

FIRST ACCEPTANCE CORP /DE/  
Form 10-Q  
November 10, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

Commission File Number: 001-12117

FIRST ACCEPTANCE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	75-1328153
(State or other jurisdiction of	(I.R.S. Employer
incorporation or organization)	Identification No.)

3813 Green Hills Village Drive

Nashville, Tennessee	37215
(Address of principal executive offices)	(Zip Code)

(615) 844-2800

(Registrant's telephone number, including area code)

Not applicable

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(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer

Accelerated filer

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

At November 9, 2015, there were 41,040,772 shares outstanding of the registrant's common stock, par value \$0.01 per share.

FIRST ACCEPTANCE CORPORATION

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2015

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## PART I – FINANCIAL INFORMATION

## Item 1. Financial Statements

## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

	September 30, 2015 (Unaudited)	December 31, 2014
<b>ASSETS</b>		
Investments, available-for-sale at fair value (amortized cost of \$131,614 and \$119,119, respectively)	\$ 135,745	\$ 125,085
Cash and cash equivalents	107,207	102,429
Premiums, fees, and commissions receivable, net of allowance of \$461 and \$392	74,458	56,486
Deferred tax assets, net	18,241	16,521
Other investments	12,087	10,530
Other assets	7,530	5,962
Property and equipment, net	3,875	3,173
Deferred acquisition costs	5,428	3,459
Goodwill	30,200	-
Identifiable intangible assets, net	8,745	4,800
<b>TOTAL ASSETS</b>	<b>\$ 403,516</b>	<b>\$ 328,445</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Loss and loss adjustment expense reserves	\$ 115,009	\$ 96,613
Unearned premiums and fees	86,877	67,942
Debentures payable	40,245	40,211
Term loan from principal stockholder	29,747	-
Accrued expenses	11,661	3,262
Other liabilities	16,207	13,453
<b>Total liabilities</b>	<b>299,746</b>	<b>221,481</b>
<b>Stockholders' equity:</b>		
Preferred stock, \$.01 par value, 10,000 shares authorized	-	-
Common stock, \$.01 par value, 75,000 shares authorized; 41,041 and 41,016 issued and outstanding, respectively	411	410
Additional paid-in capital	457,395	457,242
Accumulated other comprehensive income, net of tax of \$314 and \$923, respectively	3,959	5,090
Accumulated deficit	(357,995 )	(355,778 )
<b>Total stockholders' equity</b>	<b>103,770</b>	<b>106,964</b>

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 403,516	\$ 328,445
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See notes to consolidated financial statements.

## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(in thousands, except per share data)

	Three Months		Nine Months Ended	
	Ended September 30, 2015	2014	September 30, 2015	2014
<b>Revenues:</b>				
Premiums earned	\$67,508	\$54,369	\$197,423	\$161,971
Commission and fee income	18,974	10,097	42,252	29,323
Investment income	1,144	1,142	3,695	3,936
Net realized gains (losses) on investments, available-for-sale	(6 )	(4 )	(13 )	36
	87,620	65,604	243,357	195,266
<b>Costs and expenses:</b>				
Losses and loss adjustment expenses	57,367	41,440	160,304	119,323
Insurance operating expenses	29,309	20,624	78,039	65,739
Other operating expenses	295	244	881	722
Litigation settlement	3,406	30	3,645	106
Stock-based compensation	37	39	109	151
Depreciation	424	423	1,224	1,303
Amortization of identifiable intangibles assets	254	-	261	-
Interest expense	1,052	427	1,924	1,275
	92,144	63,227	246,387	188,619
Income (loss) before income taxes	(4,524 )	2,377	(3,030 )	6,647
Provision (benefit) for income taxes	(1,506 )	257	(813 )	547
Net income (loss)	\$(3,018 )	\$2,120	\$(2,217 )	\$6,100
Net income (loss) per share:				
Basic	\$(0.07 )	\$0.05	\$(0.05 )	\$0.15
Diluted	\$(0.07 )	\$0.05	\$(0.05 )	\$0.15
Number of shares used to calculate net income (loss) per share:				
Basic	41,041	40,995	41,026	40,981
Diluted	41,041	41,297	41,026	41,285
Reconciliation of net income (loss) to other comprehensive income				
(loss):				
Net income (loss)	\$(3,018 )	\$2,120	\$(2,217 )	\$6,100
Net unrealized change in investments, net of tax of \$(17), \$0,				
\$(609) and \$0, respectively	(32 )	(667 )	(1,131 )	2,284
Comprehensive income (loss)	\$(3,050 )	\$1,453	\$(3,348 )	\$8,384

See notes to consolidated financial statements.

## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(in thousands)

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income (loss)	\$(2,217 )	\$6,100
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Depreciation	1,224	1,303
Amortization of identifiable intangibles assets	261	-
Stock-based compensation	109	151
Deferred income taxes	(1,111 )	-
Net realized losses (gains) on sales and redemptions of investments	13	(36 )
Investment income from other investments	(301 )	(248 )
Other	212	244
Change in:		
Premiums, fees, and commission receivable	(18,041 )	(12,307)
Loss and loss adjustment expense reserves	18,396	6,958
Unearned premiums and fees	18,935	14,252
Accrued expenses	6,122	301
Other	447	(83 )
Net cash provided by operating activities	24,049	16,635
Cash flows from investing activities:		
Purchases of investments, available-for-sale	(21,022 )	(5,441 )
Purchases of other investments	(1,739 )	(2,336 )
Maturities and redemptions of investments, available-for-sale	8,372	16,379
Capital expenditures	(1,529 )	(978 )
Business acquired through asset purchase	(33,770 )	-
Other	372	173
Net cash (used in) provided by investing activities	(49,316 )	7,797
Cash flows from financing activities:		
Proceeds from term loan from principal stockholder	30,000	-
Net proceeds from issuance of common stock	45	31
Net cash provided by financing activities	30,045	31
Net change in cash and cash equivalents	4,778	24,463
Cash and cash equivalents, beginning of period	102,429	72,033
Cash and cash equivalents, end of period	\$107,207	\$96,496



See notes to consolidated financial statements.

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FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

The consolidated financial statements of First Acceptance Corporation (the “Company”) included herein have been prepared without audit pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, certain information and disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been omitted. In the opinion of management, the consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the interim periods.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the full year. These consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements included in its Annual Report on Form 10-K for the year ended December 31, 2014.

Reclassifications

Certain reclassifications have been made to the prior year’s consolidated financial statements to conform with the current presentation.

2. Fair Value

Fair value is the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs are based on market data from independent sources, while unobservable inputs reflect the Company’s view of market assumptions in the absence of observable market information. All assets and liabilities that are carried at fair value are classified and disclosed in one of the following categories:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
  - Level 2 Quoted market prices for similar assets or liabilities in active markets; quoted prices by independent pricing services for identical or similar assets or liabilities in markets that are not active; and valuations, using models or other valuation techniques, that use observable market data. All significant inputs are observable, or derived from observable information in the marketplace, or are supported by observable levels at which transactions are executed in the marketplace.
  - Level 3 - Instruments that use non-binding broker quotes or model driven valuations that do not have observable market data.
- NAV - Calculated net asset value (“NAV”) based on an ownership interest to which a proportionate share of net assets is attributed.

The Company categorizes valuation methods used in its identifiable intangible assets impairment tests as Level 3. To determine the fair value of acquired trademarks and trade names, the Company uses the relief-from-royalty method,

which requires the Company to estimate the future revenue for the related brands, the appropriate royalty rate and the weighted average cost of capital. The Company also categorizes the valuation method used to fair value an investment in the common stock of a real estate investment trust included in other investments as Level 3, since this investment has redemption and transfer restriction and is therefore not readily marketable.

#### Fair Value of Financial Instruments

The carrying values and fair values of certain of the Company's financial instruments were as follows (in thousands).

	September 30, 2015		December 31, 2014	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Assets:</b>				
Investments, available-for-sale	\$135,745	\$135,745	\$125,085	\$125,085
Other investments	12,087	12,087	10,530	10,530
<b>Liabilities:</b>				
Debentures payable	40,245	20,896	40,211	19,606
Term loan from principal stockholder	29,747	31,128	-	-

## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

The fair values as presented represent the Company's best estimates and may not be substantiated by comparisons to independent markets. The fair value of the debentures payable and the term loan from principal shareholder are categorized as Level 3, since they were based on current market rates offered for debt with similar risks and maturities, an unobservable input categorized as Level 3. Carrying values of certain financial instruments, such as cash and cash equivalents and premiums and fees receivable, approximate fair value due to the short-term nature of the instruments and are not required to be disclosed. Therefore, the aggregate of the fair values presented in the preceding table do not purport to represent the Company's underlying value.

The Company holds available-for-sale investments and other investments, which are carried at net asset value which approximates fair value. The following tables present the fair-value measurements for each major category of assets that are measured on a recurring basis (in thousands).

September 30, 2015	Total	Fair Value Measurements Using			Proportionate Share of Net Assets (NAV)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Fixed maturities, available-for-sale:</b>					
U.S. government and agencies	\$13,314	\$13,314	\$—	\$—	\$—
State	703	—	703	—	—
Political subdivisions	499	—	499	—	—
Revenue and assessment	13,480	—	13,480	—	—
Corporate bonds	86,189	—	86,189	—	—
<b>Collateralized mortgage obligations:</b>					
Agency backed	1,827	—	1,827	—	—
Non-agency backed – residential	3,670	—	3,670	—	—
Non-agency backed – commercial	2,619	—	2,619	—	—
<b>Total fixed maturities, available-for-sale</b>	<b>122,301</b>	<b>13,314</b>	<b>108,987</b>	<b>—</b>	<b>—</b>
Preferred stock, available-for-sale	1,727	1,727	—	—	—
Mutual funds, available-for-sale	11,717	11,717	—	—	—
<b>Total investments, available-for-sale</b>	<b>135,745</b>	<b>26,758</b>	<b>108,987</b>	<b>—</b>	<b>—</b>
Other investments	12,087	—	—	2,692	9,395
Cash and cash equivalents	107,207	107,207	—	—	—
<b>Total</b>	<b>\$255,039</b>	<b>\$133,965</b>	<b>\$108,987</b>	<b>\$2,692</b>	<b>\$9,395</b>



## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

December 31, 2014	Total	Fair Value Measurements Using			Proportionate Share of Net Assets (NAV)
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
<b>Fixed maturities, available-for-sale:</b>					
U.S. government and agencies	\$8,290	\$8,290	\$ —	\$ —	\$ —
State	725	—	725	—	—
Political subdivisions	506	—	506	—	—
Revenue and assessment	16,360	—	16,360	—	—
Corporate bonds	75,119	—	75,119	—	—
<b>Collateralized mortgage obligations:</b>					
Agency backed	4,807	—	4,807	—	—
Non-agency backed – residential	4,137	—	4,137	—	—
Non-agency backed – commercial	3,078	—	3,078	—	—
<b>Total fixed maturities, available-for-sale</b>	<b>113,022</b>	<b>8,290</b>	<b>104,732</b>	<b>—</b>	<b>—</b>
Preferred stock, available-for-sale	1,767	1,767	—	—	—
Mutual funds, available-for-sale	10,296	10,296	—	—	—
<b>Total investments, available-for-sale</b>	<b>125,085</b>	<b>20,353</b>	<b>104,732</b>	<b>—</b>	<b>—</b>
Other investment	10,530	—	—	947	9,583
Cash and cash equivalents	102,429	102,429	—	—	—
<b>Total</b>	<b>\$238,044</b>	<b>\$122,782</b>	<b>\$104,732</b>	<b>\$947</b>	<b>\$9,583</b>

The fair values of the Company's investments are determined by management after taking into consideration available sources of data. All of the portfolio valuations classified as Level 1 or Level 2 in the above tables are priced exclusively by utilizing the services of independent pricing sources using observable market data. The Level 2 classified security valuations are obtained from a single independent pricing service. The Level 3 classified security in the table above consists of an investment in the common stock of a real estate investment trust for which fair value has been determined using a model driven valuation that does not have observable market data. There were no transfers between Level 1 and Level 2 for the three and nine months ended September 30, 2015 and 2014. The Company's policy is to recognize transfers between levels at the end of the reporting period based on specific identification. The Company has not made any adjustments to the prices obtained from the independent pricing sources.

The Company has reviewed the pricing techniques and methodologies of the independent pricing service for Level 2 investments and believes that its policies adequately consider market activity, either based on specific transactions for the security valued or based on modeling of securities with similar credit quality, duration, yield and structure that were recently traded. The Company monitored security-specific valuation trends and has made inquiries with the pricing service about material changes or the absence of expected changes to understand the underlying factors and inputs and to validate the reasonableness of the pricing. Likewise, the Company reviews the Level 3 valuation model to understand the underlying factors and inputs and to validate the reasonableness of the pricing.



## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

The following table represents the quantitative disclosure for the asset classified as Level 3 during the nine months ended September 30, 2015 (in thousands).

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
	Common Stock at Fair Value
Balance at December 31, 2014	\$ 947
Gains included in net income	—
Gains included in comprehensive income	95
Investments and capital calls	1,650
Distributions received	—
Transfers into and out of Level 3	—
Balance at September 30, 2015	\$ 2,692

## 3. Investments

## Investments, Available-for-Sale

The following tables summarize the Company's investment securities (in thousands).

September 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	\$ 13,037	\$ 277	\$ —	\$ 13,314
State	698	5	—	703
Political subdivisions	499	—	—	499
Revenue and assessment	12,544	936	—	13,480
Corporate bonds	84,579	2,279	(669 )	86,189
Collateralized mortgage obligations:				
Agency backed	1,734	93	—	1,827
Non-agency backed – residential	3,054	618	(2 )	3,670
Non-agency backed – commercial	2,009	610	—	2,619
Total fixed maturities, available-for-sale	118,154	4,818	(671 )	122,301
Preferred stock, available-for-sale	1,500	227	—	1,727



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Mutual funds, available-for-sale	11,960	49	(292 )	11,717
	\$ 131,614	\$ 5,094	\$ (963 )	\$ 135,745

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## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

December 31, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government and agencies	\$ 8,039	\$ 277	\$ (26 )	\$ 8,290
State	698	27	—	725
Political subdivisions	500	6	—	506
Revenue and assessment	14,856	1,522	(18 )	16,360
Corporate bonds	73,051	2,698	(630 )	75,119
Collateralized mortgage obligations:				
Agency backed	4,647	160	—	4,807
Non-agency backed – residential	3,513	624	—	4,137
Non-agency backed – commercial	2,414	664	—	3,078
Total fixed maturities, available-for-sale	107,718	5,978	(674 )	113,022
Preferred stock, available-for-sale	1,500	267	—	1,767
Mutual funds, available-for-sale	9,901	403	(8 )	10,296
	\$ 119,119	\$ 6,648	\$ (682 )	\$ 125,085

The following table sets forth the scheduled maturities of the Company's fixed maturity securities based on their fair values (in thousands). Actual maturities may differ from contractual maturities because certain securities may be called or prepaid by the issuers.

September 30, 2015	Securities with Unrealized Gains	Securities with Unrealized Losses	Securities with No Unrealized Gains or Losses	All Fixed Maturity Securities
One year or less	\$ 11,067	\$ —	\$ —	\$ 11,067
After one through five years	24,166	8,770	—	32,936
After five through ten years	29,276	30,152	500	59,928
After ten years	10,254	—	—	10,254
No single maturity date	7,922	194	—	8,116
	\$ 82,685	\$ 39,116	\$ 500	\$ 122,301

The following table reflects the number of fixed maturity securities with gross unrealized gains and losses. Gross unrealized losses are further segregated by the length of time that individual securities have been in a continuous

unrealized loss position.

At:	Gross Unrealized Losses		
	Less than or equal to 12 months	Greater than 12 months	Gross Unrealized Gains
September 30, 2015	18	4	79
December 31, 2014	9	9	80

The following tables reflect the fair value and gross unrealized losses of those fixed maturity securities in a continuous unrealized loss position for greater than 12 months. Gross unrealized losses are further segregated by the percentage of amortized cost (in thousands, except number of securities).

Gross Unrealized Losses at September 30, 2015:	Number of Securities	Fair Value	Gross Unrealized Losses
Less than or equal to 10%	4	\$7,796	(165 )
Greater than 10%	—	—	—
	4	\$7,796	\$ (165 )

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## FIRST ACCEPTANCE CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

(Unaudited)

Gross Unrealized Losses at December 31, 2014:	Number of Securities	Fair Value	Gross Unrealized Losses
Less than or equal to 10%	9	\$20,567	\$ (592 )
Greater than 10%	—	—	—
	9	\$20,567	\$ (592 )

The following tables set forth the amount of gross unrealized losses by current severity (as compared to amortized cost) and length of time that individual securities have been in a continuous unrealized loss position (in thousands).

Length of Gross Unrealized Losses at September 30, 2015:	Fair Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses	Severity of Gross Unrealized Losses		
			Less than 5%	5% to 10%	Greater than 10%
Less than or equal to:					
Three months	\$ 14,736	\$ (180 )	\$ (180 )	\$ —	\$ —
Six months	18,036	(379 )	(254 )	(124 )	(1 )
Nine months	7,857	(239 )	(239 )	—	—
Twelve months	—	—	—	—	—
Greater than twelve months	7,796	(165 )	(165 )	—	—
Total	\$ 48,425	\$ (963 )	\$ (838 )	\$ (124 )	\$ (1 )

Length of Gross Unrealized Losses at December 31, 2014:	Fair Value of Securities with Gross Unrealized Losses	Gross Unrealized Losses	Severity of Gross Unrealized Losses		
			Less than 5%	5% to 10%	Greater than 10%
Less than or equal to:					
Three months	\$ 17,505	\$ (90 )	\$ (90 )	\$ —	\$ —
Six months	—	—	—	—	—