Amtrust Financial Services, Inc.
Form 10-Q
May 10, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2012

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ___________________ to ___________________

Commission file no. 001-33143

AmTrust Financial Services, Inc.

(Exact name of registrant as specified in its charter)

Delaware	04-3106389
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
59 Maiden Lane, 6th Floor, New York, New York	10038
(Address of principal executive offices)	(Zip Code)

(212) 220-7120

(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 ¨

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer ¨	Accelerated filer x
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 Securities Exchange Act). Yes ¨ No x

As of May 2, 2012, the Registrant had one class of Common Stock ($.01 par value), of which 60,535,070 shares were issued and outstanding.

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PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

AMTRUST FINANCIAL SERVICES, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In Thousands, Except Par Value)

	March 31, 2012 (Unaudited)	December 31, 2011 (Audited)
ASSETS		
Investments:		
Fixed maturities, available-for-sale, at market value (amortized cost $1,637,870; $1,382,863)	$ 1,685,022	$ 1,394,243
Equity securities, available-for-sale, at market value (cost $29,749; $34,041)	30,752	35,600
Short-term investments	84,571	128,565
Equity investment in unconsolidated subsidiaries – related parties	87,117	83,691
Other investments	14,865	14,588
Total investments	1,902,327	1,656,687
Cash and cash equivalents	277,183	406,847
Restricted cash and cash equivalents	59,236	23,104
Accrued interest and dividends	14,437	12,644
Premiums receivable, net	1,004,951	932,992
Reinsurance recoverable (related party $646,659; $597,525)	1,142,147	1,098,569
Prepaid reinsurance premium (related party $453,752; $429,124)	620,989	584,871
Prepaid expenses and other assets (recorded at fair value $142,575; $131,387)	338,144	292,849
Federal income tax receivable	8,264	13,024
Deferred policy acquisition costs	295,397	280,991
Property and equipment, net	63,801	61,553
Goodwill	173,023	147,654
Intangible assets	195,489	166,962
	$ 6,095,388	$ 5,678,747
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Loss and loss expense reserves	$ 1,968,319	$ 1,879,175
Unearned premiums	1,453,008	1,366,170
Ceded reinsurance premiums payable (related party $264,934; $222,408)	375,189	337,508
Reinsurance payable on paid losses	17,775	14,731
Funds held under reinsurance treaties	42,624	49,249

Note payable on collateral loan – related party	167,975	167,975
Securities sold but not yet purchased, at market	54,507	55,942
Securities sold under agreements to repurchase, at contract value	200,915	191,718
Accrued expenses and other current liabilities (recorded at fair value $12,050; $12,022)	337,723	267,643
Deferred income taxes	138,001	108,775
Debt	302,550	279,600
Total liabilities	5,058,586	4,718,486
Commitments and contingencies		
Redeemable non-controlling interest	600	600
Stockholders' equity:		
Common stock, $.01 par value; 100,000 shares authorized, 85,013 and 84,906 issued in 2012 and 2011, respectively; 60,463 and 60,106 outstanding in 2012 and 2011, respectively	850	849
Preferred stock, $.01 par value; 10,000 shares authorized	—	—
Additional paid-in capital	585,623	582,321
Treasury stock at cost; 24,550 and 24,800 shares in 2012 and 2011, respectively	(298,260)	(300,365)
Accumulated other comprehensive income (loss)	22,456	(9,999)
Retained earnings	651,373	617,757
Total AmTrust Financial Services, Inc. equity	962,042	890,563
Non-controlling interest	74,160	69,098
Total stockholders' equity	1,036,202	959,661
	$6,095,388	$ 5,678,747

See accompanying notes to unaudited condensed consolidated statements.

AmTrust Financial Services, Inc.

Condensed Consolidated Statements of Income

(Unaudited)

(In Thousands, Except Per Share Data)

	Three Months Ended March 31, 2012	2011
Revenues:		
Premium income:		
Net written premium	$ 359,777	$ 234,019
Change in unearned premium	(45,753)	(33,681)
Net earned premium	314,024	200,338
Ceding commission – primarily from related party	46,274	35,684
Service and fee income (related parties $6,092; $3,439)	40,538	25,189
Net investment income	14,518	14,192
Net realized gain (loss) on investments	(1,148)	415
Total revenues	414,206	275,818
Expenses:		
Loss and loss adjustment expense	199,929	128,696
Acquisition costs and other underwriting expenses	124,025	81,234
Other	35,639	20,196
Total expenses	359,593	230,126
Income before other income (expense), income taxes and equity in earnings of unconsolidated subsidiaries	54,613	45,692
Other income (expenses):		
Interest expense	(7,091)	(3,754)
Foreign currency gain (loss)	421	(284)
Gain on investment in life settlement contracts net of profit commission	90	18,886
Total other income (expenses)	(6,580)	14,848
Income before income taxes and equity in earnings of unconsolidated subsidiaries	48,033	60,540
Provision for income taxes	11,177	9,037
Income before equity in earnings of unconsolidated subsidiaries	36,856	51,503
Equity in earnings of unconsolidated subsidiaries – related party	2,364	1,819
Net income	39,220	53,322
Net income attributable to non-controlling interest of subsidiaries	(134)	(8,139)
Net income attributable to AmTrust Financial Services, Inc.	$ 39,086	$ 45,183
Earnings per common share:		
Basic earnings per share	$ 0.65	$ 0.76
Diluted earnings per share	0.63	0.74
Dividends declared per common share	$ 0.09	$ 0.08

Net realized gain (loss) on investments:

Total other-than-temporary impairment losses	$ —	$ —
Portion of loss recognized in other comprehensive income	—	—
Net impairment losses recognized in earnings	—	—
Other net realized gain (loss) on investments	(1,148)	415
Net realized investment gain (loss)	$ (1,148)	$ 415

See accompanying notes to unaudited condensed consolidated financial statements.

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AmTrust Financial Services, Inc.

Condensed Consolidated Statement of Comprehensive Income

(Unaudited)

(In Thousands)

	Three Months Ended March, 31	
	2012	2011
Other comprehensive income, net of tax:		
Net income	$39,220	$51,321
Foreign currency translation adjustments	4,197	3,840
Change in fair value of interest rate swap	(57)	—
Unrealized gains on securities:		
Unrealized holding gains arising during period	30,759	3,272
Less: Reclassification adjustment for gains included in net income	(2,444)	1,253
Other comprehensive income, net of tax	$32,455	$8,365
Comprehensive income	71,675	59,686
Less: Comprehensive income attributable to non-controlling interest	134	8,139
Comprehensive income attributable to AmTrust Financial Services, Inc.	$71,541	$51,547

See accompanying notes to unaudited condensed consolidated financial statements.

AmTrust Financial Services, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

(In Thousands)

	Three Months Ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income	$ 39,220	$ 51,321
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,746	6,071
Equity earnings and gain on investment in unconsolidated subsidiaries	(2,364)	(3,123)
Gain on investment in life settlement contracts	(90)	(18,886)
Realized (gain) loss on marketable securities	1,148	(415)
Discount on notes payable	968	163
Stock based compensation	1,180	1,459
Bad debt expense	1,994	1,147
Foreign currency (gain) loss	(421)	284
Changes in assets - (increase) decrease:		
Premiums and note receivables	(73,953)	(61,425)
Reinsurance recoverable	(43,578)	(47,114)
Deferred policy acquisition costs, net	(14,406)	(12,343)
Prepaid reinsurance premiums	(36,118)	(22,677)
Prepaid expenses and other assets	(34,589)	(9,018)
Changes in liabilities - increase (decrease):		
Reinsurance premium payable	37,681	51,523
Loss and loss expense reserve	89,144	48,085
Unearned premiums	86,838	60,458
Funds held under reinsurance treaties	(6,625)	(179)
Accrued expenses and other current liabilities	29,084	(86)
Deferred tax liability	4,575	10,086
Net cash provided by operating activities	88,434	55,331
Cash flows from investing activities:		
Net (purchases) sales of securities with fixed maturities	(212,243)	7,157
Net (purchases) sales of equity securities	7,509	1,447
Net (purchases) sales of other investments	(309)	161
Acquisition of and capitalized premiums for life settlement contracts	(7,961)	(17,453)
Acquisition of intangible assets and subsidiaries, net of cash obtained	(2,222)	—
Increase in restricted cash and cash equivalents	(36,132)	(23,402)
Purchase of property and equipment	(5,014)	(15,402)
Net cash used in investing activities	(256,372)	(47,492)
Cash flows from financing activities:		
Repurchase agreements, net	9,197	(95,251)

Revolving credit facility borrowing	—	98,200
Convertible senior notes proceeds	25,000	—
Secured loan agreement borrowings	—	10,800
Secured loan agreements payments	(240)	—
Promissory note	2,500	—
Term loan payment	—	(6,667)
Debt financing fees	(750)	(1,394)
Capital contribution to subsidiaries	4,928	8,965
Stock option exercise and other	922	857
Dividends distributed on common stock	(5,533)	(4,761)
Net cash provided by financing activities	36,024	10,749
Effect of exchange rate changes on cash	2,250	2,119
Net decrease in cash and cash equivalents	(129,664)	(20,707)
Cash and cash equivalents, beginning of the period	406,847	184,819
Cash and cash equivalents, end of the period	$ 277,183	$ 205,526
Supplemental Cash Flow Information		
Income tax payments	$ 46	$ 57
Interest payments on debt	2,880	3,151

See accompanying notes to unaudited condensed consolidated financial statements.

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Notes to Unaudited Condensed Consolidated Financial Statements

(Unaudited)

(In Thousands, Except Per Share Data)

1. Basis of Reporting

The accompanying unaudited interim consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X and, therefore, do not include all of the information and footnotes required by GAAP for complete financial statements. These interim statements should be read in conjunction with the financial statements and notes thereto included in the AmTrust Financial Services, Inc. ("AmTrust" or the "Company") Annual Report on Form 10-K for the year ended December 31, 2011, previously filed with the Securities and Exchange Commission ("SEC") on March 15, 2012. The balance sheet at December 31, 2011 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements.

These interim consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair presentation of the results for the interim period and all such adjustments are of a normal recurring nature. The results of operations for the interim period are not necessarily indicative, if annualized, of those to be expected for the full year. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

A detailed description of the Company's significant accounting policies and management judgments is located in the audited consolidated financial statements for the year ended December 31, 2011, included in the Company's Form 10-K filed with the SEC.

All significant inter-company transactions and accounts have been eliminated in the consolidated financial statements.

To facilitate period-to-period comparisons, certain reclassifications have been made to prior period consolidated financial statement amounts to conform to current period presentation. The Company and American Capital Acquisition Corporation ("ACAC") currently each have a 50% ownership interest in Tiger Capital LLC ("Tiger") and

AMT Capital Alpha, LLC (“AMT Alpha”). The Company also has a 21.25% ownership share of ACAC. As a result, the Company ultimately receives 60.625% of the income and losses related to Tiger and AMT Alpha and therefore consolidates Tiger and AMT Alpha. Prior to January 1, 2012, the Company reported Tiger’s and AMT Alpha’s income and losses attributable to its 10.625% indirect ownership as a component of Equity in Earnings of Unconsolidated Subsidiaries. This amount was offset by reporting an equal amount as a component of Non-controlling interest. Effective January 1, 2012, the Company presents the impact of the 10.625% indirect ownership of Tiger and AMT Alpha on a net basis and excludes this amount from both Equity in Earnings of Unconsolidated Subsidiaries and Non-controlling Interest. All prior periods presented have been reclassed to conform to the current presentation. There was no impact on prior period Net Income Attributable to AmTrust Financial Services, Inc. The Company’s equity investment in ACAC and non-controlling interest were reduced by $3,807 as of December 31, 2011.

2. Recent Accounting Pronouncements

With the exception of those discussed below, there have been no recent accounting pronouncements or changes in accounting pronouncements during the three months ended March 31, 2012, as compared to those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, that are of significance, or potential significance, to the Company.

In December 2011, the Financial Accounting Standards Board (“FASB”) issued a new standard which indefinitely defers certain provisions of a previously issued standard, Accounting Standards Update (“ASU”) No. 2011-05 *Comprehensive Income (Topic 220)* that revised the manner in which companies present comprehensive income in financial statements. One of the ASU provisions required companies to present reclassification adjustments out of accumulated other comprehensive income by component in both the statement in which net income is presented and the statement in which other comprehensive income is presented. Accordingly, this requirement is indefinitely deferred and will be further deliberated by the FASB at a future date. The amendment is effective for fiscal years and interim periods within those years that begin after December 15, 2011. The Company adopted this standard on January 1, 2012. The adoption of the new standard did not have a material impact on the Company’s results of operations, financial position or liquidity.

In June 2011, the FASB issued ASU No. 2011-05 *Comprehensive Income (Topic 220)*. This update required that all non-owner charges in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In the two-step approach, the first statement should present total net income and its components followed consecutively by a second statement that should present total other comprehensive income, the components of other comprehensive income, and the total of comprehensive income. The updated guidance was effective for fiscal years and interim periods beginning on or after December 15, 2011 and was to be applied on a retrospective basis to the beginning of the annual period of adoption. The new standard does not change the items that must be reported in other comprehensive income and was effective for fiscal years and interim periods within those years that begin after December 15, 2011. The Company adopted this standard on January 1, 2012. The adoption of the new standard did not have a material impact on the Company's results of operations, financial position or liquidity.

In September 2011, the FASB issued ASU No. 2011-08 *Intangibles-Goodwill and Other (Topic 350)*. The updated guidance is intended to reduce complexity and costs by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment, using factors such as changes in management, key personnel, business strategy, technology or customers, to determine whether it should calculate the fair value of a reporting unit. Previous accounting literature required an entity to test goodwill for impairment by comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit is less than its carrying amount, then the second step of the test must be performed to measure the amount of the impairment loss, if any. In the second step, the implied fair value of the reporting unit's goodwill is determined in the same manner as goodwill is measured in a business combination (by measuring the fair value of the reporting unit's assets, liabilities and unrecognized intangible assets and determining the remaining amount ascribed to goodwill) and comparing the amount of the implied goodwill to the carrying amount of the goodwill. Under the updated guidance, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that is more likely than not that its fair value is less than its carrying amount. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 31, 2011. The Company adopted this standard January 1, 2012 and it did not have any material impact on its results of operations, financial position or liquidity.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820)*. The ASU generally aligns the principles for fair value measurements and the related disclosure requirements under GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements, particularly for Level 3 fair value measurements. The amendment is effective on a prospective basis for interim and annual reporting periods beginning after December 15, 2011 and early adoption is not permitted. The Company adopted this standard on January 1, 2012 and adoption of the standard did not have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB amended its guidance on accounting for repurchase agreements. The amendments eliminate the criteria to assess whether a transferor must have the ability to repurchase or redeem the financial assets in order to demonstrate effective control over the transferred asset. Under the amended guidance, a transferor maintains effective control over transferred financial assets (and thus accounts for the transfer as a secured borrowing) if there is an agreement that both entitles and obligates the transferor to repurchase the financial assets before maturity and if all of the following conditions previously required are met: (i) financial assets to be repurchased or redeemed are the same or substantially the same as those transferred; (ii) repurchase or redemption date before maturity at a fixed or determinable price; and (iii) the agreement is entered into contemporaneously with, or in contemplation of, the transfer. As a result, more arrangements could be accounted for as secured borrowings rather than sales. The updated guidance is effective on a prospective basis for interim and annual reporting periods beginning on or after December 15, 2011. The Company adopted this standard January 1, 2012 and it did not have a material impact on the Company's results of operations, financial position or liquidity.

In October 2010, the FASB issued ASU No. 2010-26, *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts* ("ASU 2010-26"). ASU 2010-26 modifies the types of costs that may be deferred, allowing insurance companies to only defer costs directly related to a successful contract acquisition or renewal. These costs include incremental direct costs of successful contracts, the portion of employees' salaries and benefits related to time spent on acquisition activities for successful contracts and other costs incurred in the acquisition of a contract. Additional disclosure of the type of acquisition costs capitalized is also required.

The Company adopted ASU 2010-26 prospectively. During 2012, the Company estimates that pre-tax expenses will increase by approximately $8,000 to $10,000 as a lower amount of acquisition costs will be capitalized and existing costs that no longer meet the criteria for deferral under ASU 2010-26 will be recognized in expense over the original amortization periods. For the three months ended March 31, 2012, the Company recognized approximately $3,258 of expense related to such previously deferrable costs. If the Company had adopted ASU 2010-26 retrospectively, approximately $4,647 of acquisition costs that were deferred would have been recognized in expense for the three month period ended March 31, 2011.

3. Investments

(a) Available-for-Sale Securities

The amortized cost, estimated market value and gross unrealized appreciation and depreciation of available-for-sale securities as of March 31, 2012, are presented in the table below:

(Amounts in Thousands)