PICO HOLDINGS INC /NEW
Form 10-Q
August 10, 2009

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

FORM 10-Q

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

For the quarterly period ended June 30, 2009

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 or Organization)	(IRS Employer Identification No.)

875 Prospect Street, Suite 301
La Jolla, California 92037
(Address of principal executive offices, excluding zip code) (Zip code)

Registrant’s Telephone Number, Including Area Code: (858) 456-6022

Not Applicable

(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 ý 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 £ 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	ý	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 ý

On August 7, 2009, the registrant had 22,594,592 shares of common stock, $0.001 par value outstanding.

PICO HOLDINGS, INC.

FORM 10-Q
For the Three Months Ended June 30, 2009

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Part I: Financial Information
Item I: Condensed Consolidated Financial Statements

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	June 30, 2009	December 31, 2008
ASSETS		
Investments	$ 146,189,224	$ 149,417,023
Cash and cash equivalents	197,624,548	96,316,018
Notes and other receivables, net	18,146,630	24,352,367
Reinsurance receivables	15,524,905	16,373,132
Real estate and water assets, net	265,953,754	271,714,300
Property and equipment, net	1,464,883	1,512,370
Deferred income taxes	27,493,706	25,274,232
Federal, foreign and state income taxes		4,519,920
Other assets	3,548,329	3,154,434
Total assets	$ 675,945,979	$ 592,633,796
LIABILITIES AND SHAREHOLDERS' EQUITY		
Unpaid losses and loss adjustment expenses	$ 26,710,363	$ 27,773,320
Deferred compensation	27,977,619	27,744,528
Bank and other borrowings	37,307,482	42,381,718
Federal, foreign and state income taxes	5,490,230	
Other liabilities	17,144,607	16,988,040
Total liabilities	114,630,301	114,887,606
Commitments and Contingencies (Note 8)		
Common stock, $.001 par value; authorized 100,000,000 shares, 27,019,387 issued and 22,594,592 outstanding at June 30, 2009 and 23,265,187 issued and 18,840,392 outstanding at December 31, 2008	27,019	23,265
Additional paid-in capital	537,789,238	439,381,715
Retained earnings	97,172,776	118,036,716
Accumulated other comprehensive income	6,492,198	(1,423,863)
Treasury stock, at cost (common shares: 4,424,795 in 2009 and 2008)	(78,271,643)	(78,271,643)
Total PICO Holdings, Inc. shareholders’ equity	563,209,588	477,746,190
Noncontrolling interest in subsidiaries	(1,893,910)	
Total shareholders' equity	561,315,678	477,746,190
Total liabilities and shareholders' equity	$ 675,945,979	$ 592,633,796

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

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenues:				
Net investment income	$ 2,080,938	$ 3,082,923	$ 3,007,510	$ 6,110,549
Net realized gain (loss) on sale and impairment of investments	1,020,794	49,600,581	(11,080,627)	50,072,435
Sale of real estate and water assets	4,957,616	811,363	5,268,030	1,305,771
Rents, royalties and lease income	287,914	162,375	544,291	321,931
Other	652,576	266,253	935,382	589,874
Total revenues (charges)	8,999,838	53,923,495	(1,325,414)	58,400,560
Costs and Expenses:				
Operating and other costs	12,764,184	7,172,817	20,100,392	9,189,081
Impairment loss			12,378,000	
Interest expense	458,875		949,279	
Cost of real estate and water assets sold	1,419,772	172,053	1,500,305	321,898
Depreciation and amortization	337,748	308,255	672,315	604,668
Total costs and expenses	14,980,579	7,653,125	35,600,291	10,115,647
Income (loss) before income taxes	(5,980,741)	46,270,370	(36,925,705)	48,284,913
Provision (benefit) for income taxes	(2,783,126)	18,328,066	(13,917,855)	22,295,061
Net income (loss)	(3,197,615)	27,942,304	(23,007,850)	25,989,852
Net loss attributable to the noncontrolling interests	839,317	300,353	2,143,910	606,130
Net Income (loss) attributable to PICO Holdings, Inc.	$ (2,358,298)	$ 28,242,657	$ (20,863,940)	$ 26,595,982
Net income (loss) per common share – basic:	$ (0.12)	$ 1.50	$ (1.08)	$ 1.41
Weighted average shares outstanding	19,637,945	18,836,607	19,239,169	18,835,172
Net income (loss) per common share – diluted:	$ (0.12)	$ 1.49	$ (1.08)	$ 1.41
Weighted average shares outstanding	19,637,945	18,946,837	19,239,169	18,872,797

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

PICO HOLDINGS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
OPERATING ACTIVITIES:		
Net cash provided by (used in) operating activities	$4,542,290	$(28,375,943)
INVESTING ACTIVITIES:		
Purchases of investments	(4,214,079)	(20,208,159)
Proceeds from sale of investments	8,198,832	90,383,043
Proceeds from maturity of investments	1,510,000	61,192,968
Real estate and water asset capital expenditure	(301,257)	(10,972,382)
Net cash provided by investing activities	5,193,496	120,395,470
FINANCING ACTIVITIES:		
Proceeds from common stock offering, net	95,743,489	
Sale of treasury stock for deferred compensation plans		28,374
Excess tax benefits from stock based payment arrangements		479,114
Repayments of borrowings	(7,739,244)	
Proceeds from borrowings	3,111,627	6,928,629
Net cash provided by financing activities	91,115,872	7,436,117
Effect of exchange rate changes on cash	456,872	(4,315,817)
INCREASE IN CASH AND CASH EQUIVALENTS	101,308,530	95,139,827
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	96,316,018	70,791,025
CASH AND CASH EQUIVALENTS, END OF PERIOD	$197,624,548	$165,930,852
SUPPLEMENTAL CASH FLOW INFORMATION:		
Net cash paid (refunded) for Federal, foreign and state income taxes	$(20,864,667)	$638,106
Cash paid for interest (net of amounts capitalized)	$767,003	
Non-cash investing and financing activities:		
Construction in progress incurred but not paid	$11,198	$4,872,491

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

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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 ("US 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, 2009.

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, 2008 filed with the SEC.

The preparation of financial statements in accordance with US 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 consolidated financial statements relate to the assessment of other-than-temporary impairments and the application of the equity method of accounting, unpaid losses and loss adjustment expenses, reinsurance receivables, notes and other receivables, real estate and water assets, deferred income taxes, stock-based compensation and contingent liabilities. While management believes that the carrying value of such assets and liabilities are appropriate as of June 30, 2009 and December 31, 2008, it is reasonably possible that actual results could differ from the estimates upon which the carrying values were based.

Stock-Based Compensation:

At June 30, 2009 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 ("RSA"), 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 United States Federal, state and local withholding and income taxes (however, the holder of an RSU can elect to pay withholding taxes in cash).

Restricted Stock Unit Awards (RSU):

On March 3, 2009, the Company issued 300,000 RSU to certain officers of the Company. These awards entitle the recipient, who must be continuously employed by the Company until the vesting date, which is March 3, 2012, the

right to receive one share of PICO common stock with no monetary payment required. RSU do not vote and are not entitled to receive dividends. The total fair value of the awards was $5.9 million based on the Company's closing stock price on the date of grant. The compensation cost will be recognized ratably over the next three years. The Company recorded $493,000 and $658,000, of compensation expense for these awards during the three and six months ended June 30, 2009, respectively. No compensation expense for RSU was recorded during the three or six months ended June 30, 2008.

Restricted Stock Awards (RSA):

During the three months ended June 30, 2009, and as part of a duly adopted revised director annual compensation program established in 2008, the Company issued 4,200 RSA to the non-employee directors of the Company. Each director received 700 shares that vest in approximately one year. Until vested, the shares are held in escrow, however, the shares can be voted and the holder is entitled to any dividends. The total fair value of the awards was $121,000 based on the Company's closing stock price on the date of grant that will be recognized over the vesting period of the award beginning in the second quarter of 2009.

A summary of RSA and RSU awards under the Plan is as follows:

Outstanding at January 1, 2009 (all RSA)	4,200
Granted (RSU – expected to vest on March 3, 2012)	300,000
Granted (RSA – expected to vest on May10, 2012)	4,200
Total RSA and RSU Outstanding at June 30, 2009	308,400

Stock – Settled SAR

There were no SAR granted or exercised during the three or six months ended June 30, 2009 or 2008. At June 30, 2009 none of the outstanding SAR were in-the-money.

During 2007, the Company granted 659,409 SAR in five separate grants to various members of management. Compensation expense recognized for these grants was $997,000 and $2 million for the three and six months ended June 30, 2009 and 2008, respectively.

The fair value of each award was estimated on the date of grant using a Black-Scholes option pricing model that uses various assumptions and estimates to calculate a fair value as described below.

Expected volatility is based on the actual trading volatility of the Company's common stock. The Company uses historical experience to estimate expected forfeitures and estimated terms. The expected term of a SAR grant represents the period of time that the SAR is expected to be outstanding. The risk-free rate is the U.S. Treasury Bond yield that corresponds to the expected term of each SAR grant. Expected dividend yield is zero as the Company has not and does not foresee paying a dividend in the future. Forfeitures are estimated to be zero based on the strike price and expected holding period of the SAR. The Company applied the guidance of Staff Accounting Bulletin No. 110 in estimating the expected term of the SAR.

Expected volatility	29% — 31%
Expected term	7 years
Risk-free rate	4.3% — 4.7%
Expected dividend yield	0%
Expected forfeiture rate	0%

A summary of SAR activity under the Plan is as follows:

	SAR	Weighted Average Exercise Price	Weighted Average Contractual Term
Outstanding at January 1, 2009	1,995,018	$ 36.89	7 years
Granted	-		
Exercised	-		
Outstanding at June 30, 2009	1,995,018	$ 36.89	
Exercisable at June 30, 2009	1,719,190	$ 35.83	7 years

A summary of the status of the Company’s unvested SAR as of June 30, 2009 and changes during the period is as follows:

	SAR	Weighted Average Grant Date Fair Value
Unvested at January 1, 2009	275,828	$ 18.31
Granted	-	
Vested	-	
Unvested at June 30, 2009 (expected to vest over the next 15 months)	275,828	$ 18.31

At June 30, 2009 there was $1.5 million of unrecognized compensation cost related to unvested SAR granted under the Plan. That cost is expected to be recognized over the next 15 months.

Deferred Compensation:

The Company applies the provisions of Emerging Issues Task Force No. 97-14, Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested. In summary, investment returns generated are reported within the Company’s financial statements (with a corresponding increase in the trust assets) and an expense is recorded within the caption, “Operating and other costs” for increases in the market value of the assets held with a corresponding increase in the deferred compensation liability (except in the case of PICO stock, which is reported as Treasury Stock, at cost). In the event the trust assets decline in value, the Company will reverse previously expensed compensation.

At June 30, 2009 and December 31, 2008, the Company had $28 million and $27.7 million, respectively, recorded as deferred compensation payable to various members of management and certain non-employee directors of the Company. The assets of the plan are held in Rabbi Trust accounts. Such trusts hold various investments that are consistent with the Company’s investment policy. The investments are held in separate accounts, accounted for as available for sale securities, and are reported in the accompanying condensed consolidated balance sheets within the line item “Investments.” Assets of the trust will be distributed according to predetermined payout elections established by each employee.

The deferred compensation liability increased during the six months ended June 30, 2009 primarily due to increases in the fair value of the assets in the deferred compensation accounts offset by distributions of $2.1 million to various participants. Included in operating and other costs in the accompanying condensed consolidated statement s of operations for the three and six months ended June 30, 2009, the Company reported deferred compensation expense of $5.5 million and $2.3 million, respectively. For the three and six months ended June 30, 2008 the Company reported an expense of $537,000 and a recovery of $839,000, respectively.

Notes and Other Receivables:

Notes and other receivables include installment notes from the sale of real estate and water assets. These notes generally have terms ranging from three to ten years, with interest rates from 8% to 10%. The Company records a provision for doubtful accounts to allow for any specific accounts which may be unrecoverable and is based upon an analysis of the Company's prior collection experience, customer creditworthiness, and current economic trends. The

note terms are typically non-recourse which allows the Company to recover the underlying property if and when a buyer defaults. No significant provision for bad debts was required on any installment notes from the sale of real estate and water assets during the three or six months ended June 30, 2009 and 2008. At June 30, 2009 and December 31, 2008, notes and other receivables also include $4.4 million and $10.2 million respectively, of receivable from a third party for potential tax liabilities.

Operating and Other Costs:

For the three and six months ended June 30, 2009, the Company reported a foreign currency gain of $1.3 million and a loss of $1.7 million, respectively. For the three and six months ended June 30, 2008, the Company reported a foreign currency loss of $647,000 and a gain of $3.1 million, respectively. In each period, the net foreign currency gain or loss results from a Swiss Franc denominated loan from PICO Holdings to one of its subsidiaries. Included in the six months ended June 30, 2009 only, the Company also reported a $1.1 million foreign currency loss on certain third party foreign receivables. This receivable was collected on March 31, 2009.

Accounting for Income Taxes:

The Company’s provision for income tax expense includes U.S. federal, state, local and foreign income taxes currently payable and those deferred because of temporary differences between the income tax and financial reporting bases of the assets and liabilities. The liability method of accounting for income taxes also requires the Company to reflect the effect of a tax rate change on accumulated deferred income taxes in income in the period in which the change is enacted. The provision for income taxes is based on the actual effective rate for each reporting period as the Company is currently unable to reasonably estimate the annual effective tax rate considering the transactional nature of the results of operations.

In assessing the realization of deferred income taxes, management considers whether it is more likely than not that any deferred income tax assets will be realized. The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income during the period in which temporary differences become deductible. If it is more likely than not that some or all of the deferred income tax assets will not be realized , a valuation allowance is recorded.

The Company recognizes any interest and penalties related to uncertain tax positions in income tax expense. For the six months ended June 30, 2009, the Company recorded approximately $91,000 in interest and reduced accrued interest and penalties by $2.4 million related to uncertain tax positions. For the six months ended June 30, 2008, the Company recorded approximately $1.7 million in interest and penalties related to uncertain tax positions. The tax years 2003-2008 remain open to examination by the taxing jurisdictions to which the Company’s significant operations are subject. As of June 30, 2009, the Company believes that it is reasonably possible that the tax liability for a subsidiary in receivership may be decreased within the next twelve months as a result of a statute closing. The range of results is from zero to $4.4 million. The Company has accrued a receivable from a third party, which would offset any potential tax liabilities.

The effective income tax rate for the three and six months ended June 30, 2009 is 47% and 38%, respectively and 40% and 46% for the three and six months ended June 30, 2008, respectively. The effective rate differs from the statutory rate primarily due to the recognition or reversal of interest expense and penalties on uncertain tax positions, operating losses without any associated tax benefit from subsidiaries that are excluded from the consolidated federal income tax return, certain non-deductible compensation expense, and state income tax charges.

Recently Issued Accounting Pronouncements

SFAS 168 - In June 2009, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) SFAS No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles”. SFAS 168 establishes the FASB Accounting Standards Codification (the “Codification”) as the single source of authoritative nongovernmental U.S. GAAP. The Codification is effective for interim and annual periods ending after September 15, 2009. The adoption of SFAS 168 is not expected to have a material impact on the Company’s consolidated financial statements.

SFAS 166 - In June 2009, the FASB issued SFAS No. 166, “Accounting for Transfers of Financial Assets.” SFAS 166 is a revision to SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities”, and will require more information about transfers of financial assets and where companies have continuing exposure to the risk related to transferred financial assets. It eliminates the concept of a qualifying special purpose entity, changes the requirements for derecognizing financial assets, and requires additional disclosure. This standard is effective for interim and annual periods ending after November 15, 2009. The adoption of SFAS 166 is not expected to have a material impact on the Company’s consolidated financial statements.

SFAS 167 - In June 2009, the FASB issued SFAS No. 167, “Amendments to FASB Interpretation No. 46(R)”. SFAS 167 amends FASB Interpretation Number (“FIN”) 46(R) as follows: a) to require an enterprise to perform an analysis to determine whether the enterprise’s variable interest or interests give it a controlling financial interest in a variable interest entity, identifying the primary beneficiary of a variable interest entity, b) to require ongoing reassessment of whether an enterprise is the primary beneficiary of a variable interest entity, rather than only when specific events occur, c) to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, d) to amend certain guidance for determining whether an entity is a variable interest entity, e) to add an additional reconsideration event when changes in facts and circumstances pertinent to a variable interest entity occur, f) to eliminate the exception for troubled debt restructuring regarding variable interest entity reconsideration, and g) to require advanced disclosures that will provide users of financial statements with more transparent information about an enterprise’s involvement in a variable interest entity. SFAS 167 is effective for the first annual reporting period that begins after November 15, 2009. Earlier adoption is prohibited. The adoption of SFAS 167 is not expected to have a material impact on the Company’s consolidated financial statements.

Recently Adopted Accounting Pronouncements

FASB Staff Position FAS 142-3 - In April 2008, the FASB issued FSP FAS 142-3, “Determination of the Useful Life of Intangible Assets.” FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, “Goodwill and Other Intangible Assets” for intangible assets acquired after adoption. Under FSP FAS 142-3 an entity should consider its own historical experience in renewing similar arrangements, or market participant assumptions in the absence of historical experience. FSP FAS 142-3 also requires disclosures to enable users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity’s intent and/or ability to renew or extend the arrangement. FSP FAS 142-3 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008. The adoption of FSP 142-3did not have a material effect on the Company’s consolidated financial statements.

SFAS 160 - In December 2007, the FASB issued SFAS No. 160 (“SFAS 160”), “Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51.” SFAS 160 clarifies the accounting for noncontrolling interests and establishes accounting and reporting standards for the noncontrolling interest in a subsidiary, including classification as a component of equity. The Company adopted SFAS 160 on January 1,

2009. There were no noncontrolling interests in the Company's consolidated balance sheet at December 31, 2008 to be reclassified to the shareholders' equity section as of January 1, 2009. However, for the three and six months ended June 30, 2009, the Company recorded the noncontrolling interest in losses of its less than wholly owned subsidiaries of $839,000 and $2.1 million, respectively. These noncontrolling interests were previously reduced to zero and consequently under ARB No.51 such additional losses were not recorded. The Company adjusted the noncontrolling interest of $300,000 and $606,000 for the three and six months ended June 30, 2008, respectively for the retrospective adoption of SFAS 160.

SFAS 161 - In March 2008, the FASB issued SFAS No. 161 ("SFAS 161"), "Disclosures about Derivative Instruments and Hedging Activities – An Amendment of SFAS No 133." SFAS 161 seeks to improve financial reporting for derivative instruments and hedging activities by requiring enhanced disclosures regarding the impact on financial position, financial performance, and cash flows. To achieve this increased transparency, SFAS 161 requires (1) the disclosure of the fair value of derivative instruments and gains and losses in a tabular format; (2) the disclosure of derivative features that are credit risk-related; and (3) cross-referencing within the footnotes. The adoption of SFAS 161 did not have a material effect on the Company's consolidated financial statements.

SFAS 165 - In May 2009, the FASB issued SFAS No. 165 ("SFAS 165"), "Subsequent Events." SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. This disclosure should alert all users of financials statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS 165 is effective for financial periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material effect on the Company's consolidated financial statements. The Company has evaluated subsequent events through August 7, 2009, the date of issuance of the consolidated financial position and results of operations.

FASB Staff Position ("FSP") EITF 03-6-1 - In June 2008, relative to Emerging Issues Task Force Issue No. ("EITF") 03-6-1, the FASB issued FSP EITF 03-6-1 "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." FSP EITF 03-6-1 concluded that unvested share-based payment awards that contain a nonforfeitable right to receive dividends, whether paid or unpaid, are participating securities and should be included in the computation of earnings per share pursuant to the two-class method prescribed under SFAS No. 128, "Earnings per Share". This standard is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years, with early adoption prohibited. The adoption of FSP EITF 03-6-1 did not have a material effect on the Company's consolidated financial statements.

FSP FAS 157-4 - In April 2009, the FASB issued FSP 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly". Based on the guidance, if an entity determines that the level of activity for an asset or liability has significantly decreased and that a transaction is not orderly, further analysis of transactions or quoted prices is needed, and a significant adjustment to the transaction or quoted prices may be necessary to estimate fair value in accordance with SFAS No. 157 "Fair Value Measurements". This FSP is to be applied prospectively and is effective for interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The adoption of FSP 157-4 did not have a material effect on the Company's consolidated financial statements.

FSP FAS 115-2 and 124-2 - In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2 "Recognition and Presentation of Other-Than-Temporary Impairments". The guidance applies to investments in debt securities for which other-than-temporary impairments may be recorded. If an entity's management asserts that it does not have the intent to sell a debt security and it is more likely than not that it will not have to sell the security before recovery of its cost basis, then an entity may separate other-than-temporary impairments into two components: 1) the amount related to

credit losses (recorded in earnings), and 2) all other amounts (recorded in other comprehensive income). This FSP is to be applied prospectively and is effective for interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The adoption of FSP FAS 115-2 and 124-2 did not have a material effect on the Company's consolidated financial statements.

FSP FAS 107-1 and APB 28-1 - In April 2009, the FASB issued FSP FAS 107-1 and Accounting Principles Board (APB) 28-1 "Interim Disclosures about Fair Value of Financial Instruments". The FSP amends SFAS No. 107 "Disclosures about Fair Value of Financial Instruments" to require an entity to provide disclosures about fair value of financial instruments in interim financial information. This FSP is to be applied prospectively and is effective for interim and annual periods ending after June 15, 2009 with early adoption permitted for periods ending after March 15, 2009. The adoption of FSP FAS 107-1 resulted in additional disclosures included in this quarterly report on Form 10-Q.

2. Net Loss Per Share

Basic earnings or loss per share is computed by dividing net earnings by the weighted average number of shares outstanding during the period. Diluted earnings or loss per share is computed similarly to basic earnings or loss per share except the weighted average shares outstanding are increased to include additional shares from the assumed exercise of any common stock equivalents using the treasury method, if dilutive. The Company's free-standing SAR and RSU are considered common stock equivalents for this purpose. The number of additional shares related to these common stock equivalents is calculated using the treasury stock method.

For the three and six months ended June 30, 2009 the Company's stock-settled SAR and RSU were excluded from the diluted per share calculation because their effect on the loss per share was anti-dilutive. For the three and six months ended June 30, 2008 the Company's stock-settled SAR were included in the diluted per share calculation using the treasury stock method.

3. Comprehensive Loss

Comprehensive income or loss, net of income tax is comprised of the following:

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Net income (loss)	$(3,197,615)	$27,942,304	$(23,007,850)	$25,989,852
Other comprehensive income (loss), net of tax:				
Net change in unrealized appreciation (depreciation) on available for sale securities	9,928,070	(34,675,913)	6,523,083	(37,308,019)
Net change in foreign currency translation	925,282	(1,440,394)	1,392,978	771,199
Total other comprehensive income (loss), net of tax	10,853,352	(36,116,307)	7,916,061	(36,536,820)
Comprehensive income (loss)	7,655,737	(8,174,003)	(15,091,789)	(10,546,968)
Comprehensive loss attributable to the noncontrolling interest	839,317	300,353	2,143,910	606,130
Comprehensive income (loss) attributable to PICO Holdings, Inc.	$8,495,054	$(7,873,650)	$(12,947,879)	$(9,940,838)

Total comprehensive income for the three months ended and loss for the six months ended June 30, 2009 is net of a deferred income tax charge of $7.6 million and a benefit of $2.2 million, respectively. Total comprehensive loss for the three and six months ended June 30, 2008 is net of deferred income tax benefit of $17.9 million and $23.7 million, respectively.

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

	June 30, 2009	December 31, 2008
Net unrealized appreciation on available for sale investments	$ 18,090,059	$ 11,566,976
Foreign currency translation	(11,597,861)	(12,990,839)

Accumulated other comprehensive income (loss)	$ 6,492,198	$ (1,423,863)

The accumulated balance is net of deferred income tax liabilities of $4.1 million at June 30, 2009 and a deferred income tax asset of $1.7 million at December 31, 2008.

The following table reports the cost and carrying value of investments at June 30, 2009 and December 31, 2008:

June 30, 2009:	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
Fixed maturities:				
U.S. Treasury securities	$ 1,108,132	$ 83,353		$ 1,191,485
Municipal bonds	3,188,301		$ (77,921)	3,110,380
Corporate bonds	19,047,295	1,776,059	(3,232,687)	17,590,667
Government sponsored enterprises	6,415,765	369,433		6,785,198
	29,759,493	2,228,845	(3,310,608)	28,677,730
Marketable equity securities	93,319,539	29,429,404	(5,237,449)	117,511,494
Total	$ 123,079,032	$ 31,658,249	$ (8,548,057)	$ 146,189,224

December 31, 2008:	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
Fixed maturities:				
U.S. Treasury securities	$ 1,110,327	$ 111,407		$ 1,221,734
Municipal Bonds	2,137,003		$ (8,523)	2,128,480
Corporate bonds	25,627,851	34,460	(7,822,451)	17,839,860
Government sponsored enterprises	7,442,611	425,877		7,868,488
	36,317,792	571,744	(7,830,974)	29,058,562
Marketable equity securities	102,322,281	27,348,470	(9,312,290)	120,358,461
Total	$ 138,640,073	$ 27,920,214	$ (17,143,264)	$ 149,417,023

The following table summarizes the market value of those investments in an unrealized loss position for periods less than or greater than 12 months:

	2009		2008	
		Gross		Gross
		Unrealized		Unrealized
Less than 12 months	Fair Value	Loss	Fair Value	Loss
Fixed maturities:				
Municipal bonds	$ 2,067,000	$ 59,231	$ 2,128,480	$ 8,523
Corporate bonds			5,290,363	1,586,298
	2,067,000	59,231	7,418,843	1,594,821
Marketable equity securities	26,739,269	4,146,887	40,880,566	9,290,041
Total	$ 28,806,269	$ 4,206,118	$ 48,299,409	$ 10,884,862

	2009		2008	
		Gross		Gross
		Unrealized		Unrealized
Greater than 12 months	Fair Value	Loss	Fair Value	Loss
Fixed maturities:				
Municipal bonds	$ 1,043,380	$ 18,690		
Corporate bonds	10,771,266	3,232,687	$ 10,044,022	$ 6,236,152
	11,814,646	3,251,377	10,044,022	6,236,152
Marketable equity securities	7,593,197	1,090,562	160,430	22,250
Total	$ 19,407,843	$ 4,341,939	$ 10,204,452	$ 6,258,402

Marketable equity securities: The Company's investments in marketable equity securities totaled $117.5 million at June 30, 2009, and principally consist of common stock of publicly traded small-capitalization companies in the U.S. and selected foreign markets. Equities are researched, and selected for purchase, on a case by case basis depending on the fundamental characteristics of the individual security. The gross unrealized gains and losses on equity securities, after recognition of other-than-temporary impairment losses, were $29.4 million and $5.2 million respectively, at June 30, 2009 and $27.3 million and $9.3 million respectively, at December 31, 2008. The Company reviewed its equity securities in an unrealized loss position, and concluded that these investments were not other-than-temporarily impaired as the declines were not of sufficient duration and severity, and publicly-available financial information did not indicate impairment. The primary cause of the losses is due to the recent overall market decline. During the three and six months ended June 30, 2009, the Company recorded $1.1 million and $7.9 million respectively, of other-than-temporary impairment charges on marketable equity securities. During the three and six months ended June 30, 2008, the Company recorded $754,000 and $1.9 million respectively, of other-than-temporary impairment charges on marketable equity securities.

Corporate Bonds and US Treasury Obligations: At June 30, 2009, the Company's bond portfolio consisted of $17.6 million of publicly traded corporate bonds, $1.2 million U.S. Treasury obligations, $3.1 million of State of California general obligation municipal bonds and $6.8 million of government sponsored enterprise bonds. The U.S. Treasury, municipal and government sponsored enterprise bonds are typically held to meet state regulatory capital and deposit requirements. The remainder of the bond portfolio consists of corporate bonds, which are researched, and selected for purchase, on a case by case basis depending on the maturity and yield-to-maturity of the bond available for purchase,

and an analysis of the fundamental characteristics of the issuer. The total bond portfolio had gross unrealized gains and losses of $2.2 million and $3.3 million, respectively at June 30, 2009 and gross unrealized gains and losses of $572,000 and $7.8 million respectively, at December 31, 2008. The Company does not consider the unrealized losses on the bond portfolio to be other-than-temporarily impaired because the Company intends to hold, and will not be required to sell, these particular securities, and the Company expects to recover the entire amortized cost basis The Company believes that the unrealized losses are primarily attributable to the reduced availability of credit throughout the economy which is affecting the market prices of all bonds other than those issued by the U.S. Treasury as well as deterioration of the underlying issuer with certain of our bonds. During the three and six months ended June 30, 2009, the Company recorded impairment charges of zero and $5.1 million, respectively on corporate bonds due to deterioration of the underlying issuer's financial condition. During the three and six months ended June 30, 2008, the Company recorded impairment charges of $60,000 and $400,000, respectively on corporate bonds due to deterioration of the underlying issuer's financial condition.

Approximately $1.4 million of the Company's investment portfolio does not have a readily available market value.

The following table sets forth the Company’s financial assets and liabilities that were measured at fair value on a recurring basis at June 30, 2009 by level within the fair value hierarchy. As required by SFAS No. 157, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability:

Assets	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at June 30, 2009
Available for sale securities (A)	$ 141,709,331		$ 3,117,565	$ 144,826,896
Liabilities				
Deferred compensation (B)	$ 27,977,619			$ 27,977,619

(A) Where there are quoted market prices that are readily available in an active market, securities are classified as Level 1 of the valuation hierarchy. Level 1 marketable equity securities are valued using quoted market prices multiplied by the number of shares owned and debt securities are valued using a market quote in an active market. Level 2 available for sale securities include securities where the markets are not active, that is where there are few transactions, or the prices are not current or the prices vary considerably over time. Level 3 available for sale securities include securities where valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

(B) Deferred compensation plans are compensation plans directed by the Company and structured as a Rabbi Trust for certain executives and non-employee directors. The investment assets of the Rabbi Trust are valued using quoted market prices multiplied by the number of shares held in each trust account including the shares of PICO Holdings common stock held in the trusts. The related deferred compensation liability represents the fair value of the investment assets.

The following table is a reconciliation of the beginning and ending balance of Level 3 assets held by the Company at June 30, 2009. During the six months ended June 30, 2009, one bond was transferred from level 1 to level 3 as the deterioration of the underlying issuer caused the Company to value the securities based on unobservable inputs.

Asset Description	Fair Value at Beginning of Period	Unrealized Gains Included in Income	Accumulated Other Comprehensive Income	Purchases, Sales, and Issuances	Transfers In	Fair Value at End of Period
Available for sale securities	$ 2,998,055				$ 119,510	$ 3,117,565

The following table sets forth the Company's non-financial assets that were measured at fair value on a non-recurring basis at June 30, 2009 by level within the fair value hierarchy. As required by SFAS No. 157, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset:

Asset Description	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
Intangible asset (applications for water rights)		$ 3,953,033		$ 12,378,000

In accordance with the provisions of SFAS 142, as of March 31, 2009, the Company had a non-recurring fair value measurement for an intangible asset with a carrying amount of $16.4 million that was written down to its implied fair value of $4 million, resulting in an impairment charge of $12.4 million, which was included in earnings for the six months ended June 30, 2009. The implied fair value is estimated as the revenues the Company will receive on the sale of the intangible asset.

4. Disclosures About Fair Value of Financial Instruments:

The Company adopted FSP FAS 107-1 and APB Opinion 28-1 on April 1, 2009. The guidance requires disclosures about fair value of financial instruments in interim as well as annual financial statements.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that fair value:

- Cash and Cash Equivalents: Carrying amounts for these items approximate fair value because of the short maturity of these instruments.

- Investments in fixed maturities and equity securities: Fair values are estimated based on quoted market prices, or dealer quotes for the actual or comparable securities. Fair value for equity securities that do not have a readily determinable fair value is estimated based on the value of the underlying common stock. The Company regularly evaluates the carrying value of securities to determine whether there has been any diminution in value that is other-than-temporary.

- Borrowings: Carrying amounts for these items approximates fair value because current interest rates and, therefore, discounted future cash flows for the terms and amounts of loans are not significantly different from the original terms.

The table below presents the carrying values and estimated fair values for certain of the Company’s financial instruments at June 30, 2009.

	June 30, 2009	
	Carrying Amount	Estimated Fair Value
Financial assets:		
Cash and cash equivalents	$ 197,624,548	$ 197,624,548
Fixed maturities	$ 28,677,730	$ 28,677,730
Equity securities	$ 117,511,494	$ 117,511,494
Notes receivable	$ 11,161,207	$ 11,161,207
Financial liabilities:		
Borrowings	$ 37,307,482	$ 37,307,482

5. Segment Reporting

PICO is a diversified holding company engaged in four operating and reportable segments: Water Resource and Water Storage Operations, Real Estate Operations, Insurance Operations in Run Off and Corporate.

The accounting policies of the reportable segments are the same as those described in the Company’s 2008 Annual Report on Form 10-K filed with the SEC. Management analyzes segments using the following information:

Segment assets:

	June 30, 2009	December 31, 2008

Total Assets:		
Water Resource and Water Storage Operations	$ 212,340,451	$ 225,870,410
Real Estate Operations	98,642,361	97,592,062
Corporate	211,140,892	111,984,967
Insurance Operations in Run Off	153,822,275	157,186,357
	$ 675,945,979	$ 592,633,796

Segment revenues and expenses:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues (Charges):				
Water Resource and Water Storage Operations	$ 3,377,269	$ 377,896	$ 3,584,937	$ 1,197,181
Real Estate Operations	2,315,259	1,571,758	2,976,921	3,166,178
Corporate	1,665,860	47,139,402	(3,296,099)	47,529,630
Insurance Operations in Run Off	1,641,450	4,834,439	(4,591,173)	6,507,571
Total revenues (charges)	$ 8,999,838	$ 53,923,495	$ (1,325,414)	$ 58,400,560
Income (Loss) Before Taxes and Noncontrolling Interests:				
Water Resource and Water Storage Operations	$ 1,121,244	$ (1,227,923)	$ (12,796,041)	$ (2,187,961)
Real Estate Operations	(1,141,764)	440,656	(2,070,956)	862,780
Corporate	(7,024,366)	42,559,084	(16,230,175)	43,902,284
Insurance Operations in Run Off	1,064,145	4,498,553	(5,828,533)	5,707,810
Income (loss) before income taxes and noncontrolling interest	$ (5,980,741)	$ 46,270,370	$ (36,925,705)	$ 48,284,913

6. Impairment of Real Estate and Water Assets

In 1998, Lincoln County, Nevada and Vidler (“Lincoln/Vidler”) jointly filed for 14,000 acre-feet of water rights for industrial use from the Tule Desert Groundwater Basin in Lincoln County, Nevada. In November 2002, the Nevada State Engineer granted and permitted an application for 2,100 acre-feet of water rights – which Lincoln/Vidler subsequently sold in 2005 - and ruled that an additional 7,240 acre-feet could be granted pending additional studies by Lincoln/Vidler.

From 2005 through 2008, Vidler conducted the additional studies and incurred and capitalized approximately $16.4 million to date, collecting data and drilling a series of production and monitoring wells to obtain the requisite evidence to support the applications. Once completed, Vidler submitted the data to the State Engineer for final ruling.

On April 29, 2009, the Nevada State Engineer issued its ruling and granted Vidler only 400 acre feet of additional water rights. While the Company has appealed the decision, given the current market value of these water rights, the Company determined it would recover approximately $4 million of the total capitalized cost incurred to date. Consequently, an impairment loss of approximately $12.4 million was recorded during the six months ended June 30, 2009.

7. Stock Offering

The Company completed public offerings of its common stock of 3,055,556 shares on June 10, 2009, and 694,444 shares on June 15, 2009, at a price of $27 per share. The aggregate net proceeds from the offerings were approximately $95.7 million, after deducting $5.5 million in underwriting commission and offering expenses. The offerings were made pursuant to the Company's shelf registration on Form S-3 that was declared effective on December 3, 2007.

8. Commitments and Contingencies

Neither PICO nor its subsidiaries are parties to any potentially material pending legal proceedings other than the following.

Exegy Litigation:

HyperFeed Technologies, Inc. ("HyperFeed"), PICO's majority-owned subsidiary, was a provider of enterprise-wide ticker plant and transaction technology software and services enabling financial institutions to process and use high performance exchange data with Smart Order Routing and other applications. During 2006, PICO and HyperFeed negotiated a business combination with Exegy Incorporated ("Exegy"). On August 25, 2006, PICO, HyperFeed, and Exegy entered into a contribution agreement, pursuant to which the common stock of HyperFeed owned by PICO would have been contributed to Exegy in exchange for Exegy's issuance of certain Exegy stock to PICO. However, in a letter dated November 7, 2006, Exegy informed PICO and HyperFeed that it was terminating the agreement. In connection with the termination of the contribution agreement, the parties have filed certain lawsuits.

The lawsuit filed by Exegy against PICO and HyperFeed seeking monetary damages and declaratory judgment that Exegy's purported November 7, 2006 termination of the August 25, 2006 contribution agreement was valid and the lawsuit filed by PICO and HyperFeed against Exegy are still pending in the United States Bankruptcy Court, District of Delaware. On February 22, 2008 PICO and HyperFeed filed amended counterclaims against Exegy in connection with the failed merger, alleging that Exegy's termination of the contribution agreement was wrongful and in bad faith. The Company does not expect the settlement to have a material impact on the condensed consolidated financial statements.

During the second quarter of 2009, the parties reached an agreement that would resolve both lawsuits. The agreement is part of a global resolution of the HyperFeed bankruptcy estate, and is subject to approval by the Bankruptcy Court before it becomes effective. The parties have filed the necessary motions, and are awaiting a determination from the Bankruptcy Court.

Fish Springs Ranch, LLC:

In 2006, the Company started construction of a pipeline from Fish Springs in northern Nevada to the north valleys of Reno, Nevada.

The final regulatory approval required for the pipeline project was a Record of Decision ("ROD") for a right of way, which was granted on May 31, 2006. Subsequently, there were two protests against the ROD, and the matter was appealed and subsequently dismissed. However, in October 2006, one protestant, the Pyramid Lake Paiute Tribe (the "Tribe"), filed an action with the U.S. District Court against the Bureau of Land Management and US Department of the Interior. The Tribe asserted that the exportation of 8,000 acre feet of water per year from Fish Springs would negatively impact their water rights located in a basin within the boundaries of the Tribe reservation. The Company

was able to reach a $7.3 million financial settlement with the Tribe that ended the dispute in September 2007. The settlement agreement is pending ratification by the United States Congress, which PICO anticipates will occur in 2009.

Tule Desert Action to Reverse Ruling:

On May 27, 2009, Lincoln County, Nevada and Vidler Water Company, Inc. (“Lincoln/Vidler”) filed a joint complaint against the Nevada State Engineer in the Seventh Judicial District Court of the State of Nevada. On July 21, 2009, Lincoln/Vidler filed an additional U.S. federal complaint against both the Nevada State Engineer and the Acting Nevada State Engineer in the United States District Court for the District of Nevada. As previously disclosed, in November 2002, the Nevada State Engineer awarded Lincoln/Vidler a joint permit for 2,100 acre-feet of municipal and industrial use water rights from the Tule Desert Groundwater Basin in Lincoln County, Nevada and ruled that an additional 7,240 acre-feet could be granted pending additional studies by Lincoln/Vidler. Lincoln/Vidler conducted those additional engineering and scientific studies. The results of those studies supported the 2002 ruling and were consistent with the potential drawdown of 7,240 acre-feet of water and prospective injunction and declaratory relief against the Nevada State Engineer on the basis of the Nevada State Engineers failure to provide Lincoln/Vidler with substantive and procedural due process of law.

As required by the 2002 ruling, in 2008, Lincoln/Vidler submitted these studies to the Nevada State Engineer. In April 2009, the Nevada State Engineer ruled that it would permit the appropriation of a total of 2,500 acre-feet, including the 2,100 acre-feet previously awarded in November 2002. Accordingly, the 2009 ruling granted Lincoln/Vidler approximately 400 acre-feet of additional permitted water rights instead of the 7,240 acre-feet of water rights that could have been granted pursuant to the 2002 ruling. Lincoln/Vidler is seeking the reversal of the Nevada State Engineer’s 2009 ruling and the grant of a permit for an additional 7,240 acre-feet of water rights.

The Company is subject to various other litigation matters that arise in the ordinary course of its business. Members of PICO’s insurance group are frequently a party in claims proceedings and actions regarding insurance coverage, all of which PICO considers routine and incidental to its business. Based upon information presently available, management is of the opinion that resolution of such litigation will not likely have a material adverse effect on the consolidated financial position, results of operations or cash flows of the Company.

9. Subsequent Event

On August 7, 2009, Union Community Partners (“UCP”), a wholly-owned subsidiary of the Company, closed on a Loan Purchase and Sale Agreement dated July 1, 2009. The note acquired by UCP under this Loan Purchase and Sale Agreement is secured by, among other things, a deed of trust and security agreement over a 244 acre property with 1,400 entitled residential lots in Monterey County, California. The borrower under the note is currently in default and it is the Company’s intention to foreclose on this property under the rights acquired on the purchase of the note and, as a result, to take fee ownership of the land and entitled residential lots. Upon obtaining fee ownership of the property, the Company intends to complete the land development of certain partially finished lots into 441 finished lots. The Company estimates that the total cost of the acquisition of the note and these future development costs will be approximately $40 million which is expected to be incurred over the next 12 to 24 months.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of financial condition and results of operations should be read together with the Unaudited Condensed Consolidated Financial Statements and accompanying Notes included elsewhere in this report, and the Consolidated Financial Statements and accompanying Notes included in our Annual Report on Form 10-K.

Note About "Forward-Looking Statements"

This Quarterly Report on Form 10-Q (including the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section) contains "forward-looking statements", as defined in Section 21E of the United States Securities Exchange Act of 1934, as amended, regarding our business, financial condition, results of operations, and prospects, including, without limitation, statements about our expectations, beliefs, intentions, anticipated developments, and other information concerning future matters. Words such as "may", "will", "could", "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", "should", "target", "projects", "contemplates", "predicts", "potential", "co similar expressions or variations of such words are intended to identify forward-looking statements, but are not the exclusive means of identifying forward-looking statements in this Quarterly Report on Form 10-Q.

Although forward-looking statements in this Quarterly Report on Form 10-Q reflect the good faith judgment of our management, such statements can only be based on current expectations and assumptions. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and the actual results and outcomes could differ from what is expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences in results and outcomes include, without limitation, those discussed under the headings "Item 1A. Risk Factors" in our 2008 Annual Report on Form 10-K and "Part II, Item 1A. Risk Factors" in this Quarterly Report on Form 10-Q, and in other filings made from time to time with the United States Securities and Exchange Commission ("SEC") after the date of this report. Readers are urged not to place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. We undertake no obligation to (and we expressly disclaim any obligation to) revise or update any forward-looking statement, whether as a result of new information, subsequent events, or otherwise (except as may be required by law), in order to reflect any event or circumstance which may arise after the date of this Quarterly Report on Form 10-Q. Readers are urged to carefully review and consider the various disclosures made in this Quarterly Report on Form 10-Q.

INTRODUCTION

PICO Holdings, Inc. is a diversified holding company. In this Quarterly Report, PICO and its subsidiaries are collectively referred to as "PICO", "the Company", or by words such as "we" and "our". We seek to build and operate businesses where significant value can be created from the development of unique assets, and to acquire businesses which we identify as undervalued and where our management participation in operations can aid in the recognition of the business's fair value, as well as create additional value.

Our objective is to maximize long-term shareholder value. Our goal is to manage our operations to achieve a superior return on net assets over the long term, as opposed to short-term earnings.

Our business is separated into four major operating segments:

- Water Resource and Water Storage Operations;
- Real Estate Operations;
- Insurance Operations in "Run Off"; and

- Corporate.

As of June 30, 2009, our major consolidated subsidiaries are:

- Vidler Water Company, Inc. (“Vidler”), a business that we started more than 11 years ago, which acquires and develops water resources and water storage operations in the southwestern United States, with assets in Nevada, Arizona, Idaho, Colorado, and New Mexico;
- UCP, LLC (“UCP”), a business we started in 2008, which acquires and develops partially-developed and finished residential housing lots in selected markets in California;
- Nevada Land & Resource Company, LLC (“Nevada Land”), an operation that we built since we acquired the company more than 11 years ago, which owns approximately 440,000 acres of former railroad land in Nevada, and certain mineral rights and water rights related to the property;
- Physicians Insurance Company of Ohio (“Physicians”), which is “running off” its medical professional liability insurance loss reserves; and
- Citation Insurance Company (“Citation”), which is “running off” its property & casualty insurance and workers’ compensation loss reserves.

RESULTS OF OPERATIONS--THREE AND SIX MONTHS ENDED JUNE 30, 2009 AND 2008

Shareholders' Equity

At June 30, 2009, PICO had shareholders' equity of $563.2 million ($24.93 per share), compared to $457.5 million ($24.28 per share) at March 31, 2009, and $477.7 million ($25.36 per share) at December 31, 2008.

The $105.7 million increase in shareholders' equity during the second quarter of 2009 was primarily due to the sale of 3,750,000 new shares of PICO common stock for net proceeds of $95.7 million in June 2009. Shareholders' equity was also increased by comprehensive income of $8.5 million, principally resulting from a $9.9 million net increase in unrealized appreciation in investments after-tax. Book value per share attributable to PICO shareholders increased by $0.65, or 2.7%, during the second quarter of 2009.

The $85.5 million increase in shareholders' equity during the first six months of 2009 was primarily due to the sale of 3,750,000 new shares of PICO common stock for net proceeds of $95.7 million in June 2009. Shareholders' equity was decreased by a $12.9 million comprehensive loss, principally resulting from the first half net loss of $20.8 million, which was partially offset by a $6.5 million net increase in unrealized appreciation in investments after-tax. Book value per share attributable to PICO shareholders decreased by $0.43, or 1.7%, during the first half of 2009.

Comprehensive Income (Loss)

PICO reports comprehensive income or loss as well as net income or loss from the condensed consolidated statement of operations. Comprehensive income or loss measures changes in shareholders' equity, and includes unrealized items which are not recorded in the consolidated statement of operations, for example, foreign currency translation and the net change in unrealized investment gains and losses on available-for-sale securities.

For the second quarter of 2009, PICO recorded comprehensive income of $8.5 million. This consisted of a $9.9 million net increase in unrealized appreciation in investments and a $925,000 foreign currency translation gain, which were partially offset by the second quarter's $2.4 million net loss.

For the first half of 2009, PICO recorded a comprehensive loss of $12.9 million. This consisted of the first half net loss of $20.9 million, which was partially offset by a $6.5 million net increase in unrealized appreciation in investments, and a $1.4 million foreign currency translation gain.

Segment Results of Operations

Segment revenues and income (loss) before taxes and noncontrolling interest for the second quarter and first half of 2009 and 2008 were:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenues:				
Water Resource and Water Storage Operations	$3,377,000	$378,000	$3,585,000	$1,197,000
Real Estate Operations	2,315,000	1,572,000	2,977,000	3,166,000
Insurance Operations in "Run Off"	1,642,000	4,834,000	(4,591,000)	6,508,000
Corporate	1,666,000	47,139,000	(3,296,000)	47,530,000
Total Revenues (Charges)	$9,000,000	$53,923,000	$(1,325,000)	$58,401,000

Income (Loss) before income taxes and noncontrolling interest:				
Water Resource and Water Storage Operations	$1,121,000	$(1,228,000)	$(12,796,000)	$(2,188,000)
Real Estate Operations	(1,142,000)	441,000	(2,071,000)	863,000
Insurance Operations in "Run Off"	1,064,000	4,498,000	(5,829,000)	5,708,000
Corporate	(7,024,000)	42,559,000	(16,230,000)	43,902,000
Total Income (Loss) before income taxes and noncontrolling interest	$(5,981,000)	$46,270,000		