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ACMAT CORP  
Form 10-Q  
November 15, 2004

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

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 0-6234

ACMAT CORPORATION

-----  
Connecticut 06-0682460  
(State of Incorporation) (I.R.S. Employer Identification No.)

233 Main Street, New Britain, Connecticut 06050-2350

-----  
(Address of principal executive offices)

Registrant's telephone number including area code: (860) 229-9000

NONE

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to filing requirements for the past 90 days.

Yes  No

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of Class	Shares outstanding at October 31, 2004
-----	-----
Common Stock	540,329
Class A Stock	1,775,978

TABLE OF CONTENTS

Part I FINANCIAL INFORMATION

PAGE

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	-----
Item 1.Unaudited Financial Statements	
Consolidated Balance Sheets	3
Consolidated Statements of Earnings	4
Consolidated Statements of Stockholders' Equity	5
Consolidated Statements of Cash Flows	6
Notes to Unaudited Consolidated Financial Statements	7
Item 2.Management's Discussion and Analysis of Financial Conditions and Results of Operations	14
Item 3.Quantitative and Qualitative Disclosures About Market Risks.	26
Item 4.Controls and Procedures	26
Part II OTHER INFORMATION	
Item 2.Changes in Securities, Use of Proceeds and Issue Purchases Of Equity Securities	26
Item 6.Exhibits and Reports on Form 8-K	26
Signatures	27

2

Part I Financial Information  
Item I Financial Statements

ACMAT CORPORATION AND SUBSIDIARIES  
Consolidated Balance Sheets

	September 30,
Assets	2004
	-----
	(Unaudited)
Investments:	
Fixed maturities-available for sale at fair value (Cost of \$54,174,757 in 2004 and \$53,057,097 in 2003)	\$ 54,362,632
Equity securities, at fair value (Cost of \$11,341,559 in 2004 and \$10,240,559 in 2003)	11,411,731
Short-term investments, at cost which approximates fair value	16,976,437
	-----
Total investments	82,750,800
Cash and cash equivalents	34,044,758
Accrued interest receivable	550,823
Receivables, net of allowance for doubtful accounts of \$390,606 in 2004 and \$302,606 in 2003	4,094,861
Reinsurance recoverable:	
Unpaid losses	3,432,822
Paid losses	165,664
Prepaid expenses	313,747
Income tax receivable	--
Deferred income taxes	2,293,217
Property & equipment, net	10,773,554

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Deferred policy acquisition costs	1,836,803
Other assets	3,642,930
Intangibles	1,920,360
	-----
	\$145,820,339
	=====
Liabilities & Stockholders' Equity	
Accounts payable	\$ 2,717,536
Reserves for losses and loss adjustment expenses	22,311,888
Unearned premiums	7,472,814
Collateral held	50,676,628
Income taxes	573,805
Accrued liabilities	1,230,904
Long-term debt	17,086,342
	-----
Total liabilities	102,069,916
Stockholders' Equity:	
Common Stock (No par value; 3,500,000 shares authorized; 540,329 and 549,355 shares issued and outstanding)	540,329
Class A Stock (No par value; 10,000,000 shares authorized; 1,775,978 and 1,742,705 shares issued and outstanding)	1,775,978
Retained earnings	41,284,365
Accumulated other comprehensive income	149,751
	-----
Total stockholders' equity	43,750,423
	-----
	\$145,820,339
	=====

See Notes to Unaudited Consolidated Financial Statements.

3

ACMAT CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Earnings (Unaudited)

	Three months ended September 30		Nine months ended September 30	
	2004	2003	2004	2003
	-----	-----	-----	-----
Contract revenues	\$3,299,508	801,956	8,557,982	1,836,803
Earned premiums	3,577,597	3,289,433	10,504,691	8,557,982
Investment income, net	899,614	721,455	2,417,931	1,836,803
Net realized capital gains	31,408	76,000	52,059	1,836,803
Other income	253,438	215,104	616,999	1,836,803
	-----	-----	-----	-----
	8,061,565	5,103,958	22,149,662	13,884,201
	-----	-----	-----	-----
Cost of contract revenues	3,249,124	828,057	8,454,620	1,836,803
Losses and loss adjustment expenses	1,323,589	1,124,954	4,113,021	2,812,500
Amortization of policy acquisition costs	663,732	531,110	1,929,848	1,836,803
General and administrative expenses	1,290,537	1,352,740	3,780,784	3,780,784

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Interest expense	193,995	256,901	652,703	
	-----	-----	-----	-----
	6,720,977	4,093,762	18,930,976	11,-----
	-----	-----	-----	-----
Earnings before income taxes	1,340,588	1,010,196	3,218,686	2,-----
Income taxes	465,902	378,567	1,139,965	-----
	-----	-----	-----	-----
Net earnings	\$ 874,686	631,629	2,078,721	1,-----
	=====	=====	=====	=====
Basic earnings per share	\$ .38	.28	.90	
Diluted earnings per share	\$ .37	.27	.88	

See Notes to Unaudited Consolidated Financial Statements.

4

ACMAT CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Unaudited)  
September 30, 2004 and 2003

	Common Stock Par Value	Class A Stock Par Value	Retained Earnings
	-----	-----	-----
Balance as of December 31, 2002	\$ 553,355	1,756,405	37,972,5
Comprehensive income:			
Net unrealized losses on debt and equity securities, net of reclassification	--	--	
Net unrealized gains on derivatives qualifying as cash flow hedges	--	--	
Net earnings	--	--	1,513,8
Total comprehensive income			
Acquisition and retirement of 2,000 shares of Common Stock	(2,000)	--	(18,6
Acquisition and retirement of 13,700 shares of Class A Stock	--	(13,700)	(108,1
Balance as of September 30, 2003	\$ 551,355	1,742,705	39,359,6
	=====	=====	=====
Balance as of December 31, 2003	\$ 549,355	1,742,705	39,438,7
Comprehensive income:			

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Net unrealized losses on debt and equity securities, net of reclassification	--	--	
Net unrealized gains on derivatives qualifying as cash flow hedges	--	--	
Net earnings	--	--	2,078,7
Total comprehensive income			
Acquisition and retirement of 59,026 shares of Common Stock	(59,026)	--	(771,3
Acquisition and retirement of 70,727 shares of Class A Stock	--	(70,727)	(853,3
Issuance of 50,000 shares of Common Stock pursuant to stock options	50,000	--	547,0
Issuance of 104,000 shares of Class A Stock pursuant to stock options	--	104,000	844,5
Balance as of September 30, 2004	\$ 540,329	1,775,978	41,284,3

See Notes to Unaudited Consolidated Financial Statements.

5

ACMAT CORPORATION AND SUBSIDIARIES  
Consolidated Statements of Cash Flows (Unaudited)  
Nine Months Ended September 30, 2004 and 2003

	2004
	-----
Cash flows from operating activities:	
Net earnings	\$ 2,078,721
Adjustments to reconcile net earnings to net cash used for operating activities:	
Depreciation and amortization	550,791
Net realized capital gains	(52,059)
Deferred income taxes	(22,237)
Changes in:	
Accrued interest receivable	(209,372)
Reinsurance recoverable	3,105,170
Receivables, net	(1,871,890)
Deferred policy acquisition costs	(197,478)
Prepaid expenses and other assets	(381,450)
Accounts payable and other accrued liabilities	1,655,778
Reserves for losses and loss adjustment expenses	1,463,322
Collateral held	8,958,403
Income taxes	1,158,688
Unearned premiums	1,115,367
	-----
Net cash provided by operating activities	17,351,754

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Cash flows from investing activities: Proceeds from investments sold or matured:	
Fixed maturities-sold	1,670,000
Fixed maturities-matured	10,882,827
Equity securities	1,909,965
Purchases of:	
Fixed maturities	(13,801,070)
Equity securities	(2,950,695)
Short-term investments, net	(16,215,565)
Capital expenditures	(6,614)
	-----
Net cash used for investing activities	(18,511,152)
	-----
Cash flows from financing activities:	
Repayments on long-term debt	(2,020,951)
Issuance of Common Stock	537,500
Issuance of Class A Stock	754,000
Payments for acquisition & retirement of stock	(1,754,387)
	-----
Net cash used for financing activities	(2,483,838)
	-----
Net change in cash	(3,643,236)
Cash at beginning of period	37,687,994
	-----
Cash at end of period	\$ 34,044,758
	=====

See Notes to Unaudited Consolidated Financial Statements.

6

ACMAT CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS:

(1) Financial Statements

The consolidated financial statements include the accounts of ACMAT Corporation ("ACMAT" or the "Company") and its subsidiaries. The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and are unaudited.

The interim financial information contained in this report has been prepared from the books and records of the Company and its subsidiaries and reflects, in the opinion of the management of the Company, all adjustments (consisting of normal and recurring accruals) necessary to fairly present results of operations for the periods indicated. All significant intercompany accounts and transactions have been eliminated in consolidation.

These statements should be read in conjunction with the financial statements and notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2003. Certain reclassifications have been made to prior years 10-Q financial statements to conform to current year presentation.

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### (2) Earnings Per Share

The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations for the three-month periods ended September 30, 2004 and 2003:

	Earnings	Weighted Average Shares Outstanding	Per- Amou
2004:	-----	-----	-----
Basic EPS:			
Earnings available to stockholders	\$ 874,686	2,317,828	\$
Effect of Dilutive Securities:			
Stock options	--	57,804	
	-----	-----	
Diluted EPS:			
Earnings available to stockholders	\$ 874,686	2,375,632	\$
	=====	=====	=====
2003:			
Basic EPS:			
Earnings available to stockholders	\$ 631,629	2,294,868	\$
Effect of Dilutive Securities:			
Stock options	--	48,862	
	-----	-----	
Diluted EPS:			
Earnings available to stockholders	\$ 631,629	2,343,730	\$
	=====	=====	=====

7

The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations for the nine-month periods ended September 30, 2004 and 2003:

	Earnings	Weighted Average Shares Outstanding	Per- Amou
2004:	-----	-----	-----
Basic EPS:			
Earnings available to stockholders	\$2,078,721	2,306,888	\$
Effect of Dilutive Securities:			
Stock options	--	54,240	
	-----	-----	
Diluted EPS:			

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	Earnings available to stockholders	\$2,078,721	2,361,128	\$
		=====	=====	=====
2003:				
Basic EPS:				
	Earnings available to stockholders	\$1,513,806	2,301,531	\$
Effect of Dilutive Securities:				
	Stock options	--	28,883	
		-----	-----	
Diluted EPS:				
	Earnings available to stockholders	\$1,513,806	2,330,414	\$
		=====	=====	=====

### (3) Supplemental Cash Flow Information

Income taxes paid during the nine months ended September 30, 2004 and 2003 was \$3,515 and \$339,998, respectively. Interest paid for the nine months ended September 30, 2004 and 2003 was \$651,994 and \$817,982, respectively.

### (4) Comprehensive Income (Loss)

The following table summarizes reclassification adjustments for other comprehensive income (loss) and the related tax effects for the nine months ended September 30, 2004 and 2003:

	2004
	-----
Unrealized losses on investments:	
Unrealized holding losses arising during period	\$ (190,716)
Less reclassification adjustment for gains included in net income, net of income tax expense of \$17,700 and \$110,422 for 2004 and 2003, respectively	34,359
Unrealized gain (loss) on derivatives qualifying as cash flow hedges	23,486
	-----
Other comprehensive income (loss)	\$ (201,589)
	=====

### (5) Stock-Based Compensation

The Company accounts for stock options under the recognition and measurement principles of Accounting Principles Board Opinion No. 25 (APB 25), "Accounting for Stock Issued to Employees", and related interpretations.

The stock options were awarded at an exercise price equal to the market value of the underlying common stock on the date of the grant. Accordingly, there has been no employee compensation cost recognized in earnings for the stock options.

FAS 123 provides an alternative to APB 25 whereby fair values may be ascribed to options using a valuation model and amortized to compensation cost over the vesting period of the options. The following tables illustrate the pro forma effect on net income and earnings per share for each period indicated as if the Company applied the fair value recognition provisions of FAS 123 to its stock



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option program.

The pro forma fair value of stock-based compensation in the Company's Class A Shares for the three and nine months ended September 30, 2004 and 2003 is as follows:

	Three Months Ended	
	2004	2003
Net earnings as reported	\$ 874,686	631,629
Add: Stock-based employee compensation reported in net earnings, net of related tax effects	--	--
Deduct: Stock-based compensation expense determined under fair value based method, net of related tax effects	(99,037)	(20,732)
Net earnings, pro forma	\$ 775,649	610,897
Earnings per share		
Basic and diluted - as reported	\$.38/\$.37	\$.28/\$.27
Basic and diluted - pro forma	\$.33/\$.33	\$.27/\$.26

The significant assumptions used during the year in estimating the fair value on the date of the grant for options and granted in 2004 were as follows:

	2004
Expected life of stock options, in years	9
Expected volatility of ACMAT stock	44%
Risk-free interest rate	1.0
Expected annual dividend yield	--
Expected annual forfeiture rate	--

No options were granted in 2003.

### (6) Investments

The Company's portfolio is comprised primarily of fixed maturity securities rated AA or better by Standard and Poor's and includes mostly U.S. Treasuries and tax-free municipal securities. The Company also makes investments in collateralized mortgage obligations (CMOs).

In March 2004, the FASB's Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 03-01, The Meaning of Other-Than-Temporary Impairments and Its Application to Certain Investments ("EITF 03-01"). EITF 03-01 provides accounting guidance regarding the determination of when an impairment (i.e., fair value is less than amortized cost) of debt and marketable equity securities and investments accounted for under the cost method should be considered other-than-temporary and recognized in earnings. The recognition and measurement guidance of EITF 03-01 was effective July 1, 2004. EITF 03-01 also requires annual disclosures of certain quantitative and qualitative factors of debt and marketable equity securities classified as available-for-sale or held-to-maturity that are in an unrealized loss position at the balance sheet date, but for which an other-than-temporary impairment has not been recognized. The disclosure requirements of EITF 03-01 were effective December 31, 2003.

In September 2004, the FASB issued FASB Staff Position ("FSP") EITF 03-01-1,

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delaying the original effective date of the recognition and measurement guidance of EITF 03-01 until the FASB deliberates certain issues related to the implementation of EITF 03-01.

9

An investment in debt or equity security is impaired if its fair value falls below its book value and the decline is considered to be other-than-temporary. Factors considered in determining whether a decline is other-than-temporary include the length of time and the extent to which fair value has been below cost, the financial condition and the near-term prospects of the issuer; and the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. Additionally, for certain securitized financial assets with contractual cash flows (including asset backed securities), EITF 99-20 requires the Company to periodically update its best estimate of cash flows over the life of the security. If management determines that the fair value of its securitized financial asset is less than its carrying amount and there has been a decrease in the present value of the estimated cash flows since the last revised estimate, considering both timing and amount, then an other-than-temporary impairment charge is recognized. A debt security is impaired if it is probable that the Company will not be able to collect all amounts due under the security's contractual terms. Equity investments are impaired when it becomes apparent that the Company will not recover its cost over the expected holding period and consideration is given to the financial condition of the issue. Further, for securities expected to be sold, an other-than-temporary impairment charge is recognized if the Company does not expect the fair value of a security to recover the cost prior to the expected date of sale.

The Company's process for reviewing invested assets for impairments during any quarter includes the following:

- o Identification and evaluation of investments which have possible indications of impairment;

- o Analysis of investments with gross unrealized investment losses that have fair value less than 80% of amortized cost during successive quarterly periods over a rolling one-year period;
- o Management review of for other-than-temporary impairments based on the investee's current financial condition, liquidity, near term recovery prospects and other factors, as well as consideration of other investments that were not recommended for other-than-temporary impairments;
- o Consideration of evidential matter, including an evaluation of factors or triggers that would or could cause individual investments to qualify as having other-than-temporary impairment and those that would not support other-than-temporary impairments;
- o Determination of the status of each analyzed investment as other-than-temporary or not.

The gross unrealized investment losses and related fair value for fixed maturities and equity securities at September 30, 2004 were as follows:

Less than 12 months	12 months or longer
Gross	Gross
Unrealized	Unrealized

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	Fair Value	Loss	Fair Value	Loss
	-----	-----	-----	-----
Fixed maturities:				
United States government and government agencies	\$ 6,326,907	48,012	7,185,469	55
Mortgage-backed securities States, municipalities	3,307,693	45,558	3,583,707	76
Industrial and miscellaneous	--	--	543,705	2
	3,273,320	26,346	3,935,000	65
	-----	-----	-----	-----
Total fixed maturities	12,907,920	119,916	15,247,881	199
Equity securities - common stocks:	175,700	9,300	--	
Equity securities - redeemable preferred:	4,000,280	99,720	2,567,880	32
	-----	-----	-----	-----
Total equity	4,175,980	109,020	2,567,880	32
	-----	-----	-----	-----
Total temporarily impaired securities	\$17,083,900	228,936	17,815,761	231
	=====	=====	=====	=====

For debt securities which are in an unrealized loss position as of September 30, 2004, these are losses generated by an increase in interest rates from the time these securities were acquired. Our primary investment practice is to buy and hold securities for the long term. Due to swings in the interest rate cycle, from time to time we recognize there will be temporary unrealized gains and losses in these fixed rate securities. Due to the positive cash flow nature of our business, we have the ability and intent to hold these securities to maturity and redemption at full par value. The Company has determined that all unrealized losses at September are temporary impairments.

10

(7) Accounting Changes

CONSOLIDATION OF VARIABLE INTEREST ENTITIES

In December 2003, the FASB issued Revised Interpretation No. 46R, "Consolidation of Variable Interest Entities" (FIN 46R). FIN 46R clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46R separates entities into two groups: (1) those for which voting interests are used to determine consolidation and (2) those for which variable interests are used to determine consolidation. FIN 46R clarifies how to identify a variable interest entity and how to determine when a business enterprise should include the assets, liabilities, non-controlling interests and results of activities of a variable interest entity in its consolidated financial statements. FIN 46R was effective for public companies that have VIEs or potential VIEs that are special-purpose entities for periods ending after December 15, 2003. Application by public companies for all other types of entities is required for periods ending after March 15, 2004.

The Company holds mortgage-backed and asset-backed securities which are considered variable interest entities. The adoption of FIN 46R did not have any impact on the Company's results of operations or financial condition as no consolidation was required.

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### HEDGING INSTRUMENTS

In April 2003, the FASB issued Statement of Financial Standards No.149, "Amendment of Statement 133 on Derivative Investments and Hedging Activities" (FAS 149), which amends and clarifies the accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under FAS 133. FAS 149 amends FAS 133 for decisions made as part of the Derivatives Implementation Group process that effectively required amendment to FAS 133. FAS 149 also clarifies under what circumstances a contract with an initial net investment and purchases and sales of when-issued securities that do not yet exist meet the characteristics of a derivative. In addition, it clarifies when a derivative contains a Financing Component that warrants special reporting in the statement of cash flows. FAS 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of FAS 149 did not have an impact on the Company's results of operations, financial condition or liquidity.

#### (8) Segment Reporting

The Company has three reportable operating segments: ACMAT Contracting, ACSTAR Bonding and United Coastal Liability Insurance. The Company's reportable segments are primarily the three main legal entities of the Company, which offer different products and services. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Company's annual report on Form 10-K.

ACMAT Contracting provides construction contracting services to commercial and governmental customers. ACMAT Contracting also provides underwriting services to its insurance subsidiaries. In addition, ACMAT Contracting owns a commercial office building in New Britain Connecticut and leases office space to its insurance subsidiaries as well as third parties.

The United Coastal Liability Insurance operating segment offers specific lines of liability insurance as an approved non-admitted excess and surplus lines insurer in forty-six states, Puerto Rico, the Virgin Islands and the District of Columbia. United Coastal offers claims made and occurrence policies for specific specialty lines of liability insurance through certain excess and surplus lines brokers who are licensed and regulated by the state insurance department(s) in the state(s) in which they operate. United Coastal offers general, professional, products, pollution, asbestos and lead liability insurance to specialty trade contractors, environmental contractors, property owner, storage and treatment facilities and professionals. United Coastal also offers products liability insurance to manufacturers and distributors.

The Bonding operating segment provides, primarily through ACSTAR, surety bonds written for prime, specialty trade, environmental, asbestos and lead abatement contractors and miscellaneous obligations. ACSTAR also offers other miscellaneous surety such as workers' compensation bonds, supply bonds, subdivision bonds and license and permit bonds.

The Company evaluates performance based on earnings before income taxes and excluding interest expense. The Company accounts for intersegment revenue and expenses as if the products/services were to third parties. Information relating to the three segments for the three and nine-month periods ended September 30, 2004 and 2003 is summarized as follows:

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	Three Months ended		Nine Months ended	
	2004	2003	2004	2003
<b>Revenues:</b>				
ACSTAR Bonding	\$ 2,738,100	2,251,555	6,780,723	5,800,232
United Coastal Liability Insurance	1,620,075	1,779,043	5,855,154	4,933,426
ACMAT Contracting	4,352,615	1,728,444	11,413,829	4,638,405
	=====	=====	=====	=====
	\$ 8,710,790	5,759,042	24,049,706	15,372,063
<b>Operating Earnings (Loss):</b>				
ACSTAR Bonding	\$ 1,030,046	827,516	2,411,557	1,901,336
United Coastal Liability Insurance	449,462	577,303	1,492,240	1,469,604
ACMAT Contracting	55,075	(137,722)	(32,408)	(195,406)
	=====	=====	=====	=====
	\$ 1,534,583	1,267,097	3,871,389	3,175,534
<b>Depreciation and Amortization:</b>				
ACSTAR Bonding	\$ 40,403	163,930	148,022	483,050
United Coastal Liability Insurance	14,486	62,328	58,980	265,632
ACMAT Contracting	114,545	121,998	343,789	365,800
	=====	=====	=====	=====
	\$ 169,434	348,256	550,791	1,114,482

Identifiable Assets:	September 30, 2004	December 31, 2003
ACSTAR Bonding	\$ 87,254,965	73,704,644
United Coastal Liability Insurance	41,553,718	41,015,316
ACMAT Contracting	17,011,656	17,709,897
	=====	=====
	\$145,820,339	132,429,857

The components of revenue for each segment for the three and nine-month periods ended September 30, 2004 and 2003 are as follows:

	Three Months ended		Nine Months ended	
	2004	2003	2004	2003
<b>ACSTAR Bonding:</b>				
Premiums	\$ 2,326,016	1,908,238	5,696,620	4,933,426
Investment income, net	443,641	304,213	1,168,135	1,469,604
Capital gains	31,408	3,800	52,059	1,469,604
Other	(62,965)	1,104	(136,091)	(195,406)
	=====	=====	=====	=====
	\$ 2,738,100	2,251,555	6,780,723	5,800,232
<b>United Coastal Liability Insurance:</b>				
Premiums	\$ 1,251,581	1,381,205	4,808,071	3,933,426
Investment income, net	351,491	351,533	1,017,243	1,469,604
Capital gains	--	38,000	--	1,469,604

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Other	17,003	8,305	29,840	
	-----	-----	-----	-----
	\$ 1,620,075	1,779,043	5,855,154	4,
	=====	=====	=====	=====
ACMAT Contracting:				
Contract revenues	\$ 3,299,508	801,956	8,557,982	1,
Investment income, net	3,346	1,018	10,302	
Intersegment revenue:				
Rental income	181,962	178,702	608,911	
Underwriting services, agency				
commissions and funds				
administration services	757,099	541,073	2,122,295	1,
Other	110,700	205,695	345,434	
	-----	-----	-----	-----
	\$ 4,352,615	1,728,444	11,413,829	4,
	=====	=====	=====	=====

12

The following is a reconciliation of segment totals for revenue and operating income to corresponding amounts in the Company's statement of earnings:

	Three Months ended		Nine Months ended	
Revenue:	2004	2003	2004	2003
	-----	-----	-----	-----
Total revenue for reportable segments	\$ 8,710,790	5,759,042	24,049,706	15,
Intersegment eliminations	649,225	655,084	1,900,044	1,
	-----	-----	-----	-----
	\$ 8,061,565	5,103,958	22,149,662	13,
	=====	=====	=====	=====

The adjustments and eliminations required to arrive at consolidated amounts shown above consist principally of the elimination of the intersegment revenues related to the performance of certain services and rental charges. Identifiable assets are those assets that are used by each segment's operations. Foreign revenues are not significant.

Operating Earnings:				
Total operating earnings for reportable segments	\$ 1,534,583	1,267,097	3,871,	
Interest expense	(193,995)	(256,901)	(652,	
	-----	-----	-----	-----
	\$ 1,340,588	1,010,196	3,218,	
	=====	=====	=====	=====

Operating earnings for ACMAT contracting are operating revenues less cost of contract revenues and identifiable selling, general and administrative expenses. Operating earnings for the bonding and liability insurance segments are revenues less losses and loss adjustment expenses, amortization of policy acquisition costs and identifiable, general and administrative expenses.

## ACMAT CORPORATION

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

Management's discussion and analysis (MD&A) reviews our consolidated and segment financial condition as of September 30, 2004 and December 31, 2003, our consolidated results of operations for the three and nine-month periods ended September 30, 2004 and 2003 and where appropriate, factors that may affect our future financial performance. The MD&A should be read in conjunction with the consolidated financial statements of the Company and related notes included in the Company's annual report on Form 10-K for the year ended December 31, 2003.

## EXECUTIVE SUMMARY

2004 Consolidated Results of Operations for the three months ended September 30, 2004 reflect:

- o Net earnings of \$874,686, or \$.38 per share basic and \$.37 per share diluted.
- o Earned premiums increased 9%.
- o Favorable insurance premium rate environment.
- o Higher interest income and lower interest expense.

## 2004 Financial Condition:

- o Total assets of \$145.8 million, up \$13.4 million from the prior year-end.
- o Total cash and invested assets of \$116.8 million, up \$14.5 million from the prior year-end.
- o Stockholders' Equity of \$43.8 million, up \$1.7 million from the prior year-end. o Total debt reduced to \$17.1 million from \$19.1 million.
- o Cash flow provided from operations of \$17.4 million, up from \$14.5 million in the same period last year.

## CONSOLIDATED OVERVIEW FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2004:

	Three months ended September 30,	
	2004	2003
	-----	-----
Net Earnings	\$874,686	631,629
Basic Earnings Per Share	\$ .38	\$ .28
Diluted Earnings Per Share	\$ .37	\$ .27

The Company's discussions related to all items, other than net earnings, are presented on a pretax basis, unless otherwise noted.

Net earnings were \$874,686 or \$.38 per share basic and \$.37 per share diluted for the three months ended September 30, 2004 compared to \$631,629 or \$.28 per share basic and \$.27 per share diluted for the same period in 2003. The increase in net earnings for 2004 compared to 2003 is primarily due to an increase in

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earned premiums, contract revenue and investment income. Net earnings for 2004 reflected the continuing favorable environment for the insurance operations in 2003 and 2004.

Consolidated revenues were as follows:

	Three months ended September 30,	
	2004	2003
Contract revenues	\$3,299,508	801,956
Earned premium	3,577,597	3,289,433
Investment income	899,614	721,455
Net realized capital gains	31,408	76,000
Other income	253,438	215,104
Consolidated revenues	\$8,061,565	5,103,958

Total consolidated revenues increased \$2,957,607 or 58% for the three months ended September 30, 2004 compared to the same period in 2003.

Contract revenues increased \$2,497,552 or 311% for the three months ended September 30, 2004 compared to the same period in 2003 due primarily to the timing of four large projects that were awarded in late 2003. Contract revenue depends greatly on the successful securement of contracts bid and execution. The backlog at September 30, 2004 was \$3,500,000 compared to \$9,680,000 at December 31, 2003.

14

Earned premiums increased \$288,154 or 9% for the three months ended September 30, 2004 compared to the same period in 2003 due to a 16% increase in net written premiums in ACSTAR Bonding for the nine-month period ended September 30, 2004, primarily due to new business and strong customer retention, offset by a 25% decrease in 2004 net written premiums in United Coastal liability insurance. Net written premiums for United Coastal liability insurance business for the three months ended September 30, 2004 compared to the same period in 2003 decreased by 24% due to the non-renewal by several insureds with large premium policies in 2004.

Investment income increased \$178,159 or 25% for the three months ended September 30, 2004 compared to the same period in 2003 due primarily to higher average invested assets resulting from strong cash flows from operations

Net realized capital gains were \$31,408 for the three months ended September 30, 2004 compared to \$76,000 for the same period in 2003. The unrealized losses on the debt securities as of September 30, 2004 are temporary. These losses are generated by the increase in interest rates from the time these securities were acquired, therefore there are no other than temporary impairments for the three months ended September 30, 2004.

Other income increased \$38,334 or 18% for the three months ended September 30, 2004 compared to the same period in 2003. Other revenues consist primarily of rental income.

Consolidated expenses for the three months ended September 30, 2004 were as follows:

Three months ended September 30,



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	2004	2003
Cost of contract revenues	\$3,249,124	828,057
Losses and loss adjustment expenses	1,323,589	1,124,954
Amortization of policy acquisition costs	663,732	531,110
General and administrative expenses	1,290,537	1,352,740
Interest expense	193,995	256,901
	-----	-----
	\$6,720,977	4,093,762
	=====	=====

Consolidated expenses increased \$2,627,215 or 64% for the three months ended September 30, 2004 compared to the same period in 2003.

Cost of contract revenues increased \$2,421,067 or 292% for the three months ended September 30, 2004 compared to the same period in 2003. The 311% increase in contract revenues in 2004 is due to the timing of four large projects that were awarded later in 2003. The gross profit margin on construction projects was 2% in 2004 compared to a gross loss of 3% in 2003. Gross margins fluctuate each year based upon the profitability of specific projects.

Losses and loss adjustment expenses increased \$198,635 or 18% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to the 9% increase in earned premiums and an increase in current year loss trends for liability insurance.

Amortization of policy acquisition costs increased \$132,622 or 25% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to the increase in earned premiums.

General and administrative expenses decreased \$62,203 or 5% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to a decrease in salary expense and depreciation expense.

Interest expense decreased \$62,906 or 24% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to the decrease in long-term debt.

The Company's effective tax rate was 34.8% and 37.5% for the three months ended September 30 2004 and 2003, respectively.

Results of Operations by Segment For the Three Months Ended September 30, 2004:

The Company has three reportable operating segments: ACSTAR Bonding, United Coastal Liability Insurance and ACMAT Contracting. The Company's reportable segments are primarily the three main legal entities of the Company which offer different products and services. The accounting policies of the segments are the same as those described in the summary of significant accounting policies in the Company's annual report on Form 10K. The adjustments and eliminations required to arrive at consolidated amounts shown above consist principally of the elimination of the intersegment revenues related to the performance of certain services and rental charges.

Operating earnings for ACMAT contracting are operating revenues less cost of contract revenues and identifiable general and administrative expenses. Operating earnings for the bonding and liability insurance segments are revenues less losses and loss adjustment expenses, amortization of policy acquisition

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costs and identifiable general and administrative expenses.

	Three Months Ended September 30,	
ACSTAR BONDING:	2004	2003
Operating Earnings	\$1,030,046	\$827,516
GAAP Combined Ratio	73.4%	74.6%

Operating earnings for the ACSTAR Bonding segment increased \$202,530 or 24% for the three month period ended September 30, 2004 compared to the same period in 2003. The operating earnings in 2004 benefited from an increase in earned premiums, investment income and a 1.2 point improvement in the GAAP combined ratio for the three month period ended September 30, 2004 compared to the same period in 2003. The improvement in the 2004 combined ratio results primarily from the increase in earned premiums relative to the increase in underwriting expenses.

ACSTAR Bonding revenues for the three months ended September 30, 2004 were as follows:

	Three Months ended September 30,	
	2004	2003
Earned premium	\$ 2,326,016	1,908,238
Investment income	443,641	304,213
Net realized capital gains	31,408	38,000
Other income (expense)	(62,965)	1,104
	\$ 2,738,100	2,251,555
	=====	=====

Revenues increased \$486,545 or 22% for the three month period ended September 30, 2004 compared to the same period in 2003.

Earned premiums increased \$417,778 or 22% for the three month period ended September 30, 2004 compared to the same period in 2003 due to a 16% increase in net written premiums primarily due to a growth in new business and strong customer retention. ACSTAR continues to experience an increase in volume from an increase in business opportunities that meet ACSTAR's underwriting requirements.

Investment income increased \$139,428 or 46% for the three month period ended September 30, 2004 compared to the same period in 2003 primarily as a result of higher average invested assets resulting from strong cash flows from operations. The average invested assets increased 26% to \$79.5 million for the three months ended September 30, 2004 compared to the same period in 2003. The increase in investment income also resulted from an increase in investment yields to 2.23% in 2004 from 1.93% in 2003.

Net realized capital gains were \$31,408 for the three months ended September 30, 2004 compared to \$38,000 for the same period in 2003.

Other income (expense) relates primarily to fees received from customers related to funds administration services offset by the fees paid to ACMAT to administer the Funds Administration services. Funds administration fees, which represent charges to bonding customers for administering payments to subcontractors and vendors, fluctuates depending on the terms and conditions offered and accepted for the bonding programs each year. The Funds Administration fees were \$188,700 for the three months ended September 30, 2004 compared to \$41,939 for the three months ended September 30, 2003.

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16

ACSTAR Bonding expenses for the three months ended September 30, 2004 compared to the same period in 2003 were as follows:

	Three Months ended September 30,	
	2004	2003
Losses and loss adjustment expenses	\$ 697,799	572,471
Amortization of policy acquisition costs	711,877	585,404
General and administrative expenses	298,378	266,164
	\$1,708,054	1,424,039

Expenses increased \$284,015 or 20% for the three months ended September 30, 2004 compared to the same period in 2003.

Losses and loss adjustment expenses increased \$125,328 or 22% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to the increase in earned premiums from higher business volume.

Amortization of policy acquisition costs increased \$126,473 or 22% for the three months ended September 30, 2004 compared to the same period in 2003 primarily as a result of the increase in earned premiums.

General and administrative expenses increased \$32,214 or 12% for the three months ended September 30, 2004 compared to the same period in 2003.

UNITED COASTAL LIABILITY INSURANCE:

	Three Months ended September 30,	
	2004	2003
Operating Earnings	\$449,462	\$577,303
GAAP Combined Ratio	93.5%	87.0%

Operating earnings for the United Coastal Liability Insurance segment decreased \$127,841 or 22% for the three months ended September 30, 2004 compared to the same period in 2003. The operating earnings in 2004 decreased due to a 9% decrease in earned premiums and an increase in current year loss trends. The increase in the GAAP Combined Ratio reflects an increase in the current year loss trends offset in part by a reduction in underwriting expenses.

United Coastal Liability Insurance revenues for the three months ended September 30, 2004 compared to the same period in 2003 were as follows:

	Three months ended September 30,	
	2004	2003
Earned premium	\$1,251,581	1,381,205
Investment income	351,491	351,533
Net realized capital gains	--	38,000
Other income	17,003	8,305
	\$1,620,075	1,779,043

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Revenues decreased \$158,968 or 9% for the three months ended September 30, 2004 compared to the same period in 2003.

Earned premiums decreased \$129,624 or 9% in 2004 for the three months ended September 30, 2004 compared to the same period in 2003 due to a 25% decrease in net written premiums in 2004. United Coastal business is comprised of insureds with relatively large premium policies and each quarter can be impacted significantly depending on the number of new policies written or non-renewals.

Investment income decreased \$42 for the three months ended September 30, 2004 compared to the same period in 2003. The yield of 3.96% and average invested assets of \$35.5 million were relatively flat for the three month periods ended September 30, 2004 and 2003.

17

United Coastal Liability Insurance expenses for the three months ended September 30, 2004 were as follows:

	Three Months ended September 30,	
	2004	2003
Losses and loss adjustment expenses	\$ 625,790	552,483
Amortization of policy acquisition costs	323,595	389,644
General and administrative expenses	221,228	259,613
	\$1,170,613	1,201,740
	=====	=====

Expenses decreased \$31,127 or 3% for the three months ended September 30, 2004 compared to the same period in 2003.

Losses and loss adjustment expenses increased \$73,307 or 13% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to the increase in current year loss trends for liability insurance.

Amortization of policy acquisition costs decreased \$66,049 or 17% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to the 9% decrease in earned premiums.

General and administrative expenses decreased \$38,385 or 15% for the three months ended September 30, 2004 compared to the same period in 2003 primarily due to a decrease in depreciation expense.

	THREE MONTHS ENDED SEPTEMBER 30	
	2004	2003
ACMAT Contracting:		
Operating Earnings (Loss)	\$55,075	\$(137,722)

Operating earnings for the ACMAT Contracting segment increased \$192,797 for the three months ended September 30, 2004 compared to the same period in 2003.

ACMAT Contracting revenues for the three months ended September 30, 2004 were as follows:

Three months ended September 30  
-----

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	2004	2003
	-----	-----
Contract revenues	\$3,299,508	801,956
Investment income, net	3,346	1,018
Inter-segment revenue:		
Rental income	181,962	178,702
Underwriting services, agency commissions and funds administration services	757,099	541,073
Other income	110,700	205,695
	-----	-----
	\$4,352,615	1,728,444
	=====	=====

Contract revenues increased \$2,497,552 or 311% for the three months ended September 30, 2004 compared to the same period a year ago due primarily to the timing of four large projects that were awarded in late 2003. Contract revenue depends greatly on the successful securement of contracts bid and execution. The backlog at September 30, 2004 was \$3,500,000 compared to \$9,680,000 at December 31, 2003.

Inter-segment revenues consists primarily of rental income and underwriting services, agency commissions and funds administration services. Underwriting services fees, agency commissions and funds administration fees increased \$216,026 or 40% for the three months ended September 30, 2004 compared to the same period a year ago primarily due to the increase in Funds Administration fees. Other income consists primarily of rental income and varies depending on the timing of tenants and their leases. Other income decreased \$94,995 or 46% for the three months ended September 30, 2004 compared to the same period a year ago due to the absence of a one-time claim administration fee charged to ACSTAR bonding customers.

ACMAT Contracting expenses for the three months ended September 30, 2004 were as follows:

	2004	2003
	-----	-----
Cost of contract revenues	\$3,249,124	828,057
General and administrative expenses	1,048,416	1,038,109
	-----	-----
	\$4,297,540	1,866,166
	=====	=====

18

Expenses increased \$2,431,374 or 130% for the three months ended September 30, 2004 compared to the same period a year ago.

Cost of contract revenues increased \$2,421,067 or 292% for the three months ended September 30, 2004 compared to the same period a year ago primarily due to the 311% increase in contract revenues for the three months ended September 30, 2004 compared to the same period a year ago due to the timing of four large projects that were awarded in late 2003. The gross profit margin on construction projects was 2% in 2004 compared to a gross loss of 3% in 2003. The gross profit of the four current projects was offset by costs associated with closing out older projects. Gross margins fluctuate each year based upon the profitability of specific projects.

General and administrative expenses decreased \$10,307 or 1% for the three months ended September 30, 2004 compared to the same period a year ago primarily due to a decrease in salary expense and depreciation expense.

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CONSOLIDATED OVERVIEW FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004:

	Nine months ended September 30,	
	2004	2003
Net Earnings	\$2,078,721	\$1,513,806
Basic Earnings Per Share	\$ .90	\$ .66
Diluted Earnings Per Share	\$ .88	\$ .65

Net earnings were \$2,078,721 or \$.90 per share basic and \$.88 per share diluted for the nine months ended September 30, 2004 compared to \$1,513,806 or \$.66 per share basic and \$.65 per share diluted for the same period in 2003. The increase in net earnings for 2004 compared to 2003 is primarily due to an increase in earned premiums, contract revenue and investment income. Net earnings for 2004 reflected the continuing favorable rate environment for the insurance operations in 2003 and 2004.

Consolidated revenues for the nine months ended September 30, 2004 were as follows:

	Nine months ended September 30,	
	2004	2003
Contract revenues	\$ 8,557,982	1,813,069
Earned premium	10,504,691	8,667,439
Investment income	2,417,931	1,976,693
Net realized capital gains	52,059	324,771
Other income	616,999	679,357
	\$22,149,662	13,461,329
	=====	=====

Total consolidated revenues increased \$8,688,333 or 65% for the nine months ended September 30, 2004 compared to the same period in 2003.

Contract revenues increased \$6,744,913 or 372% for the nine months ended September 30, 2004 compared to the same period in 2003 due primarily to the timing of four large projects that were awarded in late 2003. Contract revenue depends greatly on the successful securement of contracts bid and execution. The backlog at September 30, 2004 was \$3,500,000 compared to \$9,680,000 at December 31, 2003.

Earned premiums increased \$1,837,252 or 21% for the nine months ended September 30, 2004 compared to the same period in 2003 due to a 16% increase in net written premiums in ACSTAR Bonding primarily due to a growth in new business and strong customer retention partially offset by a 25% decrease in 2004 net written premiums in United Coastal liability insurance. Net written premiums for United Coastal liability insurance business for the nine months ended September 30, 2004 compared to the same period in 2003 decreased by 25% due to the non-renewal in 2004 by several insureds with large premium policies.

Investment income increased \$441,238 or 22% for the nine months ended September 30, 2004 compared to the same period in 2003 due primarily to higher average invested assets resulting from strong cash flows from operations.

Net realized capital gains were \$52,059 for the nine months ended September 30, 2004 compared to \$324,771 for the same period in 2003. During 2003, the Company sold most of its tax-exempt investments in order to accelerate the use of an alternative minimum tax credit carryforward generated with the recognition of

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net life insurance proceeds in 2002 that were exempt for income tax purposes.

19

Other income decreased \$62,358 or 9% for the nine months ended September 30, 2004 compared to the same period in 2003. Other revenues consist primarily of rental income and funds administration fees charged to bonding customers.

Consolidated expenses for the nine months ended September 30, 2004 were as follows:

	NINE MONTHS ENDED SEPTEMBER 30,	
	2004	2003
Cost of contract revenues	\$ 8,454,620	1,771,686
Losses and loss adjustment expenses	4,113,021	2,988,273
Amortization of policy acquisition costs	1,929,848	1,555,806
General and Administrative expenses	3,780,784	3,970,030
Interest expense	652,703	811,330
	\$18,930,976	11,097,125

Consolidated expenses increased \$7,833,851 or 71% for the nine months ended September 30, 2004 compared to the same period in 2003.

Cost of contract revenues increased \$6,682,934 or 377% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to the 372% increase in contract revenues in 2004 due to the timing of four large projects that were awarded later in 2003. The gross profit margin on construction projects was 1% in 2004 compared to 2% in 2003. Gross margins fluctuate each year based upon the profitability of specific projects.

Losses and loss adjustment expenses increased \$1,124,748 or 38% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to the 21% increase in earned premiums and an increase in current year loss trends for liability insurance.

Amortization of policy acquisition costs increased \$374,042 or 24% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to the increase in earned premiums offset in part by a decrease in the average commission rate.

General and administrative expenses decreased \$189,246 or 5% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to a decrease in salary expense and depreciation expense.

Interest expense decreased \$158,627 or 20% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to the decrease in long-term debt.

The Company's effective tax rate was 35.4% and 36.0% for the nine months ended September 30 2004 and 2003, respectively.

Results of Operations by Segment For the Nine Months Ended September 30, 2004:

	Nine Months Ended September 30,	
	2004	2003
ACSTAR Bonding:		

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	-----	-----
Operating Earnings	\$2,411,557	\$1,901,336
GAAP Combined Ratio	76.7%	81.4%

Operating earnings for the ACSTAR Bonding segment increased \$510,221 or 27% for the nine months ended September 30, 2004 compared to the same period in 2003. The operating earnings in 2004 benefited from an increase in earned premiums, investment income and a 4.7 point improvement in the GAAP combined ratio for the nine months ended September 30, 2004 compared to the same period in 2003. The improvement in the 2004 combined ratio results primarily from the increase in earned premiums relative to the increase in underwriting expenses. There was no change in the loss ratio. Operating earnings for the nine months ended September 30, 2004 also included realized capital gains of \$52,509 compared to \$240,794 for the same period in 2003.

ACSTAR Bonding revenues for the nine months ended September 30, 2004 were as follows:

	Nine Months ended September 30,	
	-----	-----
	2004	2003
Earned premium	\$ 5,696,620	4,787,034
Investment income	1,168,135	876,539
Net realized capital gains	52,509	240,794
Other income (expense)	(136,091)	(104,135)
	-----	-----
	\$ 6,780,723	5,800,232
	=====	=====

20

Revenues increased \$980,491 or 17% for the nine months ended September 30, 2004 compared to the same period in 2003.

Earned premiums increased \$909,586 or 19% for the nine months ended September 30, 2004 compared to the same period in 2003 due to a 16% increase in net written premiums primarily due to a growth in new business and strong customer retention. ACSTAR continues to experience an increase in volume from an increase in business opportunities that meet ACSTAR's underwriting requirements.

Investment income increased \$291,596 or 33% for the nine months ended September 30, 2004 compared to the same period in 2003 as a result of higher average invested assets resulting from strong cash flows from operations. The average invested assets increased 33% to \$75.8 million for the nine months ended September 30, 2004 compared to the same period in 2003. The investment yields were 2.05% in 2004 and in 2003.

Net realized capital gains were \$52,509 for the nine months ended September 30, 2004 compared to \$240,794 for the same period in 2003. During 2003, the Company sold most of its tax-exempt investments in order to accelerate the use of an alternative minimum tax credit carryforward generated with the recognition of net life insurance proceeds in 2002 that were exempt for income tax purposes.

The unrealized losses on the debt securities as of September 30, 2004 are temporary. These losses are generated by the increase in interest rates from the time these securities were acquired, therefore there are no other than temporary impairments for the nine months ended September 30, 2004.

Other income (expense) relates primarily to fees related to funds administration



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services. Funds administration fees charged to bonding customers for administering payments to subcontractors and vendors fluctuates, depending on the terms and conditions offered and accepted for the bonding programs each year.

ACSTAR Bonding expenses for the nine months ended September 30, 2004 compared to the same period in 2003 were as follows:

	Nine Months ended September 30,	
	2004	2003
Losses and loss adjustment expenses	\$1,708,986	1,436,110
Amortization of policy acquisition costs	1,747,655	1,582,309
General and administrative expenses	912,525	880,477
	\$4,369,166	3,898,896
	=====	=====

ACSTAR Bonding expenses increased \$470,270 or 12% for the nine months ended September 30, 2004 compared to the same period in 2003.

Losses and loss adjustment expenses increased \$272,876 or 19% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to the increase in earned premiums from higher business volume.

Amortization of policy acquisition costs increased \$165,346 or 10% for the nine months ended September 30, 2004 compared to the same period in 2003.

General and administrative expenses increased \$32,048 or 4% for the nine months ended September 30, 2004 compared to the same period in 2003.

### UNITED COASTAL LIABILITY INSURANCE:

	Nine Months ended September 30,	
	2004	2003
Operating Earnings	\$1,492,240	\$1,469,604
GAAP Combined Ratio	90.7%	89.3%

Operating earnings for the United Coastal Liability Insurance segment increased \$22,636 or 2% for the nine months ended September 30, 2004 compared to the same period in 2003. The operating earnings in 2004 benefited from a 24% increase in earned premiums offset in part by an increase in current year loss trends. The GAAP Combined Ratio increased by 1.4 points due to an increase in current year loss trends offset by the increase in earned premiums.

United Coastal Liability Insurance revenues for the nine months ended September 30, 2004 compared to the same period in 2003 were as follows:

	Nine Months ended September 30,	
	2004	2003
Earned premium	\$4,808,071	3,880,405
Investment income	1,017,243	943,456
Net realized capital gains	--	83,977

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Other income	29,840	25,588
	-----	-----
	\$5,855,154	4,933,426
	=====	=====

Revenues increased \$921,728 or 19% for the nine months ended September 30, 2004 compared to the same period in 2003.

Earned premiums increased \$927,666 or 24% in 2004 for the nine months ended September 30, 2004 compared to the same period in 2003 due to a 76% increase in net written premiums for the year ended December 31, 2003 offset in part by a 25% decrease in written premiums in the first three quarters of 2004 due to the non-renewal by several insureds with large premium policies in 2004.

Investment income increased \$73,787 or 8% for the nine months ended September 30, 2004 compared to the same period in 2003 as a result of an increase in investment yield offset in part by a 4% decrease average invested assets to \$34.4 million resulting from dividends to the parent company in November 2003. Investment yields increased to 3.95% for the nine months ended September 30, 2004 from 3.51% for the same period a year ago.

United Coastal Liability Insurance expenses for the nine months ended September 30, 2004 were as follows:

	Nine Months ended September 30,	
	2004	2003
	-----	-----
Losses and loss adjustment expenses	\$2,404,035	1,552,163
Amortization of policy acquisition costs	1,200,960	1,083,377
General and administrative expenses	757,919	828,282
	-----	-----
	\$4,362,914	3,463,822
	=====	=====

Expenses increased \$899,092 or 26% for the nine months ended September 30, 2004 compared to the same period in 2003.

Losses and loss adjustment expenses increased \$851,872 or 55% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to the 24% increase in earned premiums and an increase in current year loss trends for liability insurance.

Amortization of policy acquisition costs increased \$117,583 or 11% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to the 24% increase in earned premiums.

General and administrative expenses decreased \$70,363 or 8% for the nine months ended September 30, 2004 compared to the same period in 2003 primarily due to a decrease in depreciation expense.

	NINE MONTHS ENDED SEPTEMBER 30	
	2004	2003
	-----	-----
ACMAT CONTRACTING:		
Operating Earnings (Loss)	\$ (32,408)	\$ (195,406)
	-----	-----

Operating losses for the ACMAT Contracting segment decreased \$162,998 or 83% for the nine months ended September 30, 2004 compared to the same period in 2003.

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22

ACMAT Contracting revenues for the nine months ended September 30, 2004 were as follows:

	Nine Months ended September 30	
	2004	2003
Contract revenues	\$ 8,557,982	1,813,069
Investment income, net	10,302	8,250
Inter-segment revenue:		
Rental income	608,911	589,444
Underwriting services, agency commissions and funds administration services	1,891,200	1,469,738
Other income	345,434	757,904
	-----	-----
	\$11,413,829	4,638,405

Contract revenues increased \$6,744,913 or 372% for the nine months ended September 30, 2004 compared to the same period a year ago due primarily to the timing of four large projects that were awarded in late 2003. Contract revenue depends greatly on the successful securement of contracts bid and execution. The backlog at September 30, 2004 was \$3,500,000 compared to \$9,680,000 at December 31, 2003.

Inter-segment revenues consists primarily of rental income and underwriting services fees, agency commissions and funds administration services. Underwriting services fees, agency commissions and funds administration services increased \$421,462 for the nine months ended September 30, 2004 compared to the same period a year ago. Other income consists primarily of rental income and varies depending on the timing of tenants and their leases. Other income decreased \$412,470 or 54% for the nine months ended September 30, 2004 compared to the same period a year ago due to the absence of a one-time claim administration fee charged to ACSTAR bonding customers.

ACMAT Contracting expenses for the nine months ended September 30, 2004 were as follows:

	2004	2003
Cost of contract revenues	\$ 8,454,620	1,771,686
General and administrative expenses	2,991,617	3,062,125
	-----	-----
	\$11,446,237	4,833,811
	=====	=====

Expenses increased \$6,612,426 or 137% for the nine months ended September 30, 2004 compared to the same period a year ago.

Cost of contract revenues increased \$6,682,934 or 377% for the nine months ended September 30, 2004 compared to the same period a year ago primarily due to the 372% increase in contract revenues for the nine months ended September 30, 2004 compared to the same period a year ago due to the timing of four large projects that were started in late 2003. The gross profit margin on construction projects was 1% in 2004 compared to 2% in 2003. Gross margins fluctuate each year based upon the profitability of specific projects.

General and administrative expenses decreased \$70,508 or 2% for the nine months ended September 30, 2004 compared to the same period a year ago primarily due to

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a decrease in salary expense and depreciation expense.

### CRITICAL ACCOUNTING ESTIMATES

The Company considers its most significant accounting estimates to be those applied to reserves for losses and loss adjustment expenses and revenue recognition on construction projects using the percentage of completion method.

Reserves for losses and loss adjustment expenses were \$22,311,888 at September 30, 2004. The Company maintains reserves to cover estimated ultimate unpaid liability for losses and loss adjustment expenses with respect to both reported and incurred but not reported claims for insured risks incurred as of the end of each accounting period. The amount of loss reserves for reported claims is primarily based upon a case-by-case evaluation of the type of risk involved, knowledge of the circumstances surrounding each claim and the policy provisions relating to the type of claim. As part of the reserving process, historical data is reviewed and consideration is given to the anticipated impact of various factors such as legal developments and economic conditions, including the effects of inflation. Reserves are monitored and evaluated periodically using current information on reported claims. This is a critical accounting policy for the insurance operations.

Management believes that the reserves for losses and loss adjustment expenses at September 30, 2004 are adequate to cover the unpaid portion of the ultimate net cost of losses and loss adjustment expenses, including losses incurred but not reported. Reserves for losses and loss adjustment expenses are estimates at any given point in time of what the Company may have to pay ultimately on incurred losses, including related settlement costs based on facts and circumstances then known. The Company also reviews its claims reporting patterns, past loss experience, risk factors and current trends and considers their effect in the determination of estimates of incurred but not reported reserves. Ultimate losses and loss adjustment expenses are affected by many factors which are difficult to predict, such as claim severity and frequency, inflation levels and unexpected and unfavorable judicial rulings. Reserves for surety claims also consider the amount of collateral held as well as the financial strength of the principal and its indemnitors.

23

Revenue on construction contracts is recorded using the percentage of completion method. Under this method revenues with respect to individual contracts are recognized in the proportion that costs incurred to date relate to total estimated costs. Revenues and cost estimates are subject to revision during the terms of the contracts, and any required adjustments are made in the periods in which the revisions become known. Provisions are made, where applicable, for the entire amount of anticipated future losses on contracts in progress. Construction claims are recorded as revenue at the time of settlement and profit incentives and change orders are included in revenues when their realization is reasonably assured. General and administrative expenses are not allocated to contracts. This is a critical accounting policy for the ACMAT construction segment.

### LIQUIDITY AND CAPITAL RESOURCES:

The Company internally generates sufficient funds for its operations and maintains a relatively high degree of liquidity in its investment portfolio. The primary sources of funds to meet the demands of claim settlements and operating expenses are premium collections, investment earnings and maturing investments. The Company has no material commitments for capital expenditures and, in the opinion of management, has adequate sources of liquidity to fund its operations

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over the next year.

ACMAT, exclusive of its subsidiaries, has incurred negative cash flows from operating activities primarily because of interest expense related to long-term debt incurred by ACMAT to acquire and capitalize its insurance subsidiaries and to repurchase Company stock.

ACMAT's principal sources of funds are dividends from its wholly-owned subsidiaries, insurance underwriting fees from its subsidiaries, construction contracting operations and rental income. Management believes that these sources of funds are adequate to service its indebtedness. ACMAT has relied on dividends from its insurance subsidiaries to repay debt.

The Company had net cash flow inflows from operations of \$17,351,754 and \$14,521,713 for the nine-month period ended September 30, 2004 and 2003, respectively. The cash flow from operations is due primarily to the increase in cash collateral. The Company's cash flow was used to repay long-term debt and repurchase stock and purchase investments.

Net cash used for investing activities in the first nine-months of 2004 amounted to \$18,511,152 compared to \$20,692,921 for the same period in 2003. Purchases of investments are made based upon excess cash available after the payment of losses and loss adjustment expenses and other expenses. The Company's short term investment strategy coincides with the relatively short maturity of its liabilities which are comprised primarily of reserves for losses covered by claims-made insurance policies, reserves related to surety bonds and collateral held for surety obligations.

The terms of the Company's note agreements contain limitations on payment of cash dividends, re-acquisition of shares, borrowings and investments and require maintenance of specified ratios and minimum net worth levels, including cross default provisions. The payment of future cash dividends and re-acquisition of shares are restricted. The Company was in compliance with the covenants at September 30, 2004.

The Company maintains a short-term unsecured bank credit line totaling \$10 million to fund interim cash requirements. There were no borrowings under this line of credit as of September 30, 2004.

During the nine-month period ended September 30, 2004, the Company purchased, in the open market and privately negotiated transactions, 59,026 shares of its Common Stock at an average price of \$14.07 per share. During the nine-month period ended September 30, 2004, the Company also purchased, in the open market and privately negotiated transactions, 70,727 shares of its Class A Stock at an average price of \$13.06 per share.

The Company's principal source of cash for repayment of long-term debt is from dividends from its two insurance companies. Under applicable insurance regulations, ACMAT's insurance subsidiaries are restricted as to the amount of dividends they may pay to their respective holding companies, without the prior approval of their domestic State insurance department. The amount of dividends ACMAT's insurance subsidiaries may pay, without prior approval of their domestic State insurance departments, are limited to approximately \$3,920,000 in 2004.

### REGULATORY ENVIRONMENT

Risk-based capital requirements are used as early warning tools by the National Association of Insurance Commissioners and the states to identify companies that

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require further regulatory action. The ratio for each of the Company's insurance subsidiaries as of December 31, 2003 was above the level which might require regulatory action.

### CONTRACTUAL CASH OBLIGATIONS AND COMMITMENTS:

Contractual obligations at September 30, 2004 include the following:

Payment due by Period	Total	2004	2005/2006	2007/2008
	-----	-----	-----	-----
Long-Term Debt (principal)	\$17,086,342	\$687,445	\$5,091,305	\$5,359,166

The Company also has cash collateral of \$50,676,628 at September 30, 2004, which it would be required to return at the end of expiration of applicable bond period subject to any claims.

### Forward-Looking Statement Disclosure and Certain Risks

This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements other than historical information or statements of current condition. Words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", or "estimates", or variations of such words, and similar expressions are intended to identify forward-looking statements.

In light of the risks and uncertainties inherent in future projections, many of which are beyond our control, actual results could differ materially from those in forward-looking statements. These statements should not be regarded as a representation that anticipated events will occur or that expected objectives will be achieved. Risks and uncertainties include, but are not limited to, the following:

- o Changes in the demand for, pricing of, or supply of our products;
- o Performance of the Company's investment portfolios which could be adversely impacted by adverse developments in the financial markets, interest rates and rates of inflation;
- o Additional statement of earnings charges if our loss reserves are insufficient;
- o The possibility that claims cost trends that we anticipate in our businesses may not develop as we expect;
- o The possibility of downgrades in our ratings significantly adversely affecting us, including, but not limited to, reducing the number of insurance policies we write, generally, or causing clients who require an insurer with a certain rating level to use higher-rated insurers;
- o The risk that our subsidiaries may be unable to pay dividends to us in sufficient amounts to enable us to meet our obligations;
- o The cyclicity of the property-liability insurance industry causing fluctuations in our results.
- o The adverse developments in the cost and availability of reinsurance;
- o The adverse developments in the ability to collect from reinsurers.

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25

## Item 3 - Quantitative and Qualitative Disclosures About Market Risks.

The Company's market risk has not changed materially since December 31, 2003.

## Item 4 - Controls and Procedures

The Company maintains a system of internal controls and procedures designed to provide reasonable assurance as to the reliability of our published financial statements and other disclosures included in this report. Within the 90-day period prior to the date of this report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-14 of the Securities Exchange Act of 1934. Based upon that evaluation, our Chief Executive Officer and our Principal Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information relating to ACMAT Corporation (including its consolidated subsidiaries) required to be included in this quarterly report on Form 10-Q.

There have been no significant changes in our internal controls or in other factors which could significantly affect internal controls subsequent to the date that we carried out our evaluation.

## Part II - Other Information

### Item 2 - Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

e. The following table provides information about purchases by the Company during the nine months ended September 30, 2004 of equity securities that are registered by the company pursuant to Section 12 of the Exchange Act.

#### ISSUER PURCHASE OF EQUITY SECURITIES

Period	(a)		(b)		(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs (2)
	Total Number of Shares (or Units) Purchased (1)		Average Price Paid per Share (or Unit)		
	Common	Class A	Common	Class A	
1/01/04 - 1/31/04	526	1,026	\$11.75	\$12.63	N/A
2/01/04 - 2/29/04	1,500	--	\$11.75	--	N/A
3/01/04 - 3/31/04	--	--	-	--	N/A
4/01/04 - 4/30/04	2,000	52,701	\$11.40	\$13.14	N/A
5/01/04 - 5/31/04	--	--	--	--	N/A
6/01/04 - 6/30/04	--	--	--	--	N/A
7/01/04 - 7/31/04	--	--	--	--	N/A
8/01/04 - 8/31/04	5,000	2,000	\$14.25	\$12.54	N/A
9/01/04 - 9/30/04	50,000	15,000	\$14.25	\$12.90	N/A
TOTAL	59,026	70,727	\$14.07	\$13.06	

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(1)During the nine-months ended September 30, 2004, the Company purchased, in the open market and privately negotiated transactions, 59,026 shares of its Common Stock at an average price of \$14.07 per share. In addition, the Company purchased, in the open market and privately negotiated transactions, 70,727 shares of its Class A Stock at an average price of \$13.06 per share during the nine-month period ended September 30, 2004. (2)The Company does not have any stock repurchase plans or programs. Shares were purchased in the open market and privately negotiated transactions and as a result disclosure requirements in columns (c) and (d) are not applicable (N/A).

Item 6 - Exhibits and Reports on Form 8-K

a. Exhibits:

- 31.1 Certification of Chief Executive Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Chief Financial Officer as required by Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Chief Financial Officer, as required by Section 906 of the Sarbanes-Oxley Act of 2002

b. Report on Form 8-K - None

26

SIGNATURES

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

ACMAT CORPORATION

Date: November 15, 2004

/S/ Henry W. Nozko, Jr.  
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Henry W. Nozko, Jr., President, Chairman,  
Chief Operating Officer, and Treasurer

Date: November 15, 2004

/S/ Michael P. Cifone  
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Michael P. Cifone, Senior Vice President,  
Chief Financial Officer  
(Principal Financial & Accounting Officer)

27