

Edgar Filing: UNICO AMERICAN CORP - Form 10-Q

UNICO AMERICAN CORP
Form 10-Q
August 11, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report under Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2006 or

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File No. 0-3978

UNICO AMERICAN CORPORATION
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

95-2583928
(I.R.S. Employee
Identification No.)

23251 Mulholland Drive, Woodland Hills, California
(Address of Principal Executive Offices)

91364
(Zip Code)

(818) 591-9800
(Registrant's telephone number, Including Area Code)

No Change
(Former Name, Former Address and Former Fiscal Year,
if Changed Since Last Report)

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

Yes No
--- ---

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerator filer and large accelerator in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer Accelerated Filer Non-Accelerated Filer
--- --- ---

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No
--- ---

5,589,565
Number of shares of common stock outstanding as of August 11, 2006

PART 1 - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

UNICO AMERICAN CORPORATION
AND SUBSIDIARIESCONSOLIDATED BALANCE SHEETS
(UNAUDITED)

| | June 30 2006 ---- |
|--|-------------------------|
| ASSETS | |
| ----- | |
| Investments | |
| Available for sale: | |
| Fixed maturities, at fair value (amortized cost: June 30, 2006 | |
| \$140,313,044; December 31, 2005 \$136,128,428) | \$139,162,310 |
| Short-term investments, at cost | 2,548,492 |
| | ----- |
| Total Investments | 141,710,802 |
| Cash | 48,843 |
| Accrued investment income | 1,290,255 |
| Premiums and notes receivable, net | 6,468,748 |
| Reinsurance recoverable: | |
| Paid losses and loss adjustment expenses | 1,480,930 |
| Unpaid losses and loss adjustment expenses | 26,053,580 |
| Deferred policy acquisition costs | 6,703,293 |
| Property and equipment (net of accumulated depreciation) | 757,210 |
| Deferred income taxes | 1,908,486 |
| Other assets | 718,906 |
| | ----- |
| Total Assets | \$187,141,053 |
| | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | |
| ----- | |
| LIABILITIES | |
| ----- | |
| Unpaid losses and loss adjustment expenses | \$102,101,005 |
| Unearned premiums | 27,565,699 |
| Advance premium and premium deposits | 1,570,721 |
| Accrued expenses and other liabilities | 3,555,774 |
| | ----- |
| Total Liabilities | \$134,793,199 |
| | ----- |

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STOCKHOLDERS' EQUITY

| | |
|---|---------------|
| Common stock, no par - authorized 10,000,000 shares; issued and outstanding shares 5,589,565 at June 30, 2006, and 5,496,315 at December 31, 2005 | \$3,206,958 |
| Accumulated other comprehensive (loss) | (759,484) |
| Retained earnings | 49,900,380 |
| | ----- |
| Total Stockholders' Equity | \$52,347,854 |
| | ----- |
| Total Liabilities and Stockholders' Equity | \$187,141,053 |
| | ===== |

See notes to unaudited consolidated financial statements.

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UNICO AMERICAN CORPORATION
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

| | Three Months Ended June 30 | | Six Months June |
|--|-------------------------------|--------------|--------------------|
| | 2006 | 2005 | 2006 |
| | ---- | ---- | ---- |
| REVENUES | | | |
| ----- | | | |
| Insurance Company Revenues | | | |
| Premium earned | \$14,293,870 | \$16,533,913 | \$29,138,769 |
| Premium ceded | 3,488,479 | 3,543,155 | 7,119,068 |
| | ----- | ----- | ----- |
| Net premium earned | 10,805,391 | 12,990,758 | 22,019,701 |
| Net investment income | 1,420,656 | 1,053,888 | 2,754,319 |
| Other income | 19,689 | 18,834 | 47,220 |
| | ----- | ----- | ----- |
| Total Insurance Company Revenues | 12,245,736 | 14,063,480 | 24,821,240 |
| Other Revenues from Insurance Operations | | | |
| Gross commissions and fees | 1,224,974 | 1,391,346 | 2,524,680 |
| Investment income | 23,747 | 14,954 | 45,000 |
| Finance charges and fees | 172,174 | 188,882 | 345,186 |
| Other income | 515 | 3,661 | 4,715 |
| | ----- | ----- | ----- |
| Total Revenues | 13,667,146 | 15,662,323 | 27,740,821 |
| | ----- | ----- | ----- |
| EXPENSES | | | |
| ----- | | | |
| Losses and loss adjustment expenses | 6,053,114 | 8,183,717 | 12,571,568 |
| Policy acquisition costs | 2,315,415 | 2,721,750 | 4,766,263 |
| Salaries and employee benefits | 1,398,162 | 1,271,638 | 2,683,053 |

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| | | | |
|-------------------------------|-------------|-------------|-------------|
| Commissions to agents/brokers | 152,733 | 172,263 | 310,426 |
| Other operating expenses | 734,551 | 668,964 | 1,482,197 |
| | ----- | ----- | ----- |
| Total Expenses | 10,653,975 | 13,018,332 | 21,813,507 |
| | ----- | ----- | ----- |
| Income Before Taxes | 3,013,171 | 2,643,991 | 5,927,314 |
| Income tax provision | 1,056,451 | 950,678 | 2,083,044 |
| | ----- | ----- | ----- |
| Net Income | \$1,956,720 | \$1,693,313 | \$3,844,270 |
| | ===== | ===== | ===== |

PER SHARE DATA

| | | | |
|----------------------------|-----------|-----------|-----------|
| | ----- | | |
| Basic Shares Outstanding | 5,583,344 | 5,496,315 | 5,544,503 |
| Basic Earnings Per Share | \$0.35 | \$0.31 | \$0.69 |
| Diluted Shares Outstanding | 5,657,598 | 5,614,936 | 5,641,560 |
| Diluted Earnings Per Share | \$0.35 | \$0.30 | \$0.68 |

See notes to unaudited consolidated financial statements.

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UNICO AMERICAN CORPORATION
AND SUBSIDIARIES

STATEMENT OF COMPREHENSIVE INCOME
(UNAUDITED)

| | | |
|---|-------------------------------|-------------|
| | Three Months Ended June 30 | |
| | ----- | ----- |
| | 2006 | 2005 |
| | ---- | ---- |
| Net Income | \$1,956,720 | \$1,693,313 |
| Other changes in comprehensive income, net of tax: | | |
| Unrealized gains (losses) on securities classified as available-for-sale arising during the period | (138,559) | 215,612 |
| | ----- | ----- |
| Comprehensive Income | \$1,818,161 | \$1,908,925 |
| | ===== | ===== |

See notes to unaudited consolidated financial statements.

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UNICO AMERICAN CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

FOR THE SIX MONTHS ENDED JUNE 30

| | 2006 |
|---|--------------|
| | ---- |
| Cash Flows from Operating Activities: | |
| Net Income | \$3,844,270 |
| Adjustments to reconcile net income to net cash from operations | |
| Depreciation | 114,803 |
| Bond amortization, net | (1,076) |
| Changes in assets and liabilities | |
| Premium, notes and investment income receivable | 189,068 |
| Reinsurance recoverable | (143,719) |
| Deferred policy acquisitions costs | 652,886 |
| Other assets | 251,508 |
| Reserve for unpaid losses and loss adjustment expenses | 186,457 |
| Unearned premium reserve | (3,053,348) |
| Funds held as security and advanced premiums | 109,931 |
| Accrued expenses and other liabilities | (352,647) |
| Tax benefit from disqualified incentive stock options | (196,464) |
| Income taxes current/deferred | 251,610 |
| | ----- |
| Net Cash Provided from Operations | 1,853,279 |
| | ----- |
| Investing Activities | |
| Purchase of fixed maturity investments | (34,280,540) |
| Proceeds from maturity of fixed maturity investments | 30,097,000 |
| Net decrease in short-term investments | 1,926,670 |
| Additions to property and equipment | (47,509) |
| | ----- |
| Net Cash (Used) by Investing Activities | (2,304,379) |
| | ----- |
| Financing Activities | |
| Proceeds from exercise of stock options | 290,007 |
| Tax benefit from disqualified incentive stock options | 196,464 |
| Repayment of notes payable - related parties | - |
| | ----- |
| Net Cash Provided (Used) by Financing Activities | 486,471 |
| | ----- |
| Net increase in cash | 35,371 |
| Cash at beginning of period | 13,472 |
| | ----- |
| Cash at End of Period | \$48,843 |
| | ===== |
| Supplemental Cash Flow Information Cash paid during the period for: | |
| Interest | - |
| Income taxes | \$1,850,000 |

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See notes to unaudited consolidated financial statements.

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UNICO AMERICAN CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Unico American Corporation is an insurance holding company that underwrites property and casualty insurance through its insurance company subsidiary; provides property, casualty, health and life insurance through its agency subsidiaries; and through its other subsidiaries provides insurance premium financing and membership association services. Unico American Corporation is referred to herein as the "Company" or "Unico" and such references include both the corporation and its subsidiaries, all of which are wholly owned, unless otherwise indicated. Unico was incorporated under the laws of Nevada in 1969.

Principles of Consolidation

The accompanying unaudited consolidated financial statements include the accounts of Unico American Corporation and its subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

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 the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2006, are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. Quarterly financial statements should be read in conjunction with the consolidated financial statements and related notes in the Company's 2005 Annual Report on Form 10-K as filed with the Securities and Exchange Commission.

Use of Estimates in the Preparation of the Financial Statements

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect its reported amounts of assets and liabilities and its disclosure of any contingent assets and liabilities at the date of its financial statements, as well as its reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current year presentation.

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NOTE 2 - STOCK-BASED COMPENSATION

Prior to January 1, 2006, the Company applied the intrinsic-value based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation," an interpretation of APB Opinion No. 25, to account for its fixed-plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. FASB Statement No. 123 (SFAS 123), "Accounting for Stock-Based Compensation," and FASB Statement No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure," an amendment of SFAS 123, established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation plans. As permitted by existing accounting standards, the Company had elected to continue to apply the intrinsic-value based method of accounting described above and had adopted only the disclosure requirements of SFAS 123, as amended through December 31, 2005. On January 1, 2006, the Company adopted FASB Statement No. 123 (Revised 2004) "Share-Based Payment" (SFAS 123R) on a modified prospective basis.

On December 30, 2005, the Company accelerated the vesting of all of its outstanding stock-based compensation awards granted under the Company's 1999 Omnibus Stock Plan. All accelerated options were "in the money." The number of shares covered by the options accelerated totaled 67,500 of which 37,500 were originally scheduled to vest on January 1, 2006, and 30,000 were originally scheduled to vest on January 1, 2007. The Company accelerated vesting of the options in order to minimize the compensation costs associated with the adoption of SFAS 123R.

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UNICO AMERICAN CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

All accelerated options were granted to long-term management employees who were not expected to leave the Company prior to the originally scheduled vesting date. The estimated compensation cost that will be excluded from current and future periods as a result of the acceleration of the vesting of the options is approximately \$89,100.

On adoption of SFAS 123R on the modified prospective basis on January 1, 2006, there were no unvested stock options or awards and, therefore, there was no adjustment recorded upon adoption. Prospectively, grants of share-based payment awards will be accounted for in accordance with SFAS 123R and compensation expense recognized based on an estimate of the number of awards expected to actually vest based on the estimate of fair value of the awards.

Had compensation cost for the Company's stock-based compensation plan been reflected in the accompanying consolidated financial statements based on the fair value at the grant dates for option awards consistent with the method of SFAS 123, the Company's net income would have been reduced to the pro forma amounts indicated below:

| Three Months Ended | Six Months Ended |
|--------------------|------------------|
| June 30, 2005 | June 30, 2005 |

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| | | |
|---|-------------|-------------|
| Net Income | | |
| As reported | \$1,693,313 | \$3,198,493 |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | 7,432 | 14,864 |
| Pro forma | \$1,685,881 | \$3,183,629 |
| Income Per Share - Basic | | |
| As reported | \$0.31 | \$0.58 |
| Pro forma | \$0.31 | \$0.58 |
| Income Per Share - Assuming Dilution: | | |
| As reported | \$0.30 | \$0.57 |
| Pro forma | \$0.30 | \$0.57 |

Calculations of the fair value under the method prescribed by SFAS No. 123 were made using the Black-Scholes Option-Price Model with the following weighted average assumptions used for the 1999 and 2002 grants:

| | | |
|-------------------------------|----------|----------|
| | 2002 | 1999 |
| | Grant | Grant |
| | ----- | ----- |
| Dividend yield | 1.40% | 2.46% |
| Expected volatility | 34% | 43% |
| Expected lives | 10 Years | 10 Years |
| Risk-free interest rates | 4.05% | 6.09% |
| Fair value of options granted | \$1.32 | \$4.30 |

The Company recognized a federal tax benefit in the amount of \$196,464 in the six month ended June 30, 2006. This federal tax benefit resulted from the disqualification of certain previously exercised incentive stock options. The disqualification is due to the sale of the underlying stock by employees prior to the required one year holding period under federal tax law. The Company recognized the federal tax benefit as an equity adjustment, which is also presented in the Statements of Cash Flows as a financing activity in accordance with SFAS 123R.

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UNICO AMERICAN CORPORATION
AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 3 - REPURCHASE OF COMMON STOCK - EFFECT ON STOCKHOLDERS' EQUITY

The Company has previously announced that its Board of Directors had authorized the repurchase in the open market from time to time of up to an aggregate of 945,000 shares of the common stock of the Company. During the six months ended June 30, 2006, the Company did not repurchase any shares of the Company's common stock. As of June 30, 2006, the Company had purchased and retired under the Board of Directors' authorization an aggregate of 868,958 shares of its common stock at a cost of \$5,517,465.

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NOTE 4 - EARNINGS PER SHARE

The following table represents the reconciliation of the numerators and denominators of the Company's basic earnings per share and diluted earnings per share computations reported on the Consolidated Statements of Operations for the three and six months ended June 30, 2006 and 2005:

| | Three Months Ended June 30 | |
|---|-------------------------------|-------------|
| | 2006 | 2005 |
| | ---- | ---- |
| Basic Earnings Per Share | | |
| Net income numerator | \$1,956,720 | \$1,693,313 |
| | ===== | ===== |
| Weighted average shares outstanding denominator | 5,583,344 | 5,496,315 |
| | ===== | ===== |
| Basic Earnings Per Share | \$0.35 | \$0.31 |
| Diluted Earnings Per Share | | |
| Net income numerator | \$1,956,720 | \$1,693,313 |
| | ===== | ===== |
| Weighted average shares outstanding | 5,583,344 | 5,496,315 |
| Effect of diluted securities | 74,254 | 118,621 |
| | ----- | ----- |
| Diluted shares outstanding denominator | 5,657,598 | 5,614,936 |
| | ===== | ===== |
| Diluted Earnings Per Share | \$0.35 | \$0.30 |

NOTE 5 - RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154, "Accounting Changes and Error Corrections" (SFAS No. 154). SFAS No. 154 establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition requirements specific to a newly adopted accounting principle. The statement will be effective for the Company for all accounting changes and any error corrections occurring after January 1, 2006.

FASB Staff Position (FSP) No. 115-I, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." FSP 115-1 provides guidance for determining when an investment is considered impaired, whether impairment is other-than-temporary, and measurement of an impairment loss. An investment is considered impaired if the fair value of the investment is less than its cost. If, after consideration of all available evidence to evaluate the realizable value of its investment, impairment is determined to be other-than-temporary, then an impairment loss should be recognized equal to the difference between the investment's cost and its fair value. FSP 115-1 nullifies

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certain provisions of Emerging Issues Task Force (EITF) Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," while retaining the disclosure requirements of EITF 03-1 which were adopted in 2003. FSP 115-1 is effective for reporting periods beginning after December 15, 2005. FSP 115-1 did not significantly impact the Company's financial statements upon its adoption on January 1, 2006.

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UNICO AMERICAN CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS JUNE 30, 2006

In June 2006, the Financial Accounting Standards Board (FASB) issued interpretation of FASB Statement No. 109, "Accounting for Uncertainty in Income Taxes" (FIN 48). This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation will be effective January 1, 2007. The Company is currently assessing the effect of implementing FIN 48.

NOTE 6 - SEGMENT REPORTING

Statement of Financial Accounting Standards No. 131 (SFAS No. 131), "Disclosures about Segments of an Enterprise and Related Information," became effective for fiscal years effective after December 15, 1997. SFAS No. 131 establishes standards for the way information about operating segments is reported in financial statements. The Company has adopted SFAS No. 131 and has identified its insurance company operation, Crusader Insurance Company (Crusader), as its primary reporting segment. Revenues from this segment comprised 90% and 89% of consolidated revenues for the three and six months ended June 30, 2006, respectively.

For the three and six months ended June 30, 2005, revenues from this segment comprised 90% of consolidated revenues. The Company's remaining operations constitute a variety of specialty insurance services, each with unique characteristics and individually insignificant to consolidated revenues.

Revenues, income before income taxes, and assets by segment are as follows:

| | Three Months Ended June 30 | | Six Months June 30 |
|-----------------------------|-------------------------------|--------------|-----------------------|
| | 2006 | 2005 | 2006 |
| Revenues | | | |
| ----- | | | |
| Insurance company operation | \$12,245,736 | \$14,063,480 | \$24,821,240 |

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| | | | |
|---------------------------------------|------------------|------------------|------------------|
| Other insurance operations | 5,082,798 | 6,055,522 | 10,073,855 |
| Intersegments elimination (1) | (3,661,388) | (4,456,679) | (7,154,274) |
| | ----- | ----- | ----- |
| Total other insurance operations | 1,421,410 | 1,598,843 | 2,919,581 |
| | ----- | ----- | ----- |
| Total Revenues | \$13,667,146 | \$15,662,323 | \$27,740,821 |
| | ===== | ===== | ===== |
| Income (Loss) Before Income Taxes | | | |
| ----- | | | |
| Insurance company operation | \$3,268,800 | \$2,199,883 | \$6,505,407 |
| Other insurance operations | (255,629) | 444,108 | (578,093) |
| | ----- | ----- | ----- |
| Total Income Before Income Taxes | \$3,013,171 | \$2,643,991 | \$5,927,314 |
| | ===== | ===== | ===== |

As of June 30

| | | |
|-----------------------------------|---------------|---------------|
| | 2006 | 2005 |
| | ---- | ---- |
| Assets | | |
| ----- | | |
| Insurance company operation | \$169,010,069 | \$158,985,172 |
| Intersegment eliminations (2) | (1,366,398) | (2,397,486) |
| | ----- | ----- |
| Total insurance company operation | 167,643,671 | 156,587,686 |
| Other insurance operations | 19,497,382 | 21,789,355 |
| | ----- | ----- |
| Total Assets | \$187,141,053 | \$178,377,041 |
| | ===== | ===== |

- (1) Intersegment revenue eliminations reflect commission paid by Crusader to Unifax Insurance Systems, Inc., (Unifax) a wholly owned subsidiary of the Company.
- (2) Intersegment asset eliminations reflect the elimination of Crusader receivables and Unifax payables.

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ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

AND RESULTS OF OPERATIONS

OVERVIEW

General

Unico American Corporation is an insurance holding company that underwrites property and casualty insurance through its insurance company subsidiary; provides property, casualty, health and life insurance through its agency subsidiaries; and through its other subsidiaries provides insurance premium financing and membership association services.

The Company had a net income of \$1,956,720 for the three months ended June 30, 2006, compared to net income of \$1,693,313 for the three months ended June 30, 2005, an increase in net income of \$263,407 (16%). For the six months ended June

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30, 2006, the Company had a net income of \$3,844,270 compared to a net income of \$3,198,493 for the six months ended June 30, 2005, an increase in net income of \$645,777 (20%).

This overview discusses some of the relevant factors that management considers in evaluating the Company's performance, prospects, and risks. It is not all-inclusive and is meant to be read in conjunction with the entirety of the management discussion and analysis, the Company's financial statements and notes thereto, and all other items contained within the report on this Form 10-Q.

Revenue and Income Generation

The Company receives its revenue primarily from earned premium derived from the insurance company operations, commission and fee income generated from the insurance agency operations, finance charges and fee income from the premium finance operations, and investment income from cash generated primarily from the insurance operation. The insurance company operation generated approximately 90% and 89% of consolidated revenues for the three and six months ended June 30, 2006, respectively. The Company's remaining operations constitute a variety of specialty insurance services, each with unique characteristics and individually not material to consolidated revenues.

Insurance Company Operation

The property and casualty insurance industry is highly competitive and includes many insurers, ranging from large companies offering a wide variety of products worldwide to smaller, specialized companies in a single state or region offering only a single product. Many of the Company's existing or potential competitors have considerably greater financial and other resources, have a higher rating assigned by independent rating organizations such as A.M. Best Company, have greater experience in the insurance industry, and offer a broader line of insurance products than the Company. Currently, Crusader is writing primarily Commercial Multiple Peril business only in the state of California. Crusader's A.M. Best Company rating is B+ (Very Good) with a rating outlook of stable.

A primary challenge of the property and casualty insurance company operation is contending with the fact that the Company sells its products before the ultimate costs are actually known. When pricing its products, the Company projects the ultimate losses and loss adjustment expenses that it anticipates will be incurred after the policy is sold. In addition, factors such as changes in, among other things, regulations, the legal environment, and inflation can all impact the ultimate cost.

The property and casualty insurance industry is characterized by periods of soft market conditions, in which premium rates are stable or falling and insurance is readily available, and by periods of hard market conditions, where rates rise, coverage may be more difficult to find, and insurers' profits increase. The Company believes that the "hard market" that existed in California in the past few years has transitioned to a "soft market." The Company cannot determine how long the existing market conditions will continue, nor in which direction they might change.

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Crusader's underwriting results are as follows:

Three Months Ended June 30

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| | 2006 | 2005 | Increase (Decrease) | 2006 |
|---|--------------|--------------|------------------------|----------|
| | ---- | ---- | ----- | ---- |
| Net premium earned | \$10,805,391 | \$12,990,758 | \$(2,185,367) | \$22,019 |
| Less: | | | | |
| Losses and loss adjustment expenses | 6,053,114 | 8,183,717 | (2,130,603) | 12,571 |
| Policy acquisition costs | 2,315,415 | 2,721,750 | (406,335) | 4,766 |
| | ----- | ----- | ----- | ----- |
| Total | 8,368,529 | 10,905,467 | (2,536,938) | 17,337 |
| | ----- | ----- | ----- | ----- |
| Underwriting Profit (Before Income Taxes) | \$2,436,862 | \$2,085,291 | \$351,571 | \$4,681 |
| | ===== | ===== | ===== | ===== |

The improved underwriting results for the three and six months ended June 30, 2006, as shown in the above table, are primarily the result of the following:

- o Net premium earned for the three and six months ended June 30, 2006, decreased as compared to the prior periods due to the Company's reduction in direct written premium. Policies issued decreased 799 (17%) to 3,840 for the three months ended June 30, 2006, compared to 4,639 for the three months ended June 30, 2005. For the six months ended June 30, 2006, policies issued decreased 1,521 (16%) to 7,813, compared to 9,334 for the six months ended June 30, 2005. Despite the increased competition in the property and casualty marketplace, the Company believes that rate adequacy is more important than premium growth and underwriting profit is the Company's primary goal.
- o Losses and loss adjustment expenses decreased for the three and six months ended June 30, 2006, as compared to prior periods, as a result of the decrease in earned premiums and as a result of an increase in the amount of favorable development of prior years' losses for the three and six months ended June 30, 2006, as compared to prior periods.
- o Policy acquisition costs for the three and six months ended June 30, 2006, decreased as compared to the prior periods due to the Company's reduction in direct earned premium.

Other Operations

The Company's other revenues from insurance operations consist of commissions, fees, finance charges, and investment and other income. Excluding investment and other income, these operations accounted for approximately 10% of total revenues in the three and six months ended June 30, 2006, and June 30, 2005.

Investments and Liquidity

The Company generates revenue from its investment portfolio, which consisted of approximately \$142.9 million (at amortized cost) at June 30, 2006, compared to \$140.6 million (at amortized cost) at December 31, 2005. Investment income for the three months ended June 30, 2006, increased \$375,561 (35%) to \$1,444,403 and increased \$681,209 (32%) to \$2,799,319 for the six months ended June 30, 2006, compared to \$1,068,842 and \$2,118,110 for the three and six months ended June 30, 2005, respectively. The increase in investment income is primarily a result of an increase in the Company's annualized yield on average invested assets.

LIQUIDITY AND CAPITAL RESOURCES

Due to the nature of the Company's business (insurance and insurance services)

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and whereas Company growth does not normally require material reinvestments of profits into property or equipment, the cash flow generated from operations usually results in improved liquidity for the Company.

Crusader generates a significant amount of cash as a result of its holdings of unearned premium reserves, reserves for loss payments, and its capital and surplus. Crusader's loss and loss adjustment expense payments are the most significant cash flow requirement of the Company. These payments are continually monitored and projected to ensure that the Company has the liquidity to cover these payments without the need to liquidate its investments. As of June 30, 2006, the Company had cash and investments of \$142,910,379 (at amortized cost) of which \$140,463,475 (98.3%) were investments of Crusader.

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As of June 30, 2006, the Company had invested \$140,313,044 (at amortized cost) or 98% of its invested assets in fixed maturity obligations. In accordance with Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company is required to classify its investments in debt and equity securities into one of three categories: held-to-maturity, available-for-sale, or trading securities. Although all of the Company's investments are classified as available-for-sale, the Company's investment guidelines place primary emphasis on buying and holding high-quality investments until maturity.

The Company's investments in fixed maturity obligations of \$140,313,044 (at amortized cost) include \$916,780 (0.7%) of pre-refunded state and municipal tax-exempt bonds, \$116,164,216 (82.8%) of U.S. treasury securities, \$3,000,000 (2.1%) of U.S. government sponsored enterprise securities, \$19,832,048 (14.1%) of industrial and miscellaneous securities, and \$400,000 (0.3%) of long-term certificates of deposit.

The balance of the Company's investments is in short-term investments that include U.S. treasury bills, bank money market accounts, certificates of deposit, commercial paper, and a short-term treasury money market fund.

The Company's investment guidelines on equity securities limit investments in equity securities to an aggregate maximum of \$2,000,000. The Company's investment guidelines on fixed maturities limit those investments to high-grade obligations with a maximum term of eight years. The maximum investment authorized in any one issuer is \$2,000,000 and the maximum in any one U.S. government agency or U.S. government sponsored enterprise is \$3,000,000. This dollar limitation excludes bond premiums paid in excess of par value and U.S. government or U.S. government guaranteed issues. Investments in municipal securities are primarily pre-refunded and secured by U.S. treasury securities. The short-term investments are either U.S. government obligations, FDIC insured, or are in an institution with a Moody's rating of P2 and/or a Standard & Poor's rating of A1. All of the Company's fixed maturity investment securities are rated and readily marketable and could be liquidated without any materially adverse financial impact.

During 2005 the Company began its conversion to a "paperless office" including improvements to its computer network, hardware, switching, and other related computer infrastructure. The "paperless office" conversion of the insurance company underwriting operations was completed in October 2005 and the insurance company claims operations was completed in July 2006. The Company estimates that the remaining planned conversion and improvements should be completed in less than one year. As of June 30, 2006, the Company had incurred approximately \$665,000 of capital expenditures on these projects and anticipates incurring an additional \$100,000 to complete the projects. Upon full implementation of these

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projects, the Company anticipates its potential payback on these capital expenditures in approximately two to three years due to productivity improvements, improved customer service, and lower operating costs. In addition, the Company is in the process of enhancing its technology related to its underwriting procedures to better accommodate its customers' needs and to improve operating efficiencies.

The Company has previously announced that its Board of Directors had authorized the repurchase in the open market from time to time of up to an aggregate of 945,000 shares of the common stock of the Company (see Note 3). No shares were repurchased in the three and six months ended June 30, 2006.

Although material capital expenditures may also be funded through borrowings, the Company believes that its cash and short-term investments as of the date of this report, net of trust restriction of \$90,366, statutory deposits of \$700,000, cash of \$200,000 deposited with superior courts in lieu of bonds, and the dividend restriction between Crusader and Unico plus the cash to be generated from operations, should be sufficient to meet its operating requirements during the next twelve months without the necessity of borrowing funds.

RESULTS OF OPERATIONS

All comparisons made in this discussion are comparing the three months and six months ended June 30, 2006, to the three months and six months ended June 30, 2005, unless otherwise indicated.

The Company had a net income of \$1,956,720 for the three months ended June 30, 2006, compared to a net income of \$1,693,313 for the three months ended June 30, 2005, an increase of \$263,407 (16%). For the six months ended June 30, 2006, the Company had a net income of \$3,844,270 compared to a net income of \$3,198,493 for the six months ended June 30, 2005, an increase of \$645,777 (20%). Total revenues decreased \$1,995,177 (13%) to \$13,667,146 for the three months and \$3,402,616 (11%) to \$27,740,821 for the six months ended June 30, 2006, compared to total revenues of \$15,662,323 for the three months and \$31,143,437 for the six months ended June 30, 2005.

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PREMIUM WRITTEN (before reinsurance) is a non-GAAP financial measure which is defined, under statutory accounting, as the contractually determined amount charged by the Company to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the terms of the policies. Premium earned, the most directly comparable GAAP measure, represents the portion of premiums written that is recognized as income in the financial statements for the period presented and earned on a pro-rate basis over the term of the policies. Commencing April 1, 2006, the Company prospectively changed its statutory reporting of written premium amount to exclude advance premiums that had been recorded but were not yet effective as of the reporting date. Advance premiums represent policies that have been submitted to the Company and are bound, billed, and recorded up to 30 days prior to the policy effective date. Written premium reported on the Company's statutory statement was \$12,725,564 and \$25,492,035 for the three and six months ended June 30, 2006, compared to \$16,248,649 and \$30,358,205 for the three and six months ended June 30, 2005. Had the change in excluding advance business from statutory written premium been made on a retroactive basis, written premium would have been \$13,581,284 and \$26,085,421 for the three and six months ended June 30, 2006, compared to \$16,493,296 and \$30,258,020 for the three and six months ended June 30, 2005,

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and the decrease in written premium would have been 17.7% for the three months and 13.8% for the six months ended June 30, 2006.

The decrease in written premium for the three and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005, was primarily the result of the increased competition in the property and casualty market. The Company believes that the "hard market" that existed in California in the past few years has transitioned to a "soft market." The Company cannot determine how long the existing market conditions will continue, nor in which direction they might change.

The Company intends to continue to allocate its resources toward improving its California business rates, rules, and forms. The Company continues to believe that it can compete effectively and profitably by offering better service and by marketing its policies through its current independent agents and brokers.

PREMIUM EARNED before reinsurance decreased \$2,240,043 (14%) to \$14,293,870 for the three months and \$4,070,789 (12%) to \$29,138,769 for the six months ended June 30, 2006, compared to \$16,533,913 for the three months and \$33,209,558 for the six months ended June 30, 2005. The Company writes annual policies and, therefore, earns written premium over the one-year policy term. The decrease in earned premium is a direct result of the related decrease in written premium previously discussed.

Premium ceded decreased \$54,676 (2%) to \$3,488,479 for the three months and \$273,774 (4%) to \$7,119,068 for the six months ended June 30, 2006, compared to ceded premium of \$3,543,155 in the three months and \$7,392,842 for the six months ended June 30, 2005. The Company evaluates each of its ceded reinsurance contracts at their inception to determine if there is a sufficient risk transfer to allow the contract to be accounted for as reinsurance under current accounting literature. At June 30, 2006, all such ceded contracts are accounted for as risk transfer reinsurance. Earned premium ceded consists of both premium ceded under the Company's current reinsurance contracts and premium ceded to the Company's provisionally rated reinsurance contracts. Prior to January 1, 1998, the Company's reinsurer charged a provisional rate on exposures up to \$500,000 that was subject to adjustment and was based on the amount of losses ceded, limited by a maximum percentage that could be charged. That provisionally rated treaty was cancelled on a runoff basis in 1997. Direct earned premium, earned ceded premium, and ceding commission are as follows:

| | Three Months Ended June 30 | | | Six |
|-----------------------------------|----------------------------|--------------|------------------------|--------------|
| | 2006 | 2005 | Increase (Decrease) | 2006 |
| | ----- | ----- | ----- | ----- |
| Direct earned premium | \$14,293,870 | \$16,533,913 | (\$2,240,043) | \$29,138,769 |
| Earned ceded premium: | | | | |
| Excluding provisionally | | | | |
| rated ceded premium | 3,495,185 | 3,618,163 | (122,978) | 7,094,769 |
| Provisionally rated ceded premium | (6,706) | (75,008) | 68,302 | 24,300 |
| | ----- | ----- | ----- | ----- |
| Total Earned Ceded Premium | 3,488,479 | 3,543,155 | (54,676) | 7,119,069 |
| Ceding commission | (1,103,419) | (1,188,303) | 84,884 | (2,249,388) |
| | ----- | ----- | ----- | ----- |
| Total Earned Ceded Premium | | | | |
| Net of Ceding Commission | \$2,385,060 | \$2,354,852 | \$30,208 | \$4,869,681 |
| | ===== | ===== | ===== | ===== |

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Total earned ceded premium excluding provisionally rated ceded premium was 24% of direct earned premium in the three and six months ended June 30, 2006, compared to 22% in the three and six months ended June 30, 2005. There was no change in the ceding commission rate.

In 2006 and 2005 Crusader retained a participation in its excess of loss reinsurance treaties of 10% in its 1st layer (\$700,000 in excess of \$300,000), 10% in its 2nd layer (\$1,000,000 in excess of \$1,000,000), and 30% in its property and casualty clash treaties.

Crusader's 2004 and 2003 1st layer primary excess of loss treaty provides for a contingent commission to the Company equal to 45% of the net profit, if any, accruing to the reinsurer. The first accounting period for the contingent commission covers the period from January 1, 2003, through December 31, 2005. The Company will calculate and report to the reinsurer its net profit, if any, within 90 days after 36 months following the end of the first accounting period, and within 90 days after the end of each 12 month period thereafter until all losses subject to the agreement have been finally settled. Based on losses and loss adjustment expenses ceded (including incurred but not reported losses) as of June 30, 2006, no contingent commission has been accrued. The 2006 and 2005 1st layer primary excess of loss treaties do not provide for a contingent commission.

INVESTMENT INCOME, excluding realized investment gains, increased \$375,561 (35%) to \$1,444,403 for the three months ended June 30, 2006, compared to investment income of \$1,068,842 for the three months ended June 30, 2005. Investment income, excluding realized investment gains, increased \$681,209 (32%) to \$2,799,319 for the six months ended June 30, 2006, compared to investment income of \$2,118,110 for the six months ended June 30, 2005. The increase in investment income in the current periods as compared to the prior year periods is a result of an increase in the company's annualized yield on average invested assets from 3.1% and 3.2% for the three and six months ended June 30, 2005, respectively, to 4.0% for the three and six months ended June 30, 2006. The increase in the annualized yield on average invested assets is a result of the reinvestment of maturing investments and cash generated from operations at higher yields.

The average annualized yields on the Company's average invested assets are as follows:

| | Three Months Ended June 30 | | Six Months Ended June 30 |
|---|----------------------------|---------------|--------------------------|
| | 2006 | 2005 | 2006 |
| Average Invested Assets | \$143,234,521 | \$136,950,535 | \$141,732,563 |
| Total Investment Income | \$1,444,403 | \$1,068,842 | \$2,799,319 |
| Annualized Yield on Average Invested Assets | 4.0% | 3.1% | 4.0% |

The par value, amortized cost, estimated market value and weighted average yield of fixed maturity investments at June 30, 2006, by contractual maturity are as follows. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

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| Maturities by Calendar Year | Par Value | Amortized Cost | Fair Value | Weighted Average Yield |
|--------------------------------|---------------|----------------|---------------|------------------------------|
| December 31, 2006 | \$33,475,000 | \$33,494,805 | \$33,335,784 | 3.3% |
| December 31, 2007 | 67,775,000 | 67,689,157 | 66,954,586 | 4.2% |
| December 31, 2008 | 30,610,000 | 30,614,972 | 30,417,474 | 4.8% |
| December 31, 2009 | 8,300,000 | 8,414,110 | 8,354,466 | 5.2% |
| December 31, 2010 | 100,000 | 100,000 | 100,000 | 4.1% |
| | ----- | ----- | ----- | --- |
| Total | \$140,260,000 | \$140,313,044 | \$139,162,310 | 4.2% |
| | ===== | ===== | ===== | === |

The weighted average maturity of the Company's fixed maturity investments was 1.1 years as of June 30, 2006, compared to 1.4 years as of June 30, 2005. Due to the current interest rate environment, management believes it is prudent to purchase fixed maturity investments with maturities of three years or less and with minimal credit risk.

As of June 30, 2006, the Company held fixed maturity investments with unrealized appreciation of \$43,621 and fixed maturity investments with unrealized depreciation of \$1,194,355. The Company monitors its investments closely. If an unrealized loss is determined to be other than temporary, it is written off as a realized loss through the Consolidated Statements of Operations. The Company's methodology of assessing other-than-temporary impairments is based on security-specific analysis as of the balance sheet date and considers various factors including the length of time to maturity and the extent to which the fair value has been less than the cost, the

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financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, and the Company's intent to hold the investment for a period of time sufficient to allow the Company to recover its costs. The Company has concluded that the gross unrealized losses of \$1,194,355 as of June 30, 2006, were temporary in nature. However, facts and circumstances may change which could result in a decline in market value considered to be other than temporary. The following table summarizes, all fixed maturities in an unrealized loss position at June 30, 2006, and the aggregate fair value and gross unrealized loss by length of time those fixed maturities have been continuously in an unrealized loss position:

| | Market Value | Gross Unrealized Loss |
|----------------|-----------------|--------------------------|
| 0-6 months | \$43,324,926 | \$294,112 |
| 7-12 months | 46,296,194 | 583,492 |
| Over 12 months | 35,925,905 | 316,751 |
| | ----- | ----- |
| Total | \$125,547,025 | \$1,194,355 |
| | ===== | ===== |

As of June 30, 2006, the fixed maturity investments with a gross unrealized loss for a continuous period of 0 to 6 months consisted of U.S. treasury securities and investment grade industrial securities. The fixed maturity investments with a gross unrealized loss position for a continuous period of 7 to 12 months consisted of U.S. treasury securities and investment grade industrial securities. The fixed maturity investments with a gross unrealized loss position for a continuous period over 12 months consisted of U.S. treasury securities,

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U.S. government sponsored enterprise securities, investment grade industrial securities and pre-refunded municipal bonds.

GROSS COMMISSIONS AND FEES decreased \$166,372 (12%) to \$1,224,974 for the three months and \$239,991 (9%) to \$2,524,680 for the six months ended June 30, 2006, compared to commissions and fees of \$1,391,346 for the three months and \$2,764,671 for the six months ended June 30, 2005. The decrease in gross commissions and fee income for the three and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005, is as follows:

| | Three Months Ended June 30 | | | |
|---|----------------------------|-------------|------------------------|-------|
| | 2006 | 2005 | Increase (Decrease) | |
| Policy fee income | \$662,329 | \$750,778 | \$(88,449) | \$1,3 |
| Health and life insurance program commission income | 398,194 | 409,847 | (11,653) | 8 |
| Membership and fee income | 74,667 | 79,565 | (4,898) | 1 |
| Other commission and fee income | 15,380 | 12,684 | 2,696 | |
| Daily automobile rental insurance program: | | | | |
| Commission income (excluding contingent commission) | 74,404 | 108,596 | (34,192) | 1 |
| Contingent commission | - | 29,876 | (29,876) | |
| Total | \$1,224,974 | \$1,391,346 | \$(166,372) | \$2,5 |

Unifax primarily sells and services insurance policies for Crusader. The commissions paid by Crusader to Unifax are eliminated as intercompany transactions and are not reflected as income in the financial statements. Unifax also receives policy fee income that is directly related to the Crusader policies it sells. Policy fee income decreased \$88,449 (12%) and \$151,548 (10%) for the three and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005. The decrease in policy fee income is a result of a decrease in the number of policies issued during the three and six months ended June 30, 2006, as compared to the three and six months ended June 30, 2005, offset in part by an approximate 8% increase in the policy fee for policies effective on or after June 26, 2005.

American Insurance Brokers, Inc. (AIB), a wholly owned subsidiary of the Company, sells and services health insurance policies for individual/family and small business groups and receives commission and fee income based on the premiums that it writes. Commission income in this program decreased \$11,653 (3%) and \$23,347 (3%) for the three and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005. The Company's subsidiary Insurance Club, Inc., DBA the American Association for Quality Health Care (AAQHC), is a membership association that provides various consumer benefits to its members, including participation in group health care and life insurance policies that AAQHC negotiates for the association. For these services,

AAQHC receives membership and fee income from its members. Membership and fee income decreased \$4,898 (6%) and \$9,724 (6%) for the three and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005. In May 2006, CIGNA HealthCare began offering new small group medical insurance policies in the state of California. Currently, all new CIGNA small group medical insurance policies are written through AIB and all CIGNA small group medical

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insurance policyholders are members of AAQHC. The new programs are competitively priced and are being actively marketed.

The daily automobile rental insurance program is produced by Bedford Insurance Services, Inc., a wholly owned subsidiary of the Company. Bedford receives a commission from a non-affiliated insurance company based on premium written. Commission in the daily automobile rental insurance program (excluding contingent commission) decreased \$34,192 (31%) and \$75,793 (33%) for the three and six months ended June 30, 2006, compared to the three and six months ended June 30, 2005. The decrease is primarily due to the continued intense price competition in the daily automobile rental insurance program. Bedford continues to produce business only at rates that it believes to be adequate. Primarily due to declining sales, in April 2006 the Company hired for its Bedford division a new general manager who has substantial experience in the daily automobile rental insurance business. Currently, the daily automobile rental insurance program operation is in the course of developing and implementing a new business plan to better compete in the market place.

LOSSES AND LOSS ADJUSTMENT EXPENSES were 56% of net premium earned for the three months and 57% of net premium earned for the six months ended June 30, 2006, compared to 63% of net premium earned for the three months and 64% of net premium earned for the six months ended June 30, 2005. Favorable development of all prior accident years' losses and loss adjustment expenses for the three and six months ended June 30, 2006, were \$1,533,975 and \$2,880,644, respectively. Favorable development of all prior accident years' losses and loss adjustment expenses for the three and six months ended June 30, 2005, were \$875,620 and \$1,614,198, respectively. The development of prior years' losses and loss adjustment expenses for the periods indicated was lower than previously anticipated. Accordingly, the Company reduced its estimate of its ultimate losses and loss adjustment expenses for those prior accident years. Losses and loss adjustment expenses for the 2006 accident year was 70% of net premium earned as of March 31, 2006, and June 30, 2006. Losses and loss adjustment expenses for the 2005 accident year was 70% of net premium earned as of March 31, 2005, and June 30, 2005.

The Company's consolidated financial statements include estimated reserves for unpaid losses and related loss adjustment expenses of the insurance company operation. Crusader sets loss and loss adjustment expense reserves at each balance sheet date at management's best estimate of the ultimate payments that it anticipates will be made to settle all losses incurred and related loss adjustment expenses incurred as of that date for both reported and unreported losses. Estimating loss reserves is a difficult process as there are many factors that can ultimately affect the final settlement of a claim and, therefore, the reserve that is needed. Changes in the regulatory and legal environment, results of litigation, medical costs, the cost of repair materials and labor rates can all impact ultimate claim costs. In addition, time can be a critical part of reserving determinations since the longer the span between the incidence of a loss and the payment or settlement of the claim, the more variable the ultimate settlement amount can be. Accordingly, short-tail claims, such as property damage claims, tend to be more reasonably predictable than long-tail liability claims. The liability for unpaid losses and loss adjustment expenses is based upon the accumulation of individual case estimates for losses reported prior to the close of the accounting period plus estimates based on experience and industry data for development of case estimates and for unreported losses and loss adjustment expenses. Since the emergence and disposition of claims are subject to uncertainties, the net amounts that will ultimately be paid to settle claims may vary significantly from the estimated amounts provided for in the accompanying consolidated financial statements. Any adjustments to reserves are reflected in the operating results of the periods in which they are made. Management believes that the aggregate reserves for losses and loss adjustment expenses are reasonable and adequate to cover the cost of claims, both reported and unreported.

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POLICY ACQUISITION COSTS consist of commissions, premium taxes, inspection fees, and certain other underwriting costs, which are related to the production of Crusader insurance policies. These costs include both Crusader expenses and allocated expenses of other Unico subsidiaries. Crusader's reinsurers pay Crusader a ceding commission, which is primarily a reimbursement of the acquisition cost related to the ceded premium. Policy acquisition costs, net of ceding commission, are deferred and amortized as the related premiums are earned. These costs were approximately 21% and 22% of net premium earned for the three and six months ended June 30, 2006, and 21% of net premium earned for the three and six months ended June 30, 2005.

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SALARIES AND EMPLOYEE BENEFITS increased \$126,524 (10%) to \$1,398,162 for the three months and \$124,058 (5%) to \$2,683,053 for the six months ended June 30, 2006, compared to salary and employee benefits of \$1,271,638 for the three months and \$2,558,995 for the six months ended June 30, 2005.

COMMISSIONS TO AGENTS/BROKERS decreased \$19,530 (11%) to \$152,733 for the three months and \$46,877 (13%) to \$310,426 for the six months ended June 30, 2006, compared to commission expense of \$172,263 for the three months and \$357,303 for the six months ended June 30, 2005. The decrease is primarily the result of a decrease in premiums written in the daily automobile rental insurance program and the health and life insurance program and is related to the decrease in commission income from both programs.

OTHER OPERATING EXPENSES increased \$65,587 (10%) to \$734,551 for the three months and \$138,627 (10%) to \$1,482,197 for the six months ended June 30, 2006, compared to \$668,964 for the three months and \$1,343,570 for the six months ended June 30, 2005.

INCOME TAX PROVISION was an expense of \$1,056,451 (35% of pre-tax income) for the three months and \$2,083,044 (35% of pre-tax income) for the six months ended June 30, 2006, compared to an income tax expense of \$950,678 (36% of pre-tax income) in the three months and an income tax expense of \$1,801,825 (36% of pre-tax income) for the six months ended June 30, 2005. This change was primarily due to a pre-tax income of \$3,013,171 (including tax-exempt investment income of \$3,491) in the three months and \$5,927,314 (including tax-exempt investment income of \$7,216) in the six months ended June 30, 2006, compared to pre-tax income of \$2,643,991 (including tax-exempt investment income of \$3,491) in the three months and a pre-tax income of \$5,000,318 (including tax-exempt investment income of \$7,216) in the six months ended June 30, 2005.

The effect of inflation on net income of the Company during the three and six months ended June 30, 2006, and the three and six months ended June 30, 2005, was not significant.

FORWARD LOOKING STATEMENTS

Certain statements contained herein, including the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations," that are not historical facts are forward-looking. These statements, which may be identified by forward-looking words or phrases such as "anticipate," "believe," "expect," "intend," "may," "should," and "would," involve risks and uncertainties, many of which are beyond the control of the Company. Such risks and uncertainties could cause actual results to differ materially from these forward-looking statements. Factors which could cause actual results to differ materially include underwriting actions not being effective, rate increases for coverages not being sufficient, premium rate adequacy relating to competition or regulation, actual versus estimated claim

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experience, regulatory changes or developments, unforeseen calamities, general market conditions and the Company's ability to introduce new profitable products.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's consolidated balance sheet includes a substantial amount of invested assets whose fair values are subject to various market risk exposures including interest rate risk and equity price risk. The Company's invested assets consist of the following:

| | June 30 2006 ---- | December 31 2005 ---- | Increase (Decrease) ----- |
|--|-------------------------|-----------------------------|---------------------------------|
| Fixed maturity bonds (at amortized value) | \$139,913,044 | \$135,628,428 | \$4,284,616 |
| Short-term cash investments (at cost) | 2,548,492 | 4,475,162 | (1,926,670) |
| Certificates of deposit (over 1 year, at cost) | 400,000 | 500,000 | (100,000) |
| | ----- | ----- | ----- |
| Total Invested Assets | \$142,861,536 ===== | \$140,603,590 ===== | \$2,257,946 ===== |

There have been no material changes in the composition of the Company's invested assets or market risk exposures since the end of the preceding fiscal year end.

ITEM 4 - CONTROLS AND PROCEDURES

An evaluation was carried out by the Company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2006, (as defined in Rule 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

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During the period covered by this report, there have been no changes in the Company's internal control over financial reporting that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1A. RISK FACTORS

There were no material changes from risk factors as previously disclosed in the Company's Form 10-K for the year ended December 31, 2005, in response to Item 1A to Part I of Form 10-K.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF STOCKHOLDERS

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- (a) On May 25, 2006, the Company held its Annual Meeting of Stockholders.
 - (b) Proxies for the meeting were solicited pursuant to Regulation 14 under the Securities Exchange Act of 1934; there was no solicitation in opposition to nominees of the Board of Directors as listed in the Proxy Statement and all such nominees were elected.
 - (c) At the meeting, the following persons were elected by the vote indicated as directors to serve until the next annual meeting of stockholders and until their successors are duly elected and qualified. There were no broker non-votes.

| Name ----- | For --- | Against or Withheld ----- |
|----------------------|------------|---------------------------------|
| Erwin Cheldin | 4,699,180 | 275,731 |
| Cary L. Cheldin | 4,690,180 | 284,731 |
| Lester A. Aaron | 4,669,709 | 305,202 |
| George C. Gilpatrick | 4,699,580 | 275,331 |
| David A. Lewis | 4,941,222 | 33,689 |
| Warren D. Orloff | 4,961,593 | 13,318 |
| Donald B. Urfrig | 4,961,693 | 13,218 |

ITEM 6 - EXHIBITS

- 31.1 Certificate of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certificate of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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.

UNICO AMERICAN CORPORATION

Date: August 11, 2006

By: /s/ ERWIN CHELDIN

Erwin Cheldin
 Chairman of the Board, President and Chief
 Executive Officer, (Principal Executive Officer)

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Date: August 11, 2006

By: /s/ LESTER A. AARON

Lester A. Aaron
Treasurer, Chief Financial Officer, (Principal
Accounting and Principal Financial Officer)

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EXHIBIT INDEX

| Exhibit No. ----- | Description ----- |
|----------------------|--|
| 31.1 | Certificate of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 31.2 | Certificate of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith) |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith) |