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Table of Contents

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

FORM 10-Q

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

For the quarterly period ended March 31, 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 001-34496

PENN MILLERS HOLDING CORPORATION

(Exact name of registrant as specified in its charter)

Pennsylvania	**80-0482459**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

72 North Franklin Street, Wilkes-Barre, PA 18773
(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: **(800) 233-8347**

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 ☑ (Do not check if a smaller reporting company)	Smaller reporting company ☐

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

At April 30, 2010, 5,226,261 shares of common stock, $0.01 par value, of Penn Millers Holding Corporation were outstanding.

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

For the Quarter Ended March 31, 2010

INDEX

	Page Number
Part I Financial Information	
Item 1. Financial Statements	3
Consolidated Balance Sheets — March 31, 2010 (unaudited) and December 31, 2009	3
Consolidated Statements of Operations (unaudited) — Three months ended March 31, 2010 and 2009	4
Consolidated Statements of Shareholders' Equity (unaudited) — Three months ended March 31, 2010 and 2009	5
Consolidated Statements of Cash Flows (unaudited) — Three months ended March 31, 2010 and 2009	6
Notes to Consolidated Financial Statements (unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3. Quantitative and Qualitative Disclosures About Market Risk	41
Item 4. Controls and Procedures	42
Part II Other Information	
Item 1. Legal Proceedings	42
Item 1A. Risk Factors	42
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	43
Item 4. (Removed and Reserved)	43
Item 5. Other Information	43
Item 6. Exhibits	43
SIGNATURES	44

Exhibit 31.1
Exhibit 31.2
Exhibit 32.1
Exhibit 32.2

Table of Contents

PART 1 FINANCIAL INFORMATION

Item 1. — Financial Statements

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

Consolidated Balance Sheets

March 31, 2010 and December 31, 2009

(Dollars in thousands, except per share amounts)

	March 31, 2010 (Unaudited)	December 31, 2009
Assets		
Investments:		
Fixed maturities:		
Available for sale, at fair value (amortized cost $157,636 in 2010 and $161,730 in 2009)	$ 163,520	167,155
Equity securities, at fair value (cost $8,033 in 2010 and $0 in 2009)	8,276	—
Total investments	171,796	167,155
Cash and cash equivalents	17,806	20,220
Premiums and fees receivable	27,596	29,526
Reinsurance receivables and recoverables	19,376	19,502
Deferred policy acquisition costs	10,192	10,053
Prepaid reinsurance premiums	4,081	4,076
Accrued investment income	1,608	1,810
Property and equipment, net of accumulated depreciation	3,643	3,769
Income taxes receivable	22	—
Deferred income taxes	3,268	3,518
Other	4,093	3,821
Total assets	$ 263,481	263,450
Liabilities and Shareholders' Equity		
Liabilities:		
Losses and loss adjustment expense reserves	$ 109,974	106,710
Unearned premiums	42,624	43,313
Accounts payable and accrued expenses	10,445	12,762
Income taxes payable	—	617
Total liabilities	163,043	163,402
Shareholders' equity:		
Preferred stock, no par value, authorized 1,000,000; no shares issued or outstanding	—	—
Common stock, $0.01 par value, authorized 10,000,000; issued 5,444,022; outstanding 4,708,762 and 4,695,262 shares	54	54
Additional paid-in capital	50,533	50,520
Accumulated other comprehensive income	3,003	2,519
Retained earnings	54,239	54,481
Unearned ESOP, 517,499 and 530,999 shares	(5,175)	(5,310)
Treasury stock, at cost, 217,761 shares	(2,216)	(2,216)
Total shareholders' equity	100,438	100,048
Total liabilities and shareholders' equity	$ 263,481	263,450

See accompanying notes to consolidated financial statements.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

Consolidated Statements of Operations

(Unaudited)

Three months ended March 31, 2010 and 2009

(Dollars in thousands, except per share amounts)

	2010	2009
Revenues:		
Premiums earned	$ 17,056	18,057
Investment income, net of investment expense	1,572	1,359
Realized investment gains on securities sold, net	372	29
Other income	92	20
Total revenues	19,092	19,465
Losses and expenses:		
Losses and loss adjustment expenses	13,372	11,970
Amortization of deferred policy acquisition costs	4,877	5,506
Underwriting and administrative expenses	1,119	976
Interest expense	—	76
Other expense, net	33	47
Total losses and expenses	19,401	18,575
(Loss) income from continuing operations, before income taxes	(309)	890
Income tax (benefit) expense	(67)	205
(Loss) income from continuing operations	(242)	685
Discontinued operations:		
Loss from discontinued operations, before income taxes	—	(16)
Income tax expense	—	804
Loss from discontinued operations	—	(820)
Net loss	$ (242)	(135)
Basic earnings per common share:		
Loss from continuing operations	$ (0.05)	
Loss from discontinued operations	—	
Net loss per common share	$ (0.05)	
Diluted earnings per common share:		
Loss from continuing operations	$ (0.05)	
Loss from discontinued operations	—	
Net loss per common share	$ (0.05)	

See accompanying notes to consolidated financial statements.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

Consolidated Statements of Shareholders' Equity

(Unaudited)

Three months ended March 31, 2010 and 2009

(Dollars in thousands, except per share amounts)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Unearned ESOP Shares	Treasury Stock	Total
Balance at December 31, 2008	—	—	—	(1,159)	51,914	—	—	50,755
Net loss					(135)			(135)
Other comprehensive income, net of taxes:								
Unrealized investment holding gain arising during period, net of related income tax expense of $184				357				357
Reclassification adjustment for realized gains included in net income, net of related income tax expense of $9				(17)				(17)
Net unrealized investment gain								340
Defined benefit pension plan, net of related income tax expense of $18				35				35
Comprehensive income								240
Balance at March 31, 2009	—	—	—	(784)	51,779	—	—	50,995
Balance at December 31, 2009	5,444,022	$ 54	50,520	2,519	54,481	(5,310)	(2,216)	100,048
Net loss					(242)			(242)
Other comprehensive income, net of taxes:								
Unrealized investment holding gain arising during period, net of related income tax expense of $365				709				709
Reclassification adjustment for realized gains included in net income, net of related income tax expense of $126				(246)				(246)
Net unrealized investment gain								463
Defined benefit pension plan, net of related income tax expense of $11				21				21
Comprehensive income								242
ESOP shares released			13			135		148
Balance at March 31, 2010	5,444,022	$ 54	50,533	3,003	54,239	(5,175)	(2,216)	100,438

See accompanying notes to consolidated financial statements.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

Consolidated Statements of Cash Flows

(Unaudited)

Three months ended March 31, 2010 and 2009

(Dollars in thousands)

	2010	2009
Cash flows from operating activities:		
Net loss	$ (242)	(135)
Loss from discontinued operations	—	820
Adjustments to reconcile net loss to net cash provided by operating activities:		
Change in receivables, unearned premiums, and prepaid reinsurance	1,363	(1,619)
Change in losses and loss adjustment expense reserves	3,264	8,710
Change in accounts payable and accrued expenses	(2,286)	(779)
Deferred income taxes	—	910
Change in deferred acquisition costs	(139)	79
Amortization and depreciation	156	172
ESOP share allocation	148	—
Realized investment gains, net	(372)	(29)
Other, net	(476)	(1,016)
Net cash provided by operating activities	1,416	7,113
Cash flows from investing activities:		
Available-for-sale investments:		
Purchases	(17,209)	(9,983)
Sales	11,009	2,066
Maturities	2,400	2,000
Proceeds on sale of net assets of subsidiaries	—	2,576
(Purchases) and sales of property and equipment, net	(30)	139
Cash used in investing activities — continuing operations	(3,830)	(3,202)
Cash provided by investing activities — discontinued operations	—	285
Net cash used in investing activities	(3,830)	(2,917)
Cash flows from financing activities:		
Initial public offering costs paid	—	(830)
Net borrowings on line of credit	—	733
Repayment of long-term debt	—	(78)
Cash used in financing activities — continuing operations	—	(175)
Cash used in financing activities — discontinued operations	—	(285)
Net cash used in financing activities	—	(460)
Net (decrease) increase in cash	(2,414)	3,736
Cash and cash equivalents at beginning of period	20,220	11,959
Cash and cash equivalents at end of period	17,806	15,695
Less cash of discontinued operations at end of period	—	—
Cash and cash equivalents of continuing operations at end of period	$ 17,806	15,695

See accompanying notes to consolidated financial statements.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

(1) Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934, as amended. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Such information reflects all adjustments which are, in the opinion of management, necessary to a fair presentation of the financial position, results of operations, and cash flows for the interim periods. The results of operations for interim periods are not necessarily indicative of results to be expected for the full year. All material intercompany balances and accounts have been eliminated in consolidation. As described in Note 18 to the Company's financial statements included in the Company's Registration Statement on Form S-1, during the second quarter of 2009 the Company discovered an immaterial error in the accrual of ceded premium under the aggregate stop loss. The March 31, 2009 financial statements have been corrected to properly account for the stop loss. The impact on net income was a decrease of $166. Pursuant to SAB No. 108, it was determined that the misstatement is not material to the financial statements issued as of and for the three months ended March 31, 2009. These financial statements should be read in conjunction with the financial statements and notes for the year ended December 31, 2009 included in the Company's 2009 Annual Report on Form 10-K.

(2) Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including loss reserves, contingent assets and liabilities, tax valuation reserves, valuation of defined benefit pension obligations, valuation of investments, including other-than-temporary impairment of investments, the disclosure of contingent assets and liabilities, at the date of the consolidated financial statements, and the reported amounts of revenues and expenses, during the reporting period. Actual results could differ from these estimates.

(3) Concentration of Risk

The Company's business is subject to concentration of risk with respect to geographic concentration. Although the Company's operating subsidiaries are licensed collectively in 33 states, direct premiums written for two states, New Jersey and Pennsylvania, accounted for more than 20% of the Company's direct premiums written for the three months ended March 31, 2010. Consequently, changes in the New Jersey or Pennsylvania legal, regulatory, or economic environment could adversely affect the Company.

(4) Stock-Based Compensation

The Company has adopted a stock-based incentive plan, which was submitted to and approved by the shareholders at the annual meeting on May 12, 2010. Under this plan, participants will be awarded restricted shares of common stock, restricted stock units denominated in shares of common stock or options to purchase shares of common stock. The fair value of stock options will be estimated using an acceptable valuation model. The fair value of non-vested stock awards and restricted stock units will be the market price of the Company's stock on the date of grant.

Table of Contents

(5) Adoption of New Accounting Standards

In January 2010, the FASB issued guidance to improve the disclosures related to fair value measurements. The new guidance requires expanded fair value disclosures, including the reasons for significant transfers between Level 1 and Level 2 and the amount of significant transfers into each level disclosed separately from transfers out of each level. For Level 3 fair value measurements, information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements shall be presented separately on a gross basis, rather than as one net number. In addition, clarification is provided about existing disclosure requirements, such as presenting fair value measurement disclosures for each class of assets and liabilities that are determined based on their nature and risk characteristics and their placement in the fair value hierarchy (that is, Level 1, 2, or 3), as opposed to each major category of assets and liabilities, as required in the previous guidance. Disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements are required for fair value measurement that fall in either Level 2 or Level 3. The Company adopted this new guidance effective January 1, 2010, except for the gross presentation of purchases, sales, issuances and settlements in the Level 3 reconciliation, which is effective for annual and interim reporting periods beginning after December 15, 2010. The disclosures required by this new guidance are provided in the accompanying Note 7.

All other standards and updates of those standards issued during the three months ended March 31, 2010 either (i) provide supplemental guidance, (ii) are technical corrections, (iii) are not applicable to the Company, or (iv) are not expected to have a significant impact on the Company.

(6) Earnings per Share

Basic earnings per share are computed by dividing net loss for the period by the weighted average number of common shares outstanding for the period of 4,702,012. There were no dilutive potential common shares outstanding during this period. Consolidated net loss for the period ended March 31, 2010 was $242, resulting in basic loss per share of $0.05.

(7) Fair Value Measurements

The Company’s estimates of fair value for financial assets and financial liabilities are based on the framework established in the fair value accounting guidance, which is now a part of ASC 820.

The fair value of a financial asset or financial liability is the amount at which the asset or liability could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidated sale. In accordance with the guidance set forth by ASC 820, the Company’s financial assets and financial liabilities measured at fair value are categorized into three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 — Unadjusted quoted market prices for identical assets or liabilities in active markets that the Company has the ability to access. The Company classifies U.S. Treasury fixed maturity securities and publicly traded equity mutual funds as Level 1.

Table of Contents

Level 2 — Valuations based on observable inputs, other than quoted prices included in Level 1, for assets and liabilities traded in less active dealer or broker markets. Valuations are based on identical or comparable assets and liabilities.

Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including option pricing models, discounted cash flow models, and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections that are often unobservable in determining the fair value assigned to such assets or liabilities.

Transfers between level categorizations may occur due to changes in the availability of market observable inputs. Transfers in and out of level categorizations are reported as having occurred at the beginning of the quarter in which the transfer occurred. There were no transfers between level categorizations during the three months ended March 31, 2010 and 2009.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of March 31, 2010 and December 31, 2009:

	Level 1	Level 2	Level 3	Total
March 31, 2010:				
Fixed maturities, available for sale				
U.S. treasuries	$ 3,570	—	—	3,570
Agencies not backed by the full faith and credit of the U.S. government	—	15,427	—	15,427
State and political subdivisions	—	39,747	—	39,747
Commercial mortgage-backed securities	—	2,829	—	2,829
Residential mortgage-backed securities	—	27,171	—	27,171
Corporate securities	—	74,776	—	74,776
Total available for sale	$ 3,570	159,950	—	163,520
Equity securities				
Stock Market Index Fund	$ 8,276	—	—	8,276
Total equities	$ 8,276	—	—	8,276
Total assets	$ 11,846	159,950	—	171,796

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

	Level 1	Level 2	Level 3	Total
December 31, 2009:				
Fixed maturities, available for sale				
U.S. treasuries	$ 4,612	—	—	4,612
Agencies not backed by the full faith and credit of the U.S. government	—	17,441	—	17,441
State and political subdivisions	—	39,334	—	39,334
Commercial mortgage-backed securities	—	3,775	—	3,775
Residential mortgage-backed securities	—	28,302	—	28,302
Corporate securities	—	73,691	—	73,691
Total available for sale	$ 4,612	162,543	—	167,155

The Company uses quoted values and other data provided by a nationally recognized independent pricing service in its process for determining fair values of its investments. The pricing service provides the Company one quote per instrument. For fixed maturity securities that have quoted prices in active markets, market quotations are provided. For fixed maturity securities that do not trade on a daily basis, the independent pricing service prepares estimates of fair value using a wide array of observable inputs including relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. The observable market inputs that the Company's independent pricing service utilizes include (listed in order of priority for use) benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, market bids/offers, and other reference data on markets, industry, and the economy. Additionally, the independent pricing service uses an Option Adjusted Spread model to develop prepayment and interest rate scenarios.

Should the independent pricing service be unable to provide a fair value estimate, the Company would attempt to obtain a non-binding fair value estimate from a number of broker-dealers and review this estimate in conjunction with a fair value estimate reported by an independent business news service or other sources. In instances where only one broker-dealer provides a fair value for a fixed maturity security, the Company uses that estimate. In instances where the Company is able to obtain fair value estimates from more than one broker-dealer, the Company would review the range of estimates and would select the most appropriate value based on the facts and circumstances. Should neither the independent pricing service nor a broker-dealer provide a fair value estimate, the Company would develop a fair value estimate based on cash flow analyses and other valuation techniques that utilize certain unobservable inputs. Accordingly, the Company would classify such a security as a Level 3 investment.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

The fair value estimates of the Company's investments provided by the independent pricing service at March 31, 2010, were utilized, among other resources, in reaching a conclusion as to the fair value of investments. As of March 31, 2010, all of the Company's fixed maturity investments were priced using this one primary service. Management reviews the reasonableness of the pricing provided by the independent pricing service by employing various analytical procedures. The Company reviews all securities to identify recent downgrades, significant changes in pricing, and pricing anomalies on individual securities relative to other similar securities. This will include looking for relative consistency across securities in various common blocks or sectors, durations, and credit ratings. This review will also include all fixed maturity securities rated lower than "A" by Moody's or S&P. If, after this review, management does not believe the pricing for any security is a reasonable estimate of fair value, then it will seek to resolve the discrepancy through discussions with the pricing service or its asset manager. The classification within the fair value hierarchy as presented in ASC 820 is then confirmed based on the final conclusions from the pricing review. The Company did not have any such discrepancies at March 31, 2010.

The fair value of other financial instruments, principally receivables, accounts payable and accrued expenses, approximates their March 31, 2010 and December 31, 2009 carrying values.

(8) Investments

The amortized cost and fair value of investments in fixed maturity and equity securities, which are all available for sale, at March 31, 2010 and December 31, 2009 are as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
March 31, 2010:				
U.S. Treasuries	$ 3,496	74	—	3,570
Agencies not backed by the full faith and credit of the U.S. government	15,003	440	16	15,427
State and political subdivisions	37,987	1,844	84	39,747
Commercial mortgage-backed securities	2,768	72	11	2,829
Residential mortgage-backed securities	26,320	939	88	27,171
Corporate securities	72,062	2,760	46	74,776
Total fixed maturities	$ 157,636	6,129	245	163,520
Total equity securities	$ 8,033	243	—	8,276
December 31, 2009:				
U.S. Treasuries	$ 4,499	113	—	4,612
Agencies not backed by the full faith and credit of the U.S. government	16,933	538	30	17,441

State and political subdivisions	37,415	1,994	75	39,334
Commercial mortgage-backed securities	3,806	34	65	3,775
Residential mortgage-backed securities	27,607	844	149	28,302
Corporate securities	71,470	2,463	242	73,691
Total fixed maturities	$ 161,730	5,986	561	167,155

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

The amortized cost and estimated fair value of fixed maturity securities at March 31, 2010, by contractual maturity, are shown below:

	Amortized cost	Estimated fair value
Due in one year or less	$ 11,658	11,851
Due after one year through five years	74,720	77,670
Due after five years through ten years	34,438	36,098
Due after ten years	7,732	7,901
	128,548	133,520
Commercial mortgage-backed securities	2,768	2,829
Residential mortgage-backed securities	26,320	27,171
Total fixed maturities	$ 157,636	163,520

The expected maturities may differ from contractual maturities in the foregoing table because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

At March 31, 2010 and December 31, 2009, investments with a fair value of $4,326 and $4,358, respectively, were on deposit with regulatory authorities, as required by law.

Major categories of net investment income are as follows:

	For the three months ended March 31,	
	2010	2009
Interest on fixed maturities	$ 1,659	1,478
Dividends on equity securities	33	—
Interest on cash and cash equivalents	3	5
Total investment income	1,695	1,483
Investment expense	(123)	(124)
Investment income, net of investment expense	$ 1,572	1,359

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

Realized gross gains (losses) from investments and the change in difference between fair value and cost of investments, before applicable income taxes, are as follows:

	For the three months ended March 31, 2010	2009
Fixed maturity securities:		
Available for sale:		
Gross gains	$ 382	26
Gross losses	(10)	—
Other-than-temporary impairment losses	—	—
Realized investment gains, net	372	26
Change in value of interest rate swap	—	3
Realized investment gains after change in value of interest rate swap, net	$ 372	29
Change in difference between fair value and cost of investments:		
Fixed maturity securities for continuing operations	$ 459	508
Equity securities for continuing operations	243	—
Total for continuing operations	702	508
Equity securities for discontinued operations	—	7
Total including discontinued operations	$ 702	515

Income tax expense on net realized investment gains was $126 and $9 for the three months ended March 31, 2010 and 2009, respectively. Deferred income tax expense applicable to net unrealized investment gains included in equity was $2,083 and $1,845 at March 31, 2010 and December 31, 2009, respectively.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

The fair value and unrealized losses for securities temporarily impaired as of March 31, 2010 and December 31, 2009 are as follows:

	Less than 12 months		12 months or longer		Total	
Description of securities	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
2010:						
Agencies not backed by the full faith and credit of the U.S. government	$ 4,671	16	—	—	4,671	16
State and political subdivisions	5,604	69	548	15	6,152	84
Commercial mortgage-backed securities	—	—	493	11	493	11

Residential mortgage-backed securities	8,939	88	—	—	8,939	88
Corporate securities	13,083	39	1,502	7	14,585	46
Total temporarily impaired securities	$ 32,297	212	2,543	33	34,840	245
2009:						
Agencies not backed by the full faith and credit of the U.S. government	$ 5,965	30	—	—	5,965	30
State and political subdivisions	5,021	65	555	10	5,576	75
Commercial mortgage-backed securities	—	—	1,938	65	1,938	65
Residential mortgage-backed securities	9,549	149	—	—	9,549	149
Corporate securities	21,283	179	3,471	63	24,754	242
Total temporarily impaired securities	$ 41,818	423	5,964	138	47,782	561

The Company invests in high credit quality bonds. These fixed maturity investments are classified as available for sale because the Company will, from time to time, sell securities that are not impaired, consistent with its investment goals and policies. Fair values of interest rate sensitive instruments may be affected by increases and decreases in prevailing interest rates which generally translate, respectively, into decreases and increases in fair values of fixed maturity investments. The fair values of interest rate sensitive instruments also may be affected by the credit worthiness of the issuer, prepayment options, relative values of other investments, the liquidity of the instrument, and other general market conditions. There are $2,543 in fixed maturity securities, at fair value, that at March 31, 2010, had been below cost for over 12 months. The $33 of unrealized losses on such securities relates to securities, which carry an investment grade debt rating and have declined in fair value roughly in line with overall market conditions. The Company has evaluated each security and taken into account the severity and duration of the impairment, the current rating on the bond, and the outlook for the issuer according to independent analysts. The Company has found that the declines in fair value are most likely attributable to the current interest rate environment.

Per the Company's current policy, a fixed maturity security is other-than-temporarily impaired if the present value of the cash flows expected to be collected is less than the amortized cost of the security or where the Company intends to sell or more likely than not will be required to sell the security before recovery of its value. The Company believes, based on its analysis, that these securities are not other-than-temporarily impaired. However, depending on developments involving both the issuers and overall economic conditions, these investments may be written down in the consolidated statements of operations in the future.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

For the three months ended March 31, 2010 and 2009, no impairment charges had been incurred by the Company.

The Company does not engage in subprime residential mortgage lending. The only securitized financial assets that the Company owns are residential and commercial mortgage-backed securities of high credit quality. The Company's exposure to subprime lending is limited to investments in corporate bonds of banks, which may contain some subprime loans on their balance sheets. These bonds are reported at fair value. As of March 31, 2010, fixed maturity securities issued by banks accounted for 9.1% of the bond portfolio's book value. None of the Company's fixed maturity securities have defaulted or required an impairment charge due to the subprime credit crisis.

(9) Comprehensive Income

Comprehensive income for the three months ended March 31, 2010 and 2009 consisted of the following (all amounts net of taxes):

	For the three months ended March 31,	
	2010	2009
Net loss	$ (242)	(135)
Other comprehensive income:		
Unrealized gains on securities:		
Unrealized investment holding gains arising during period	709	357
Less:		
Reclassification adjustment for realized gains included in net loss	(246)	(17)
Net unrealized investment gains	463	340
Change in defined benefit plans	21	35
Other comprehensive income	484	375
Comprehensive income	$ 242	240

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

Accumulated other comprehensive income at March 31, 2010 and December 31, 2009 consisted of the following amounts (all amounts net of taxes):

	March 31, 2010	December 31, 2009
Unrealized investment gains for continuing operations	$ 4,043	3,580
Defined benefit pension plan — net actuarial loss	(1,040)	(1,061)
Accumulated other comprehensive income	$ 3,003	2,519

(10) Employee Benefit Plans

Retirement Plans

The Company has a noncontributory defined benefit pension plan covering substantially all employees. Retirement benefits are a function of both the years of service and level of compensation. It is the Company's policy to fund the plan in amounts not greater than the amount deductible for federal income tax purposes and not less than the minimum required contribution under the Pension Protection Act of 2006. The Company also sponsors a Supplemental Executive Retirement Plan (SERP). The SERP, which is unfunded, provides defined pension benefits outside of the qualified defined benefit pension plan to eligible executives based on average earnings, years of service, and age at retirement.

The net periodic pension cost for the plans consists of the following components:

	For the three months ended March 31,	
	2010	2009
Components of net periodic pension cost:		

Service cost	$ 48	170
Interest cost	123	147
Expected return on plan assets	(98)	(93)
Amortization of prior service costs	10	10
Amortization of net loss	21	43
Net periodic pension cost	$ 104	277

The Company expects to contribute $900 to the pension plan in 2010.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

(11) Federal Income Tax

As of March 31, 2010, the Company had no material unrecognized tax benefits or accrued interest and penalties. The Company's policy is to account for interest as a component of interest expense and penalties as a component of other expense. Federal tax years 2006 through 2009 were open for examination as of March 31, 2010.

Income tax payments, net of refunds were $573 in the first quarter of 2010.

(12) Reinsurance

Reinsurance is ceded by the Company on a pro rata and excess of loss basis, with the Company's retention generally at $500 per occurrence in 2010 and 2009. The Company purchased catastrophe excess-of-loss reinsurance with a retention of $2,000 per event in 2009. Effective January 1, 2010, the Company increased its retention to $3,000 per event.

Effective January 1, 2010, the Company increased its participation in the per-risk reinsurance treaty. Losses between $500 and $1,000 are retained at a rate of 60% in 2010 versus a 52.5% retention rate in 2009.

The Company continues to maintain a whole account, accident year aggregate excess of loss (aggregate stop loss) contract. This contract covers the 2008 and 2009 accident years and provides reinsurance coverage for loss and allocated loss adjustment expense (ALAE) from all lines of business, in excess of a 72% loss and ALAE ratio. The reinsurance coverage has a limit of 20% of subject net earned premiums. As of March 31, 2010, the Company has not ceded any losses under the aggregate stop loss contract. Effective January 1, 2010, the Company has not entered into a new stop loss contract.

The Company's assumed reinsurance relates primarily to its participation in various involuntary pools and associations and the runoff of the Company's participation in voluntary reinsurance agreements that have been terminated.

The effect of reinsurance, with respect to premiums and losses, for the three months ended March 31, 2010 and 2009 is as follows:

(a) Premiums

	For the three months ended March 31,			
	2010		2009	
	Written	Earned	Written	Earned

Direct	$ 20,849	21,526	22,754	23,302
Assumed	88	88	222	222
Ceded	(4,563)	(4,558)	(5,294)	(5,467)
Net	$ 16,374	17,056	17,682	18,057

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

(b) Losses and Loss Adjustment Expenses

	For the three months ended March 31, 2010	2009
Direct	$ 15,953	19,799
Assumed	(216)	(31)
Ceded	(2,365)	(7,798)
Net	$ 13,372	11,970

(c) Unearned Premiums

	March 31, 2010	December 31, 2009
Direct	$ 42,615	43,304
Assumed	9	9
Prepaid reinsurance (ceded)	(4,081)	(4,076)
Net	$ 38,543	39,237

(d) Loss and Loss Adjustment Expense Reserves

	March 31, 2010	December 31, 2009
Direct	$ 101,608	97,889
Assumed	8,366	8,821
Gross	$ 109,974	106,710

(13) Segment Information

The Company’s operations are organized into three segments: agribusiness, commercial business, and other. These segments reflect the manner in which the Company currently manages the business based on type of customer, how the business is marketed, and the manner in which risks are underwritten. Within each segment, the Company underwrites and markets its insurance products through a packaged offering of coverages sold to generally consistent types of customers.

The other segment includes the runoff of discontinued lines of insurance business and the results of mandatory-assigned risk reinsurance programs that the Company must participate in as a cost of doing business in the states in which the Company operates. The discontinued lines of insurance business include personal lines, which the Company began exiting in 2001, and assumed reinsurance contracts for which the Company participated on a voluntary basis. Participation in these assumed reinsurance contracts ceased in the 1980s and early 1990s.

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

Segment information for the three months ended March 31, 2010 and 2009 is as follows:

	For the three months ended March 31,	
	2010	**2009**
Revenues:		
Premiums earned:		
Agribusiness	$ 11,042	10,736
Commercial business	5,881	7,017
Other	133	304
Total premiums earned	17,056	18,057
Investment income, net of investment expense	1,572	1,359
Realized investment gains, net	372	29
Other income	92	20
Total revenues	$ 19,092	19,465
Components of net loss:		
Underwriting (loss) income:		
Agribusiness	$ (482)	(669)
Commercial business	(1,948)	157
Other	268	150
Total underwriting losses	(2,162)	(362)
Investment income, net of investment expense	1,572	1,359
Realized investment gains, net	372	29
Other income	92	20
Corporate expense	(150)	(33)
Interest expense	—	(76)
Other expense, net	(33)	(47)
(Loss) income from continuing operations, before income taxes	(309)	890
Income tax (benefit) expense	(67)	205
(Loss) income from continuing operations	$ (242)	685

Table of Contents

PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY

(Unaudited)

Notes to Consolidated Financial Statements

(Dollars in thousands, except per share amounts)

	For the three months ended March 31, 2010	2009
Discontinued operations:		
Loss from discontinued operations, before income taxes	$ —	(16)
Income tax expense	—	804
Loss from discontinued operations	—	(820)
Net loss	$ (242)	(135)

The following table sets forth the net premiums earned by major lines of business for our core insurance products in the three months ended March 31, 2010 and 2009:

	For the three months ended March 31, 2010	2009
Net premiums earned:		
Agribusiness		
Property	$ 3,883	3,802
Commercial auto	2,814	2,746
Liability	2,291	2,330
Workers' compensation	1,880	1,691
Other	174	167
Agribusiness subtotal	11,042	10,736
Commercial lines		
Property & liability	3,522	4,280
Workers' compensation	1,243	1,546
Commercial auto	1,061	1,124
Other	55	67
Commercial lines subtotal	5,881	7,017
Other	133	304
Total net premiums earned	$ 17,056	18,057

Table of Contents

(14) Subsequent Events

Stock-Based Compensation Plan

At the Company's annual meeting on May 12, 2010, the shareholders approved a stock based incentive plan that authorizes the Company to award, during the ten year plan term, stock options for no more than 544,402 shares and restricted stock or restricted stock units for no more than 217,761 shares. The Company will award stock options to executives, directors, and key employee contributors as part of a long term incentive plan intended to reward growth in shareholder value.

In addition, on May 12, 2010, the Board of Directors approved the termination of the Supplemental Executive Retirement Plan (SERP) in anticipation of awarding restricted stock to the active SERP participants as a replacement for the lost SERP benefit. The termination of the SERP plan was contingent upon the approval of the stock incentive plan and any necessary releases or acknowledgments to be obtained from SERP participants.

Open Market Share Purchase Incentive Plan

At the Company's annual meeting, the shareholders also approved a cash-based long-term incentive plan for certain designated employees. This Plan provides award opportunities based on achievement of performance goals established by the Compensation Committee over an established performance period. The award recipients will be required to use the after-tax cash award proceeds to purchase the Company's common stock on the open market.

Share Repurchase Plan

In 2009, the Board of Directors authorized the Company to repurchase up to 5%, or 272,201, of the issued and outstanding shares of our common stock from time to time in open market or privately negotiated transactions. During the fourth quarter of 2009, the Company repurchased 217,761 shares under the share repurchase program and expects to use the treasury shares for the stock incentive plan.

On May 12, 2010, the Board of Directors also approved a new share repurchase plan, authorizing the Company to repurchase up to an additional 5%, or 258,591, of the issued and outstanding shares of common stock. Under the plan, the shares may be purchased in the open market or through privately negotiated transactions. No shares have been purchased in 2010.

Table of Contents

Item 2. **PENN MILLERS HOLDING CORPORATION AND SUBSIDIARY**

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS
Dollars in Thousands, Except Per Share Amounts
(Unaudited)

Some of the statements contained in this document are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "intend," "anticipate," "believe," "estimate," "predict," "potential" or "continue," the negative of these terms or other terminology. Forward-looking statements are based on the opinions and estimates of management at the time the statements are made and are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. These forward-looking statements include statements of goals, intentions and expectations; statements regarding prospects and business strategy; and estimates of future costs, benefits and results. The forward-looking statements are subject to numerous assumptions, risks and uncertainties, including, among other things, the factors discussed under Item 1A "Risk Factors" included in the Company's Form 10-K for the year ended December 31, 2009 that could affect the actual outcome of future events. All of these factors are difficult to predict and many are beyond our control.

Factors that could affect our actual results include, among others, the fact that our loss reserves are based on estimates and may be inadequate to cover our actual losses; the uncertain effects of emerging claim and coverage issues on our business, including the effects of climate change; the geographic concentration of our business; an inability to obtain or collect on our reinsurance protection; a downgrade in the A.M. Best rating of our insurance subsidiaries; the impact of extensive regulation of the insurance industry and legislative and regulatory changes; a failure to realize our investment objectives; the effects of intense competition; the loss of one or more principal employees; the inability to acquire additional capital on favorable terms; a failure of independent insurance brokers to adequately market our products; and the effects of acts of terrorism or war.

The references herein to "the Company," "we," "us" and "our" and "Penn Millers" refer to Penn Millers Holding Corporation and its subsidiary, PMMHC Corp., and its indirect subsidiary Penn Millers Insurance Company.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and accompanying notes included thereto included in our 2009 annual report on Form 10-K.

Overview

Our lead insurance company is Penn Millers Insurance Company, which is a Pennsylvania stock insurance company originally incorporated as a mutual insurance company in 1887. In 1999, Penn Millers Insurance Company converted from a mutual to a stock insurance company within a mutual holding company structure. This conversion created Penn Millers Mutual Holding Company (Penn Millers Mutual), a Pennsylvania mutual holding company, and established a "mid-tier" stock holding company, PMHC Corp. (PMHC), to hold all of the outstanding shares of Penn Millers Insurance Company. American Millers Insurance Company is a wholly owned subsidiary of Penn Millers Insurance Company that provides Penn Millers Insurance Company with excess of loss reinsurance.

On April 22, 2009, Penn Millers Mutual adopted a plan of conversion to convert Penn Millers Mutual from the mutual to the stock form of organization, which was approved by its eligible members on October 15, 2009. Upon its conversion, Penn Millers Mutual was renamed PMMHC Corp. and PMHC was subsequently merged with and into PMMHC Corp., thereby terminating PMHC's existence and making PMMHC Corp. the stock holding company for Penn Millers Insurance Company and a wholly owned subsidiary of Penn Millers Holding Corporation. The historical consolidated financial statements of Penn Millers Mutual prior to the conversion became the consolidated financial statements of Penn Millers Holding Corporation upon completion of the conversion. Neither PMMHC Corp. nor Penn Millers Holding Corporation engages in any business operation. After the conversion, the outstanding capital stock of Penn Millers Insurance Company and proceeds derived from the public stock offering are the primary assets of PMMHC Corp. and Penn Millers Holding Corporation, respectively.

On October 16, 2009, the Company completed the sale of 5,444,022 shares of Penn Millers Holding Corporation common stock, par value $0.01 per share, at an initial offering price of $10.00 per share in a concurrently-held subscription and community offering.

Prior to the completion of the offering, in accordance with the provisions of the Plan of Conversion of PMMHC Corp., our Employee Stock Ownership Plan (ESOP) purchased 539,999 of the shares in the offering, which was funded by a loan from Penn Millers Holding Corporation.

Our common stock is traded on the Nasdaq Global Market under the symbol "PMIC."

Table of Contents

On February 2, 2009, we completed the sale of substantially all of the net assets of Eastern Insurance Group, which was a wholly owned subsidiary insurance agency of PMHC. In July 2008, we completed the sale of substantially all of the net assets of Penn Software and Technology Services, Inc. (Penn Software), a Pennsylvania corporation specializing in providing information technology consulting for small businesses. Penn Software was a wholly owned subsidiary of PMHC. Both Eastern Insurance Group and Penn Software are accounted for as discontinued operations. We are in the process of formally dissolving both Eastern Insurance Group and Penn Software.

We offer insurance products designed to meet the needs of certain segments of the agricultural industry and the needs of middle market commercial businesses. We are licensed in 39 states, but we currently limit our sales of our insurance products to 33 states. We report our operating results in three operating segments: agribusiness insurance, commercial business insurance, and our "other" segment. Assets are not allocated to segments and are reviewed in the aggregate for decision-making purposes. Our agribusiness insurance segment product includes property (fire and allied lines and inland marine), liability (general, products and umbrella), commercial automobile, and workers' compensation insurance. We specialize in writing coverage for manufacturers, processors, and distributors of products for the agricultural industry. We do not write property or liability insurance for farms or farming operations unless written in conjunction with an eligible agribusiness operation; and we do not write any crop or weather insurance. We market our agribusiness lines through independent producers and our employees.

Our commercial business insurance segment product consists of a business owner's policy called Solutions that combines the following: property, liability, business interruption, and crime coverage for small businesses; workers' compensation; commercial automobile; and umbrella liability coverage. The types of businesses we target under our Solutions offering include retail, service, hospitality, wholesalers, light manufacturers, and printers. In early 2009, we introduced an insurance product called PennEdge that allows us to write customized coverages on mid-size commercial accounts. PennEdge provides property and liability coverage to accounts that currently do not meet the eligibility requirements for our traditional business owners Solutions policy or our agribusiness products. PennEdge is specifically tailored to unique business and industry segments, including wholesalers, light manufacturing, hospitality, printers, commercial laundries and dry cleaners. These segments were chosen based on the experience of our underwriting staff and the market opportunities available to our existing producers. Currently, the PennEdge product is approved in seventeen states.

Our third business segment, which we refer to as our "other" segment, includes the runoff of lines of business that we no longer offer or assume, and assigned risk reinsurance programs in which we are required to participate.

Penn Millers Insurance Company has been assigned an "A-" (Excellent) rating by A.M. Best Company, Inc., (A.M. Best) which is the fourth highest out of fifteen possible ratings. The latest rating evaluation by A.M. Best occurred on June 23, 2009.

Financial Highlights of Results for the Three Months Ended March 31, 2010:

- Net book value per share of $21.33 at March 31, 2010.
- Shareholders' equity increased $390 in the first quarter of 2010 primarily from net unrealized gains from investments of $463; and ESOP shares released of $148; these favorable items were offset by a net loss of $242 for the same period.
- Catastrophe and other weather related losses in the first quarter of 2010 were $2,364 in the period, compared to $1,361 in the first quarter of 2009.
- Our public offering in October 2009 provided us with capital to reduce our reliance on reinsurance, and therefore, we did not renew the aggregate excess of loss reinsurance contract in 2010. For the three months ended March 31, 2009, we had ceded $795 of premiums and $964 of losses to the reinsurers under this contract.
- Consistent with our investment policy, we have taken actions to invest a portion of our investment portfolio in equity securities, because we believe that over the long-term equities will provide a better return to us. We anticipate that by the end of the second quarter of 2010, approximately 6% of our investment portfolio will be comprised of equity securities in passively-managed equity index funds that follow the broader U.S. stock market. Equity securities comprised approximately 4.8% of our investment portfolio at March 31, 2010.

Results of Operations

Our results of operations are influenced by factors affecting the property and casualty insurance industry in general. The operating results of the United States property and casualty insurance industry are subject to significant variations due to competition, weather, catastrophic events, regulation, general economic conditions, judicial trends, fluctuations in interest rates and other changes in the investment environment.

Table of Contents

Our premium growth and underwriting results have been, and continue to be, influenced by market conditions. Pricing in the property and casualty insurance industry historically has been cyclical. During a soft market cycle, price competition is more significant than during a hard market cycle and makes it difficult to attract and retain properly priced agribusiness and commercial business. The insurance industry is currently experiencing a soft market cycle. Therefore, insurers may be unable to increase premiums and increase profit margins. A hard market typically has a positive effect on premium growth.

The major components of operating revenues and net loss are as follows:

	Three Months Ended March 31,	
	2010	2009
Revenues:		

	2010	2009
Premiums earned:		
Agribusiness	$ 11,042	$ 10,736
Commercial business	5,881	7,017
Other	133	304
Total premiums earned	17,056	18,057
Investment income, net of investment expense	1,572	1,359
Realized investment gains, net	372	29
Other income	92	20
Total revenues	$ 19,092	$ 19,465
Components of net loss:		
Underwriting (loss) income:		
Agribusiness	$ (482)	$ (669)
Commercial business	(1,948)	157
Other	268	150
Total underwriting loss	(2,162)	(362)
Investment income, net of investment expense	1,572	1,359
Realized investment gains, net	372	29
Other income	92	20
Corporate expense	(150)	(33)
Interest expense	—	(76)
Other expense, net	(33)	(47)
(Loss) income from continuing operations, before income taxes	(309)	890
Income tax (benefit) expense	(67)	205
(Loss) income (loss) from continuing operations	(242)	685
Discontinued operations:		
Loss from discontinued operations, before income taxes	—	(16)
Income tax expense	—	804
Loss from discontinued operations	—	(820)
Net loss	$ (242)	$ (135)
Underwriting Ratios:		
Loss and loss adjustment expense ratio	78.4%	66.3%
Underwriting expense ratio	35.2%	35.9%
GAAP combined ratio	113.6%	102.2%

Table of Contents

Consolidated Premiums Written and Premiums Earned

The components of premiums written and earned, for the three months ended March 31, 2010 and 2009 are as follows:

	Three Months Ended March 31,			
	2010		2009	
Consolidated	Written	Earned	Written	Earned
Direct	$ 20,849	$ 21,526	$ 22,754	$ 23,302
Assumed	88	88	222	222
Ceded — Stop loss contract	—	—	(795)	(795)
Ceded — All other	(4,563)	(4,558)	(4,499)	(4,672)
Net	$ 16,374	$ 17,056	$ 17,682	$ 18,057

- For the three months ended March 31, 2010, we had $17,056 of net premiums earned, compared to $18,057 of net premiums earned for the three months ended March 31, 2009. The $1,001, or 5.5%, decrease is primarily due to a reduction in net premiums earned in our commercial business segment of $1,136 as we continue to see the effects of our efforts to improve our underwriting results in this segment by terminating relationships with underperforming producers and of our strategic decision to discontinue writing premium in certain unprofitable classes of business in 2008 and 2009.

- In 2009, we ceded $795 of premiums to our reinsurers under our aggregate stop loss contract. The premiums ceded under the contract were subsequently reversed in the third quarter of 2009 as a result of favorable development in the loss ratio subject to the contract. The stop loss contract was not renewed for 2010 because the reinsurance protection is no longer necessary as we have raised additional capital through our stock offering in October 2009.

Net Investment Income

The following table sets forth our average invested assets and investment income for the reported periods:

	Three Months Ended March 31,	
	2010	**2009**
Average cash and invested assets (1)	$ 188,489	$ 138,933
Net investment income	1,572	1,359
Return on average cash and invested assets (2)	3.4%	4.0%

(1) Average cash and invested assets for 2010 include net proceeds from our October 2009 initial public offering of $45,666.

(2) Return on average cash and invested assets for interim periods is calculated on an annualized basis.

Net investment income increased $213 for the three months ended March 31, 2010 as compared to the same period ended March 31, 2009. The increase in the three month period is primarily attributable to higher balances of available for sale securities funded with cash from our October 2009 initial public offering, partially offset by the impact of declining interest rates.

Realized Investment Gains, Net

We had net realized investment gains from the sale of fixed maturity securities of $372 for the three months ended March 31, 2010, compared to net realized investment gains from the sales of fixed maturity securities of $29 for the same period ended March 31, 2009.

Other Income

Other income primarily consists of premium installment charges and fluctuations in returns on company-owned life insurance (COLI) policies. Other income was $92 and $20 for the three months ended March 31, 2010 and 2009, respectively. The net increase in other income for the three month period is due primarily to higher returns on the COLI policies compared to 2009.

Table of Contents

Consolidated Underwriting (Loss) Income

We evaluate our insurance operations by monitoring certain key measures of growth and profitability. In addition to using GAAP based performance measurements, we also utilize certain non-GAAP financial measures that we believe are valuable in managing our business and for comparison to our peers. These non-GAAP measures are underwriting income (loss), combined ratios, and written premiums.

Underwriting (loss) income measures the pre-tax profitability of our insurance segments. It is derived by subtracting losses and loss adjustment expenses, amortization of deferred policy acquisition costs, and underwriting and administrative expenses from earned premiums. Each of these captions is presented in our consolidated statements of operations but not subtotaled. The sections below provide more insight into the variances in the categories of losses and loss adjustment expenses and amortization of deferred policy acquisition costs and underwriting and administrative expenses, which impact underwriting profitability.

Losses and Loss Adjustment Expenses

The components of incurred losses and LAE and the loss and LAE ratio in the three months ended March 31, 2010 and 2009 are as follows:

Consolidated	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Net premiums earned	$ 17,056	$ 18,057
Incurred losses and LAE:		
Losses	$ 11,059	$ 12,070
Catastrophe losses	994	436
Other weather losses	1,370	925
Stop loss ceded	—	(964)
Prior year development (1)	(51)	(497)
Total incurred losses and LAE	$ 13,372	$ 11,970
Loss and LAE ratios:		
Losses	64.9%	66.9%
Catastrophe losses	5.8%	2.4%
Other weather losses	8.0%	5.1%
Stop loss ceded	0.0%	(5.3)%
Prior year development (1)	(0.3)%	(2.8)%
Total Loss and LAE ratio	78.4%	66.3%

(1) 2009 prior year development excludes the impact of the stop loss.

Our loss and loss adjustment expense (LAE) ratio was 78.4% for the three months ended March 31, 2010, compared to 66.3% for the three months ended March 31, 2009. The increase in losses and LAE in 2010 as compared to 2009 of $1,402 is due to:

- Catastrophe losses were $558 higher in the three months ended March 31, 2010 compared to the same period of 2009 due to claims arising from winter storms in the Northeast and Mid-Atlantic states that adversely impacted results in our commercial business segment.

- In the first quarter of 2010, we also experienced approximately $1,370 of non-catastrophe, weather-related losses, compared to approximately $925 of losses in the first quarter of 2009 from non-catastrophic weather events.

- Lower ceded losses attributable to the stop loss contract. For the three months ended March 31, 2009, we recorded ceded losses of $964 under the stop loss for the 2008 accident year, which were ultimately reversed in the third quarter of 2009 as a result of favorable development on that accident year. We did not renew the aggregate stop loss contract in 2010.

- For the three months ended March 31, 2010, we recorded $51 of favorable development, net of changes in additional reserves carried above the actuarial central estimate (see our discussion of “Losses and Loss Adjustment Expense Reserves” under the section entitled “Critical Accounting Estimates”). The favorable development in 2010 was primarily driven by lower emergence, relative to expectations, on the commercial multi-peril and commercial auto lines of business within our commercial business segment. This favorable development was mostly offset by unfavorable development on prior accident year fire and allied claims in our agribusiness segment and on workers’ compensation claims in our commercial business segment. The favorable development of $497 for the three months ended March 31, 2009 was primarily in our commercial auto and workers’ compensation lines due to better than expected loss emergence trends in those lines.

- Other losses declined by $1,011 due to lower new claim activity across most lines of business.

Underwriting Expenses

Our underwriting expense ratio represents the ratio of underwriting expenses (amortization of deferred policy acquisition costs and underwriting and administrative expenses) divided by net premiums earned. As one component of the combined ratio, along with the loss and loss adjustment expense ratio, the underwriting expense ratio is a key measure of profitability. The underwriting expense ratio can exhibit volatility from year to year from such factors as changes in premium volume, one-time or infrequent expenses for strategic initiatives, or profitability based bonuses to employees and producers. Our strategy has been to grow our net premium volume while controlling overhead costs.

Total underwriting and administrative expenses, including amortization of deferred policy acquisition costs, were $5,996 for the three months ended March 31, 2010 and $6,482 for the three months ended March 31, 2009. The net decrease of $486 is due to:

- Amortization of deferred policy acquisition costs decreased $629, or 11.4%, for the three months ended March 31, 2010 as compared to the same period in 2009, as a result of the 8.1% decline in direct and assumed earned premiums.

- Underwriting and administrative expenses increased $143 primarily from increased insurance, consulting and legal costs as we comply with public company reporting requirements.

Interest Expense

Interest expense was $0 and $76 in the three months ended March 31, 2010 and 2009, respectively. The three month period ended 2009 included interest on our aggregate stop loss reinsurance contract of $48 and interest expense associated with our long term debt and line of credit, the principal amounts of which were repaid in the latter half of 2009.

Other Expense

Other expense is comprised primarily of estimated reserves and specific write-offs of uncollectible premiums. Other expense was $33 for the three months ended March 31, 2010, as compared to $47 for the three month period ended March 31, 2009. The decrease of $14 was due primarily to higher levels of write-offs and aging of receivables in 2009 as compared to 2010, the positive impact of which we attribute to our decision to withdraw from certain unprofitable classes of business.

(Loss) Income from Continuing Operations, Before Income Taxes

For the three months ended March 31, 2010, we had a pre-tax loss from continuing operations of $309 compared to pre-tax income of $890 for the three months ended March 31, 2009. This net decrease of $1,199 was primarily attributable to:

- Lower net premiums earned in 2010 compared to 2009 of $1,001.

- Higher losses and LAE of $1,402 which was impacted by our no longer ceding losses under our aggregate stop loss reinsurance contract in 2010, higher weather-related losses, and a lower amount of net favorable development in 2010 compared to 2009. The prior year development in 2010 is net of a $1,175 reversal of incremental loss and LAE reserves that had been carried above the actuarial central estimate. These unfavorable items were offset by:

- Higher investment income of $213 primarily from our higher cash and invested assets balances due to our October 2009 initial public offering.

- Higher realized gains of $343 from sales of fixed maturity securities.

- Underwriting expenses were $486 lower primarily from our lower level of earned premium in 2010 compared to 2009, which resulted in lower amortization expense for policy acquisition costs.

Income Tax (Benefit) Expense

For the three months ended March 31, 2010, the income tax benefit for continuing operations was $67, or an effective rate of 21.7%, as compared to $205 of income tax expense, or an effective rate of 23.0%, for the three month period ended March 31, 2009. The decrease in the consolidated effective income tax rate is due primarily to our lower pre-tax income, which results in a higher proportion of tax exempt income relative to total pre-tax income.

Table of Contents

We have reviewed the potential of a tax position regarding a worthless stock deduction for our investment in Eastern Insurance Group. We have determined that the more-likely-than-not (i.e., a greater than fifty percent likelihood that the deduction will be sustained upon examination) recognition threshold would not be met. If we were to conclude to take this tax deduction on our 2009 federal income tax return, the benefit would need to be recorded as an uncertain tax position, with no current benefit recognized. The maximum impact of a tax deduction is approximately $900, with a reasonable possibility that the tax return position will not be taken.

Net Loss from Discontinued Operations

Discontinued operations in 2009 include the results related to our agency operations at Eastern Insurance Group. The sale of the net assets of Eastern Insurance Group was completed in February 2009. For the three months ended March 31, 2010, the net loss from discounted operations was $0, compared to $820 for the same period in 2009. The 2009 amount of $820 includes a provision for income taxes of $804, the majority of which represents state and federal income tax expense from the sale of the net assets of Eastern Insurance Group whose book basis exceeded their tax basis.

Net Loss

For the three months ended March 31, 2010, we had a net loss of $242, or $0.05 per share, compared to a net loss of $135 for the three months ended March 31, 2009. The decrease of $107 was due to the items discussed above.

Results of Operations by Segment

Our operations are organized into three business segments: agribusiness, commercial business, and our other segment. These segments reflect the manner in which we are currently managed based on type of customer, how the business is marketed, and the manner in which risks are underwritten. Within each segment we underwrite and market our insurance products through packaged offerings of coverages sold to generally consistent types of customers.

For purposes of segment reporting, the other segment includes the runoff of discontinued lines of insurance business and the results of mandatory assigned risk reinsurance programs that we must participate in as a cost of doing business in the states in which we operate. The discontinued lines of insurance business include personal lines, which we began exiting in 2001, and assumed reinsurance contracts in which we previously participated on a voluntary basis. Participation in these assumed reinsurance contracts ceased in the 1980s and early 1990s.

Agribusiness

The results of our agribusiness segment were as follows:

	Three Months Ended March 31,	
	2010	**2009**
Direct premiums written	$ 14,566	$ 15,299
Net premiums written	11,210	11,702
Revenues:		
Net premiums earned	$ 11,042	$ 10,736
Other income (expense)	27	(27)
Total revenues(1)	$ 11,069	$ 10,709
Operating loss:		
Underwriting loss	$ (482)	$ (669)
Other income (expense)	27	(27)
Interest & other expenses	(13)	(43)
Total operating loss(1)	$ (468)	$ (739)
Loss and loss expense ratio	75.6%	74.6%
Underwriting expense ratio	28.8%	31.6%
GAAP combined ratio	104.4%	106.2%

(1) Revenues exclude net realized investment gains (losses) and net investment income. Operating income (loss) equals pre-tax income (loss) from continuing operations excluding the impact of net realized investment gains (losses) and net investment income.

Table of Contents

Agribusiness Segment Premiums Written and Premiums Earned

The components of premiums written and earned, for the three months ended March 31, 2010 and 2009 are as follows:

	Three Months Ended March 31,			
	2010		2009	
Agribusiness	**Written**	**Earned**	**Written**	**Earned**
Direct	$ 14,566	$ 14,351	$ 15,299	$ 14,400
Ceded — Stop loss contract	—	—	(429)	(429)
Ceded — All other	(3,356)	(3,309)	(3,168)	(3,235)
Net	$ 11,210	$ 11,042	$ 11,702	$ 10,736

The agribusiness marketplace has been very competitive during the last few years, putting pressure on pricing. These competitive pressures are affecting our writing of new and renewal business and putting downward pressure on our existing rates. Our focus on underwriting discipline and rate adequacy in the midst of this soft market resulted in only modest premium revenue growth during 2009 and a decline in written premium thus far in 2010. Direct premiums written decreased from $15,299 for the three months ended March 31, 2009 to $14,566 for the three months ended March 31, 2010. The changes in direct premiums written for the quarterly period reflects lower retention rates in 2010 as we continue to hold the line on rates while we believe that our competition often reduces rates below what we feel are adequate levels compared to the risks underwritten. This continued competition has resulted in the loss of a few larger accounts in 2010 and has resulted in our level of new business declining in the first quarter of 2010 compared to the same period in 2009. However, we believe that our strong financial position, our stable and consistent presence in the agribusiness market, and our reputation for strong customer service will serve us better in the long run as these attributes differentiate us from competitors who we believe compete purely on price. In 2010, we did not renew our stop loss contract and, therefore, experienced a reduction in ceded premiums associated with that contract. This decrease in ceded premiums helped offset the aforementioned reduction in direct premiums written, resulting in the increase in premiums earned in our agribusiness segment of $306.

Agribusiness Segment Underwriting Loss

The discussion below provides more insight into the variances in the categories of losses and LAE and underwriting and administrative expenses, which impact underwriting profitability:

Losses and Loss Adjustment Expenses and Loss and LAE Ratio

The components of incurred losses and LAE and the loss and LAE ratio in the three months ended March 31, 2010 and 2009 are as follows:

	Three Months Ended March 31,	
Agribusiness	**2010**	**2009**
Net premiums earned	$ 11,042	$ 10,736
Incurred losses and LAE:		
Losses	$ 6,513	$ 7,087
Catastrophe losses	150	387
Other weather losses	698	452

Stop loss ceded	—	(395)
Prior year development (1)	988	479
Total incurred losses and LAE	$ 8,349	$ 8,010
Loss and LAE ratios:		
Losses	59.0%	66.0%
Catastrophe losses	1.4%	3.6%
Other weather losses	6.3%	4.2%
Stop loss ceded	0.0%	(3.7)%
Prior year development (1)	8.9%	4.5%
Total Loss and LAE ratio	75.6%	74.6%

(1) 2009 prior year development excludes the impact of the stop loss.

Table of Contents

Our agribusiness segment incurred $8,349 of losses and LAE for the three months ended March 31, 2010, compared to $8,010 of losses and LAE for the three months ended March 31, 2009. The increase of $339 is due to:

- Weather-related losses from both catastrophic and non-catastrophic events increased only modestly as they were $848 and $839 for the quarters ended March 31, 2010 and 2009, respectively.
- In 2009, we ceded $395 of 2008 accident year losses under our aggregate stop loss contract. The losses ceded under the contract were subsequently reversed in the third quarter of 2009 as a result of favorable development in the loss ratio subject to the contract. We did not renew the stop loss contract in 2010.
- We experienced $988 of unfavorable development in our agribusiness segment in 2010, net of changes in additional reserves carried above the actuarial central estimate (see our discussion of “Losses and Loss Adjustment Expense Reserves” under the section entitled “Critical Accounting Estimates”), compared to unfavorable development of $479 in 2009. The unfavorable development in 2010 was primarily in the fire and allied lines of business due to development on previously reported large property claims resulting from further details obtained in the investigation and settlement process.
- Other current year losses were lower by $574 as a result of improved case incurred loss experience in our commercial auto, other liability, and workers’ compensation lines of business, mostly arising from lower claim frequency.

The losses and LAE increase of $339 in 2010 compared to 2009, combined with a more modest increase in earned premiums of $306, led to the increase in our loss ratio from 74.6% for the first quarter of 2009 to 75.6% for the same quarter in 2010.

Underwriting Expenses and GAAP Combined Ratio

Total underwriting and administrative expenses, including amortization of deferred policy acquisition costs were $3,175 and $3,395 for the three month periods ended March 31, 2010 and 2009, respectively. The decline in underwriting expenses was attributable to the lower direct written premium volume and, combined with the increase in net premiums earned resulting from lower ceded premium from the stop loss, resulted in a lower expense ratio in 2010. The underwriting expense ratio decreased from 31.6% for the three months ended March 31, 2009 to 28.8% for the three months ended March 31, 2010. This decrease in the underwriting expense ratio was the primary driver of our combined ratio in our agribusiness segment decreasing from 106.2% for the three months ended March 31, 2009 to 104.4% for the three months ended March 31, 2010.

Commercial Business

The results of our commercial business segment were as follows:

	Three Months Ended March 31,

	2010	2009
Direct premiums written	$ 6,238	$ 7,373
Net premiums written	5,031	5,676
Revenues:		
Net premiums earned	$ 5,881	$ 7,017
Other income	65	47
Total revenues(1)	$ 5,946	$ 7,064
Operating (loss) income:		
Underwriting (loss) income	$ (1,948)	$ 157
Other income	65	47
Interest & other expenses	(20)	(52)
Operating (loss) income(1)	$ (1,903)	$ 152
Loss and loss expense ratio	88.8%	56.1%
Underwriting expense ratio	44.3%	41.6%
GAAP Combined ratio	133.1%	97.7%

(1) Revenues exclude net realized investment gains (losses) and net investment income. Operating income (loss) equals pre-tax income (loss) from continuing operations excluding the impact of net realized investment gains (losses) and net investment income.

Table of Contents

Commercial Business Segment Premiums Written and Premiums Earned

The components of premiums written and earned, for the three months ended March 31, 2010 and 2009 are as follows:

	Three Months Ended March 31,			
	2010		2009	
Commercial Business	**Written**	**Earned**	**Written**	**Earned**
Direct	$ 6,238	$ 7,130	$ 7,373	$ 8,820
Ceded — Stop loss contract	—	—	(366)	(366)
Ceded — All other	(1,207)	(1,249)	(1,331)	(1,437)
Net	$ 5,031	$ 5,881	$ 5,676	$ 7,017

Our direct premiums written in our commercial business segment were $6,238 for the three months ended March 31, 2010 and $7,373 for the three months ended March 31, 2009. This decline of $1,135 is primarily attributable to our late 2008 strategic decision to withdraw from certain unprofitable classes of business and our 2009 decision to terminate relationships with several underperforming producers. In 2009, we introduced our PennEdge product within our commercial business segment to enable us to write customized coverages on mid-size commercial accounts. Currently, the PennEdge product is offered in fifteen states, and we believe it has been well received by our agents and policyholders. Direct premiums written of our PennEdge product in the first quarter 2010 and 2009 were $614 and $57, respectively. In 2010 we did not renew our stop loss contract and, therefore, did not cede premiums under that contract. This decrease in ceded premiums partially offset the decline in direct earned premium associated with the aforementioned reduction in direct premiums written during 2009 and 2010, which led to the reduction in net premiums earned in our commercial business segment of $1,136.

Commercial Business Segment Underwriting (Loss) Income

The sections below provide more insight into the variances in the categories of losses and LAE and underwriting and administrative expenses, which impact our underwriting profitability:

Losses and Loss Adjustment Expenses and Loss and LAE Ratio

The components of incurred losses and LAE and the loss and LAE ratio in the three months ended March 31, 2010 and 2009 are as follows:

Commercial Business	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Net premiums earned	$ 5,881	$ 7,017
Incurred losses and LAE:		
Losses	$ 4,386	$ 4,783
Catastrophe losses	844	49
Other weather losses	672	473
Stop loss ceded	—	(569)
Prior year development (1)	(677)	(797)
Total incurred losses and LAE	$ 5,225	$ 3,939
Loss and LAE ratios:		
Losses	74.5%	68.2%
Catastrophe losses	14.4%	0.7%
Other weather losses	11.4%	6.7%
Stop loss ceded	0.0%	(8.1)%
Prior year development (1)	(11.5)%	(11.4)%
Total Loss and LAE ratio	88.8%	56.1%

(1) 2009 prior year development excludes the impact of the stop loss.

Table of Contents

Our commercial business segment incurred $5,225 of losses and LAE for the three months ended March 31, 2010, compared to $3,939 of losses and LAE for the three months ended March 31, 2009. The increase of $1,286 is due to:

- Catastrophe losses were $844 in the first quarter of 2010, compared to $49 in the first quarter of 2009. Our commercial business is highly concentrated in the northeastern United States, and several storms that occurred in this area in the first quarter of 2010 were designated as catastrophes.
- Our commercial business segment also experienced an increase of weather-related losses from non-catastrophic events of $199.
- In 2009, we ceded $569 of 2008 accident year losses under our aggregate stop loss contract. The losses ceded under the contract were subsequently reversed in the third quarter of 2009 as a result of favorable development in the loss ratio subject to the contract. We did not renew the stop loss contract in 2010.
- We experienced $677 of favorable development in our commercial business segment in 2010, compared to favorable development of $797 in 2009. The 2010 development was primarily attributable to lower than expected loss emergence in our commercial multi-peril and commercial auto lines of business. This favorable development was partially offset by unfavorable development on prior accident year workers' compensation.
- The unfavorable variances from the above mentioned items were partially offset by lower current year losses of $397.

The higher losses and LAE in 2010, arising primarily from the high level of winter storm activity, when combined with the decrease in earned premiums, resulted in our loss ratio in our commercial business segment increasing from 56.1% at March 31, 2009 to 88.8% at March 31, 2010.

Underwriting Expenses and GAAP Combined Ratio

Total underwriting and administrative expenses, including amortization of deferred policy acquisition costs were $2,604 and $2,921 for the three month periods ended March 31, 2010 and 2009, respectively. The reductions in direct premiums written in 2009 and 2010 contributed to the decrease in underwriting expenses of $317.

The lower underwriting expenses in 2010 were not enough to offset the reduction in earned premium in 2010 compared to 2009, and the underwriting expense ratio increased from 41.6% for the three months ended March 31, 2009 to 44.3% for the three months ended March 31, 2010. This increase in the expense ratio, together with the increase in the loss and LAE ratio, resulted in our combined ratio in our commercial business segment increasing from 97.7% for the three months ended March 31, 2009 to 133.1% for the three months ended March 31, 2010.

Other Segment

For purposes of segment reporting, the other segment includes the runoff of discontinued lines of insurance business and the results of mandatory assigned risk reinsurance programs that we must participate in as a cost of doing business in the states in which we operate. The discontinued lines of insurance business include personal lines, which we began exiting in 2001, and assumed reinsurance contracts in which we previously participated on a voluntary basis. Participation in these assumed reinsurance contracts ceased in the 1980s and early 1990s. The most significant of these is a reinsurance agreement we entered into with Munich Re America (formerly American Re), beginning January 1, 1969 and covering various property and liability lines of business. Penn Millers Insurance Company’s participation percentage ranged from 0.625% to 0.75%. We canceled the contract effective December 31, 1986. We have experienced adverse development and periodic reserve strengthening over the years, but we believe that Munich Re America has established adequate case and IBNR reserves at this time. At March 31, 2010 and at December 31, 2009 we had $5,098 and $5,260, respectively of loss reserves established for our voluntary assumed pools. The mandatory assigned risk programs serve as a secondary market for high risk insureds and include: the Fair Access to Insurance Requirements (FAIR) Plans; beachfront and windstorm plans; Commercial Automobile Insurance Plans (CAIPs); and national and state workers’ compensation pools.

The results of our other segment were as follows:

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
Assumed premiums written	$ 133	$ 304
Net premiums written	133	304
Revenues:		
Net premiums earned	$ 133	$ 304
Total revenues	$ 133	$ 304
Underwriting income	$ 268	$ 150
Operating income	$ 268	$ 150
Loss and loss expense ratio	(151.9)%	6.9%
Underwriting expense ratio	50.4%	43.8%
GAAP Combined ratio	(101.5)%	50.7%

Table of Contents

For the three months ended March 31, 2010, net premiums earned were $133, compared to $304 for the three months ended March 31, 2009. The year over year decrease in earned premium on our mandatory assumed business of $171 for the first quarter of 2010 was primarily driven by the continued decline in business assumed from the workers’ compensation residual market pools. The underwriting income for our other segment increased from $150 in the first quarter of 2009 to $268 for the first quarter of 2010. This increase resulted primarily from favorable development of $362 during the quarter in the loss reserves for both the mandatory assumed pools and the Munich Re America pool as the loss experience has not emerged as originally expected.

Financial Position

At March 31, 2010 we had total assets of $263,481, compared to total assets of $263,450 at December 31, 2009. The change in our total assets is primarily due to increased cash and invested assets from operating cash flow and investment appreciation, offset by lower premiums receivable due to our lower volume of earned premiums.

At March 31, 2010 we had total liabilities of $163,043, compared to $163,402 at December 31, 2009. The change in our total liabilities is primarily due to an increase in losses and LAE reserves of $3,264, partly offset by declines in unearned premiums of $689, and decreases in accounts payable, accrued expenses, and income taxes of $2,934, primarily due to timing of expenditures.

Liquidity and Capital Resources

We generate sufficient funds from our operations and maintain a high degree of liquidity in our investment portfolio to meet the demands of claim settlements and operating expenses. The primary sources of recurring funds are premium collections, investment earnings and maturing investments.

We maintain investment and reinsurance programs that are intended to provide sufficient funds to meet our obligations without forced sales of investments. We maintain a portion of our investment portfolio in relatively short-term and highly liquid assets to ensure the availability of funds.

The following table summarizes the distribution of our portfolio of fixed maturity investments as a percentage of total estimated fair value based on credit ratings assigned by Standard & Poor's Corporation (S&P) at March 31, 2010 and at December 31, 2009:

	March 31, 2010		December 31, 2009	
Rating(1)	Estimated Fair Value	Percent of Total(2)	Estimated Fair Value	Percent of Total(2)
Agencies not backed by the full faith and credit of the U.S. government	$ 15,427	9.4%	$ 17,441	10.4%
U.S. treasury securities	3,570	2.2%	4,612	2.8%
AAA	54,677	33.4%	58,249	34.9%
AA	36,220	22.2%	34,572	20.7%
A	44,294	27.1%	42,538	25.4%
BBB	9,332	5.7%	9,743	5.8%
Total	$ 163,520	100.0%	$ 167,155	100.0%

(1) The ratings set forth in this table are based on the ratings assigned by S&P. If S&P's ratings were unavailable, the equivalent ratings supplied by Moody's Investor Service, Fitch Investors Service, Inc. or the National Association of Insurance Commissioners (NAIC) were used where available.

(2) Represents percent of fair value for classification as a percent of the total fixed maturity portfolio.

Table of Contents

The table below sets forth the maturity profile of our fixed maturity securities at March 31, 2010 and December 31, 2009. Expected maturities could differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties:

	March 31, 2010		December 31, 2009	
	Amortized Cost	Estimated Fair Value(1)	Amortized Cost	Estimated Fair Value(1)
Less than one year	$ 11,658	$ 11,851	$ 10,008	$ 10,203
One though five years	74,720	77,670	73,532	76,405
Five through ten years	34,438	36,098	40,196	41,719
Greater than ten years	7,732	7,901	6,581	6,751
Commercial Mortgage-Backed(2)	2,768	2,829	3,806	3,775

Residential Mortgaged-Backed(2)	26,320	27,171	27,607	28,302
Total fixed maturity securities	$ 157,636	$ 163,520	$ 161,730	$ 167,155

(1) Fixed maturity securities are carried at fair value in our financial statements.

(2) Mortgage-backed securities consist of residential and commercial mortgage-backed securities and securities collateralized by home equity loans. These securities are presented separately in the maturity schedule due to the inherent risk associated with prepayment or early amortization. Prepayment rates are influenced by a number of factors that cannot be predicted with certainty, including: the relative sensitivity of the underlying mortgages or other collateral to changes in interest rates; a variety of economic, geographic and other factors; and the repayment priority of the securities in the overall securitization structures.

At March 31, 2010, the average effective duration of our mortgage-backed securities was 3.9 years. The average effective duration of our total fixed maturity investment portfolio was 3.3 years. The fair value of our investments may fluctuate significantly in response to changes in interest rates. In addition, we may experience investment losses to the extent our liquidity needs require the disposition of fixed maturity securities in unfavorable interest rate environments.

Our fixed maturity portfolio held $27,171 (with an average credit rating of AAA), and $28,302 (with an average credit rating of AAA) of United States Agency-guaranteed residential mortgage-backed securities (RMBS) at March 31, 2010 and December 31, 2009, respectively. We held no non-agency RMBS during the three months ended March 31, 2010 and during the year ended December 31, 2009.

Approximately 13% and 14% of our investments in fixed maturity securities at March 31, 2010 and December 31, 2009, respectively, were guaranteed by third party monoline insurers. As of March 31, 2010 and as of December 31, 2009, the fixed maturity securities guaranteed by these monoline insurers were comprised entirely of municipal bonds with a fair value of $21,453 and $22,695, respectively, and an average credit rating of AA+ for each of these periods. We base our investment decision on the credit characteristics of the municipal security, without consideration of the guarantee. We hold no securities issued by any third party insurer.

On October 16, 2009, we completed an initial public offering of 5,444,022 shares of common stock at $10.00 per share. Consistent with our expectations, the gross proceeds of $54,440 were allocated through December 31, 2009 as follows: conversion and offering expenses and commissions of $3,867; the loan to our ESOP of $5,400; pay down of our line of credit of $1,800; and general corporate purposes of approximately $43,373. After using a portion of the proceeds to fund a loan to our ESOP and retire our line of credit, we contributed $25,000 of the remaining net proceeds from the offering to Penn Millers Insurance Company. These net proceeds will supply additional capital that Penn Millers Insurance Company needs to support future premium growth through the expansion of our producer networks and the marketing of our new PennEdge product. The net proceeds have been invested in securities consistent with our investment policy.

In connection with our conversion and public offering, we established an ESOP which purchased 539,999 shares in the offering in return for a note from us bearing interest at 4.06% on the principal amount of $5,400. The issuance of the shares to the ESOP was fully recognized in the additional paid-in capital account at the offering closing date, with a contra account established in the shareholders' equity section of the balance sheet for the unallocated shares at an amount equal to their $10.00 per-share purchase price.

[Table of Contents](#)

It is anticipated that approximately 10% of the ESOP shares will be allocated annually to employee participants of the ESOP. An expense charge is booked ratably during each year for the shares committed to be allocated to participants that year, determined with reference to the fair market value of our stock at the time the commitment to allocate the shares is accrued and recognized. For the three months ended March 31, 2010, we recognized compensation expense of $148 on 13,500 shares of our common stock that were committed to be released to participants' accounts at December 31, 2010.

On October 27, 2009, our board of directors authorized the repurchase of up to 5% of the issued and outstanding shares of our common stock. The repurchases are authorized to be made from time to time in open market or privately negotiated transactions as, in our management's sole opinion, market conditions warrant. We will have the right to repurchase issued and outstanding shares of common stock until 5% of the shares, or 272,201, are repurchased, unless our board of directors expands the program. In the three months ended March 31, 2010 we did not repurchase any of our common shares. As of December 31, 2009, we repurchased 217,761 shares at an average cost of $10.18 per share. The repurchased shares will be held as treasury shares and will be used in connection with our stock-based incentive plan.

Cash flows from continuing operations for the three months ended March 31, 2010 and 2009 were as follows:

	Three Months Ended March 31,	
	2010	2009
Cash flows provided by operating activities	$ 1,416	$ 7,113
Cash flows used in investing activities	(3,830)	(3,202)
Cash flows used in financing activities	—	(175)
Net (decrease) increase in cash and cash equivalents	$ (2,414)	$ 3,736

Cash flows from operating activities decreased by $5,697 for the three month period ended March 31, 2010 compared to the period ended March 31, 2009. The change is primarily due to lower premium volume and higher claims payments in 2010 compared to 2009.

Investing activities used $3,830 and $3,202 of net cash for the three months ended March 31, 2010 and 2009, respectively. In the first three months of 2010, net purchases of available-for-sale securities were $3,800. For the first three months of 2009, net proceeds from our February 2009 sale of the net assets of Eastern Insurance Group provided $2,576 of net cash.

Cash flows used in financing activities for the three months ended March 31, 2009 include $830 of amounts paid for fees and expenses associated with our 2009 conversion and public offering. In the first quarter of 2009, we borrowed $733 on our $2,000 line of credit that existed at that time.

As of March 31, 2010, our parent company, Penn Millers Holding Corporation, held total cash and invested assets in fixed maturity securities and equity securities of $18,376. In addition, at March 31, 2010, we had no outstanding debt and, therefore, do not expect to have any need for dividends from Penn Millers Insurance Company in the near future.

Penn Millers Insurance Company is restricted by the insurance laws of Pennsylvania as to the amount of dividends or other distributions it may pay to us. Under Pennsylvania law, there is a maximum amount that may be paid by Penn Millers Insurance Company during any twelve-month period. Penn Millers Insurance Company may pay dividends to us after notice to, but without prior approval of the Pennsylvania Insurance Department in an amount "not to exceed" the greater of (i) 10% of the surplus as regards policyholders of Penn Millers Insurance Company as reported on its most recent annual statement filed with the Pennsylvania Insurance Department, or (ii) the statutory net income of Penn Millers Insurance Company for the period covered by such annual statement. Dividends in excess of this amount are considered "extraordinary" and are subject to the approval of the Pennsylvania Insurance Department. As of January 1, 2010 and March 31, 2010, the amount available for payment of dividends from Penn Millers Insurance Company in 2010 without the prior approval of the Pennsylvania Insurance Department is $7,249 based upon the insurance company's 2009 annual statement. Prior to its payment of any dividend, Penn Millers Insurance Company is required to provide notice of the dividend to the Pennsylvania Insurance Department. This notice must be provided to the Pennsylvania Insurance Department 30 days prior to the payment of an extraordinary dividend and 10 days prior to the payment of an ordinary dividend. The Pennsylvania Insurance Department has the power to limit or prohibit dividend payments if Penn Millers Insurance Company is in violation of any law or regulation. These restrictions or any subsequently imposed restrictions may affect our future liquidity.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital reserves.

Table of Contents

Impact of Inflation

Inflation increases consumers' needs for property and casualty insurance coverage due to the increase in the value of the property covered and any potential liability exposure. Inflation also increases claims incurred by property and casualty insurers as property repairs, replacements and medical expenses increase. These cost increases reduce profit margins to the extent that rate increases are not implemented on an adequate and timely basis. We establish property and casualty insurance premiums levels before the amount of loss and loss expenses, or the extent to which inflation may impact these expenses, are known. Therefore, we attempt to anticipate the potential impact of inflation when establishing rates. Because inflation has remained relatively low in recent years, financial results have not been significantly affected by it.

Critical Accounting Estimates

General

The preparation of financial statements in accordance with GAAP requires both the use of estimates and judgment relative to the application of appropriate accounting policies. We are required to make estimates and assumptions in certain circumstances that affect amounts reported in our financial statements and related footnotes. We evaluate these estimates and assumptions on an on-going basis based on historical developments, market conditions, industry trends and other information that we believe to be reasonable under the circumstances. There can be no assurance that actual results will conform to our estimates and assumptions and that reported results of operations will not be materially adversely affected by the need to make accounting adjustments to reflect changes in these estimates and assumptions from time to time. Our critical accounting estimates are more comprehensively described in our 2009 Form 10-K in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations-Critical Accounting Estimates." We believe that our most significant accounting estimates to be those applied to losses and loss adjustment expense reserves and related reinsurance recoverables; and investment valuation and impairments.

Losses and Loss Adjustment Expense Reserves

How reserves are established

We maintain reserves for the payment of claims (incurred losses) and expenses related to adjusting those claims (loss adjustment expenses or LAE). Our loss reserves consist of case reserves, which are reserves for claims that have been reported to us, and reserves for "IBNR" which is comprised of estimated development of our case reserves and estimates of claims that have been incurred but have not yet been reported.

When a claim is reported to us, our claims personnel establish a case reserve for the estimated amount of the ultimate payment. The amount of the loss reserve for the reported claim is based primarily upon a claim-by-claim evaluation of coverage, liability, injury severity or scope of property damage, and any other information considered pertinent to estimating the exposure presented by the claim. Each claim is settled individually based upon its merits, and some claims may take years to settle, especially if legal action is involved. Case reserves are reviewed on a regular basis and are updated as new data becomes available.

In addition to case reserves, we maintain estimates of reserves for losses and loss adjustment expenses incurred but not reported. Some claims may not be reported for many years. As a result, the liability for unpaid losses and loss adjustment reserves includes significant estimates for IBNR.

We utilize an independent actuary to assist with the estimation of our losses and LAE reserves each quarter. The actuary prepares estimates of the ultimate liability for unpaid losses and LAE based on established actuarial methods. Our management reviews these estimates and supplements the actuarial analysis with information not fully incorporated into the actuarially based estimate, such as changes in the external business environment and changes in internal company processes and strategy. We may adjust the actuarial estimates based on this supplemental information in order to arrive at the amount recorded in the financial statements.

We estimate IBNR reserves by first deriving an actuarially-based estimate of the ultimate cost of total losses and loss adjustment expenses incurred by line of business as of the financial statement date. We then reduce the estimated ultimate losses and loss adjustment expenses by losses and loss adjustment expense payments and case reserves carried as of the financial statement date. The actuarially-determined estimate is based upon indications from one of several recognized actuarial methodologies or uses a weighted average of these results. The specific method used to estimate the ultimate losses for individual lines of business, or individual accident years within a line of business, will vary depending on the judgment of the actuary as to what is the most appropriate method for a line of business' unique characteristics. Finally, we consider other factors that impact reserves that are not fully incorporated in the actuarially based estimate, such as changes in the external business environment and changes in internal company processes and strategy.

Table of Contents

The process of estimating loss reserves involves a high degree of judgment and is subject to a number of variables. These variables can be affected by both internal and external events, such as changes in claims handling procedures, economic inflation, legal trends, and legislative changes, among others. The impact of many of these items on ultimate costs for claims and claim adjustment expenses is difficult to estimate. Loss reserve estimation difficulties also differ significantly by line of business due to differences in claim complexity, the volume of claims, the potential severity of individual claims, the determination of occurrence date for a claim, and reporting lags (the time between the occurrence of the policyholder event and when it is actually reported to the insurer). Informed judgment is applied throughout the process, including the application of various individual experiences and expertise to multiple sets of data and analyses. We continually refine our loss reserve estimates in a regular ongoing process as historical loss experience develops and additional claims are reported and settled. We consider all significant facts and circumstances known at the time loss reserves are established.

Due to the inherent uncertainty underlying loss reserve estimates, final resolution of the estimated liability for losses and loss adjustment expenses may be higher or lower than the related loss reserves at the reporting date. Therefore, actual paid losses, as claims are settled in the future, may be materially higher or lower in amount than current loss reserves. We reflect adjustments to loss reserves in the results of operations in the period the estimates are changed.

Our reserves for unpaid losses and LAE are summarized below:

	As of March 31, 2010	As of December 31, 2009
Case reserves	$ 57,444	$ 55,258
IBNR reserves	32,224	33,096
Net unpaid losses and LAE	89,668	88,354
Reinsurance recoverables on unpaid losses and LAE	20,306	18,356
Reserves for unpaid losses and LAE	$ 109,974	$ 106,710

At March 31, 2010, the amount recorded as compared to the actuarially-determined reserve range, net of reinsurance was as follows:

Reserve Range for Unpaid Losses and LAE		
Low End	Recorded	High End
	(Dollars in thousands)	
$ 80,548	$ 89,668	$ 92,058

Our actuary determined a range of reasonable reserve estimates which reflect the uncertainty inherent in the loss reserving process. This range does not represent the range of all possible outcomes. We believe that the actuarially-determined ranges represent reasonably likely changes in the losses and LAE estimates, however actual results could differ significantly from these estimates. The range was determined by line of business and accident year after a review of the output generated by the various actuarial methods utilized.

The selection of the ultimate loss is based on information unique to each line of business and accident year and the judgment and expertise of our actuary and management. Although we raised the net retention of our per risk excess of loss reinsurance covering many of these lines of business in 2008, our aggregate stop loss reinsurance contract limits the potential for further development across all lines for the reserves associated with the 2008 and 2009 accident years. The stop loss contract was not renewed for 2010 because the reinsurance protection is no longer necessary as we have raised additional capital through our stock offering in October 2009. As of March 31, 2010 and at December 31, 2009 we had ceded reinsurance loss recoverable under this stop loss contract of $0 due to our reversing the stop loss benefit in 2009 that had accrued to us for the 2008 accident year because of favorable loss development we had experienced for that year. As of March 31, 2010, the actual 2009 and 2008 accident year loss ratios for business subject to the aggregate stop loss treaty were approximately 67% and 77%, respectively.

The following table provides case and IBNR reserves for losses and loss adjustment expenses by major lines of business as of March 31, 2010:

	Case Reserves	IBNR Reserves	Total Reserves	Actuarially Determined Range of Estimates Low	Actuarially Determined Range of Estimates High
Commercial auto liability	$ 9,882	$ 5,211	$ 15,093	$ 13,840	$ 15,466
Workers' compensation	13,671	7,815	21,486	19,920	21,566
Commercial multi-peril	14,038	6,293	20,331	19,008	20,870
Liability	8,823	7,718	16,541	14,350	17,180
Fire & allied	5,328	1,028	6,356	5,418	6,521
Assumed	4,484	3,422	7,906	6,506	8,001
Other	1,218	737	1,955	1,506	2,454
Total net reserves	57,444	32,224	89,668	$ 80,548	$ 92,058
Reinsurance recoverables	10,761	9,545	20,306		
Gross reserves	$ 68,205	$ 41,769	$ 109,974		

Table of Contents

As discussed earlier, the estimation of our reserves is based on several actuarial methods, each of which incorporates many quantitative assumptions. The judgment of the actuary plays an important role in selecting among various loss development factors and selecting the appropriate method, or combination of methods, to use for a given line of business and accident year. The ranges presented above represent the expected variability around the actuarially determined central estimate. The width of the range is primarily determined by the specific line of business. For example, long tail casualty lines typically involve greater uncertainty and, therefore, have a wider range of expected outcomes. The magnitude of the line of business (i.e. volume of insured exposures) can also factor into the range such that more significantly sized lines of business provide more statistically significant data to rely upon. The total range around our actuarially determined estimate varies from -9% to +4%, with the ranges around each of our core lines of business (excluding assumed and other lines) ranging from the widest being -15% to +3% (fire and allied) to the narrowest being -5% to +3% (workers' compensation).

The table below summarizes the impact on equity from changes in estimates of unpaid losses and LAE reserves as of March 31, 2010:

Reserve Range for Unpaid Loss and LAE	Aggregate Loss and LAE Reserve	Percentage Change in Shareholders' Equity (1)
Low End	$ 80,548	6.0%
Recorded	$ 89,668	—
High End	$ 92,058	(1.6)%

(1) Net of tax

If the losses and LAE reserves were recorded at the high end of the actuarially-determined range, the losses and LAE reserves would increase by $2,390. This increase in reserves would reduce our shareholders' equity as of March 31, 2010 by $1,577. If the losses and LAE reserves were recorded at the low end of the actuarially-determined range, the losses and LAE reserves at March 31, 2010 would be reduced by $9,120, with a corresponding increase in shareholders' equity of $6,019.

If the losses and LAE reserves were to adversely develop to the high end of the range, $2,390 of anticipated future payments for the losses and LAE expenses would be required to be paid, thereby affecting cash flows in future periods as the payments for losses are made.

Specific considerations for major lines of business

Commercial Multi-Peril

At March 31, 2010, the commercial multi-peril line of business had recorded reserves, net of reinsurance, of $20,331, which represented 22.7% of our total net reserves. This line of business includes both property and liability coverage provided under a business owner's policy. This line of business can be prone to adverse development arising from delayed reporting of claims and adverse settlement trends related to the liability portion of the line. At March 31, 2010 and December 31, 2009, no adjustment was made to the actuarially selected estimate for this line. While management has not identified any specific trends relating to additional reserve uncertainty on prior accident years, a declining economic climate and unfavorable changes to the legal environment could lead to the filing of more claims for previously unreported losses.

Workers' Compensation

At March 31, 2010, our workers' compensation line of business had recorded reserves, net of reinsurance, of $21,486, or 24.0% of our total net reserves. At March 31, 2010, this reserve was $525, or 2.5%, above the actuarially selected estimate. At December 31, 2009 this reserve was $525, or 2.6% above the actuarially selected estimate. In addition to the uncertainties associated with the actuarial assumptions and methodologies described above, the workers' compensation line of business can be impacted by a variety of issues such as unexpected changes in medical cost inflation, medical treatment options and duration, changes in overall economic conditions, and company specific initiatives. Initiatives to limit the long term costs of workers' compensation claims costs, such as return to work programs, can be adversely impacted by poor economic conditions when there are fewer jobs available for injured workers.

Liability

This line of business includes general liability, products liability, and umbrella liability coverages. At March 31, 2010, our liability line of business had recorded reserves, net of reinsurance of $16,541, which represented 18.4% of our total net reserves and was equal to the actuarially selected estimate for this line. At December 31, 2009, our liability line of business had recorded reserves, net of reinsurance of $17,060, which represented 19.3% of our total net reserves. This reserve at December 31, 2009 was $650, or 4.0%, above the actuarially selected estimate. This line can be prone to volatility and adverse development. In particular, many claims in these coverages often involve a complex set of facts and high claim amounts, and litigation often takes place in challenging court environments. The additional reserve above the actuarial central estimate at December 31, 2009 was held to cover this potential for adverse development. During the first quarter of 2010, we experienced unfavorable development on accident year 2009 claims that contributed to an increase in our actuary's ultimate loss estimate for this line of business by approximately $800. As of March 31, 2010, we believe that the actuary has updated assumptions for this line of business to appropriately capture the inherent uncertainty related to the reserving that will be sufficient to cover future losses. Therefore, we have recorded our reserves at March 31, 2010 at the same amount as the actuarial central estimate.

Commercial Automobile Liability

At March 31, 2010, our commercial automobile liability line of business had recorded reserves, net of reinsurance, of $15,093, which represented 16.8% of our total net reserves and was equal to the actuarially selected estimate for this line. At December 31, 2009, our commercial automobile liability line of business had recorded reserves, net of reinsurance, of $14,501, which represented 16.4% of our total net reserves. This reserve at December 31, 2009 was $525, or 3.8%, above the actuarially selected estimate. This line of business is similar to workers' compensation in that the reporting of claims is generally timely but understanding the true extent of the liability can be difficult to estimate, both at the claim level and in aggregate. The gathering of important information can be delayed due to a slow legal discovery process. Also, uncertainty about the true severity of injuries and unpredictability of medical cost inflation can make reserving for specific claims a challenge. Medical cost inflation and evolving legal environments can also invoke uncertainty into the process of estimating IBNR. The additional reserve above the actuarial central estimate at December 31, 2009 was held to cover this potential for adverse development. During the first quarter of 2010, we experienced unfavorable development on accident year 2008 claims that contributed to an increase in our actuary's ultimate loss estimate for this line of business by over $800. As of March 31, 2010, we believe that the actuary has updated assumptions for this line of business to appropriately capture the inherent uncertainty related to the reserving that will be sufficient to cover future losses. Therefore, we have recorded our reserves at March 31, 2010 at the same amount as the actuarial central estimate.

Fire and Allied

March 31, 2010, our fire and allied lines of business had recorded reserves, net of reinsurance, of $6,356, which represented 7.1% of our total net reserves. These lines of business comprise a substantial amount of the property exposures that we insure. Our allied line of business covers losses primarily from wind, hail, and snow. No adjustment was been made to the actuarially selected estimate for this line at March 31, 2010 and December 31, 2009. Favorable or unfavorable development can occur on specific claims based on changes in the cost of building materials, refinement of damage assessments, and resolution of coverage issues; and as opportunities for salvage and subrogation are investigated.

Assumed

At March 31, 2010, our assumed lines of business had recorded reserves, net of reinsurance, of $7,906, which represented 8.8% of our total net reserves. At March 31, 2010, this reserve was $300, or 3.9%, above the actuarially selected estimate. At December 31, 2009, this reserve was $300, or 3.8% above the actuarially selected estimate. These lines comprise the majority of our other segment, with the reserves mostly attributable to a Munich Re America reinsurance pool, in which we terminated our participation in 1986, and the mandatory assumed risk pools in which we are required to participate in the states we do business. The case reserves for these pools are established based on amounts reported to us by the ceding parties. The IBNR is estimated based on observed development trends using the various methodologies described earlier. The exposures within these pools include long tail lines such as workers' compensation, auto liability, general liability, and products liability; and also include asbestos exposures. Development can occur in these reserves due to such factors as the changing legal environment, the economic climate, and medical cost inflation. In addition, we are dependent on information from third parties which can make it difficult to estimate the IBNR for this business.

Our estimated liability for asbestos and environmental claims is $2,318 at March 31, 2010, and $2,397 at December 31, 2009, a substantial portion of which results from our participation in assumed reinsurance pools. The estimation of the ultimate liability for these claims is difficult due to outstanding issues such as whether coverage exists, the definition of an occurrence, the determination of ultimate damages, and the allocation of such damages to financially responsible parties. Therefore, any estimation of these liabilities is subject to significantly greater-than-normal variation and uncertainty.

Table of Contents

Investments

Our fixed maturity investments are classified as available-for-sale and carried at estimated fair value as determined by management based upon quoted market prices or a recognized pricing service at the reporting date for those or similar investments. Changes in unrealized investment gains or losses on our investments, net of applicable income taxes, are reflected directly in equity as a component of comprehensive income (loss) and, accordingly, have no effect on net income (loss). Investment income is recognized when earned, and capital gains and losses are recognized when investments are sold, or other-than-temporarily impaired.

The fair value and unrealized losses for our securities that were temporarily impaired as of March 31, 2010 are as follows:

	Less than 12 Months		12 Months or Longer		Total	
Description of Securities	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Agencies not backed by the full faith and credit of the U.S. government	$ 4,671	$ 16	$ —	$ —	$ 4,671	$ 16
State and political subdivisions	5,604	69	548	15	6,152	84
Commercial mortgage-backed						

securities	—	—	493	11	493	11
Residential mortgage-backed securities	8,939	88	—	—	8,939	88
Corporate securities	13,083	39	1,502	7	14,585	46
Total temporarily impaired securities	$ 32,297	$ 212	$ 2,543	$ 33	$ 34,840	$ 245

Fair values of interest rate sensitive instruments may be affected by increases and decreases in prevailing interest rates which generally translate, respectively, into decreases and increases in fair values of fixed maturity investments. The fair values of interest rate sensitive instruments also may be affected by the credit worthiness of the issuer, prepayment options, relative values of other investments, the liquidity of the instrument, and other general market conditions.

At March 31, 2010 and December 31, 2009, we had gross unrealized losses on fixed maturity securities of $245 and $561, respectively. We have evaluated each security and taken into account the severity and duration of any declines in fair value, the current rating on the bond and the outlook for the issuer according to independent analysts. We believe that the foregoing declines in fair value in our existing portfolio are most likely attributable to current market conditions and we will recover the entire amortized cost basis. Our fixed maturity investments are classified as available for sale because we will, from time to time, make sales of securities that are not impaired, consistent with our investment goals and policies. Our investment portfolio is managed by an independent investment manager who has discretion to buy and sell securities, however, by agreement; the investment manager cannot sell any security without our consent if such sale will result in a net realized loss.

We monitor our investment portfolio and review securities that have experienced a decline in fair value below cost to evaluate whether the decline is other-than-temporary. When assessing whether the amortized cost basis of a fixed maturity security will be recovered, we compare the present value of the cash flows likely to be collected, based on an evaluation of all available information relevant to the collectability of the security, to the amortized cost basis of the security. The shortfall of the present value of the cash flows expected to be collected in relation to the amortized cost basis is referred to as the “credit loss.” If we determine that we intend to sell the securities that have experienced a decline in fair value below cost, or that it is more likely than not that we will be required to sell the securities prior to recovering their amortized cost basis less any current-period credit losses, the full amount of the other-than-temporary impairment will be recognized in earnings. If we conclude based on our analysis that there is a credit loss, and we determine that we do not intend to sell, and it is not more likely than not that we will be required to sell the securities, the amount of the credit loss will be recorded in earnings, and the remaining portion of the other-than-temporary impairment loss will be recognized in other comprehensive income (loss), net of tax.

Table of Contents

Our board of directors developed our investment policy in conjunction with our external investment manager and reviews the policy at least annually. Our investment portfolio is professionally managed by a registered independent investment advisor specializing in the management of insurance company assets. As a result of our public offering in 2009, we and our investment advisor have analyzed our portfolio allocations; and in accordance with the guidelines, goals and objectives of our investment policy, we have set a target allocation of 6% of our investment portfolio to be invested in passively-managed equity index funds that follow the broader U.S. stock market. We anticipate that this target allocation of 6% equities will be attained in the second quarter of 2010. Equity securities comprised approximately 4.8% of our investment portfolio at March 31, 2010.

We use quoted values and other data provided by a nationally recognized independent pricing service in our process for determining the fair values of our investments. Its evaluations represent an exit price and a good faith estimate as to what a buyer in the marketplace would pay for a security in a current sale. This pricing service provides us with one quote per instrument. For fixed maturity securities that have quoted prices in active markets, market quotations are provided. For fixed maturity securities that do not trade on a daily basis, the independent pricing service prepares estimates of fair value using a wide array of observable inputs including relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. The observable market inputs that our independent pricing service utilizes may include (listed in order of priority for use) benchmark yields, reported trades, broker-dealer quotes, issuer spreads, two-sided markets, benchmark securities, market bids/offers, and other reference data on markets, industry, and the economy. Additionally, the independent pricing service uses an

Option Adjusted Spread model to develop prepayment and interest rate scenarios.

In the event that the independent pricing service is unable to provide a fair value estimate, we would attempt to obtain a non-binding fair value estimate from a number of broker-dealers and review this estimate in conjunction with a fair value estimate reported by an independent business news service or other sources. In instances where only one broker-dealer provides a fair value for a fixed maturity security, we would use that estimate. In instances where we are able to obtain fair value estimates from more than one broker-dealer, we would review the range of estimates and would select the most appropriate value based on the facts and circumstances. Should neither the independent pricing service nor a broker-dealer provide a fair value estimate, we would develop a fair value estimate based on cash flow analyses and other valuation techniques that utilize certain unobservable inputs. Accordingly, we would classify such a security as a Level 3 investment.

The fair value estimates of our investments provided by the independent pricing service at March 31, 2010 and December 31, 2009 were utilized, among other resources, in reaching a conclusion as to the fair value of our investments. As of March 31, 2010 and December 31, 2009, all of our investments were priced using this one primary service.

Management reviews the reasonableness of the pricing provided by the independent pricing service by employing various analytical procedures. We review all fixed maturity securities to identify recent downgrades, significant changes in pricing, and pricing anomalies on individual securities relative to other similar securities. This will include looking for relative consistency across securities in common sectors, durations and credit ratings. This review will also include all fixed maturity securities rated lower than “A” by Moody’s or S&P. If, after this review, management does not believe the pricing for any security is a reasonable estimate of fair value, then it will seek to resolve the discrepancy through discussions with the pricing service. In our review, we did not identify any such discrepancies for the three months ended March 31, 2010 and the year ended December 31, 2009, and no adjustments were made to the estimates provided by the pricing service for the three months ended March 31, 2010 and the year ended December 31, 2009. The classification within the fair value hierarchy of FASB ASC 820, *Fair Value Measurements and Disclosures*, is then confirmed based on the final conclusions from the pricing review.

Recent Accounting Pronouncements

In January 2010, the FASB issued guidance to improve the disclosures related to fair value measurements. The new guidance requires expanded fair value disclosures, including the reasons for significant transfers between Level 1 and Level 2 and the amount of significant transfers into each level disclosed separately from transfers out of each level. For Level 3 fair value measurements, information in the reconciliation of recurring Level 3 measurements about purchases, sales, issuances and settlements shall be presented separately on a gross basis, rather than as one net number. In addition, clarification is provided about existing disclosure requirements, such as presenting fair value measurement disclosures for each class of assets and liabilities that are determined based on their nature and risk characteristics and their placement in the fair value hierarchy (that is, Level 1, 2, or 3), as opposed to each major category of assets and liabilities, as required in the previous guidance. Disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements are required for fair value measurement that fall in either Level 2 or Level 3. We adopted this new guidance effective January 1, 2010, except for the gross presentation of purchases, sales, issuances and settlements in the Level 3 reconciliation, which is effective for annual and interim reporting periods beginning after December 15, 2010. The disclosures required by this new guidance are provided in Note 7 to the consolidated financial statements.

All other standards and updates of those standards issued during the three months ended March 31, 2010 either (i) provide supplemental guidance, (ii) are technical corrections, (iii) are not applicable to us or (iv) are not expected to have a significant impact on our results of operations or financial condition.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk that we will incur losses due to adverse changes in the fair value of financial instruments. We have exposure to three principal types of market risk through our investment activities: interest rate risk, credit risk and equity risk. Our primary market risk exposure is to changes in interest rates. We have not entered, and do not plan to enter, into any derivative financial instruments for trading or speculative purposes.

Table of Contents

Interest Rate Risk

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. Our exposure to interest rate changes primarily results from our significant holdings of fixed rate investments. Fluctuations in interest rates have a direct impact on the fair value of these securities.

The average effective duration of the fixed maturity securities in our investment portfolio at March 31, 2010, was 3.3 years. Our fixed maturity securities investments include U.S. government bonds, securities issued by government agencies, obligations of state and local governments and governmental authorities, corporate bonds and mortgage-backed securities, most of which are exposed to changes in prevailing interest rates and which may experience moderate fluctuations in fair value resulting from changes in interest rates. We carry these investments as available for sale. This allows us to manage our exposure to risks associated with interest rate fluctuations through active review of our investment portfolio by our management and board of directors and consultation with our external investment manager.

Fluctuations in near-term interest rates could have an impact on our results of operations and cash flows. Certain of these securities may have call features. In a declining interest rate environment these securities may be called by their issuer and replaced with securities bearing lower interest rates. If we are required to sell these securities in a rising interest rate environment we may recognize losses.

As a general matter, we attempt to match the durations of our assets with the durations of our liabilities. Our investment objectives include maintaining adequate liquidity to meet our operational needs, optimizing our after-tax investment income, and our after-tax total return, all of which are subject to our tolerance for risk.

The table below shows the interest rate sensitivity of our fixed maturity investments measured in terms of fair value (which is equal to the carrying value for all of our investment securities that are subject to interest rate changes) at March 31, 2010:

Hypothetical Change in Interest Rates	Estimated Change in Fair Value	Fair Value
200 basis point increase	$ (11,252)	$ 152,268
100 basis point increase	(5,624)	157,896
No change	—	163,520
100 basis point decrease	5,465	168,985
200 basis point decrease	10,906	174,426

Credit Risk

Credit risk is the potential economic loss principally arising from adverse changes in the financial condition of a specific debt issuer. We address this risk by investing primarily in fixed maturity securities that are rated investment grade with a minimum average portfolio quality of “Aa2” by Moody’s or an equivalent rating quality. We also independently, and through our outside investment manager, monitor the financial condition of all of the issuers of fixed maturity securities in the portfolio. To limit our exposure to risk, we employ diversification rules that limit the credit exposure to any single issuer or asset class.

Equity Risk

Equity price risk is the risk that we will incur economic losses due to adverse changes in equity prices. As a result of our public offering we and our investment advisor have analyzed our portfolio allocations; and in accordance with the guidelines, goals and objectives of our investment policy, we have set a target allocation of 6% of our investment portfolio to be invested in passively-managed equity index funds that follow the broader U.S. stock market. Equity securities comprised approximately 4.8% of our investment portfolio at March 31, 2010. We anticipate that the target allocation of 6% equities will be attained in the second quarter of 2010.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including the President and Chief Executive Officer and the Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer have concluded that these disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are subject to legal proceedings and claims that arise in the ordinary course of our business. While the outcome of these proceedings cannot be predicted with certainty, we do not currently expect them to have a material adverse effect on our financial statements. There has been no material developments during the quarter ended March 31, 2010 regarding our currently pending legal proceedings.

Item 1A. Risk Factors

There are no material changes from the risk factors previously disclosed under the heading “Risk Factors” in the Company’s Form 10-K as filed on March 31, 2010, SEC File No. 001-34496.

Table of Contents

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 4. (Removed and Reserved)

Item 5. Other Information

None

Item 6. Exhibits

Exhibits marked with an asterisk are filed herewith.

Exhibit No.	Description
2.1	Penn Millers Mutual Holding Company Plan of Conversion from Mutual to Stock Form is incorporated by reference herein to Exhibit No. 2.1 to the Company’s Pre-Effective Amendment No. 1 to Form S-1, (Commission File No. 333-156936).
3.1	Articles of Incorporation of Penn Millers Holding Corporation are incorporated by reference herein to Exhibit No. 3.1 to the Company’s Pre-Effective Amendment No. 1 to Form S-1, (Commission File No. 333-156936).
3.2	Bylaws of Penn Millers Holding Corporation are incorporated by reference herein to Exhibit No. 3.2 to the Company’s Pre-Effective Amendment No. 1 to Form S-1, (Commission File No. 333-156936).
10.1	Employment Agreement, between Penn Millers Mutual Holding Company, Penn Millers Holding Corporation, Penn Millers Insurance Company and Keith A. Fry dated February 9, 2010 is incorporated by reference herein to Exhibit No. 10.1 to the Company’s Current Report on Form 8-K filed February 9, 2010, (Commission File No. 001-34496).
10.2	Amendment of the Penn Millers Holding Corporation Supplemental Executive Retirement Plan, effective October 31, 2009 is incorporated by reference to Exhibit 99.1 to the Company’s Current Report on Form 8-K filed January 29, 2010, (Commission File No. 001-34496).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PENN MILLERS HOLDING CORPORATION

Date: May 14, 2010	By: /s/ Douglas A. Gaudet Douglas A. Gaudet President and Chief Executive Officer
Date: May 14, 2010	By: /s/ Michael O. Banks Michael O. Banks Executive Vice President and Chief Financial Officer