PICO HOLDINGS INC /NEW
Form 10-Q
May 10, 2013
UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

SQUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2013
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 033-36383
PICO HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

California	94-2723335
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)

7979 Ivanhoe Avenue, Suite 300 La Jolla, California 92037
(Address of principal executive offices, including Zip Code)

(858) 456-6022
(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 S 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 S 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	£	Accelerated filer	S
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 S
On May 9, 2013, the registrant had 22,733,649 shares of common stock, $0.001 par value outstanding.

PICO HOLDINGS, INC.

FORM 10-Q
For the Three Months Ended March 31, 2013

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Part I: Financial Information

Item I: Condensed Consolidated Financial Statements (Unaudited)

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED
(In thousands)

	March 31, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	$62,368	$100,115
Investments ($48.4 million and $48.5 million measured at fair value at March 31, 2013, and December 31, 2012, respectively)	50,450	50,524
Notes and other receivables, net	15,297	10,487
Real estate and water assets, net	361,178	342,338
Property and equipment, net	127,896	128,654
Other assets	58,703	35,056
Total assets	$675,892	$667,174
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts payable and accrued expenses	$30,215	$25,063
Deferred compensation	22,964	22,607
Debt	158,810	141,008
Total liabilities	211,989	188,678
Commitments and contingencies		
Common stock, $0.001 par value; authorized 100,000 shares, 25,807 issued and 22,734 outstanding at March 31, 2013, and December 31, 2012.	26	26
Additional paid-in capital	527,537	526,591
Retained earnings (deficit)	(9,760)	5,215
Accumulated other comprehensive loss	(1,026)	(2,014)
Treasury stock, at cost (common shares: 3,073 in 2013 and 2012)	(56,593)	(56,593)
Total PICO Holdings, Inc. shareholders' equity	460,184	473,225
Noncontrolling interest in subsidiaries	3,719	5,271
Total shareholders' equity	463,903	478,496
Total liabilities and shareholders' equity	$675,892	$667,174

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

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME OR LOSS - UNAUDITED
(In thousands, except per share data)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
REVENUES AND OTHER INCOME:		
Sale of real estate and water assets	$11,807	$3,544
Sale of canola oil and meal	39,556	
Sale of software	3,650	
Other income	1,795	2,141
Total revenues and other income	56,808	5,685
COST OF SALES:		
Cost of real estate and water assets sold	8,052	2,310
Cost of canola oil and meal sold	40,605	
Cost of software sold	1,301	
Total cost of sales	49,958	2,310
EXPENSES:		
Operating and other costs	20,178	8,889
Interest	1,698	1,014
Depreciation and amortization	2,533	405
Total costs and expenses	74,367	12,618
Loss from continuing operations before income taxes	(17,559)	(6,933)
Benefit for federal, foreign, and state income taxes	(784)	(1,198)
Loss from continuing operations	(16,775)	(5,735)
Income from discontinued operations, net of income taxes		617
Net loss	(16,775)	(5,118)
Loss attributable to noncontrolling interests	1,800	222
Net loss attributable to PICO Holdings, Inc.	$(14,975)	$(4,896)

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

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME OR LOSS - UNAUDITED, CONTINUED
(In thousands, except per share data)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
Other Comprehensive Income:		
Net loss	$(16,775)	$(5,118)
Other comprehensive income, net of tax:		
Unrealized appreciation on available-for-sale securities	752	1,540
Foreign currency translation	236	11
Total other comprehensive income, net of tax	988	1,551
Comprehensive loss	(15,787)	(3,567)
Comprehensive loss attributable to noncontrolling interests	1,800	222
Comprehensive loss attributable to PICO Holdings, Inc.	$(13,987)	$(3,345)
Net loss per common share – basic and diluted:		
Loss from continuing operations	$(0.66)	$(0.24)
Income from discontinued operations		0.02
Net loss per common share	$(0.66)	$(0.22)
Weighted average shares outstanding	22,734	22,723

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

PICO HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY - UNAUDITED
THREE MONTHS ENDED MARCH 31, 2013 AND 2012
(In thousands)

	Shares of Common Stock Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Shares of Treasury Stock	Treasury Stock, at Cost	Non-controlling Interest	Total
Beginning balance, January 1, 2013	25,807	$26	$526,591	$5,215	$ (2,014)	3,073	$(56,593)	$5,271	$478,496
Stock-based compensation expense			946						946
Changes in ownership of noncontrolling interest								248	248
Net loss				(14,975)				(1,800)	(16,775)
Unrealized appreciation on investments					752				752
Foreign currency translation					236				236
Ending balance, March 31, 2013	25,807	$26	$527,537	$(9,760)	$ (1,026)	3,073	$(56,593)	$3,719	$463,903

	Shares of Common Stock Outstanding	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Shares of Treasury Stock	Treasury Stock, at Cost	Non-controlling Interest	Total
Beginning balance, January 1, 2012	27,122	$27	$546,608	$34,288	$ (959)	4,417	$(78,152)	$7,850	$509,662
Stock-based compensation expense			1,061						1,061
Exercise of restricted stock unit	94		(1,019)			30	(667)		(1,686)
Retirement of PICO common stock	(1,207)	(1)	(18,278)			(1,207)	18,279		—
Net loss				(4,896)				(222)	(5,118)
Unrealized appreciation on investments					1,540				1,540
					11				11

Foreign currency translation									
Ending balance, March 31, 2012	26,009	$26	$528,372	$29,392	$ 592	3,240	$(60,540)	$7,628	$505,470

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

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PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED
(In thousands)

	Three Months Ended March 31, 2013	Three Months Ended March 31, 2012
OPERATING ACTIVITIES:		
Cash used in operating activities - continuing operations	$(46,865)	$(19,736)
Cash provided by operating activities - discontinued operations		51
Net cash used in operating activities	(46,865)	(19,685)
INVESTING ACTIVITIES:		
Purchases of investments	(5,526)	(4,650)
Proceeds from sale of investments	6,810	6,499
Proceeds from maturity of investments		831
Purchases of property and equipment	(432)	(14,371)
Cash acquired in connection with purchase of Spigit, net of cash paid	174	
Decrease in restricted deposits	1,870	
Other investing activities, net		10
Cash provided by (used in) investing activities - continuing operations	2,896	(11,681)
Cash provided by investing activities - discontinued operations		2,110
Net cash provided by (used in) investing activities	2,896	(9,571)
FINANCING ACTIVITIES:		
Repurchase of shares and payment of withholding taxes on RSU exercise		(1,019)
Repayment of debt	(3,832)	(1,807)
Proceeds from debt	9,513	17,413
Net cash provided by financing activities - continuing operations	5,681	14,587
Effect of exchange rate changes on cash	541	(480)
Decrease in cash and cash equivalents	(37,747)	(15,149)
Cash and cash equivalents beginning of the period	100,115	125,547
Cash and cash equivalents end of the period	62,368	110,398
Less cash and cash equivalents of discontinued operations at the end of the period		28,378
Cash and cash equivalents of continuing operations at the end of the period	$62,368	$82,020
SUPPLEMENTAL CASH FLOW INFORMATION:		
(Refund) payment for federal, foreign, and state income taxes	$(33)	$2,567
Interest paid, net of amounts capitalized	$2,717	$827
Non-cash investing and financing activities:		
Increase in assets from business combination	$21,533	
Increase in liabilities from business combination	$20,377	
Conversion of note receivable to common stock in Spigit	$820	
Accrued offering costs	$923	
Unpaid liability incurred for construction costs		$7,102
Mortgage incurred to purchase real estate	$4,691	$360

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

PICO HOLDINGS, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of PICO Holdings, Inc. and subsidiaries (collectively, the "Company" or "PICO") have been prepared in accordance with the interim reporting requirements of Form 10-Q, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America ("U.S. GAAP") for complete consolidated financial statements.

In the opinion of management, all adjustments and reclassifications considered necessary for a fair and comparable presentation of the financial statements presented have been included and are of a normal recurring nature. Operating results presented are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012 filed with the SEC. During the year ended 2012, the Company sold the two companies that previously comprised the insurance in run-off segment. As a result of the transaction, the assets and liabilities of the insurance segment qualified as held for sale and were classified as discontinued operations in the accompanying consolidated financial statements as of the earliest period presented. Consequently, prior periods presented have been recast from amounts previously reported to reflect the insurance segment as discontinued operations.

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses for each reporting period. The significant estimates made in the preparation of the Company's condensed consolidated financial statements relate to the assessment of other-than-temporary impairments, and the application of the equity method of accounting, goodwill and intangibles, real estate and water assets, deferred income taxes, stock-based compensation, fair value of derivatives, purchase price allocation, and contingent liabilities. While management believes that the carrying value of such assets and liabilities are appropriate as of March 31, 2013, and December 31, 2012, it is reasonably possible that actual results could differ from the estimates upon which the carrying values were based.

Stock-Based Compensation:

Stock-based compensation expense is measured at the grant date based on the fair values of the awards and is recognized as expense over the period in which the share-based compensation vests.

At March 31, 2013, the Company had one stock-based payment arrangement outstanding:

The PICO Holdings, Inc. 2005 Long Term Incentive Plan (the "Plan"). The Plan provides for the grant or award of various equity incentives to PICO employees, non-employee, directors, and consultants. A total of 2,654,000 shares of common stock are issuable under the Plan and it provides for the issuance of incentive stock options, non-statutory stock options, free-standing stock-settled stock appreciation rights ("SAR"), restricted stock awards, performance shares, performance units, restricted stock units ("RSU"), deferred compensation awards, and other stock-based awards. The Plan allows for broker assisted cashless exercises and net-settlement of income taxes and employee withholding taxes. Upon exercise of a SAR and RSU, the employee will receive newly issued shares of PICO Holdings common stock with a fair value equal to the in-the-money value of the award, less applicable federal, state and local withholding and income taxes (however, the holder of an RSU can elect to pay withholding taxes in cash).

Restricted Stock Units (RSU):

A summary of activity of the RSU is as follows:

	RSU
Outstanding at January 1, 2013	467,716
Granted	—
Vested	—
Outstanding at March 31, 2013	467,716
Unrecognized compensation cost (in thousands)	$5,565

The Company recorded stock based compensation expense of $946,000 and $1 million, for the three months ended March 31, 2013 and 2012, respectively for the RSU outstanding during the period.

During the three months ended March 31, 2012, 140,000 RSU vested which resulted in delivery of 94,176 newly issued shares of PICO common stock.

Stock-Settled Stock Appreciation Rights (SAR):

There were no SAR granted or exercised during the three months ended March 31, 2013 or 2012. There was no stock-based compensation expense recognized for SAR during the three months ended March 31, 2013 or 2012 as there were no unvested SAR in those periods.

A summary of SAR activity is as follows:

	SAR	Weighted Average Exercise Price	Weighted Average Contractual Term
Outstanding at January 1, 2013	1,812,079	$36.16	3.5 years
Expired	(195,454)		
Outstanding and exercisable at March 31, 2013	1,616,625	$36.45	3.1 years

At March 31, 2013, none of the outstanding SAR were in-the-money.

Business Combination:

At December 31, 2012, the Company owned 27% of the voting stock in Spigit, Inc. (“Spigit”), a privately held company that develops enterprise innovation software. Accordingly, the Company recorded its investment in Spigit as an unconsolidated affiliate using the equity method of accounting. However, the Company had not recorded any losses reported by Spigit since 2011, as previous losses had reduced the carrying value of the Company’s investment in Spigit to zero at December 31, 2011.

Effective January 31, 2013, the Company acquired additional voting preferred stock (“Series F preferred stock”) in Spigit for $5 million and obtained additional common stock by converting existing outstanding term loans with Spigit. Simultaneous with the Company’s acquisition of the Series F preferred stock, Spigit completed a one-for-five reverse split of certain other preferred shares outstanding. All issuances of Spigit’s preferred stock prior to the Series F preferred stock were then converted to common stock such that, as of March 31, 2013, Spigit’s capitalization consists only of Series F preferred stock which is owned entirely by the Company, and common stock. The effect of these transactions resulted in the Company owning approximately 67% of the total outstanding voting interest of Spigit. In accordance with applicable accounting guidance, the acquisition was accounted for under the acquisition method of accounting and as such, the results of Spigit were included in the Company's results of operations from the date of acquisition.

In conjunction with the acquisition, the Company also agreed to invest an additional $5 million by May 31, 2013 if Spigit, as of April 30, 2013, achieved certain pre-determined operational cash flow targets established by the

Company. Spigit has met the pre - determined targets and accordingly the Company will invest a further $5 million in the Series F preferred stock upon satisfactory resolution of Spigit's breach of its debt reporting covenant discussed below under Debt.

The allocation of the acquired assets and liabilities requires extensive use of accounting estimates and judgments to allocate the purchase price to tangible and intangible assets acquired and liabilities assumed based on respective fair values. The Company's purchase price allocations are preliminary and subject to revision as more detailed analyses are completed and additional information about the fair value of assets and liabilities becomes available, including information relating to tax matters and finalization of the Company's valuation of identified intangible assets. The major classes of assets to which the Company preliminarily allocated the purchase price were goodwill of $5.1 million and identifiable intangible assets of $10.2 million. The measurement periods for purchase price allocations end as soon as information on the facts and circumstances becomes available, but do not exceed 12 months. Adjustments in purchase price allocations may require a recasting of the amounts allocated to goodwill, retroactive to the periods in which the acquisitions occurred.

The following table summarizes the consideration transferred and the estimated fair values of net assets acquired and liabilities assumed (in thousands):

Consideration transferred:		
Cash paid	$5,000	
Term loan converted to common stock	820	
Fair value of the noncontrolling interest	248	
Fair value of the Company's existing investment prior to the acquisition	88	
	$6,156	
Net assets acquired:		
Cash	$5,174	
Property, plant and equipment	1,524	
Accounts receivable	3,608	
Goodwill	5,101	
Intangible assets	10,249	
Other assets	877	
Total asset	26,533	
Debt	(8,038	)
Deferred revenue	(8,271	)
Accounts payable and accrued liabilities	(4,068	)
Total liabilities	(20,377	)
Net assets acquired	$6,156	

The following table summarizes the proforma financial information of the Company as if the acquisition occurred at the beginning of the periods presented:

	March 31, 2013		March 31, 2012	
Revenue	$58,345		$9,747	
Net loss	$(17,272	)	$(7,599	)
Basic and diluted loss per share	$(0.76	)	$(0.33	)

Sale of Software:

Revenue consists of fixed subscription fees for the Company's software and services. The Company commences revenue recognition when all of the following conditions are met: (1) Persuasive evidence of an arrangement exists; (2) Subscription or services have been delivered to the customer; (3) Collection of related fees is reasonably assured; and (4) Related fees are fixed or determinable.

The Company’s customers do not have the contractual right to take possession of the software in substantially all transactions. Instead, the software is delivered through the internet from the Company’s hosting facilities. Fixed fee subscription services include access to the hosted software, set-up assistance and customer support, which are exclusively provided to direct customers by Spigit and considered non-separable deliverables. The Company recognizes the subscription fee ratably over the contracted term of the subscription agreement, generally one year. Revenue recognition commences on the later of the start date specified in the subscription arrangement, the date the customer’s first module is set-up and access is granted to the customer, and when all of the revenue recognition criteria have been met, including when any acceptance period lapses.

The Company’s consulting services consist of certain professional services, business process consulting and training services that are short-term in nature. Consulting services may be purchased separately at any time to complement or enhance the customers' experience in Spigit products and services.
The Company accounts for subscription and consulting services revenue as separate units of account. Subscription services are routinely sold separately by the Company as the consulting services are not essential to the functionality of the hosted application and customers renew their subscription without additional services. The Company allocates revenue to each unit of account based on a selling price hierarchy. The selling price for a deliverable is based on its VSOE, if available, TPE, if VSOE is not available, or ESP, if neither VSOE nor TPE are available. Since VSOE and TPE are not available for the Company’s subscription or consulting services, the Company uses ESP to allocate revenue. The Company establishes ESP within a range of selling prices considering multiple factors including, but not limited to, standalone sales, price list adjusted for discounting practices and margin objectives.

Cost of Software Sold:

Cost of software sold primarily consists of costs related to hosting of the Company’s application suite and expenses related to its hosting facility, plus the cost of providing consulting services to our customers.

Software Development Costs

The Company accounts for costs related to the development of software products in accordance with the applicable authoritative guidance. For software products to be sold, leased, or otherwise marketed, the Company expenses all costs incurred to establish the technological feasibility of the software product and capitalizes qualifying costs incurred after technological feasibility is achieved. For software products developed or obtained for internal use, the Company capitalizes all related costs, beginning when it is determined that certain factors are present including, among others, that technology exists to achieve performance requirements. All costs that relate to the planning and post implementation phases of software developed for internal use are expensed as incurred.

Deferred Compensation:

The Company reports the investment returns generated in the deferred compensation accounts in revenues with a corresponding increase in the trust assets (except in the case of PICO stock, which is reported as treasury stock, at cost). There is an increase in the deferred compensation liability when there is appreciation in the market value of the assets held, with a corresponding expense recognized in operating and other costs. In the event the trust assets decline in value, the Company reverses previously expensed compensation. The assets of the plan are held in rabbi trust accounts. Such accounts hold various investments that are consistent with the Company’s investment policy, and are accounted for and reported as available-for-sale securities in the accompanying condensed consolidated balance sheets. Assets of the trust are distributed according to predetermined payout elections established by each participant.

At March 31, 2013 and December 31, 2012, the Company had $23 million and $22.6 million, respectively, recorded as deferred compensation payable to various members of management and certain non-employee members of the board of directors of the Company.

The deferred compensation liability increased by $357,000 during the three months ended March 31, 2013 primarily due to an increase in the fair value of the assets of $618,000, offset by payments to participants. Included in operating and other costs in the accompanying condensed consolidated statements of operations and comprehensive income or loss for the three months ended March 31, 2013 and 2012 is compensation expense of $618,000 and $1.6 million, respectively.

Accumulated Other Comprehensive Loss:

The components of accumulated other comprehensive loss are as follows (in thousands):

	March 31, 2013	December 31, 2012
Net unrealized appreciation on available-for-sale investments	$5,207	$4,455
Foreign currency translation	(6,233)	(6,469)
Accumulated other comprehensive loss	$(1,026)	