(231)
Net deferred derivative losses - hedging activity	(413)	(381)
Less reclassification adjustment for investment gains included in net income	(1,645)	(1,070)
Other comprehensive gains	5,892	11,896
Comprehensive (loss) income	$(1,840)	$ 21,676

MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Six Months Ended June 30,

	2012	As Adjusted 2011
	(Unaudited) (In thousands)	
Net income	$372	$ 24,429
Other comprehensive income, net of tax:		
Unrealized gains on securities	7,732	11,148
Unrealized gains (losses) in affiliates and unconsolidated subsidiaries	165	(1)
Increase on non-credit other-than-temporary impairments on securities	292	85
Net deferred derivative (losses) gains - hedging activity	(113)	285
Less reclassification adjustment for investment gains included in net income	(2,356)	(1,880)
Other comprehensive gains	5,720	9,637
Comprehensive income	$6,092	$ 34,066

The accompanying notes are an integral part of the Consolidated Financial Statements.

MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2012 (Unaudited)	As Adjusted December 31, 2011
	(In thousands, except share data)	
ASSETS		
Investments		
Debt securities available for sale, at fair value (amortized cost of $1,352,554 and $1,252,775)	$ 1,466,000	$ 1,358,749
Equity securities available for sale, at fair value (cost of $23,065 and $25,176)	25,823	27,174
Cash and cash equivalents	88,159	101,757
Accrued investment income	14,528	13,757
Premiums and agent balances receivable, net	216,485	183,160
Reinsurance recoverable on:		
Paid losses	12,788	9,870
Unpaid losses	349,361	315,884
Prepaid reinsurance premiums	37,678	33,754
Deferred policy acquisition costs	80,554	74,467
Goodwill	121,041	120,792
Other intangible assets	32,837	34,483
Other assets	102,351	96,251
Total assets	$ 2,547,605	$ 2,370,098
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Losses and loss adjustment expenses	$ 1,301,002	$ 1,194,977
Unearned premiums	424,760	386,750
Debt	61,000	28,375
Debentures	80,930	80,930
Accounts payable and accrued expenses	39,233	38,716
Funds held and reinsurance balances payable	34,264	25,903
Payable to insurance companies	6,059	4,321
Deferred income taxes, net	8,966	8,453
Other liabilities	16,407	16,522
Total liabilities	1,972,621	1,784,947
Shareholders' Equity		
Common stock, $0.01 par value; authorized 75,000,000 shares; 49,776,011 and 51,050,204 shares issued and outstanding	505	520
Additional paid-in capital	272,198	279,005
Retained earnings	229,459	238,539
Note receivable from officer	(752)	(767)
Accumulated other comprehensive income	73,574	67,854
Total shareholders' equity	574,984	585,151
Total liabilities and shareholders' equity	$ 2,547,605	$ 2,370,098

The accompanying notes are an integral part of the Consolidated Financial Statements.

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MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

	Common Stock	Additional Paid-In Capital	Retained Earnings	Note Receivable from Officer	Accumulated Other Comprehensive Income	Total Shareholders' Equity
			(Unaudited, In thousands)			
Balances December 31, 2011 (As previously reported)	$520	$ 279,005	$245,816	$ (767)	$ 67,854	$ 592,428
Cumulative effect of adjustment resulting from adoption of new accounting guidance	-	-	(7,277)	-	-	(7,277)
As Adjusted Balances December 31, 2011	520	279,005	238,539	(767)	67,854	585,151
Net income	-	-	372	-	-	372
Dividends declared	-	-	(5,057)	-	-	(5,057)
Change in unrealized gain or loss on available for sale securities, net of tax	-	-	-	-	5,351	5,351
Change in valuation allowance on deferred tax assets	-	-	-	-	317	317
Net deferred derivative loss - hedging activity	-	-	-	-	(113)	(113)
Stock award	-	194	-	-	-	194
Long term incentive plan; stock award for 2012 plan years	-	106	-	-	-	106
Change in investment of affiliates, net of tax	-	-	-	-	156	156
Change in investment of unconsolidated subsidiaries	-	-	-	-	9	9
Repurchase of 1,267,300 shares of common stock	(15)	(7,107)	(4,395)	-	-	(11,517)
Note receivable from officer	-	-	-	15	-	15
Balances June 30, 2012	$505	$ 272,198	$229,459	$ (752)	$ 73,574	$ 574,984

The accompanying notes are an integral part of the Consolidated Financial Statements.

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MEADOWBROOK INSURANCE GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months Ended June 30,

	2012	As Adjusted 2011
	(Unaudited) (In thousands)	
Cash Flows From Operating Activities		
Net income	$372	$ 24,429
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of other intangible assets	2,723	2,438
Amortization of deferred debenture issuance costs	63	63
Depreciation of furniture, equipment, and building	2,821	2,697
Net amortization of discount and premiums on bonds	2,990	1,829
Gain on sale of investments, net	(2,356)	(1,880)
Gain on sale of fixed assets	(44)	(44)
Long-term incentive plan expense (benefit)	106	(973)
Stock award	194	366
Equity earnings of affiliates, net of taxes	(1,250)	(1,246)
Equity losses of unconsolidated subsidiaries, net of tax	13	22
Deferred income tax benefit	(2,075)	(522)
Goodwill adjustment	(249)	-
Write-off of book of business	123	-
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Premiums and agent balances receivable	(33,325)	(25,634)
Reinsurance recoverable on paid and unpaid losses	(36,395)	(11,771)
Prepaid reinsurance premiums	(3,924)	(292)
Deferred policy acquisition costs	(6,087)	(5,115)
Other assets	(3,561)	(285)
Increase (decrease) in:		
Losses and loss adjustment expenses	106,025	60,160
Unearned premiums	38,010	27,257
Payable to insurance companies	1,738	2,373
Funds held and reinsurance balances payable	8,361	2,825
Other liabilities	(1,233)	(14,826)
Total adjustments	72,668	37,442
Net cash provided by operating activities	73,040	61,871
Cash Flows From Investing Activities		
Purchase of debt securities available for sale	(169,329)	(133,777)
Proceeds from sales and maturities of debt securities available for sale	69,247	78,352
Proceeds from sales of equity securities available for sale	2,506	200
Capital expenditures	(958)	(3,970)
Acquisition of rights renewals	-	(129)
Other investing activities	(4,367)	592
Net cash used in investing activities	(102,901)	(58,732)
Cash Flows From Financing Activities		

Proceeds from line of credit and FHLBI	40,000	-
Payments on term loan	(7,375)	(6,500)
Book overdrafts	197	(1,785)
Dividends paid on common stock	(5,057)	(4,262)
Share repurchases	(11,517)	(3,904)
Other financing activities	15	20
Net cash used in financing activities	16,263	(16,431)
Net decrease in cash and cash equivalents	(13,598)	(13,292)
Cash and cash equivalents, beginning of period	101,757	90,414
Cash and cash equivalents, end of period	$88,159	$ 77,122
Supplemental Disclosure of Cash Flow Information:		
Interest paid	$3,695	$ 4,070
Net income taxes paid (1)	$3,476	$ 14,678
Supplemental Disclosure of Non-Cash Investing and Financing Activities:		
Stock-based employee compensation	$194	$ 366

(1)Tax return refunds were received in first quarter of 2012 and 2011 for $475 and $732, respectively.

The accompanying notes are an integral part of the Consolidated Financial Statements.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 – Summary of Significant Accounting Policies

Basis of Presentation and Management Representation

The consolidated financial statements include accounts, after elimination of intercompany accounts and transactions, of Meadowbrook Insurance Group, Inc. (the “Company” or “Meadowbrook”), its wholly owned subsidiary Star Insurance Company (“Star”), and Star’s wholly owned subsidiaries, Savers Property and Casualty Insurance Company (“Savers”), Williamsburg National Insurance Company (“Williamsburg”), and Ameritrust Insurance Corporation (“Ameritrust”). The consolidated financial statements also include Meadowbrook, Inc., Crest Financial Corporation, and their respective subsidiaries. In addition, the consolidated financial statements also include ProCentury Corporation (“ProCentury”) and its wholly owned subsidiaries. ProCentury’s wholly owned subsidiaries consist of Century Surety Company (“Century”) and its wholly owned subsidiary ProCentury Insurance Company (“PIC”). In addition, ProCentury Risk Partners Insurance Company, Ltd., is a wholly owned subsidiary of ProCentury. Star, Savers, Williamsburg, Ameritrust, Century, and PIC are collectively referred to as the Insurance Company Subsidiaries.

In the opinion of management, the consolidated financial statements reflect all normal recurring adjustments necessary to present a fair statement of the results for the interim period. Preparation of financial statements under generally accepted accounting principles (“GAAP”) requires management to make estimates. Actual results could differ from those estimates. The results of operations for the three months and six months ended June 30, 2012 are not necessarily indicative of the results expected for the full year.

These financial statements and the notes thereto should be read in conjunction with the Company’s audited financial statements and accompanying notes included in its Annual Report on Form 10-K, as filed with the United States Securities and Exchange Commission, for the year ended December 31, 2011.

Revenue Recognition

Premiums written, which include direct, assumed and ceded amounts are recognized as earned on a pro rata basis over the life of the policy term. Unearned premiums represent the portion of premiums written that are applicable to the unexpired terms of policies in force. Provisions for unearned premiums on reinsurance assumed from others are made on the basis of ceding reports when received and actuarial estimates.

Assumed premium estimates include business where the Company accepts a portion of the risk from a ceding carrier as well as the mandatory assumed pool business from the National Council on Compensation Insurance (“NCCI”), or residual market business. The majority of the assumed premium is from an established book of workers’ compensation business produced by a ceding company in which the Company has an equity stake.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Fee income, which includes risk management consulting, loss control, and claims services, is recognized during the period the services are provided. Depending on the terms of the contract, claims processing fees are recognized as revenue over the estimated life of the claims, or the estimated life of the contract. For those contracts that provide services beyond the expiration or termination of the contract, fees are deferred in an amount equal to management's estimate of the Company's obligation to continue to provide services in the future.

Commission income, which includes reinsurance placement, is recorded on the later of the effective date or the billing date of the policies on which they were earned. Commission income is reported net of any sub-producer commission expense. Commission adjustments that occur subsequent to the issuance of the policy, because of cancellation typically are recognized when the policy is effectively cancelled. Profit sharing commissions from insurance companies are recognized when determinable, which is when such commissions are received.

Income Taxes

As of June 30, 2012 and December 31, 2011, the Company did not have any unrecognized tax benefits and had no accrued interest or penalties related to uncertain tax positions.

Recent Accounting Pronouncements

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

In October 2010, the Financial Accounting Standards Board ("FASB") issued guidance to assist in a consistent application of accounting for costs related to acquiring or renewing insurance contracts among industry practice. The new guidance restricts the capitalization of a contract's acquisition costs to those that are directly related to the successful acquisition of a new or renewing insurance contract. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2011. The Company adopted this guidance retrospectively on January 1, 2012 and has adjusted its previously issued financial information.

MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The effect of adoption of this new guidance on the consolidated balance sheet and shareholders’ equity statements as of December 31, 2011 was as follows:

	December 31, 2011		
(In thousands)	As Previously Reported	Adjustment	As Adjusted Reported
Deferred policy acquisition costs	$85,663	$(11,196)	$ 74,467
Total assets	2,381,294	(11,196)	2,370,098
Deferred income tax, net	12,372	(3,919)	8,453
Total liabilities	1,788,866	(3,919)	1,784,947
Retained earnings	245,816	(7,277)	238,539
Total shareholders' equity	592,428	(7,277)	585,151
Total liabilities and shareholders' equity	2,381,294	(11,196)	2,370,098

The effect of adoption of this new guidance on the consolidated income and comprehensive income statements for the three months and six months ended June 30, 2011 was as follows:

	Three Months Ended June 30, 2011		
(In thousands)	As Previously Reported	Adjustment	As Adjusted Reported
Policy acquisition and other underwriting expenses	$62,450	$244	$ 62,694
Total expenses	192,053	244	192,297
Income before taxes and equity earnings	12,173	(244)	11,929
Federal and state income tax expense	2,408	(85)	2,323
Net income	9,939	(159)	9,780
Comprehensive income	21,835	(159)	21,676
Earnings per share			
Basic	$0.19	$(0.01)	$ 0.18
Diluted	$0.19	$(0.01)	$ 0.18

	Six Months Ended June 30, 2011		
(In thousands)	As Previously Reported	Adjustment	As Adjusted Reported
Policy acquisition and other underwriting expenses	$119,888	$963	$ 120,851
Total expenses	365,756	963	366,719
Income before taxes and equity earnings	31,950	(963)	30,987
Federal and state income tax expense	8,119	(337)	7,782
Net income	25,055	(626)	24,429
Comprehensive income	34,692	(626)	34,066

Earnings per share			
Basic	$0.47	$(0.01)	$0.46
Diluted	$0.47	$(0.01)	$0.46

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The effect of adoption of this new guidance on the consolidated cash flows statement for the six months ended June 30, 2011 was as follows:

	Six Months Ended June 30, 2011		
(In thousands)	As Previously Reported	Adjustment	As adjusted Reported
Net income	$25,055	$(626)	$24,429
Deferred income tax expense	(185)	(337)	(552)
Deferred policy acquisition costs	(6,078)	963	(5,115)

Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs

In May 2011, the FASB issued guidance to achieve common requirements for measuring fair value and for disclosing information about fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards (IFRSs). The guidance explains how to measure fair value and does not require additional fair value measurements, nor is it intended to establish valuation standards or affect valuation practices outside of financial reporting. The guidance is to be applied prospectively for interim and annual periods beginning after December 15, 2011. The Company adopted this guidance in the first quarter of 2012. The adoption did not have a material impact on its financial condition and results of operations.

Presentation of Comprehensive Income

In June 2011, the FASB issued guidance to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The guidance requires that all nonowner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance is to be applied retrospectively and is effective for interim and annual periods beginning after December 15, 2011, with early adoption permitted. The Company adopted this guidance in the first quarter of 2012. The adoption of this guidance did not have a material impact on its financial condition and results of operations.

Testing Indefinite-Lived Intangible Assets for Impairment

In July 2012, the FASB issued guidance on how to test indefinite-lived intangible assets for impairment through use of a qualitative approach. The guidance permits an entity to first assess qualitative factors to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other than Goodwill. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, with early adoption permitted. The Company is still evaluating the impact of adoption on its financial condition and results of operations.

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2 – Investments

The cost or amortized cost, gross unrealized gains, losses, non-credit other-than-temporary impairments ("OTTI") and estimated fair value of investments in securities classified as available for sale at June 30, 2012 and December 31, 2011 were as follows (in thousands):

	June 30, 2012				
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Non-Credit OTTI	Estimated Fair Value
Debt Securities:					
U.S. Government and agencies	$21,077	$1,772	$-	$-	$22,849
Obligations of states and political subs	598,436	50,344	(371)	-	648,409
Corporate securities	547,966	47,728	(525)	-	595,169
Redeemable preferred stock	1,743	460	-	-	2,203
Residential mortgage-backed securities	134,203	10,294	(112)	-	144,385
Commercial mortgage-backed securities	37,066	2,633	-	-	39,699
Other asset-backed securities	12,063	1,596	(373)	-	13,286
Total debt securities available for sale	1,352,554	114,827	(1,381)	-	1,466,000
Equity Securities:					
Perpetual preferred stock	8,302	2,029	(10)	-	10,321
Common stock	14,763	971	(232)	-	15,502
Total equity securities available for sale	23,065	3,000	(242)	-	25,823
Total securities available for sale	$1,375,619	$117,827	$(1,623)	$-	$1,491,823

	December 31, 2011				
	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Non-Credit OTTI	Estimated Fair Value
Debt Securities:					
U.S. Government and agencies	$20,510	$1,856	$-	$-	$22,366
Obligations of states and political subs	556,265	49,742	(5)	-	606,002
Corporate securities	469,770	40,591	(1,292)	-	509,069
Redeemable preferred stock	1,924	330	-	-	2,254
Residential mortgage-backed securities	152,719	11,534	(40)	(228)	163,985
Commercial mortgage-backed securities	37,191	2,337	-	-	39,528
Other asset-backed securities	14,396	1,695	(33)	(513)	15,545
Total debt securities available for sale	1,252,775	108,085	(1,370)	(741)	1,358,749
Equity Securities:					
Perpetual preferred stock	10,413	1,792	(58)	-	12,147
Common stock	14,763	597	(333)	-	15,027
Total equity securities available for sale	25,176	2,389	(391)	-	27,174
Total securities available for sale	$1,277,951	$110,474	$(1,761)	$(741)	$1,385,923

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MEADOWBROOK INSURANCE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Gross unrealized gains, losses, and non-credit OTTI on available for sale securities as of June 30, 2012 and December 31, 2011 were as follows (in thousands):

	June 30, 2012	December 31, 2011
Unrealized gains	$ 117,827	$ 110,474
Unrealized losses	(1,623)	(1,761)
Non-credit OTTI	-	(741)
Net unrealized gains	116,204	107,972
Deferred federal income tax expense	(40,671)	(37,790)
Net unrealized gains on investments, net of deferred federal income taxes	$ 75,533	$ 70,182

Net realized gains (losses including OTTI) on securities, for the three months and six months ended June 30, 2012 and 2011 were as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Realized gains (losses):				
Debt securities:				
Gross realized gains	$ 1,328	$ 942	$ 1,994	$ 1,866
Gross realized losses	(21)	(27)	(33)	(141)
Total debt securities	1,307	915	1,961	1,725
Equity securities:				
Gross realized gains	338	154	395	154
Gross realized losses	-	-	-	-
Total equity securities	338	154	395	154
Net realized gains	$ 1,645	$ 1,069	$ 2,356	$ 1,879
OTTI included in realized losses on securities above	$ -	$ -	$ -	$ (84)

Proceeds from the sales of fixed maturity securities available for sale were $9.6 million and $11.1 million for the three months ended June 30, 2012 and 2011, respectively. Proceeds from the sales of fixed maturity securities available for sale were $20.4 million and $27.4 million for the six months ended June 30, 2012 and 2011, respectively.

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At June 30, 2012, the amortized cost and estimated fair value of available for sale debt securities by contractual maturity are shown below. Expected maturities may differ from contractual maturities, because certain borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (in thousands):

	Available for Sale Amortized Cost	Estimated Fair Value
Due in one year or less	$ 31,634	$ 32,007
Due after one year through five years	329,713	346,905
Due after five years through ten years	634,506	705,493
Due after ten years	173,369	184,225
Mortgage-backed securities, collateralized obligations and asset-backed securities	183,332	197,370
	$ 1,352,554	$ 1,466,000

Net investment income for the three months and six months ended June 30, 2012 and 2011 was as follows (in thousands):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Net Investment Income Earned From:				
Debt securities	$ 13,507	$ 13,436	$ 26,800	$ 26,628
Equity Securities	370	473	876	979
Cash and cash equivalents	143	174	417	390
Total gross investment income	14,020	14,083	28,093	27,997
Less investment expenses	337	318	678	660
Net investment income	$ 13,683	$ 13,765	$ 27,415	$ 27,337

Other-Than-Temporary Impairments of Securities and Unrealized Losses on Investments

Available for sale securities are reviewed for declines in fair value that are determined to be other-than-temporary. For a debt security, if the Company intends to sell a security and it is more likely than not the Company will be required to sell a debt security before recovery of its amortized cost basis and the fair value of the debt security is below amortized cost, the Company concludes that an OTTI has occurred and the amortized cost is written down to current fair value, with a corresponding charge to realized loss in the Consolidated Statements of Income. If the Company does not intend to sell a debt security and it is not more likely than not the Company will be required to sell a debt security before recovery of its amortized cost basis, but the present value of the cash flows expected to be collected is less than the amortized cost of the debt security (referred to as the credit loss), the Company concludes that an OTTI has occurred. In this instance, accounting guidance requires the bifurcation of the total OTTI into the amount related to the credit loss, which is recognized in earnings, and the non-credit OTTI, which is recorded in Other Comprehensive Income as an unrealized non-credit OTTI in the Consolidated Statements of

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When assessing the Company's intent to sell a debt security, if it is more likely than not the Company will be required to sell a debt security before recovery of its cost basis, facts and circumstances such as, but not limited to, decisions to reposition the security portfolio, sale of securities to meet cash flow needs and sales of securities to capitalize on favorable pricing, are evaluated. In order to determine the amount of the credit loss for a debt security, the Company calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows expected to be recovered. The discount rate is the effective interest rate implicit in the underlying debt security upon issuance. The effective interest rate is the original yield or the coupon if the debt security was previously impaired. If an OTTI exists and there is not sufficient cash flows or other information to determine a recovery value of the security, the Company concludes that the entire OTTI is credit-related and the amortized cost for the security is written down to current fair value with a corresponding charge to realized loss in the Consolidated Statements of Income.

To determine the recovery period of a debt security, the Company considers the facts and circumstances surrounding the underlying issuer including, but not limited to the following:

- Historical and implied volatility of the security;
- Length of time and extent to which the fair value has been less than amortized cost;
- Conditions specifically related to the security such as default rates, loss severities, loan to value ratios, current levels of subordination, third party guarantees, and vintage;
- Specific conditions in an industry or geographic area;
- Any changes to the rating of the security by a rating agency;
- Failure, if any, of the issuer of the security to make scheduled payments; and
- Recoveries or additional declines in fair value subsequent to the balance sheet date.

In periods subsequent to the recognition of an OTTI, the security is accounted for as if it had been purchased on the measurement date of the OTTI. Therefore, for a fixed maturity security, the discount or reduced premium is reflected in net investment income over the contractual term of the investment in a manner that produces a constant effective yield.

For an equity security, if the Company does not have the ability and intent to hold the security for a sufficient period of time to allow for a recovery in value, the Company concludes that an OTTI has occurred, and the cost of the equity security is written down to the current fair value, with a corresponding charge to realized loss within the Consolidated Statements of Income. When assessing the Company's ability and intent to hold the equity security to recovery, the Company considers, among other things, the severity and duration of the decline in fair value of the equity security, the cause of the decline and a fundamental analysis of the liquidity, business prospects and overall financial condition of the issuer.

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After the Company's review of its investment portfolio in relation to this policy, the Company did not record a credit or a non-credit related OTTI loss for the three months or six months ended June 30, 2012. For the three months and six months ended June 30, 2011, the Company recorded no credit OTTI loss and a credit OTTI loss of $84,000, respectively. For the three months and six months ended June 30, 2011, no non-credit related OTTI losses were recognized by the Company in other comprehensive income.

The fair value and amount of unrealized losses segregated by the time period the investment has been in an unrealized loss position were as follows (in thousands):

	June 30, 2012								
	Less than 12 months			Greater than 12 months			Total		
	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI
Debt Securities:									
U.S. Government and agencies	1	$ 151	$ -	-	$ -	$ -	1	$ 151	$ -
Obligations of states and political subs	13	39,769	(371)	-	-	-	13	39,769	(371)
Corporate securities	10	24,653	(481)	1	3,005	(44)	11	27,658	(525)
Redeemable preferred stock	-	-	-	-	-	-	-	-	-
Residential mortgage-backed securities	2	93	-	3	3,538	(112)	5	3,631	(112)
Commercial mortgage-backed securities	-	-	-	-	-	-	-	-	-
Other asset-backed securities	1	1,120	(7)	9	1,406	(366)	10	2,526	(373)
Total debt securities	27	65,786	(859)	13	7,949	(522)	40	73,735	(1,381)
Equity Securities:									
Perpetual preferred stock	2	4	(10)	-	-	-	2	4	(10)
Common stock	1	279	(11)	3	4,932	(221)	4	5,211	(232)
Total equity securities	3	283	(21)	3	4,932	(221)	6	5,215	(242)
Total securities	30	$ 66,069	$ (880)	16	$ 12,881	$ (743)	46	$ 78,950	$ (1,623)

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	December 31, 2011								
	Less than 12 months			Greater than 12 months			Total		
	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI	Number of Issues	Fair Value of Investments with Unrealized Losses	Gross Unrealized Losses and Non-Credit OTTI
Debt Securities:									
U.S. Government and agencies	-	$ -	$ -	-	$ -	$ -	-	$ -	$ -
Obligations of states and political subs	1	202	(2)	2	923	(3)	3	1,125	(5)
Corporate securities	15	27,154	(1,292)	-	-	-	15	27,154	(1,292)
Redeemable preferred stock	-	-	-	-	-	-	-	-	-
Residential mortgage-backed securities	4	183	(38)	2	3,561	(230)	6	3,744	(268)
Commercial mortgage-backed securities	1	683	-	-	-	-	1	683	-
Other asset-backed securities	3	1,163	(27)	8	1,831	(519)	11	2,994	(546)
Total debt securities	24	29,385	(1,359)	12	6,315	(752)	36	35,700	(2,111)
Equity Securities:									
Perpetual preferred stock	3	1,079	(58)	-	-	-	3	1,079	(58)
Common stock	1	279	(12)	3	4,851	(321)	4	5,130	(333)
Total equity securities	4	1,358	(70)	3	4,851	(321)	7	6,209	(391)
Total securities	28	$ 30,743	$ (1,429)	15	$ 11,166	$ (1,073)	43	$ 41,909	$ (2,502)

Changes in the amount of credit loss on fixed maturities for which a portion of an OTTI related to other factors was recognized in other comprehensive income were as follows (in thousands):

Balance as of December 31, 2011	$ (789)
Additional credit impairments on:	
Previously impaired securities	-
Securities for which an impairment was not previously recognized	-
Reductions	-
Balance as of June 30, 2012	$ (789)

NOTE 3 – Fair Value Measurements

According to accounting guidance for fair value measurements and disclosures, fair value is the price that would be received in the sale of an asset or would be paid in the transfer of a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. The guidance establishes a three-level hierarchy for fair value measurements that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity ("observable inputs") and the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances ("unobservable inputs").

The estimated fair values of the Company's fixed investment portfolio are based on prices provided by a third party pricing service and a third party investment manager. The prices provided by these services are based on quoted market prices, when available, non-binding broker quotes, or matrix pricing. The third party pricing service and the third party investment manager provide a single price or quote per security and the Company has not historically adjusted security prices. The Company obtains an understanding of the methods, models and inputs used by the third party pricing service and the third party investment manager, and has controls in place to validate that amounts provided represent fair values. The Company's control process includes, but is not limited to, initial and ongoing evaluation of the methodologies used, a review of specific securities and an assessment for proper classification within the fair value hierarchy. The hierarchy level assigned to each security in the Company's available for sale portfolio is based upon its assessment of the transparency and reliability of the inputs used in the valuation as of the measurement date. The three hierarchy levels are defined as follows:

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Level 1 – Valuations that are based on unadjusted quoted prices in active markets for identical securities. The fair value of exchange-traded preferred and common equities, and mutual funds included in the Level 1 category were based on quoted prices that are readily and regularly available in an active market. The fair value measurements that were based on Level 1 inputs comprise 1.8% of the fair value of the total investment portfolio.

Level 2 – Valuations that are based on observable inputs (other than Level 1 prices) such as quoted prices for similar assets at the measurement date; quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly. The fair value of securities included in the Level 2 category were based on the market values obtained from a third party pricing service that were evaluated using pricing models that vary by asset class and incorporate available trade, bid and other observable market information. The third party pricing service monitors market indicators, as well as industry and economic events. The Level 2 category includes corporate bonds, government and agency bonds, asset-backed, residential mortgage-backed and commercial mortgage-backed securities and municipal bonds. The fair value measurements that were based on Level 2 inputs comprise 97.9% of the fair value of the total investment portfolio.

Level 3 – Valuations that are derived from techniques in which one or more of the significant inputs are unobservable and/or involve management judgment and/or are based on non-binding broker quotes. The fair value measurements that were based on Level 3 inputs comprise 0.3% of the fair value of the total investment portfolio.

For corporate, government and municipal bonds, the third party pricing service utilizes a pricing model with standard inputs that include benchmark yields, reported trades, issuer spreads, two-sided markets, benchmark securities, market bids/offers, and other reference data observable in the marketplace. The model uses the option adjusted spread methodology and is a multi-dimensional relational model. All bonds valued under these techniques are classified as Level 2.

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For asset-backed, residential mortgage-backed and commercial mortgage-backed securities, the third party pricing service valuation methodology includes consideration of interest rate movements, new issue data, monthly remittance reports and other pertinent data that is observable in the marketplace. This information is used to determine the cash flows for each tranche and identifies the inputs to be used, such as benchmark yields, prepayment assumptions and collateral performance. All asset-backed, residential mortgage-backed and commercial mortgage-backed securities valued under these methods are classified as Level 2.

Also included in Level 2 valuation are interest rate swap agreements the Company utilizes to hedge the floating interest rate on its debt, thereby changing the variable rate exposure to a fixed rate exposure for interest on these obligations. The estimated fair value of the interest rate swaps is obtained from the third party financial institution counterparties and measured using discounted cash flow analysis that incorporates significant observable inputs, including the LIBOR forward curve, derivative counterparty spreads, and measurements of volatility.

The Level 3 securities consist of 13 securities totaling $4.8 million or 0.3% of the fair value of the total investment portfolio. These primarily represent asset-backed securities and corporate debt securities that have a principal protection feature supported by a U.S. Treasury strip. To fair value these securities, the third party investment manager uses a combination of methods. Non-binding broker/dealer quotes are used on 1 holding. Benchmarking techniques based upon industry sector, rating and other factors are used on the other12 holdings.

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The following table presents the Company's assets and liabilities measured at fair value on a recurring basis, classified by the valuation hierarchy as of June 30, 2012 (in thousands):

		Fair Value Measurements Using		
	June 30, 2012 Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Debt Securities:				
U.S. Government and agencies	$ 22,849	$ -	$ 22,849	$ -
Obligations of states and political subs	648,409	-	648,409	-
Corporate securities	595,169	-	594,045	1,124
Redeemable preferred stock	2,203	2,203	-	-
Residential mortgage-backed securities	144,385	-	144,385	-
Commercial mortgage-backed securities	39,699	-	39,699	-
Other asset-backed securities	13,286	-	9,657	3,629
Total debt securities available for sale	1,466,000	2,203	1,459,044	4,753
Equity Securities:				
Perpetual preferred stock	10,321	9,582	739	-
Common stock	15,502	15,502	-	-
Total equity securities available for sale	25,823	25,084	739	-
Total securities available for sale	$ 1,491,823	$ 27,287	$ 1,459,783	$ 4,753
Derivatives - interest rate swaps	$ (5,217)	$ -	$ (5,217)	$ -

The following table presents changes in Level 3 available for sale investments measured at fair value on a recurring basis as of June 30, 2012 (in thousands):

	Fair Value Measurement Using Significant Unobservable Inputs - Level 3
Balance as of December 31, 2011	$ 4,659
Total gains or losses (realized/unrealized):	
Included in earnings	33
Included in other comprehensive income	63
Purchases	-

Issuances		-
Settlements		(2)
Transfers in and out of Level 3		-
Balance as of June 30, 2012	$	4,753

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There were no credit losses for the period included in earnings attributable to the change in unrealized losses on Level 3 assets still held at the reporting date.

The Company's policy on recognizing transfers between hierarchy levels is applied at the end of a reporting period. During the three months ended June 30, 2012, there were no transfers between levels. During the six months ended June 30, 2012, there was one asset-backed security of negligible value transferred into Level 3 from Level 2 as fair value was no longer determined using market inputs that could be directly or indirectly observable.

NOTE 4 – Debt

Credit Facilities

On July 31, 2008, the Company executed $100 million in senior credit facilities (the "Credit Facilities"). The Credit Facilities included a $65.0 million term loan facility, which was fully funded upon the closing of its merger with ProCentury (the "Merger") and a $35.0 million revolving credit facility, which was partially funded upon closing of the Merger.

The revolving credit facility includes a letter of credit facility with a sublimit. The total amount of credit available under the revolving credit facility is $35.0 million, which may include up to $15 million in letters of credit. As of June 30, 2012, the outstanding balance on its term loan facility was $16.5 million. The Company had a $14.5 million outstanding balance on its revolving credit facility as of June 30, 2012, and $0.5 million in letters of credit had been issued as of June 30, 2012. The undrawn portion of the revolving credit facility is available to finance working capital and for general corporate purposes, including but not limited to, surplus contributions to its Insurance Company Subsidiaries to support premium growth or strategic acquisitions. At December 31, 2011, the Company had an outstanding balance of $23.9 million on its term loan and a $4.5 million outstanding balance on its revolving credit facility. There was $0.5 million in letters of credit that had been issued as of December 31, 2011.

The principal amount outstanding under the Credit Facilities provides for interest at LIBOR, plus the applicable margin, or at the Company's option, the base rate. The base rate is defined as the higher of the lending bank's prime rate or the Federal Funds rate, plus 0.50%, plus the applicable margin. The applicable margin is determined by the consolidated indebtedness to consolidated total capital ratio. In addition, the Credit Facilities provide for an unused facility fee ranging between twenty basis points and forty basis points, based on our consolidated leverage ratio as defined by the Credit Facilities. At June 30, 2012, the interest rate on the Company's term loan was 5.70%, which consisted of a fixed rate of 3.95%, as described in Note 5 ~ Derivative Instruments, plus an applicable margin of 1.75%.

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The financial covenants applicable to the Credit Facilities consist of: (1) minimum consolidated net worth starting at eighty percent of pro forma consolidated net worth after giving effect to the Merger, with quarterly increases thereafter, (2) minimum Risk Based Capital Ratio for Star and Century of 1.75 to 1.00, (3) maximum permitted consolidated leverage ratio of 0.35 to 1.00, (4) minimum consolidated debt service coverage ratio of 1.25 to 1.00, and (5) minimum A.M. Best rating of “B++.” As of June 30, 2012, the Company was in compliance with these debt covenants.

During 2011, several of the Company's insurance subsidiaries (Star, Williamsburg, and Ameritrust) became members of the Federal Home Loan Bank of Indianapolis ("FHLBI"). As a member of the FHLBI, these subsidiaries have the ability to borrow on a collateralized basis at relatively low borrowing rates, providing a source of liquidity. As of June 30, 2012, the Company had borrowed $30.0 million from the FHLBI after pledging as collateral residential mortgage-backed securities (“RMBS”) having a carrying value of $31.0 million, and making a FHLBI common stock investment of approximately $1.6 million. The Company has the ability to increase its borrowing capacity through purchasing additional investments and pledging additional securities. The Company retains all the rights regarding the collateralized RMBS.

Debentures

The following table summarizes the principal amounts and certain other information associated with the Company’s debentures (in thousands):

Year of Issuance	Description	Year Callable	Year Due	Interest Rate Terms	Interest Rate at June 30, 2012 (1)		Principal Amount
2003	Junior subordinated debentures	2008	2033	Three-month LIBOR, plus 4.05%	4.51	%	$10,310
2004	Senior debentures	2009	2034	Three-month LIBOR, plus 4.00%	4.47	%	13,000
2004	Senior debentures	2009	2034	Three-month LIBOR, plus 4.20%	4.67	%	12,000
2005	Junior subordinated debentures	2010	2035	Three-month LIBOR, plus 3.58%	4.05	%	20,620
	Junior subordinated debentures (2)	2007	2032	Three-month LIBOR, plus 4.00%	4.47	%	15,000
	Junior subordinated debentures (2)	2008	2033	Three-month LIBOR, plus 4.10%	4.57	%	10,000
					Total		$80,930

(1) The underlying three-month LIBOR rate varies as a result of the interest rate reset dates used in determining the three-month LIBOR rate, which varies for each long-term debt item each quarter.

(2) Represents the junior subordinated debentures acquired in conjunction with the Merger on July 31, 2008.

Excluding the junior subordinated debentures acquired in conjunction with the Merger, the Company received a total of $53.3 million in net proceeds from the issuances of the above long-term debt, of which $26.2 million was contributed to the surplus of its Insurance Company Subsidiaries and the remaining balance was used for general corporate purposes. Associated with the issuance of the above long-term debt, the Company incurred approximately $1.7 million in issuance costs for commissions paid to the placement agents in the transactions.

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The issuance costs associated with these debentures have been capitalized and are included in other assets on the balance sheet. As of June 30, 2007, these issuance costs were being amortized over a seven year period as a component of interest expense. The seven year amortization period represented management's best estimate of the estimated useful life of the bonds related to both the senior debentures and junior subordinated debentures. Beginning July 1, 2007, the Company reevaluated its best estimate and determined a five year amortization period to be a more accurate representation of the estimated useful life. Therefore, this change in amortization period from seven years to five years has been applied prospectively beginning July 1, 2007.

The junior subordinated debentures issued in 2003 and 2005 were issued in conjunction with the issuance of $10.0 million and $20.0 million in mandatory redeemable trust preferred securities to a trust formed by an institutional investor from the Company's unconsolidated subsidiary trusts, Meadowbrook Capital Trust I and Meadowbrook Capital Trust II, respectively.

The junior subordinated debentures acquired in the Merger were issued in conjunction with the issuance of $15.0 million and $10.0 million in floating rate trust preferred securities to a trust formed from the Company's unconsolidated trust, ProFinance Statutory Trust I and ProFinance Statutory Trust II. The Company also acquired the remaining unamortized portion of the capitalized issuance costs associated with these debentures. The remaining unamortized portion of the issuance costs acquired was $625,000. These issuance costs are included in other assets on the balance sheet. The remaining balance is being amortized over a five year period beginning August 1, 2008, as a component of interest expense.

The junior subordinated debentures are unsecured obligations of the Company and are junior in the right of payment to all senior indebtedness of the Company. The Company has guaranteed that the payments made to the four trusts mentioned above will be distributed to the holders of the respective trust preferred securities.

The Company estimates that the fair value of the above mentioned junior subordinated debentures and senior debentures issued approximated the gross proceeds of cash received at the time of issuance.

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NOTE 5 – Derivative Instruments

The Company has entered into interest rate swap transactions to mitigate its interest rate risk on its existing debt obligations. These interest rate swap transactions have been designated as cash flow hedges and are deemed highly effective hedges. These interest rate swap transactions are recorded at fair value on the balance sheet and the effective portion of the changes in fair value are accounted for within other comprehensive income. The interest differential to be paid or received is accrued and recognized as an adjustment to interest expense.

The following table summarizes the rates and amounts associated with the Company's interest rate swaps (in thousands):

Effective Date	Expiration Date	Debt Instrument	Counterparty Interest Rate Terms	Fixed Rate		Fixed Amount at June 30, 2012
4/23/2008	6/30/2013	Junior subordinated debentures (1)	Three-month LIBOR, plus 4.05%	8.020	%	$ 10,000
4/29/2008	4/29/2013	Senior debentures (1)	Three-month LIBOR, plus 4.00%	7.940	%	13,000
7/31/2008	7/31/2013	Term loan (2)	Three-month LIBOR	3.950	%	16,500
8/15/2008	8/15/2013	Junior subordinated debentures (1)(3)	Three-month LIBOR	3.780	%	10,000
9/4/2008	9/4/2013	Junior subordinated debentures (1)(3)	Three-month LIBOR	3.790	%	15,000
9/8/2010	5/24/2016	Senior debentures	Three-month LIBOR, plus 4.20%	6.248	%	5,000
9/16/2010	9/15/2015	Junior subordinated debentures	Three-month LIBOR, plus 3.58%	6.160	%	10,000
9/16/2010	9/15/2015	Junior subordinated debentures	Three-month LIBOR, plus 3.58%	6.190	%	10,000
5/24/2011	5/24/2016	Senior debentures	Three-month LIBOR, plus 4.20%	6.472	%	7,000

(1) During the quarter ended June 30, 2012, the Company entered into four forward starting interest rate swaps. The swaps will replace the identified interest rate swaps, upon their expiration in 2013. The fixed rates on the forward starting interest rate swaps are approximately 150 basis points less than the fixed rates on the current swaps in place. Additionally, the forward starting interest rate swaps will expire ten years from the effective date.

(2) The Company is required to make fixed rate interest payments on the current balance of the term loan, amortizing in accordance with the term loan amortization schedule. The Company fixed only the variable interest portion of the loan. The actual interest payments associated with the term loan also include an additional rate of 1.75% in accordance with the Credit Facilities.

(3) The Company fixed only the variable interest portion of the debt. The actual interest payments associated with the debentures also include an additional rate of 4.10% and 4.00% on the $10.0 million and $15.0 million debentures, respectively.

In relation to the above interest rate swaps, the net interest expense incurred for the three months ended June 30, 2012 and 2011, was approximately $0.7 million and $0.9 million, respectively. The net interest expense incurred for the six months ended June 30, 2012 and 2011, was approximately $1.5 million and $1.9 million, respectively.

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As of June 30, 2012 and December 31, 2011, the total fair value of the interest rate swaps was an unrealized loss of $5.2 million and $5.0 million, respectively. At June 30, 2012 and December 31, 2011, accumulated other comprehensive income included accumulated loss on the cash flow hedge, net of taxes, of approximately $3.4 million and $3.3 million, respectively.

In March 2012, the Company replaced its existing $5.6 million convertible note and $664,000 demand note receivables with an unaffiliated insurance agency into new debt instruments with a related limited liability company. The new instruments were effective January 1, 2012 and consist of a $2 million convertible note and a $4.2 million term loan. The interest rate on the convertible note is 3% and is due on January 1, 2022. This note is convertible at the option of the Company based upon a pre-determined formula. The interest rate on the term loan is 5.5% and is due on April 30, 2016. As security for the note and term loan, the borrower granted the Company a first lien on all of its accounts receivable, cash, general intangibles, and other assets. As additional collateral for the note and term loan, the Company obtained guaranties of payment and performance from certain affiliated companies of the borrower, as well as related individuals, which guaranties are secured by additional collateral.

NOTE 6 – Restricted and Non-Restricted Stock Awards

On February 23, 2011 and 2010, the Company issued 28,500 and 202,500 restricted stock awards, respectively, to executives of the Company, out of its 2002 Amended and Restated Stock Option Plan (the “Plan”). The restricted stock awards vest over a four year period, with the first twenty percent vesting immediately on the date issued (i.e., February 23) and the remaining eighty percent vesting annually on a straight line basis over the requisite four year service period. The unvested restricted stock awards are subject to forfeiture in the event the employee is terminated for “Good Cause” or voluntarily resigns their employment without “Good Reason” as provided for in the employees’ respective employment agreements. The Company recorded approximately $82,000 and $86,000 of compensation expense related to the restricted stock awards for the three months ended June 30, 2012 and 2011, respectively. The Company recorded approximately $128,000 and $218,000 of compensation expense related to the restricted stock awards for the six months ended June 30, 2012 and 2011, respectively.

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On February 23, 2012 and 2011, the Company issued 1,500 non-restricted stock awards to each member of the Board of Directors pursuant to the Plan, which vested immediately. The Company recorded zero non-restricted stock awards compensation expense for the three months ended June 30, 2012 and 2011. The Company recorded approximately $149,000 and $150,000 of compensation expense related to the non-restricted stock awards for the six months ended June 30, 2012 and 2011, respectively.

NOTE 7 – Shareholders' Equity

At June 30, 2012, shareholders' equity was $575.0 million, or a book value of $11.55 per common share, compared to $585.2 million, or a book value of $11.46 per common share, at December 31, 2011.

On October 28, 2011, the Company's Board of Directors approved a Share Repurchase Plan authorizing management to purchase up to 5.0 million shares of the Company's common stock in market transactions for a period not to exceed twenty-four months. For the three months and six months ended June 30, 2012, the Company purchased and retired approximately 0.7 million and 1.3 million shares of common stock for a total cost of approximately $6.5 million and $11.5 million, respectively. For the year ended December 31, 2011, the Company purchased and retired approximately 2.2 million shares of common stock for a total cost of approximately $20.4 million.

For the period ended June 30, 2012, the Company paid dividends to its common shareholders of $5.1 million. For the year ended December 31, 2011, the Company paid dividends to its common shareholders of $8.9 million. On July 27, 2012, the Company's Board of Directors declared a quarterly dividend of $0.05 per common share. The dividend is payable on August 27, 2012, to shareholders of record as of August 10, 2012.

When evaluating the declaration of a dividend, the Company's Board of Directors considers a variety of factors, including but not limited to, cash flow, liquidity needs, results of operations, industry conditions, and our overall financial condition. As a holding company, the ability to pay cash dividends is partially dependent on dividends and other permitted payments from its Insurance Company Subsidiaries.

NOTE 8 – Earnings Per Share

Basic earnings per share are based on the weighted average number of common shares outstanding during the year, while diluted earnings per share includes the weighted average number of common shares and potential dilution from shares issuable pursuant to stock awards using the treasury stock method.

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The following table is a reconciliation of the (loss) income and share data used in the basic and diluted earnings per share computations for the three months and six months ended June 30, 2012 and 2011 (in thousands, except per share amounts):

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	As Adjusted 2011	2012	As Adjusted 2011
Net (loss) income	$ (7,732)	$ 9,780	$ 372	$ 24,429
Common shares:				
Basic				
Weighted average shares outstanding	50,251,591	53,100,479	50,583,368	53,175,824
Diluted				