

ALLIED WORLD ASSURANCE CO HOLDINGS LTD

Form 10-Q

August 06, 2010

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

Form 10-Q

(Mark One)

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

For the quarterly period ended: June 30, 2010

OR

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

For the transition period from _____ to _____

Commission file number: 001-32938

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD

(Exact Name of Registrant as Specified in Its Charter)

Bermuda

*(State or Other Jurisdiction of
Incorporation or Organization)*

98-0481737

*(I.R.S. Employer
Identification No.)*

27 Richmond Road, Pembroke HM 08, Bermuda

(Address of Principal Executive Offices and Zip Code)

(441) 278-5400

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a 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

The number of outstanding common shares, par value \$0.03 per share, of Allied World Assurance Company Holdings, Ltd as of August 2, 2010 was 48,873,660.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements.

ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

as of June 30, 2010 and December 31, 2009

(Expressed in thousands of United States dollars, except share and per share amounts)

	As of June 30, 2010	As of December 31, 2009
ASSETS		
Fixed maturity investments available for sale, at fair value (amortized cost: 2010: \$2,602,000; 2009: \$4,260,844)	\$ 2,755,934	\$ 4,427,072
Fixed maturity investments trading, at fair value	4,275,893	2,544,322
Other invested assets trading, at fair value	388,761	184,869
Total investments	7,420,588	7,156,263
Cash and cash equivalents	442,689	292,188
Restricted cash	101,206	87,563
Insurance balances receivable	552,330	395,621
Prepaid reinsurance	202,107	186,610
Reinsurance recoverable	932,435	919,991
Accrued investment income	46,105	53,046
Net deferred acquisition costs	103,286	87,821
Goodwill	268,376	268,376
Intangible assets	58,576	60,359
Balances receivable on sale of investments	24,318	55,854
Net deferred tax assets	14,170	21,895
Other assets	48,182	67,566
Total assets	\$ 10,214,368	\$ 9,653,153
LIABILITIES		
Reserve for losses and loss expenses	\$ 4,920,435	\$ 4,761,772
Unearned premiums	1,069,956	928,619
Reinsurance balances payable	137,790	102,837
Balances due on purchases of investments	50,425	55,670
Senior notes	498,984	498,919
Accounts payable and accrued liabilities	68,235	92,041
Total liabilities	\$ 6,745,825	\$ 6,439,858
SHAREHOLDERS EQUITY		
Common shares, par value \$0.03 per share (2010: 50,488,342; 2009: 49,734,487 shares issued and 2010: 49,407,301; 2009: 49,734,487 shares outstanding)	\$ 1,515	\$ 1,492
Additional paid-in capital	1,378,262	1,359,934

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Treasury shares, at cost (2010: 1,081,041; 2009: nil)	(49,089)	
Accumulated other comprehensive income:		
net unrealized gains on investments, net of tax	138,245	149,849
Retained earnings	1,999,610	1,702,020
Total shareholders' equity	\$ 3,468,543	\$ 3,213,295
Total liabilities and shareholders' equity	\$ 10,214,368	\$ 9,653,153

See accompanying notes to the consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME

for the three and six months ended June 30, 2010 and 2009

(Expressed in thousands of United States dollars, except share and per share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
REVENUES:				
Gross premiums written	\$ 493,847	\$ 492,782	\$ 998,010	\$ 972,377
Premiums ceded	(124,052)	(131,344)	(194,923)	(205,900)
Net premiums written	369,795	361,438	803,087	766,477
Change in unearned premiums	(30,871)	(27,770)	(125,839)	(108,830)
Net premiums earned	338,924	333,668	677,248	657,647
Net investment income	65,594	76,537	134,496	154,390
Net realized investment gains	94,933	5,093	172,420	41,690
Net impairment charges recognized in earnings:				
Total other-than-temporary impairment charges		(16,225)	(168)	(58,180)
Portion of loss recognized in other comprehensive income, before taxes		10,751		10,751
Net impairment charges recognized in earnings		(5,474)	(168)	(47,430)
Other income	616	369	913	830
	500,067	410,193	984,909	807,127
EXPENSES:				
Net losses and loss expenses	188,722	177,719	420,876	326,210
Acquisition costs	37,938	36,963	78,722	74,090
General and administrative expenses	68,089	61,495	131,552	118,860
Amortization and impairment of intangible assets	891	1,065	1,783	2,130
Interest expense	9,531	9,522	19,059	19,960
Foreign exchange loss (gain)	559	(1,222)	1,635	(380)
	305,730	285,542	653,627	540,870
Income before income taxes	194,337	124,651	331,282	266,247
Income tax expense	10,378	10,981	13,583	21,160
NET INCOME	183,959	113,670	317,699	245,087
Other comprehensive (loss) income:				
Unrealized gains on investments arising during the period net of applicable deferred income tax expense for the three months 2010: \$(471); 2009: \$(1,822); and six months 2010: \$(690); 2009: \$(441)	63,852	140,209	101,322	76,140
Portion of other-than-temporary impairment losses recognized in other comprehensive income, net of applicable deferred income tax for the three		(10,751)		(10,751)

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months and six months ended June 30, 2010 nil; 2009: nil

reclassification adjustment for net realized investment (gains) losses included

net income, net of applicable income tax (67,891) 7,856 (112,926) 14,48

Other comprehensive (loss) income (4,039) 137,314 (11,604) 79,88

COMPREHENSIVE INCOME \$ 179,920 \$ 250,984 \$ 306,095 \$ 324,96

PER SHARE DATA

Basic earnings per share \$ 3.66 \$ 2.30 \$ 6.34 \$ 4.9

Diluted earnings per share \$ 3.47 \$ 2.22 \$ 5.98 \$ 4.7

Weighted average common shares outstanding 50,222,974 49,523,459 50,123,945 49,386,54

Weighted average common shares and common share equivalents outstanding 52,974,410 51,257,887 53,086,708 51,215,80

Dividends declared per share \$ 0.20 \$ 0.18 \$ 0.40 \$ 0.3

See accompanying notes to the consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

for the six months ended June 30, 2010 and 2009

(Expressed in thousands of United States dollars)

	Share Capital	Additional Paid-in Capital	Treasury Shares	Accumulated Other Comprehensive Income	Retained Earnings	Total
December 31, 2009	\$ 1,492	\$ 1,359,934	\$	\$ 149,849	\$ 1,702,020	\$ 3,213,295
Net income					317,699	317,699
Dividends					(20,109)	(20,109)
Other comprehensive loss:						
Net unrealized losses, net of deferred income tax				(11,604)		(11,604)
Portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax						
Total other comprehensive loss				(11,604)		(11,604)
Stock compensation	23	18,328				18,351
Share repurchase			(49,089)			(49,089)
June 30, 2010	\$ 1,515	\$ 1,378,262	\$ (49,089)	\$ 138,245	\$ 1,999,610	\$ 3,468,543

	Share Capital	Additional Paid-in Capital	Treasury Shares	Accumulated Other Comprehensive Income	Retained Earnings	Total
December 31, 2008	\$ 1,471	\$ 1,314,785		\$ 105,632	\$ 994,974	\$ 2,416,862
Cumulative effect adjustment upon adoption of ASC 320-10-65 ¹ , net of deferred taxes				(136,848)	136,848	
Net income					245,078	245,078
Dividends					(17,828)	(17,828)
Other comprehensive income:						
Unrealized gains				90,636		90,636
Portion of other-than-temporary impairment losses recognized in other comprehensive income, net of deferred income tax				(10,751)		(10,751)

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Total other comprehensive income				79,885		79,885
Stock compensation	15	17,415				17,430
June 30, 2009	\$ 1,486	\$ 1,332,200	\$	48,669	\$ 1,359,072	\$ 2,741,427

¹ Cumulative effect adjustment reflects adoption of ASC 320-10-65 as of April 1, 2009.

See accompanying notes to the consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

for the six months ended June 30, 2010 and 2009

(Expressed in thousands of United States dollars)

	Six Months Ended	
	June 30,	
	2010	2009
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:		
Net income	\$ 317,699	\$ 245,078
Adjustments to reconcile net income to cash provided by operating activities:		
Net realized gains on sales of investments	(113,151)	(34,311)
Mark to market adjustments	(59,269)	(7,384)
Net impairment charges recognized in earnings	168	47,437
Stock compensation expense	17,454	16,560
Insurance balances receivable	(156,709)	(73,832)
Prepaid reinsurance	(15,497)	(27,531)
Reinsurance recoverable	(12,444)	(21,402)
Accrued investment income	6,941	(5,980)
Net deferred acquisition costs	(15,465)	(10,422)
Net deferred tax assets	8,415	(8,783)
Other assets	22,318	(1,353)
Reserve for losses and loss expenses	158,663	136,899
Unearned premiums	141,337	136,368
Reinsurance balances payable	34,953	37,819
Accounts payable and accrued liabilities	(23,806)	(24,263)
Other items, net	(6,005)	(2,518)
Net cash provided by operating activities	305,602	402,382
CASH FLOWS USED IN INVESTING ACTIVITIES:		
Purchases of fixed maturity investments available for sale	(113,118)	(5,379,219)
Purchases of fixed maturity investments trading	(6,927,637)	(234,049)
Purchases of other invested assets	(203,011)	(125,376)
Sales of fixed maturity investments available for sale	1,827,800	5,297,600
Sales of fixed maturity investments trading	5,344,007	357
Sales of other invested assets	3,155	134,386
Changes in securities lending collateral received		171,026
Purchases of fixed assets	(5,213)	(3,072)
Change in restricted cash	(13,643)	(8,636)
Net cash used in investing activities	(87,660)	(146,983)
CASH FLOWS USED IN FINANCING ACTIVITIES:		
Dividends paid	(20,109)	(17,828)
Proceeds from the exercise of stock options	3,576	2,228
Share repurchase	(49,089)	
Repayment of syndicated loan		(243,750)
Changes in securities lending collateral		(177,010)

Net cash used in financing activities	(65,622)	(436,360)
Effect of exchange rate changes on foreign currency cash	(1,819)	801
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	150,501	(180,160)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	292,188	655,828
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 442,689	\$ 475,668
Supplemental disclosure of cash flow information:		
Cash paid for income taxes	\$ 4,386	\$ 37,878
Cash paid for interest expense	18,750	20,365

See accompanying notes to the consolidated financial statements.

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ALLIED WORLD ASSURANCE COMPANY HOLDINGS, LTD
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

1. GENERAL

Allied World Assurance Company Holdings, Ltd (Holdings) was incorporated in Bermuda on November 13, 2001. Holdings, through its wholly-owned subsidiaries (collectively, the Company), provides property and casualty insurance and reinsurance on a worldwide basis through operations in Bermuda, the United States, Europe, Hong Kong and Singapore.

2. BASIS OF PREPARATION AND CONSOLIDATION

These unaudited condensed consolidated financial statements include the accounts of Holdings and its subsidiaries and have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with Article 10 of Regulation S-X as promulgated by the U.S. Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, these unaudited condensed consolidated financial statements reflect all adjustments that are normal and recurring in nature and necessary for a fair presentation of financial position and results of operations as of the end of and for the periods presented. The results of operations for any interim period are not necessarily indicative of the results for a full year.

The preparation of financial statements in conformity with U.S. GAAP 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. The significant estimates reflected in the Company s financial statements include, but are not limited to:

The premium estimates for certain reinsurance agreements,

Recoverability of deferred acquisition costs,

The reserve for outstanding losses and loss expenses,

Valuation of ceded reinsurance recoverables,

Determination of impairment of goodwill and other intangible assets,

Valuation of financial instruments, and

Determination of other-than-temporary impairment of investments.

Inter-company accounts and transactions have been eliminated on consolidation and all entities meeting consolidation requirements have been included in the consolidation. Certain immaterial reclassifications in the unaudited condensed consolidated statements of operations and comprehensive income (consolidated income statements) and consolidated statements of cash flows and notes to the unaudited condensed consolidated financial statements have been made to prior years amounts to conform to the current year s presentation.

These unaudited condensed consolidated financial statements, including these notes, should be read in conjunction with the Company s audited consolidated financial statements, and related notes thereto, included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

3. NEW ACCOUNTING PRONOUNCEMENTS

In January 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2010-06 Fair Value Measurements and Disclosures (ASU 2010-06). ASU 2010-06 updated section ASC 820-10 to require a greater level of disaggregated information and more robust disclosure about valuation techniques and inputs to fair value measurements. ASU 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, with the exception of the disclosures about purchases, sales, issuances and settlements in the roll

forward of activity in Level 3 fair value measures which are effective for interim and annual reporting periods beginning after December 15, 2010. See Note 6 Fair Value of Financial Instruments for the Company's disclosures about the fair value of financial instruments.

In March 2010, the FASB issued ASU 2010-11 Derivatives and Hedging: Scope Exception Related to Embedded Credit

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(Expressed in thousands of United States dollars, except share, per share, percentage and ratio information)

Derivatives (ASU 2010-11). ASU 2010-11 clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements, specifically one that is related only to the subordination of one financial instrument to another. ASU 2010-11 is effective for interim and annual periods beginning after June 15, 2010. As permitted under the transitional provisions of ASU 2010-11, effective July 1, 2010 the Company has elected the fair value option for any investment in a beneficial interest in a securitized asset. As a result, the Company elected the fair value option for all of its mortgage-backed and asset-backed securities held as of June 30, 2010. On July 1, 2010, the Company reclassified net unrealized gains of \$42,402 from accumulated other comprehensive income to retained earnings. As a result of the fair value election, any changes in fair value of the mortgage-backed and asset-backed securities will be recognized in net realized investment gains (losses) on the consolidated income statement. On July 1, 2010, these investments, which totaled \$968,825 as of June 30, 2010, were classified as fixed maturity investments trading, at fair value on the consolidated balance sheet.

4. INVESTMENTS**a) Available for Sale Securities**

The amortized cost, gross unrealized gains, unrealized losses, other-than-temporary-impairment charges (OTTI) recorded through other comprehensive income (OCI) and fair value of the Company's available for sale investments by category as of June 30, 2010 and December 31, 2009 are as follows:

	Cost	Gross Unrealized Gains	Unrealized Losses	OTTI OCI	Fair Value
June 30, 2010					
U.S. Government and Government agencies	\$ 197,602	\$ 13,662	\$ (8)	\$	\$ 211,256
Non-U.S. Government and Government agencies	135,790	10,055	(5,239)		140,606
States, municipalities and political subdivisions	145,495	14,550			160,045
Corporate debt:					
Financial institutions	337,266	15,609	(2,378)		350,497
Industrials	691,159	49,728	(9)		740,878
Utilities	168,265	15,562			183,827
Residential mortgage-backed:					
Non-agency residential	151,416	6,306	(6,759)	(563)	150,400
Agency residential	551,635	32,508	(68)		584,075
Commercial mortgage-backed	157,464	8,715			166,179
Asset-backed	65,908	2,345	(82)		68,171
Total fixed maturity investments, available for sale	\$ 2,602,000	\$ 169,040	\$ (14,543)	\$ (563)	\$ 2,755,934

&nbsp;