ASSURANCEAMERICA CORP
Form 10QSB
May 14, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-QSB

(Mark one)

|X| QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2004

|_| TRANSITION REPORT UNDER SECTION 13 OR 15 (D) OF THE EXCHANGE ACT OF 1934 for the transition period from __________ to ___________

Commission File Number: 0-06334

AssuranceAmerica Corporation
(Exact name of small business issuer as specified in its charter)

Nevada	87-0291240
(State of Incorporation)	(IRS Employer ID Number)
5500 Interstate North Parkway, Suite 600	30328
(Address of principal executive offices)	(Zip Code)

(770) 952-0200
(Issuer's telephone number, including area code)

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

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

YES |X| NO |_|

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 45,211,090 shares, $.01 par value, as of April 30, 2004.

Transitional Small Business Disclosure Format (check one): Yes |_| No |X|

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PART I - FINANCIAL INFORMATION

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

ASSURANCEAMERICA CORPORATION
(UNAUDITED) CONSOLIDATED BALANCE SHEETS
MARCH 31, 2004 AND DECEMBER 31, 2003

Assets	March 31, 2004	December 31, 2003
Cash and cash equivalents	$ 4,882,277	$ 3,130,553
Short term investments	2,625,000	2,625,000
Receivable from insured	5,782,294	4,332,942
Due from related party	30,783	30,783
Prepaid expenses and other assets	92,260	157,632
Prepaid reinsurance premium	5,588,275	4,048,201
Investment Income due and accrued	23,946	20,971
Reinsurance recoverable	6,639,244	4,639,626
Property and equipment:		
Furniture,fixtures and improvements	1,878,404	1,863,053
Less accumulated depreciation	(894,655)	(827,078)
Property and equipment, net	983,749	1,035,975
Intangibles:		
Intangibles	4,419,685	4,419,685
Less accumulated amortization	(1,097,563)	(1,097,563)
Intangibles, net	3,322,122	3,322,122
Deferred acquisition costs	134,626	124,505
Security deposits	72,315	70,016

Total assets	$ 30,176,891	$ 23,538,326
Liabilities and equity		
Accounts payable and accrued expenses	$ 3,031,056	$ 2,533,981
Unearned premium	8,138,577	5,861,592
Unpaid losses and loss adjustment expenses	6,163,404	4,499,152
Reinsurance payable	5,858,377	3,879,340
Provisional commission reserve	1,002,779	1,007,333
Current portion of long term debt	1,138,720	1,138,720
Capital lease obligations	91,600	91,600
Long term debt, related party	5,904,658	5,904,658
Total liabilities	31,329,171	24,916,376
Stockholder's equity		
Common stock, .01 par value	452,111	452,111
(authorized 60,000,000, outstanding 45,211,090)		
Surplus-paid in	14,456,255	14,456,255
Accumulated deficit	(16,060,646)	(16,286,416)
Total stockholder's equity	(1,152,280)	(1,378,050)
Total liabilities and stockholder's equity	$ 30,176,891	$ 23,538,326

See accompanying notes to consolidated financial statements

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ASSURANCEAMERICA CORPORATION
(UNAUDITED) CONSOLIDATED STATEMENTS OF INCOME

For the three months ended March 31,	2004	2003
Revenue:		
Gross premiums written	$ 8,503,724	--
Gross premiums ceded	(5,838,417)	--
Net premiums written	2,665,307	--
Decrease (increase) in unearned premiums, net of prepaid reinsurance premiums	(736,912)	--
Net premiums earned	1,928,395	--
Commission income	2,990,630	3,343,607
Managing general agent fees	823,409	727,506
Other fee income	300,759	245,561
Investment income	2,974	4,109

Total revenue	6,045,807	4,320,783
Operating expenses:		
Selling expenses	2,598,977	2,828,697
General and admin expenses	1,516,140	1,287,019
Losses and loss adjustment expenses	1,495,644	--
Depreciation and amortization expense	67,577	55,924
Total operating expenses	5,678,338	4,171,640
Income (loss) from operations	367,469	149,143
Other income (expense)		
Interest expense	(141,699)	(130,002)
Total other income(expense)	(141,699)	(130,002)
Income (loss) before provision for income	--	--
tax expense	$ 225,770	$ 19,141
Provision for income tax	--	--
Income after tax	$ 225,770	$ 19,141
Per share data:		
Basic	0.005	0.001
Diluted	0.005	0.001
Weighted average shares outstanding-basic	45,211,090	45,211,090
Weighted average shares outstanding-diluted	46,182,909	46,182,909

See accompanying notes to consolidated financial statements

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AssuranceAmerica Corporation
Consolidated Statements of Cash Flows

For the three months ended March 31,	2004	2003
Operating activities		
Net income	$ 225,770	$ 19,141
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation and amortization	67,577	55,942
Deferred acquisition costs	(10,121)	--
Other assets	63,073	61,544
Reinsurance recoverable	(1,999,618)	--
Prepaid reinsurance premiums	(1,540,074)	--
Unearned premiums	2,276,985	--
Unpaid loss and loss adjustment expense	1,664,252	--

Other liabilities	492,521	120,193
Receivable from insureds	(1,449,352)	--
Reinsurance payable	1,979,037	--
Net cash provided by operating activities	1,770,050	256,820
Investing activities		
Investment income due and accrued	(2,975)	(4,110)
Purchase of fixed assets	(15,351)	(146,393)
Purchase of short term investments	--	(2,600,000)
Net cash used by investing activities	(18,326)	(2,750,503)
Financing activities		
Note Payable	--	3,048,784
Net cash provided by financing activities	--	3,048,784
Net change in cash	1,751,724	555,101
Cash beginning of period	3,130,553	477,197
Cash end of period	$ 4,882,277	$ 1,032,298

See accompanying notes to consolidated financial statements

ASSURANCEAMERICA CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A - THE COMPANY AND BASIS OF PRESENTATION

AssuranceAmerica Insurance Company ("Carrier"), AssuranceAmerica Managing General Agency, LLC ("MGA") AssetAmerica Insurance Agencies ("Agencies"), each wholly-owned subsidiaries of AssuranceAmerica Corporation, a Nevada corporation (the "Company"), were organized to solicit, underwrite, and retain risks associated with private passenger nonstandard automobile insurance.

The accompanying unaudited, consolidated, financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated. These unaudited financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and in accordance with the instructions to Form 10-QSB for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, such statements include all adjustments (consisting of normally recurring accruals) considered necessary for fair presentation. Operating results for the quarter ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. For further information refer to the financial statements and footnotes thereto included in the Company's Form 10-KSB for the year ended December 31, 2003. Footnote disclosures, which would substantially duplicate the disclosure contained in those documents, have been omitted.

Net income per share is computed in accordance with SFAS No. 128 "Earnings per Share."

Contingencies

In the normal course of business, the Company is named as a defendant in lawsuits related to claims and other insurance policy issues. Some of the actions request extra-contractual and/or punitive damages. These actions are vigorously defended unless a reasonable settlement appears appropriate. In the opinion of management, the ultimate outcome of litigation is not expected to be material to the Company's financial condition, results of operations, or cash flows.

Income Recognition

Commission income is generally recognized on the effective date of the policies. Commissions on premiums billed and collected directly by insurance companies are recorded as revenue when received. Premium adjustments, including policy cancellations, are recorded as they occur. An estimated reserve is carried for income that will not be earned due to anticipated policy cancellations.

Recognition of Premium Reserves

Property and liability premiums are generally recognized on a pro rata basis over the policy term. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums.

Deferred Policy Acquisition Costs

Commissions and other costs of acquiring insurance that vary with and are primarily related to the production of new and renewal business, less ceding commissions allowed by reinsurers, are deferred and charged or credited to earnings proportionate to premiums earned. Historical and current loss and loss adjustment expense experience and anticipated investment income are considered in determining the recoverability of deferred policy acquisition costs.

Start-Up Costs

Start-up costs are expensed when incurred.

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Property and Equipment

Items capitalized as property and equipment are carried at historical cost. Depreciation is computed over the estimated useful lives of the assets using straight-line and accelerated methods. Depreciation expense was approximately $67,500 and $55,900 for the three months ended March 31, 2004 and 2003, respectively.

Improvements, additions and major renewals which extend the life of an asset are capitalized. Repairs are expensed in the year incurred.

Amortization of Intangible Assets

Intangible assets consist of noncompetition agreements and goodwill. Intangible assets are stated at cost. Effective January 1, 2002, the Company adopted the Financial Accounting Standards Board ("FASB")'s Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets". SFAS 142 requires that goodwill and certain intangibles with indefinite lives no longer be amortized, but instead be tested for impairment at least annually. The noncompetition agreements are amortized.

Cash Flows

For the purpose of the statements of cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash and cash equivalents.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Some material estimates that are particularly sensitive are:

Return commission incurred on policies originated by MGA - The Company has calculated a provision for return commission due to cancellation of policies before all premiums written are fully earned. This estimate is based on past Company history.

The Company maintains a liability for unpaid losses and loss adjustment expense based on management's estimate of the ultimate cost to settle claims currently in process. In addition a reserve for claims that have occurred but have not been reported is also carried as a liability. The ultimate costs to settle these claims may vary from the current estimates. The Company does not discount the liability for unpaid losses and loss adjustment expense.

Advertising Costs

Advertising costs are expensed as incurred.

Concentration of Risk

The Company operates in Florida, Georgia and South Carolina and is dependent upon the economy in the area. Automobiles insured through the Carrier are principally in South Carolina and Georgia. Premium increases generally must be approved by state insurance commissioners.

Income taxes

The Company files a consolidated federal income tax return. The tax liability of the group is apportioned among the members of the group in accordance with the ratio, which that portion of the consolidated taxable income attributable to each member of the group having taxable income bears to the consolidated income.

Each entity within the consolidated group calculates its own tax provision and is directly responsible for its own tax benefits and/or expense.

The Company has loss carry-forwards that may be offset against future taxable income and tax credits that may be used against future income taxes. If not used, the carry-forwards will expire between now and December 31, 2022. The loss carry-forwards at December 31, 2003 were approximately $2,710,000 and are subject to limitations each year under Section 382 of the Internal Revenue Code.

After the merger, the Company had a net operating loss for the nine months ended December 31, 2003 of approximately $1,220,000. There was no benefit recorded for the quarter due to management's uncertainty as to the realization of the net operating loss.

As a result of the net operating loss carry-forwards, the Company had a deferred tax asset of approximately $767,000 with a 100% valuation allowance for the quarter ended March 31, 2004. The Company has established the valuation allowance for its net deferred tax assets due to the uncertainty regarding the realization of these deferred income tax assets.

Stock Based Compensation

Under the Company's 2000 Stock Option Plan, the aggregate number of common shares authorized is currently 5,000,000. As of March 31, 2004, the Company had options to purchase an aggregate of 2,438,918 shares of common stock outstanding. Prior to the acquisition of AssuranceAmerica Corporation, a Georgia corporation, the Company had options to purchase 948,918 shares of common stock outstanding and AssuranceAmerica had options to purchase 1,300,000 shares of common stock outstanding. In connection with such acquisition, the options to purchase shares of AssuranceAmerica common stock were exchanged on a one-for-one basis for options to purchase shares of the Company's common stock under the Company's 2000 Stock Option Plan. The weighted-average exercise price for all options outstanding at March 31, 2004 is $1.81.

Reclassifications

Certain reclassifications have been made to the 2003 financial statements to conform to the 2004 presentation.

Related Party Transactions

The Company has issued certain unsecured promissory notes payable to by Guy W. Millner, the Chairman of the Company's Board of Directors, and Lawrence (Bud) Stumbaugh, the Company's President and Chief Executive Officer. The promissory notes accrue interest at a rate of 8.0% per annum. As of March 31, 2004, the amount of outstanding principal and accrued interest under such promissory notes totaled approximately $7.1 million. The promissory notes provide for the repayment of principal beginning in December 2004 in an amount equal to the greater of $500,000 or an amount equal to 25% of the Company's net income after tax, plus non-cash items, less working capital. However, the promissory notes also permit the Company to postpone any and all payments under the promissory notes without obtaining the consent of, and without giving notice or paying additional consideration.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto included as Item 1 of this report. This document contains "forward-looking statements" relating to future events or the Company's future financial performance within the meaning of Section 21E of the Securities Exchange Act of 1934 and that are intended to be covered by the safe harbor created thereby. These forward-looking statements are based on the beliefs of management as well as assumptions made by and information currently available to management. These statements contain the words "anticipate", "believe," "expect" and words or phrases of similar import, as they relate to the Company or management. You should be aware that these "forward-looking" statements are subject to certain risks, uncertainties and assumptions related to certain factors including, without limitation, risks relating to the significant competitive pressures that the Company faces, the extensive governmental regulation of the Company's business, the availability of reinsurance, the Company's limited experience in underwriting nonstandard automobile insurance, the Company's ability to respond to future business opportunities and other risks and difficulties generally experienced by growth stage businesses. The Company undertakes no obligation to update these forward-looking statements.

On April 1, 2003, a wholly-owned subsidiary of the Company merged with and into AssuranceAmerica Corporation, a Georgia corporation ("AAC"), a property and casualty-oriented holding company, focusing on the nonstandard automobile insurance markets. As a result of the Merger, AAC became the surviving subsidiary of the Company.

Following the merger, the Company has three operating entities, each of which is a wholly-owned subsidiary of AAC: Agencies, which owns 30 independent agencies located primarily in Florida, writing nonstandard automobile insurance, MGA, which writes nonstandard automobile insurance in Georgia, and Carrier, which underwrites the business written by MGA and is licensed in South Carolina and Georgia. Carrier commenced operations in April, 2003.

Financial Condition

Investments and cash as of March 31, 2004 increased approximately $1.8 million (56%) over investments and cash as of December 31, 2003. The increase was primarily due to cash provided by operations. The Company's investments are currently in money market accounts which management believes offers the most safety regarding principle risk. The Company has no investments in equity securities as of March 31, 2004.

Receivable from insured as of March 31, 2004 increased approximately $1.4 million or 33% compared to December 31, 2003. The increased results from the Carrier's increase in written premium during the three months ended March 31, 2004 ($8.5 million) compared to its written premium for the three month period ended December 31, 2003 ($5.5 million).

Prepaid reinsurance premium increased $1.5 million or 38% for the period ending March 31, 2004 compared to December 31, 2003 and is the result of the company's increase in written premium compared to the previous period.

Reinsurance recoverable represents claims and claims expense due from the company's reinsurer. The increase of $2.0 million is the result of an increase in claims activity for the period ending March 31, 2004 compared to December 31, 2003.

Accounts payable and accrued expense increased $0.5 million as of March 31, 2004 compared to December 31, 2003 and is due primarily to the increase in agent's commission accrual resulting from the company's increase in written premium.

Unearned premium represents premiums written by the company, which have not been earned. The amount increased $2.2 million or 39% compared to December 31, 2003 and is the result of the company's increase in written premium.

Unpaid losses and loss adjustments expense represents claims and claims expense reserves for claims recognized but have not been paid. The increase of $1.7 million or 37% for the period ending March 31, 2004 is the result increased claims activity for the period.

Reinsurance payable represents premium written by the company which is payable to its reinsurer under its current reinsurance contract. The increase of approximately $2.0 million for the period ending March 31, 2004 compared to

December 31, 2003 is the result of the company's increase in premium written for the period.

Liquidity and Capital Resources

Net cash provided by operating activities for the three month period ending March 31, 2004 was approximately $1.7 million. The increase of approximately $1.5 million, compared to the three month period ending March 31, 2003 was primarily the result of the carrier commencing operations on April 1, 2003.

Investing and Financing activities for the three month period ending March 31, 2003 were primarily related to the formation and capitalization of the carrier.

The Company's liquidity and capital needs have been met in the past through premium, commission and fee income and debt from its Chairman and President. The Company's long-term debt consists of unsecured promissory notes payable to its Chairman and President. The promissory notes carry an interest rate of 8% per annum and provide for the repayment of principal beginning in December 2004 in an amount equal to the greater of $500,000 or an amount equal to 25% of the Company's net income after tax, plus non-cash items, less working capital.

The growth of the company has and will continue to put pressure on its liquidity and capital resources. The company is currently engaged in an effort to raise additional capital through a private placement of equity

securities. Carrier is required by the states of South Carolina and Georgia to maintain a minimum capital and surplus of $3.0 million. As of March 31, 2004, Carrier's capital and surplus was approximately $3.2 million.

The Company's only equity currently outstanding is its common stock, which has no mandatory dividend obligations.

Results of Operations

The Company's reported a net income of $225,000 for the three month period ending March 31, 2004. Based on the Company's operating loss carry forwards, no provision for income tax has been established. Historically, the Company's results for the first quarter have been more favorable than subsequent quarters and management believes that trend will continue.

Gross premiums written was approximately $8.5 million for the quarter ended March 31, 2004. The Carrier commenced operations April 1, 2003 and therefore recorded no premium for the quarter ended March 31, 2003. The Carrier began operations in the state of South Carolina in December 2003 and wrote approximately $700,000 in premium for the quarter ended March 31, 2004.

Gross premiums ceded represents amounts ceded to reinsurers under the Carrier's quota-share treaty. The $5.8 million ceded during the quarter ended March 31, 2004 is approximately 70% of the Carrier's eligible premium and the Carrier ceded approximately the same percentage of claims and claims expense.

Increase in unearned premiums, net of prepaid reinsurance premium, was approximately $736,000 for the quarter ended March 31, 2004 and represents the Carrier's portion of the change in premiums written but not yet earned.

Commission income for the quarter ended March 31, 2004 was approximately $2.9 million, a decrease of $353,000 compared to the quarter ended March 31, 2003. The decrease is primarily the result of the Carrier commencing operations April

2003 and the effect on MGA commission income. Commission paid to MGA from the Carrier for the Carrier's retained business (30%) is eliminated upon consolidation.

Managing General Agent fees for the quarter ended March 31, 2004 were $823,000 compared to $727,000 for the quarter ended March 31, 2003. The increase is primarily the result of an 8.5% increase in written premium for the quarter ended March 31, 2004 compared to the same quarter 2003.

Other fee income for the quarter ended March 31, 2004 was approximately $301,000, approximately 22% more than the same quarter 2003. The increase is primarily the result of Agencies receiving bonus income of approximately $42,000 during the quarter ended March 31, 2004.

Selling expenses for the quarter ended March 31, 2004 were approximately $2.6 million, $230,000 less than the same quarter 2003. Prior to the carrier's formation, MGA's selling expense included a fronting fee to a third party Carrier represented by the MGA, with the formation of our Carrier the fronting fee was eliminated. In addition, the MGA reduced the commission rate paid to its agents from 15% to approximately 12.5% during the third quarter of 2003.

General and administrative expense was approximately $1.5 million for the quarter ending March 31, 2004 which was an increase of approximately $230,000 over the same quarter 2003. The increase is the result generally of small increases in several of the Company's general operating expenses.

Losses and loss adjust expenses are the Company's portion (after reinsurance) of the cost and anticipated costs to settle claims. The Carrier's net loss and loss adjustment expense ratio for the quarter ending March 31, 2004 was 77.6%

Interest expense for the quarter ended March 31, 2004 was $142,000 and increase of $12,000 over the same quarter in 2003. The increase resulted from interest charged on interest expense accrued but not paid relating to 2003.

Market Risk

Market risk is the risk of loss from adverse changes in market prices and interest rates. Currently, the Company's investments are in money market accounts and bank certificates of deposit, both of which minimize market risk.

ITEM 3. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, of the design and operation of the Company's disclosure controls and procedures. Based on this evaluation, the Company's Chief Executive and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective for gathering, analyzing and disclosing the information that the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms. The Company's Chief Executive Officer and Chief Financial Officer also concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in its periodic SEC filings.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to the date of this evaluation.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits.

31.1 Certification of the Company's Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of the Company's Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of the Company's Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K. None.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ASSURANCEAMERICA CORPORATION

By: /s/ Lawrence Stumbaugh

Lawrence Stumbaugh
President and CEO

Dated: May 14, 2004