

COMMERCE GROUP INC /MA
Form 10-Q
November 09, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2007

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 001-13672

The Commerce Group, Inc.

(Exact name of registrant as specified in its charter)

Massachusetts

(State or other jurisdiction of incorporation or organization)

04-2599931

(IRS Employer Identification No.)

211 Main Street, Webster, Massachusetts

(Address of principal executive offices)

01570

(Zip Code)

Registrant's telephone number, including area code: (508) 943-9000

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 and 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one.)

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of October 31, 2007, the number of shares outstanding of the Registrant's common stock (excluding Treasury Shares) was 60,126,578.

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The Commerce Group, Inc.

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Part I - Financial Information

Item 1. Financial Statements

The Commerce Group, Inc. and Subsidiaries
Consolidated Balance Sheets
September 30, 2007 and December 31, 2006

	2007	2006
	(Unaudited)	
ASSETS		
(Thousands of dollars, except per share data)		
Investments and cash (Note 4):	\$1,906,047	\$1,993,106
Fixed maturities, at market (amortized cost: \$1,923,163 and \$1,961,080)		
Preferred stocks, at market (amortized cost: \$584,362 and \$597,366)	544,580	606,222
Common stocks, at market (cost: \$36,038 and \$97,776)	36,176	109,752
Preferred stock mutual funds, at equity (cost: \$147,473 and \$120,990)	165,190	141,654
Mortgage loans on real estate and collateral notes receivable (less allowance for possible loan losses of \$61 and \$58)	19,520	19,417
Cash and cash equivalents	114,789	141,367
Short-term investments	2,500	13,414
Other investments (cost: \$48,962 and \$43,001)	57,778	45,910
Total investments and cash	2,846,580	3,070,842
Accrued investment income	24,010	23,094
Premiums receivable (less allowance for doubtful receivables of \$2,720 and \$2,454)	497,940	480,605
Deferred policy acquisition costs	194,488	177,852
Property and equipment, net of accumulated depreciation	70,791	68,383
Residual market receivable	153,531	157,227
Due from reinsurers	58,846	53,679
Deferred income taxes (Note 11)	68,798	31,420
Current income taxes (Note 11)	13,212	7,796
Other assets	51,532	39,971
Total assets	\$3,979,728	\$4,110,869
Liabilities:		
Unpaid losses and loss adjustment expenses (Note 5)	\$1,011,865	\$ 971,949
Unearned premiums	989,932	935,385
Bonds payable (\$300,000 face less discount) (Note 6)	298,740	298,589
Deferred income	8,435	10,913
Accrued agents' profit sharing	181,827	232,440
Other liabilities and accrued expenses	135,064	151,363
Total liabilities	2,625,863	2,600,639

Minority interest	13,987	6,959
Commitments and contingencies (Note 8)	-	-
Stockholders' equity (Note 12):		
Preferred stock, authorized 5,000,000 shares at \$1.00 par value, none issued	-	-
Common stock, authorized 100,000,000 shares at \$.50 par value, 81,831,546 and 81,927,916 shares issued	40,915	40,964
Paid-in capital	142,391	135,033
Net accumulated other comprehensive income (loss), net of income taxes (benefits) of \$(19,728) and \$18,455	(36,642)	34,273
Retained earnings	1,652,490	1,539,056
Total stockholders' equity before treasury stock	1,799,154	1,749,326
Treasury stock, 21,704,968 and 15,200,437 shares, at cost	(459,276)	(246,055)
Total stockholders' equity	1,339,878	1,503,271
Total liabilities, minority interest and stockholders' equity	\$3,979,728	\$4,110,869

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

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The Commerce Group, Inc. and Subsidiaries
Consolidated Statements of Earnings and Comprehensive Income
Three and Nine Months Ended September 30, 2007 and 2006
(Unaudited)

(Thousands of dollars, except per share data)	Three Months		Nine Months	
	2007	2006	2007	2006
Revenues:				
Direct premiums written	\$466,499	\$479,156	\$1,447,729	\$1,444,956
Assumed premiums	20,666	32,645	78,621	78,377
Ceded premiums	(35,556)	37,776	(125,817)	(94,716)
Net premiums written	451,609	549,577	1,400,533	1,428,617
(Increase) decrease in unearned premiums	6,539	(89,629)	(36,949)	(125,728)
Earned premiums	458,148	459,948	1,363,584	1,302,889
Net investment income	40,310	34,417	119,762	104,065

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Premium finance and service fees	8,427	7,282	23,459	21,353
Net realized investment gains (losses) (Note 4)	(3,166)	7,830	28,945	7,665
Total revenues	503,719	509,477	1,535,750	1,435,972
Expenses:				
Losses and loss adjustment expenses (Note 5)	281,706	272,511	885,180	778,912
Policy acquisition costs	139,312	151,811	394,997	381,434
Interest expense and amortization of bond fees	4,583	4,584	13,745	13,746
Total expenses	425,601	428,906	1,293,922	1,174,092
Earnings before income taxes and minority interest	78,118	80,571	241,828	261,880
Income taxes (Note 11)	22,170	23,819	69,241	79,088
Earnings before minority interest	55,948	56,752	172,587	182,792
Minority interest in net earnings of subsidiary	(448)	(217)	(1,237)	(683)
Net earnings	\$ 55,500	\$ 56,535	\$ 171,350	\$ 182,109
Comprehensive income (Note 2)	\$ 33,860	\$104,925	\$ 100,435	\$ 207,768
Net earnings per common share (Note 3):				
Basic	\$ 0.89	\$ 0.83	\$ 2.66	\$ 2.69
Diluted	\$ 0.88	\$ 0.83	\$ 2.63	\$ 2.68
Cash dividends paid per common share	\$ 0.30	\$ 0.25	\$ 0.90	\$ 0.725
Weighted average number of common shares outstanding (Note 3):				
Basic	62,108,082	67,754,791	64,489,422	67,675,649
Diluted	62,830,662	68,182,710	65,260,028	68,036,253

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

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The Commerce Group, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2007 and 2006
(Unaudited)

(Thousands of Dollars)	2007	2006
Operating activities:		
Premiums collected	\$1,355,449	\$1,334,379
Net investment income received	116,208	103,911
Premium finance and service fees received	23,459	21,353
Losses and loss adjustment expenses paid	(871,286)	(758,588)
Policy acquisition costs paid	(452,854)	(380,379)
Federal income taxes	(70,351)	(91,253)
Interest paid	(8,925)	(8,925)
	91,700	220,498
Investing activities:		
Investment sales, repayments and maturities	1,790,547	1,487,622
Mortgage loans and collateral notes receipts	2,957	3,193
Proceeds from sale of agency assets	1,648	-
Proceeds from sale of minority interest in subsidiary	4,867	-
Net cash paid for acquisition	(50,501)	-
Investment purchases	(1,589,200)	(1,616,855)
Mortgage loans and collateral notes originated	(3,063)	(3,853)
Net activity in short-term investments	10,903	-
Property and equipment purchases	(8,077)	(11,975)
Other investing activities	692	1,846
	160,773	(140,022)
Financing activities:		
Dividends paid to stockholders	(57,916)	(49,101)
Treasury stock purchases	(223,366)	-
Capital stock issued	-	130
Capital infusion by minority interest	2,732	-
Outstanding checks payable	(501)	(920)
	(279,051)	(49,891)
(Decrease) increase in cash and cash equivalents	(26,578)	30,585
Cash and cash equivalents at beginning of period	141,367	97,942

	\$ 114,789	\$ 128,527
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The accompanying notes are an integral part of these consolidated financial statements.

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The Commerce Group, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Nine Months Ended September 30, 2007 and 2006
(Unaudited)
(continued)

	2007	2006
Reconciliation of net earnings to cash from operating activities:		
Net earnings	\$ 171,350	\$ 182,109
Adjustments to reconcile net earnings to cash from operating activities:		
Premiums receivable	(8,535)	(36,466)
Deferred policy acquisition costs	(13,058)	(11,617)
Residual market receivable	3,696	25,051
Due from reinsurers	(5,167)	93,768
Unpaid losses and loss adjustment expenses	(3,643)	(32,153)
Unearned premiums	35,542	52,829
Current income taxes	(5,496)	(28,854)
Deferred income taxes	(33,799)	30,488
Deferred income	(2,478)	2,107
Accrued agents' profit sharing	(50,636)	9,992
Other assets, liabilities and accrued expenses	(25,776)	(63,599)
Net realized investment gains	(28,945)	(7,665)
Other - net	58,645	4,508
	\$ 91,700	\$ 220,498

Supplemental information:

Purchase transaction:

Fair value of noncash assets acquired	\$ 114,171	-
Fair value of liabilities assumed	63,670	-

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

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The Commerce Group, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements

1. Organization and Interim Financial Statements

Unless otherwise stated, "we," "our," "us" or "CGI" means The Commerce Group, Inc. and its subsidiaries. Our consolidated financial statements include the accounts of The Commerce Group, Inc. and its subsidiaries. The Commerce Group, Inc. is a publicly-traded holding company and is engaged in various property-casualty insurance operations. CGI owns Commerce Holdings, Inc., which wholly owns two insurance subsidiaries: Commerce Insurance Company (Commerce) and Citation Insurance Company (Citation), as well as 95% of ACIC Holding Company, Inc. (AHI). AHI is a joint venture with AAA Southern New England, which owns the remaining 5%. AHI wholly owns two insurance subsidiaries: American Commerce Insurance Company (American Commerce or ACIC) and Commerce West Insurance Company (Commerce West or CWIC). In addition, AHI wholly owns the recently acquired holding company, SWICO Enterprises, Ltd., which owns a fifth insurer, State-Wide Insurance Company (State-Wide).

On April 2, 2007, AHI completed its acquisition of SWICO Enterprises, Ltd. The total cost of the acquisition was \$55,776. The results of operations of SWICO and State-Wide are included in the consolidated financial statements only for periods subsequent to the date of acquisition. For the 2006 year, State-Wide reported approximately \$38,000 in direct written premiums.

During the second quarter of 2007, Commerce Holdings, Inc. transferred its ownership of Commerce West to AHI, resulting in AAA Southern New England acquiring a 5% indirect ownership in CWIC. We recorded a gain of \$1,510 in this transaction.

We have prepared these financial statements in accordance with accounting principles generally accepted in the United States of America (GAAP). In preparing these financial statements in conformity with GAAP, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities at reporting dates and the reported amounts of revenues and expenses during the reporting periods. Actual results will differ from these estimates and assumptions. We employ significant estimates and assumptions in the determination of unpaid losses and loss adjustment expenses (LAE), the potential impairment of investments for other-than-temporary declines in market value and accrued agents' profit sharing. Our significant accounting policies are presented in the notes to our consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2006.

Our interim financial statements do not include all of the disclosures required by GAAP for annual financial statements. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. In our opinion, we have included all adjustments, consisting of normal, recurring adjustments, considered necessary for a fair statement of the results for the interim periods. Operating results for the three and nine month periods ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. These unaudited consolidated financial statements should be read in conjunction with our consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2006. Dollar amounts are in thousands, except per share data and as otherwise noted. We have eliminated significant intercompany accounts and transactions in consolidating these financial statements. Also, we have reclassified certain 2006 amounts to conform with 2007 presentations.

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2. Comprehensive Income

Our comprehensive income for the three and nine months ended September 30 follows:

Three Months

Nine Months

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	2007	2006	2007	2006
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net earnings	\$ 55,500	\$ 56,535	\$171,350	\$182,109
Other comprehensive income (loss), net of taxes:				
Unrealized holding gains (losses) arising during the period ^(a)	(18,007)	46,867	(47,823)	20,909
Reclassification adjustment for investment (gains) losses included in net earnings ^(b)	(3,633)	1,523	(23,092)	4,750
Other comprehensive income (loss), net of taxes	(21,640)	48,390	(70,915)	25,659
Comprehensive income	<u>\$ 33,860</u>	<u>\$104,925</u>	<u>\$100,435</u>	<u>\$207,768</u>

(a) Unrealized holding gains (losses) are net of income tax expense (benefits) of \$(9,696) and \$25,236 for the three months ended September 30, 2007 and 2006, respectively, and \$(25,751) and \$11,259 for the nine months ended September 30, 2007 and 2006, respectively.

(b) Reclassification adjustments are net of income tax expense (benefit) of \$(1,956) and \$820 for the three months ended September 30, 2007 and 2006, respectively, and \$(12,434) and \$2,540 for the nine months ended September 30, 2007 and 2006, respectively.

3. Net Earnings Per Common Share (EPS)

Basic EPS is based on the weighted average number of common shares outstanding. Diluted EPS is based on the weighted average number of common shares outstanding adjusted by the number of additional common shares that would have been outstanding had potentially dilutive common shares been issued and reduced by the number of common shares we could have purchased from the proceeds of the potentially dilutive shares. Our potentially dilutive instruments include stock options and nonvested restricted stock units. We had 5,079,278 and 4,963,434 stock options outstanding at September 30, 2007 and 2006, respectively. Our outstanding stock options at September 30, 2007 and 2006 included 103,928 and 16,084 of stock options, respectively, that were granted to our directors and officers under our Incentive Compensation Plan; the remainder of the total outstanding stock options consisted of American Commerce agents' options. Additionally, at September 30, 2007, there were 613,369 officer nonvested restricted stock units outstanding. Basic and diluted EPS for the three and nine months ended September 30 follow:

	Three Months		Nine Months	
	2007	2006	2007	2006
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net earnings for basic and diluted EPS	\$55,500	\$56,535	\$171,350	\$182,109

Common share information:

Average shares outstanding for basic EPS	62,108,082	67,754,791	64,489,422	67,675,649
Dilutive effect of equity awards	722,580	427,919	770,606	360,604
	<hr/>	<hr/>	<hr/>	<hr/>
Average shares outstanding for diluted EPS	62,830,662	68,182,710	65,260,028	68,036,253
	<hr/>	<hr/>	<hr/>	<hr/>
Basic EPS	\$ 0.89	\$ 0.83	\$ 2.66	\$ 2.69
	<hr/>	<hr/>	<hr/>	<hr/>
Diluted EPS	\$ 0.88	\$ 0.83	\$ 2.63	\$ 2.68
	<hr/>	<hr/>	<hr/>	<hr/>

The diluted EPS calculation excludes stock options and nonvested restricted stock units that are anti-dilutive using the treasury stock method. For the three and nine months ended September 30, 2007, there were 1,800,000 and 1,800,000 anti-dilutive options, while for the same periods in 2006, there were 1,250,000 and 2,200,000 anti-dilutive options, respectively. In addition, there were 119,510 officer nonvested restricted stock units excluded for the three months ended September 30, 2007, as they were anti-dilutive. None were anti-dilutive for the nine month period.

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4. Investments

Closed-end Preferred Stock Mutual Funds

Our closed-end preferred stock mutual fund holdings at December 31, 2006 and September 30, 2007 accounted for under the equity method follow:

Fund Shares Held	Percentage of Ownership	Carrying Value, at Equity	Quoted Market
------------------------	-------------------------------	---------------------------------	------------------