

INFINITY PROPERTY & CASUALTY CORP
Form 10-Q
November 06, 2014

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

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2014

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 No. 0-50167

INFINITY PROPERTY AND CASUALTY CORPORATION

(Exact name of registrant as specified in its charter)

Incorporated under

the Laws of Ohio

(State or other jurisdiction of

incorporation or organization)

3700 Colonnade Parkway, Suite 600, Birmingham, Alabama 35243

(Address of principal executive offices and zip code)

(205) 870-4000

(Registrant's telephone number, including area code)

Not Applicable

(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 and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company) Smaller reporting company

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

As of October 31, 2014 there were 11,495,254 shares of the registrant's common stock outstanding.

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Condensed Notes to Consolidated Financial Statements

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101.INS XBRL Instance Document
101.SCH XBRL Taxonomy Extension Schema
101.CAL XBRL Taxonomy Extension Calculation Linkbase
101.DEF XBRL Taxonomy Extension Definition Linkbase
101.LAB XBRL Taxonomy Extension Label Linkbase
101.PRE XBRL Taxonomy Extension Presentation Linkbase

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Condensed Notes to Consolidated Financial Statements

PART I
FINANCIAL INFORMATIONITEM 1
Financial StatementsINFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands, except per share data)

(unaudited)

| | Three months ended September 30, | | | Nine months ended September 30, | | | |
|--|----------------------------------|-----------|----------|---------------------------------|-----------|----------|----|
| | 2014 | 2013 | % Change | 2014 | 2013 | % Change | |
| Revenues: | | | | | | | |
| Earned premium | \$332,977 | \$327,078 | 1.8 | % \$993,680 | \$976,882 | 1.7 | % |
| Installment and other fee income | 23,254 | 24,183 | (3.8) |)% 71,439 | 74,435 | (4.0) |)% |
| Net investment income | 8,754 | 8,141 | 7.5 | % 26,663 | 25,101 | 6.2 | % |
| Net realized gains (losses) on investments ¹ | 1,013 | (546) |) NM | 3,503 | 4,072 | (14.0) |)% |
| Other income | 162 | 289 | (43.9) |)% 442 | 414 | 6.7 | % |
| Total revenues | 366,160 | 359,145 | 2.0 | % 1,095,727 | 1,080,903 | 1.4 | % |
| Costs and Expenses: | | | | | | | |
| Losses and loss adjustment expenses | 248,483 | 255,240 | (2.6) |)% 759,120 | 762,690 | (0.5) |)% |
| Commissions and other underwriting expenses | 90,560 | 88,508 | 2.3 | % 268,258 | 268,119 | 0.1 | % |
| Interest expense | 3,450 | 3,458 | (0.2) |)% 10,354 | 10,456 | (1.0) |)% |
| Corporate general and administrative expenses | 1,790 | 1,888 | (5.2) |)% 6,012 | 5,960 | 0.9 | % |
| Other expenses | 151 | 409 | (63.1) |)% 467 | 1,802 | (74.1) |)% |
| Total costs and expenses | 344,433 | 349,503 | (1.5) |)% 1,044,211 | 1,049,027 | (0.5) |)% |
| Earnings before income taxes | 21,727 | 9,643 | 125.3 | % 51,516 | 31,877 | 61.6 | % |
| Provision for income taxes | 6,872 | 2,448 | 180.7 | % 15,667 | 8,612 | 81.9 | % |
| Net Earnings | \$14,855 | \$7,195 | 106.5 | % \$35,849 | \$23,265 | 54.1 | % |
| Net Earnings per Common Share: | | | | | | | |
| Basic | \$1.30 | \$0.63 | 106.3 | % \$3.13 | \$2.03 | 54.2 | % |
| Diluted | 1.29 | 0.62 | 108.1 | % 3.10 | 1.99 | 55.8 | % |
| Average Number of Common Shares: | | | | | | | |
| Basic | 11,451 | 11,421 | 0.3 | % 11,438 | 11,463 | (0.2) |)% |
| Diluted | 11,554 | 11,622 | (0.6) |)% 11,572 | 11,670 | (0.8) |)% |
| Cash Dividends per Common Share | \$0.36 | \$0.30 | 20.0 | % \$1.08 | \$0.90 | 20.0 | % |
| ¹ Net realized gains before impairment losses | \$1,034 | \$273 | 278.4 | % \$3,558 | \$5,262 | (32.4) |)% |
| Total other-than-temporary impairment (OTTI) losses | (24) |) (1,547) |) (98.5) |)% (917) |) (2,105) |) (56.4) |)% |
| Non-credit portion in other comprehensive income | 2 | 728 | (99.7) |)% 888 | 915 | (3.0) |)% |
| OTTI losses reclassified from other comprehensive income | 0 | 0 | NM | (25) |) 0 | NM | |

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| | | | | | | | | | | | | |
|--|---------|---|--------|---|-------|----|---------|---|---------|---|-------|----|
| Net impairment losses recognized in earnings | (21 |) | (819 |) | (97.4 |)% | (55 |) | (1,190 |) | (95.4 |)% |
| Total net realized gains (losses) on investments | \$1,013 | | \$(546 |) | NM | | \$3,503 | | \$4,072 | | (14.0 |)% |

NM = Not Meaningful

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

(unaudited)

| | Three months ended | | Nine months ended | |
|--|--------------------|-----------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2014 | 2013 | 2014 | 2013 |
| Net earnings | \$ 14,855 | \$ 7,195 | \$ 35,849 | \$ 23,265 |
| Other comprehensive income (loss) before tax: | | | | |
| Net change in postretirement benefit liability | (3 |) 50 | 652 | 150 |
| Unrealized gains (losses) on investments: | | | | |
| Unrealized holding gains (losses) arising during the period | (10,232 |) 9,847 | 13,138 | (17,463 |
| Less: Reclassification adjustments for (gains) losses included in net earnings | (1,013 |) 546 | (3,503 |) (4,072 |
| Unrealized gains (losses) on investments, net | (11,245 |) 10,393 | 9,634 | (21,534 |
| Other comprehensive income (loss), before tax | (11,247 |) 10,443 | 10,287 | (21,385 |
| Income tax (expense) benefit related to components of other comprehensive income | 3,937 | (3,655 |) (3,600 |) 7,485 |
| Other comprehensive income (loss), net of tax | (7,311 |) 6,788 | 6,686 | (13,900 |
| Comprehensive income | \$ 7,544 | \$ 13,983 | \$ 42,535 | \$ 9,364 |

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share amounts in line descriptions)

| | September 30, 2014 (unaudited) | December 31, 2013 |
|---|--------------------------------------|----------------------|
| Assets | | |
| Investments: | | |
| Fixed maturities – at fair value (amortized cost \$1,411,360 and \$1,345,077) | \$1,429,734 | \$1,354,305 |
| Equity securities – at fair value (cost \$73,739 and \$74,718) | 90,638 | 91,127 |
| Short-term investments - at fair value (amortized cost \$813 and \$2,595) | 813 | 2,596 |
| Total investments | 1,521,184 | 1,448,027 |
| Cash and cash equivalents | 94,672 | 134,211 |
| Accrued investment income | 12,200 | 12,772 |
| Agents' balances and premium receivable, net of allowances for doubtful accounts of \$15,410 and \$15,884 | 507,755 | 451,339 |
| Property and equipment, net of accumulated depreciation of \$61,188 and \$53,368 | 56,119 | 48,061 |
| Prepaid reinsurance premium | 5,220 | 3,133 |
| Recoverables from reinsurers (includes \$70 and \$77 on paid losses and LAE) | 13,953 | 14,508 |
| Deferred policy acquisition costs | 95,365 | 88,258 |
| Current and deferred income taxes | 21,994 | 28,648 |
| Receivable for securities sold | 1,871 | 2,791 |
| Other assets | 11,926 | 10,242 |
| Goodwill | 75,275 | 75,275 |
| Total assets | \$2,417,536 | \$2,317,265 |
| Liabilities and Shareholders' Equity | | |
| Liabilities: | | |
| Unpaid losses and loss adjustment expenses | \$673,198 | \$646,577 |
| Unearned premium | 622,276 | 566,004 |
| Payable to reinsurers | 0 | 2 |
| Long-term debt (fair value \$288,824 and \$272,632) | 275,000 | 275,000 |
| Commissions payable | 18,573 | 19,100 |
| Payable for securities purchased | 24,654 | 39,887 |
| Other liabilities | 122,366 | 113,936 |
| Total liabilities | 1,736,067 | 1,660,507 |
| Commitments and contingencies (See Note 9) | | |
| Shareholders' equity: | | |
| Common stock, no par value (50,000,000 shares authorized; 21,726,573 and 21,599,047 shares issued) | 21,742 | 21,684 |
| Additional paid-in capital | 372,195 | 368,902 |
| Retained earnings | 708,435 | 685,011 |
| Accumulated other comprehensive income, net of tax | 23,311 | 16,624 |
| Treasury stock, at cost (10,225,372 and 10,095,416 shares) | (444,213 |) (435,463 |
| Total shareholders' equity | 681,469 | 656,758 |
| Total liabilities and shareholders' equity | \$2,417,536 | \$2,317,265 |

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands)

(unaudited)

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss), Net of Tax | Treasury Stock | Total |
|---|-----------------|----------------------------------|----------------------|---|-------------------|-----------|
| Balance at December 31, 2012 | \$21,529 | \$361,845 | \$666,199 | \$29,851 | \$(423,181) | \$656,242 |
| Net earnings | — | — | 23,265 | — | — | 23,265 |
| Net change in postretirement benefit liability | — | — | — | 97 | — | 97 |
| Change in unrealized gain on investments | — | — | — | (13,770) | — | (13,770) |
| Change in non-credit component of impairment losses on fixed maturities | — | — | — | (228) | — | (228) |
| Comprehensive income | — | — | — | — | — | 9,364 |
| Dividends paid to common shareholders | — | — | (10,376) | — | — | (10,376) |
| Shares issued and share-based compensation expense, including tax benefit | 106 | 4,854 | — | — | — | 4,960 |
| Acquisition of treasury stock | — | — | — | — | (11,017) | (11,017) |
| Balance at September 30, 2013 | \$21,635 | \$366,698 | \$679,088 | \$15,950 | \$(434,198) | \$649,174 |
| Net earnings | — | — | 9,368 | — | — | 9,368 |
| Net change in postretirement benefit liability | — | — | — | 491 | — | 491 |
| Change in unrealized gain on investments | — | — | — | 1,045 | — | 1,045 |
| Change in non-credit component of impairment losses on fixed maturities | — | — | — | (863) | — | (863) |
| Comprehensive income | — | — | — | — | — | 10,042 |
| Dividends paid to common shareholders | — | — | (3,445) | — | — | (3,445) |
| Shares issued and share-based compensation expense, including tax benefit | 49 | 2,204 | — | — | — | 2,252 |
| Acquisition of treasury stock | — | — | — | — | (1,265) | (1,265) |
| Balance at December 31, 2013 | \$21,684 | \$368,902 | \$685,011 | \$16,624 | \$(435,463) | \$656,758 |
| Net earnings | — | — | 35,849 | — | — | 35,849 |
| Net change in postretirement benefit liability | — | — | — | 424 | — | 424 |
| Change in unrealized gain on investments | — | — | — | 6,430 | — | 6,430 |
| Change in non-credit component of impairment losses on fixed maturities | — | — | — | (168) | — | (168) |
| Comprehensive income | — | — | — | — | — | 42,535 |
| Dividends paid to common shareholders | — | — | (12,425) | — | — | (12,425) |
| | 58 | 3,293 | — | — | — | 3,350 |

Shares issued and share-based
 compensation expense, including tax
 benefit

| | | | | | | |
|-------------------------------|----------|-----------|-----------|----------|-------------|-----------|
| Acquisition of treasury stock | — | — | — | — | (8,750) | (8,750) |
| Balance at September 30, 2014 | \$21,742 | \$372,195 | \$708,435 | \$23,311 | \$(444,213) | \$681,469 |

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

| | Three months ended September 30, | |
|--|-------------------------------------|------------|
| | 2014 | 2013 |
| Operating Activities: | | |
| Net earnings | \$ 14,855 | \$ 7,195 |
| Adjustments: | | |
| Depreciation | 2,769 | 2,259 |
| Amortization | 5,519 | 5,357 |
| Net realized (gains) losses on investments | (1,013 |) 546 |
| (Gain) loss on disposal of property and equipment | 10 | (121 |
| Share-based compensation expense | 732 | 956 |
| Excess tax benefits from share-based payment arrangements | (62 |) (218 |
| Activity related to rabbi trust | (22 |) 50 |
| Change in accrued investment income | 1,278 | 687 |
| Change in agents' balances and premium receivable | (13,222 |) (4,849 |
| Change in reinsurance receivables | 206 | 765 |
| Change in deferred policy acquisition costs | (1,348 |) 1,034 |
| Change in other assets | (34 |) (2,418 |
| Change in unpaid losses and loss adjustment expenses | 7,976 | 20,857 |
| Change in unearned premium | 11,530 | (927 |
| Change in payable to reinsurers | 0 | 159 |
| Change in other liabilities | 3,801 | 11,000 |
| Net cash provided by operating activities | 32,976 | 42,334 |
| Investing Activities: | | |
| Purchases of fixed maturities | (97,660 |) (148,160 |
| Purchases of equity securities | 0 | (1,000 |
| Purchases of short-term investments | (7,720 |) (575 |
| Purchases of property and equipment | (3,092 |) (5,908 |
| Maturities and redemptions of fixed maturities | 50,767 | 46,100 |
| Maturities and redemptions of short-term investments | 200 | 0 |
| Proceeds from sale of fixed maturities | 60,915 | 42,909 |
| Proceeds from sale of short-term investments | 6,864 | 125 |
| Proceeds from sale of property and equipment | 4 | 171 |
| Net cash provided by (used in) investing activities | 10,277 | (66,338 |
| Financing Activities: | | |
| Proceeds from stock options exercised and employee stock purchases | 73 | 972 |
| Excess tax benefits from share-based payment arrangements | 62 | 218 |
| Principal payments under capital lease obligation | (123 |) (133 |
| Acquisition of treasury stock | (3,589 |) (2,208 |
| Dividends paid to shareholders | (4,142 |) (3,448 |
| Net cash used in financing activities | (7,719 |) (4,600 |
| Net increase (decrease) in cash and cash equivalents | 35,534 | (28,604 |
| Cash and cash equivalents at beginning of period | 59,139 | 115,861 |
| Cash and cash equivalents at end of period | \$94,672 | \$87,257 |

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

| | Nine months ended September | |
|--|-----------------------------|------------|
| | 30, | |
| | 2014 | 2013 |
| Operating Activities: | | |
| Net earnings | \$35,849 | \$23,265 |
| Adjustments: | | |
| Depreciation | 7,967 | 6,312 |
| Amortization | 16,786 | 15,072 |
| Net realized gains on investments | (3,503 |) (4,072 |
| Gain on disposal of property and equipment | (17 |) (120 |
| Share-based compensation expense | 2,441 | 3,043 |
| Excess tax benefits from share-based payment arrangements | (213 |) (375 |
| Activity related to rabbi trust | 39 | 75 |
| Change in accrued investment income | 572 | (171 |
| Change in agents' balances and premium receivable | (56,416 |) (34,140 |
| Change in reinsurance receivables | (1,532 |) (323 |
| Change in deferred policy acquisition costs | (7,107 |) (2,983 |
| Change in other assets | 1,811 | 2,217 |
| Change in unpaid losses and loss adjustment expenses | 26,621 | 59,966 |
| Change in unearned premium | 56,272 | 42,726 |
| Change in payable to reinsurers | (2 |) 23 |
| Change in other liabilities | 8,114 | 11,205 |
| Net cash provided by operating activities | 87,681 | 121,720 |
| Investing Activities: | | |
| Purchases of fixed maturities | (396,904 |) (638,575 |
| Purchases of equity securities | (2,600 |) (2,100 |
| Purchases of short-term investments | (7,920 |) (4,191 |
| Purchases of property and equipment | (16,043 |) (15,139 |
| Maturities and redemptions of fixed maturities | 123,958 | 149,382 |
| Maturities and redemptions of short-term investments | 2,800 | 0 |
| Proceeds from sale of fixed maturities | 178,254 | 323,845 |
| Proceeds from sale of equity securities | 4,999 | 7,244 |
| Proceeds from sale of short-term investments | 6,864 | 125 |
| Proceeds from sale of property and equipment | 34 | 171 |
| Net cash used in investing activities | (106,558 |) (179,239 |
| Financing Activities: | | |
| Proceeds from stock options exercised and employee stock purchases | 697 | 1,543 |
| Excess tax benefits from share-based payment arrangements | 213 | 375 |
| Principal payments under capital lease obligation | (398 |) (582 |
| Acquisition of treasury stock | (8,749 |) (11,365 |
| Dividends paid to shareholders | (12,425 |) (10,376 |
| Net cash used in financing activities | (20,662 |) (20,406 |
| Net decrease in cash and cash equivalents | (39,539 |) (77,925 |
| Cash and cash equivalents at beginning of period | 134,211 | 165,182 |
| Cash and cash equivalents at end of period | \$94,672 | \$87,257 |

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2014

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| 5. <u>Long-Term Debt</u> | 10. <u>Accumulated Other Comprehensive Income</u> |

Note 1 Reporting and Accounting Policies

Nature of Operations

We are a holding company that, through subsidiaries, provides personal automobile insurance with a concentration on nonstandard auto insurance. Although licensed to write insurance in all 50 states and the District of Columbia, we focus on select states that we believe offer the greatest opportunity for premium growth and profitability.

Basis of Consolidation and Reporting

The accompanying consolidated financial statements are unaudited and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2013. This Quarterly Report on Form 10-Q, including the Condensed Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations, focuses on our financial performance since the beginning of the year.

These financial statements reflect certain adjustments necessary for a fair presentation of our results of operations and financial position. Such adjustments consist of normal, recurring accruals recorded to match expenses with their related revenue streams and the elimination of all significant inter-company transactions and balances.

We revised the presentation of our Consolidated Statements of Earnings for the three and nine months ended September 30, 2013 to correctly classify \$24.2 million and \$74.4 million, respectively, of installment and other fee income as a component of total revenues and to conform to our current-year presentation. Previously, installment and other fee income was presented net within our commissions and other underwriting expenses, which was not in compliance with GAAP, thereby understating both total revenues and total expenses by an equivalent amount. This revision is not considered to be material to previously issued financial statements since it has no effect on the results of operations, financial condition or cash flows in any period presented or in any previously issued financial statements.

We have evaluated events that occurred after September 30, 2014 for recognition or disclosure in our financial statements and the notes to the financial statements.

Schedules may not foot due to rounding.

Estimates

We based certain accounts and balances within these financial statements upon our estimates and assumptions. The amount of reserves for claims not yet paid, for example, is an item that we can only record by estimation. Unrealized capital gains and losses on investments are subject to market fluctuations, and we use judgment in the determination of whether unrealized losses on certain securities are temporary or other-than-temporary. Should actual results differ significantly from these estimates, the effect on our results of operations could be material. The results of operations

for the periods presented may not be indicative of our results for the entire year.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) related to the accounting for revenue from contracts with customers. Insurance contracts have been excluded from the scope of the guidance, which is effective for fiscal years beginning after December 15, 2016. We do not expect the adoption of this standard to have a material impact on our financial condition or results of operations.

Note 2 Computation of Net Earnings per Share

The following table illustrates our computations of basic and diluted net earnings per common share (in thousands, except per share figures):

| | Three months ended September | | Nine months ended September | |
|---|------------------------------|---------|-----------------------------|----------|
| | 30, 2014 | 2013 | 30, 2014 | 2013 |
| Net earnings | \$14,855 | \$7,195 | \$35,849 | \$23,265 |
| Average basic shares outstanding | 11,451 | 11,421 | 11,438 | 11,463 |
| Basic net earnings per share | \$1.30 | \$0.63 | \$3.13 | \$2.03 |
| Average basic shares outstanding | 11,451 | 11,421 | 11,438 | 11,463 |
| Restricted stock not yet vested | 23 | 49 | 47 | 44 |
| Dilutive effect of assumed option exercises | 0 | 26 | 1 | 31 |
| Dilutive effect of Performance Share Plan | 79 | 127 | 86 | 132 |
| Average diluted shares outstanding | 11,554 | 11,622 | 11,572 | 11,670 |
| Diluted net earnings per share | \$1.29 | \$0.62 | \$3.10 | \$1.99 |

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

Note 3 Fair Value

Fair values of instruments are based on:

- (i) quoted prices in active markets for identical assets (Level 1),
 quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in
 (ii) markets that are not active and model-derived valuations in which all significant inputs are observable in active
 markets (Level 2) or
 (iii) valuations derived from valuation techniques in which one or more significant inputs are unobservable in the
 marketplace (Level 3).

The following tables present, for each of the fair value hierarchy levels, our assets and liabilities for which we report fair value on a recurring basis (\$ in thousands):

| September 30, 2014 | Fair Value | | | Total | |
|--|------------|-------------|---------|-------------|---|
| | Level 1 | Level 2 | Level 3 | | |
| Cash and cash equivalents | \$94,672 | \$0 | \$0 | \$94,672 | |
| Fixed maturity securities: | | | | | |
| U.S. government | 65,646 | 92 | 0 | 65,738 | |
| State and municipal | 0 | 502,672 | 0 | 502,672 | |
| Mortgage-backed securities: | | | | | |
| Residential | 0 | 352,412 | 0 | 352,412 | |
| Commercial | 0 | 46,253 | 0 | 46,253 | |
| Total mortgage-backed securities | 0 | 398,665 | 0 | 398,665 | |
| Asset-backed securities | 0 | 61,634 | 262 | 61,896 | |
| Corporates | 0 | 397,054 | 3,709 | 400,763 | |
| Total fixed maturities | 65,646 | 1,360,117 | 3,971 | 1,429,734 | |
| Equity securities | 90,638 | 0 | 0 | 90,638 | |
| Short-term investments | 0 | 813 | 0 | 813 | |
| Total cash and investments | \$250,956 | \$1,360,929 | \$3,971 | \$1,615,856 | |
| Percentage of total cash and investments | 15.5 | % 84.2 | % 0.2 | % 100.0 | % |

| December 31, 2013 | Fair Value | | | Total | |
|--|------------|-------------|---------|-------------|---|
| | Level 1 | Level 2 | Level 3 | | |
| Cash and cash equivalents | \$134,211 | \$0 | \$0 | \$134,211 | |
| Fixed maturity securities: | | | | | |
| U.S. government | 64,496 | 171 | 0 | 64,666 | |
| State and municipal | 0 | 487,111 | 0 | 487,111 | |
| Mortgage-backed securities: | | | | | |
| Residential | 0 | 323,346 | 0 | 323,346 | |
| Commercial | 0 | 35,816 | 0 | 35,816 | |
| Total mortgage-backed securities | 0 | 359,162 | 0 | 359,162 | |
| Collateralized mortgage obligations | 0 | 1,291 | 0 | 1,291 | |
| Asset-backed securities | 0 | 70,573 | 686 | 71,259 | |
| Corporates | 0 | 365,642 | 5,175 | 370,816 | |
| Total fixed maturities | 64,496 | 1,283,949 | 5,860 | 1,354,305 | |
| Equity securities | 91,127 | 0 | 0 | 91,127 | |
| Short-term investments | 1,200 | 1,396 | 0 | 2,596 | |
| Total cash and investments | \$291,033 | \$1,285,345 | \$5,860 | \$1,582,238 | |
| Percentage of total cash and investments | 18.4 | % 81.2 | % 0.4 | % 100.0 | % |

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

We do not report our long-term debt at fair value in the Consolidated Balance Sheets. The \$288.8 million and \$272.6 million fair value of our long-term debt at September 30, 2014 and December 31, 2013, respectively, would be included in Level 2 of the fair value hierarchy if it were reported at fair value.

Level 1 includes cash and cash equivalents, U.S. Treasury securities, an exchange-traded fund and equities held in a rabbi trust which funds our Supplemental Employee Retirement Plan ("SERP"). Level 2 includes securities whose fair value was determined using observable market inputs. Level 3 securities are comprised of (i) securities for which there is no active or inactive market for similar instruments, (ii) securities whose fair value is determined based on unobservable inputs and (iii) securities, other than those backed by the U.S. Government, that are not rated by a nationally recognized statistical rating organization ("NRSRO"). We recognize transfers between levels at the beginning of the reporting period.

A third party nationally recognized pricing service provides the fair value of securities in Level 2. We review the third party pricing methodologies quarterly and test for significant differences between the market price used to value the security and recent sales activity.

The following tables present the progression in the Level 3 fair value category (\$ in thousands):

| | Three months ended September 30, 2014 | | | |
|---|---------------------------------------|------------|----------------------------|---------|
| | U.S. Government | Corporates | Asset-Backed Securities | Total |
| Balance at beginning of period | \$0 | \$4,569 | \$380 | \$4,949 |
| Total gains or (losses), unrealized or realized | | | | |
| Included in net earnings | 0 | 191 | 0 | 191 |
| Included in other comprehensive income | 0 | (90 |) 0 | (90 |
| Sales | | (690 |) 0 | (690 |
| Settlements | 0 | (271 |) (118 |) (389 |
| Balance at end of period | \$0 | \$3,709 | \$262 | \$3,971 |

| | Three months ended September 30, 2013 | | | |
|---|---------------------------------------|------------|----------------------------|----------|
| | U.S. Government | Corporates | Asset-Backed Securities | Total |
| Balance at beginning of period | \$3,124 | \$8,055 | \$0 | \$11,179 |
| Total gains or (losses), unrealized or realized | | | | |
| Included in net earnings | (7 |) 22 | 0 | 15 |
| Included in other comprehensive income | (66 |) (72 |) 0 | (138 |
| Settlements | (109 |) (147 |) 0 | (255 |
| Balance at end of period | \$2,942 | \$7,858 | \$0 | \$10,800 |

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

| | Nine months ended September 30, 2014 | | | |
|--|--------------------------------------|------------|----------------------------|----------|
| | U.S. Government | Corporates | Asset-Backed Securities | Total |
| Balance at beginning of period | \$0 | \$ 5,175 | \$ 686 | \$ 5,860 |
| Total gains or (losses), unrealized or realized | | | | |
| Included in net earnings | 0 | 220 | 0 | 220 |
| Included in other comprehensive income | 0 | (149) | (1) | (151) |
| Sales | | (690) | 0 | (690) |
| Settlements | 0 | (846) | (422) | (1,268) |
| Balance at end of period | \$0 | \$ 3,709 | \$ 262 | \$ 3,971 |

| | Nine months ended September 30, 2013 | | | |
|--|--------------------------------------|------------|----------------------------|-----------|
| | U.S. Government | Corporates | Asset-Backed Securities | Total |
| Balance at beginning of period | \$ 3,712 | \$ 9,101 | \$ 0 | \$ 12,813 |
| Total gains or (losses), unrealized or realized | | | | |
| Included in net earnings | (39) | 494 | 0 | 455 |
| Included in other comprehensive income | (137) | (393) | 0 | (530) |
| Settlements | (594) | (1,343) | 0 | (1,938) |
| Balance at end of period | \$ 2,942 | \$ 7,858 | \$ 0 | \$ 10,800 |

Of the \$4.0 million fair value of securities in Level 3 at September 30, 2014, which consists of seven securities, we priced five based on non-binding broker quotes, one price was provided by our unaffiliated money manager and one security, which was included in Level 3 because it was not rated by a nationally recognized statistical rating organization, was priced by a nationally recognized pricing service.

There were no transfers between Levels 1, 2 or 3 during the nine months ended September 30, 2014.

The gains or losses included in net earnings are included in the line item "Net realized gains (losses) on investments" in the Consolidated Statements of Earnings. We recognize the net gains or losses included in other comprehensive income in the line item "Unrealized gains (losses) on investments, net" in the Consolidated Statements of Comprehensive Income and the line item "Change in unrealized gain on investments" or the line item "Change in non-credit component of impairment losses on fixed maturities" in the Consolidated Statements of Changes in Shareholders' Equity.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

The following table presents the carrying value and estimated fair value of our financial instruments (\$ in thousands):

| | September 30, 2014 | | December 31, 2013 | |
|----------------------------|--------------------|-------------|-------------------|-------------|
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Assets: | | | | |
| Cash and cash equivalents | \$94,672 | \$94,672 | \$134,211 | \$134,211 |
| Investments | | | | |
| Fixed maturities | 1,429,734 | 1,429,734 | 1,354,305 | 1,354,305 |
| Equity securities | 90,638 | 90,638 | 91,127 | 91,127 |
| Short-term | 813 | 813 | 2,596 | 2,596 |
| Total cash and investments | \$1,615,856 | \$1,615,856 | \$1,582,238 | \$1,582,238 |
| Liabilities: | | | | |
| Long-term debt | \$275,000 | \$288,824 | \$275,000 | \$272,632 |

See Note 4 to the Consolidated Financial Statements for additional information on investments and Note 5 to the Consolidated Financial Statements for additional information on long-term debt.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

Note 4 Investments

We consider all fixed maturity and equity securities to be available-for-sale and report them at fair value with the net unrealized gains or losses reported after-tax (net of any valuation allowance) as a component of other comprehensive income. The proceeds from sales of securities for the three and nine months ended September 30, 2014 were \$67.8 million and \$190.1 million, respectively. The proceeds from the sales of securities for the three and nine months ended September 30, 2013 were \$43.0 million and \$331.2 million, respectively. The proceeds for the nine months ended September 30, 2014 were net of \$1.9 million of receivable for securities sold during the third quarter of 2014 that had not settled at September 30, 2014. The proceeds for the nine months ended September 30, 2013 were net of \$0.5 million of receivable for securities sold during the third quarter of 2013 that had not settled at September 30, 2013. Gross gains of \$1.1 million and gross losses of \$0.1 million were realized on sales of available for sale securities during the three months ended September 30, 2014, compared with gross gains of \$0.7 million and gross losses of \$0.4 million realized on sales during the three months ended September 30, 2013. Gross gains of \$3.9 million and gross losses of \$0.3 million were realized on sales of available for sale securities during the nine months ended September 30, 2014, compared with gross gains of \$6.8 million and gross losses of \$1.5 million realized on sales during the nine months ended September 30, 2013. Gains or losses on securities are determined on a specific identification basis.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

Summarized information for the major categories of our investment portfolio follows (\$ in thousands):

September 30, 2014

| | Amortized Cost or Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | OTTI Recognized in Accumulated OCI ⁽¹⁾ |
|----------------------------------|---------------------------|------------------------------|-------------------------------|---------------|--|
| Fixed maturities: | | | | | |
| U.S. government | \$65,416 | \$627 | \$(305) |) \$65,738 | \$0 |
| State and municipal | 490,333 | 12,456 | (118) |) 502,672 | (69) |
| Mortgage-backed securities: | | | | | |
| Residential | 351,137 | 4,476 | (3,201) |) 352,412 | (3,029) |
| Commercial | 46,360 | 148 | (256) |) 46,253 | 0 |
| Total mortgage-backed securities | 397,497 | \$4,624 | (3,457) |) \$398,665 | (3,029) |
| Asset-backed securities | 61,808 | 175 | (86) |) 61,896 | (8) |
| Corporates | 396,305 | 6,875 | (2,417) |) 400,763 | (441) |
| Total fixed maturities | 1,411,360 | 24,757 | (6,383) |) 1,429,734 | (3,548) |
| Equity securities | 73,739 | 16,898 | 0 | 90,638 | 0 |
| Short-term investments | 813 | 0 | (0) |) 813 | 0 |
| Total | \$1,485,912 | \$41,655 | \$(6,383) |) \$1,521,184 | \$(3,548) |

December 31, 2013

| | Amortized Cost or Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | OTTI Recognized in Accumulated OCI ⁽¹⁾ |
|-------------------------------------|---------------------------|------------------------------|-------------------------------|---------------|--|
| Fixed maturities: | | | | | |
| U.S. government | \$64,194 | \$900 | \$(427) |) \$64,666 | \$0 |
| State and municipal | 478,092 | 10,789 | (1,771) |) 487,111 | (73) |
| Mortgage-backed securities: | | | | | |
| Residential | 330,169 | 1,985 | (8,809) |) 323,346 | (2,435) |
| Commercial | 35,781 | 339 | (304) |) 35,816 | 0 |
| Total mortgage-backed securities | 365,950 | 2,324 | (9,113) |) 359,162 | (2,435) |
| Collateralized mortgage obligations | 1,228 | 63 | 0 | 1,291 | (161) |
| Asset-backed securities | 71,183 | 178 | (103) |) 71,259 | (8) |
| Corporates | 364,430 | 9,086 | (2,700) |) 370,816 | (612) |
| Total fixed maturities | 1,345,077 | 23,340 | (14,112) |) 1,354,305 | (3,290) |
| Equity securities | 74,718 | 16,409 | 0 | 91,127 | 0 |
| Short-term investments | 2,595 | 1 | 0 | 2,596 | 0 |
| Total | \$1,422,390 | \$39,750 | \$(14,112) |) \$1,448,027 | \$(3,290) |

(1) The total non-credit portion of OTTI recognized in Accumulated OCI reflecting the original non-credit loss at the time the credit impairment was determined.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

The following tables set forth the amount of unrealized loss by investment category and length of time that individual securities have been in a continuous unrealized loss position (\$ in thousands):

| | Less than 12 Months | | | | 12 Months or More | | | | |
|----------------------------------|---|------------|-------------------------|--------------------------------|---|------------|-------------------------|--------------------------------|--|
| | Number of Securities with Unrealized Losses | Fair Value | Gross Unrealized Losses | Unrealized Losses as % of Cost | Number of Securities with Unrealized Losses | Fair Value | Gross Unrealized Losses | Unrealized Losses as % of Cost | |
| September 30, 2014 | | | | | | | | | |
| Fixed maturities: | | | | | | | | | |
| U.S. government | 6 | \$4,863 | \$(15) | 0.3 % | 9 | \$26,082 | \$(290) | 1.1 % | |
| State and municipal | 13 | 28,559 | (65) | 0.2 % | 4 | 7,753 | (52) | 0.7 % | |
| Mortgage-backed securities: | | | | | | | | | |
| Residential | 57 | 40,672 | (130) | 0.3 % | 131 | 130,149 | (3,071) | 2.3 % | |
| Commercial | 11 | 20,966 | (80) | 0.4 % | 8 | 13,391 | (176) | 1.3 % | |
| Total mortgage-backed securities | 68 | 61,638 | (210) | 0.3 % | 139 | 143,540 | (3,247) | 2.2 % | |
| Asset-backed securities | 23 | 19,949 | (74) | 0.4 % | 2 | 1,148 | (12) | 1.0 % | |
| Corporates | 95 | 127,191 | (1,776) | 1.4 % | 18 | 24,036 | (640) | 2.6 % | |
| Total fixed maturities | 205 | 242,200 | (2,141) | 0.9 % | 172 | 202,559 | (4,242) | 2.1 % | |
| Equity securities | 0 | 0 | 0 | 0.0 % | 0 | 0 | 0 | 0.0 % | |
| Short-term investments | 2 | 813 | 0 | 0.0 % | 0 | 0 | 0 | 0.0 % | |
| Total | 207 | \$243,013 | \$(2,141) | 0.9 % | 172 | \$202,559 | \$(4,242) | 2.1 % | |

| | Less than 12 Months | | | | 12 Months or More | | | | |
|----------------------------------|---|------------|-------------------------|--------------------------------|---|------------|-------------------------|--------------------------------|--|
| | Number of Securities with Unrealized Losses | Fair Value | Gross Unrealized Losses | Unrealized Losses as % of Cost | Number of Securities with Unrealized Losses | Fair Value | Gross Unrealized Losses | Unrealized Losses as % of Cost | |
| December 31, 2013 | | | | | | | | | |
| Fixed maturities: | | | | | | | | | |
| U.S. government | 11 | \$26,396 | \$(427) | 1.6 % | 0 | \$0 | \$0 | 0.0 % | |
| State and municipal | 51 | 121,431 | (1,425) | 1.2 % | 4 | 8,062 | (346) | 4.1 % | |
| Mortgage-backed securities: | | | | | | | | | |
| Residential | 229 | 207,821 | (7,064) | 3.3 % | 34 | 39,659 | (1,744) | 4.2 % | |
| Commercial | 11 | 22,311 | (290) | 1.3 % | 1 | 756 | (14) | 1.8 % | |
| Total mortgage-backed securities | 240 | 230,133 | (7,354) | 3.1 % | 35 | 40,415 | (1,758) | 4.2 % | |
| Asset-backed securities | 18 | 14,738 | (103) | 0.7 % | 0 | 0 | 0 | 0.0 % | |
| Corporates | 90 | 115,735 | (2,621) | 2.2 % | 1 | 1,212 | (79) | 6.1 % | |
| Total fixed maturities | 410 | 508,432 | (11,929) | 2.3 % | 40 | 49,688 | (2,183) | 4.2 % | |
| Equity securities | 0 | 0 | 0 | 0.0 % | 0 | 0 | 0 | 0.0 % | |

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| | | | | | | | | | |
|------------------------|-----|-----------|-------------|-----|------|----------|------------|-----|---|
| Short-term investments | 0 | 0 | 0 | 0.0 | % 0 | 0 | 0 | 0.0 | % |
| Total | 410 | \$508,432 | \$(11,929) | 2.3 | % 40 | \$49,688 | \$(2,183) | 4.2 | % |

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

The determination of whether unrealized losses are “other-than-temporary” requires judgment based on subjective as well as objective factors. Factors we considered and resources we used in our determination include:

- the intent to sell the security;
- whether it is more likely than not that there will be a requirement to sell the security before our anticipated recovery;
- whether the unrealized loss is credit-driven or a result of changes in market interest rates;
- the length of time the security’s fair value has been below our cost;
- the extent to which fair value is less than cost basis;
- historical operating, balance sheet and cash flow data contained in issuer SEC filings;
- issuer news releases;
- near-term prospects for improvement in the issuer and/or its industry;
- industry research and communications with industry specialists and
- third-party research and credit rating reports.

We regularly evaluate for potential impairment each security position that has either of the following: a fair value of less than 95% of its book value or an unrealized loss that equals or exceeds \$100,000.

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

The following table summarizes those securities, excluding the rabbi trust, with unrealized gains or losses:

| | September 30, 2014 | December 31, 2013 | | |
|---|-----------------------|----------------------|--|---|
| Number of positions held with unrealized: | | | | |
| Gains | 738 | 590 | | |
| Losses | 379 | 450 | | |
| Number of positions held that individually exceed unrealized: | | | | |
| Gains of \$500,000 | 3 | 1 | | |
| Losses of \$500,000 | 0 | 0 | | |
| Percentage of positions held with unrealized: | | | | |
| Gains that were investment grade | 91 | % 81 | | % |
| Losses that were investment grade | 83 | % 93 | | % |
| Percentage of fair value held with unrealized: | | | | |
| Gains that were investment grade | 94 | % 88 | | % |
| Losses that were investment grade | 83 | % 95 | | % |

The following table sets forth the amount of unrealized loss, excluding the rabbi trust, by age and severity at September 30, 2014 (\$ in thousands):

| Age of Unrealized Losses: | Fair Value of Securities with Unrealized Losses | Total Gross Unrealized Losses | Less Than 5%* | 5% - 10%* | Greater Than 10%* |
|----------------------------------|--|-------------------------------------|---------------|-----------|----------------------|
| Three months or less | \$218,857 | \$(1,779) | \$(1,562) | \$(218) | \$0 |
| Four months through six months | 18,838 | (269) | (241) | (28) | 0 |
| Seven months through nine months | 5,242 | (91) | (91) | 0 | 0 |
| Ten months through twelve months | 4,470 | (59) | (59) | 0 | 0 |
| Greater than twelve months | 198,164 | (4,185) | (3,944) | (242) | 0 |
| Total | \$445,572 | \$(6,383) | \$(5,896) | \$(487) | \$0 |

* As a percentage of amortized cost or cost.

The change in unrealized gains (losses) on marketable securities included the following (\$ in thousands):

| | Pre-tax Fixed Maturities | Equity Securities | Short-Term Investments | Tax Effects | Net |
|---|--------------------------------|----------------------|---------------------------|----------------|------------|
| Nine months ended September 30, 2014 | | | | | |
| Unrealized holding gains (losses) on securities arising during the period | \$11,371 | \$1,762 | \$4 | \$(4,598) | \$8,539 |
| Realized (gains) losses on securities sold | (2,280) | (1,273) | (5) | 1,245 | (2,313) |
| Impairment loss recognized in earnings | 55 | 0 | 0 | (19) | 36 |
| Change in unrealized gains (losses) on marketable securities, net | \$9,146 | \$489 | \$(1) | \$(3,372) | \$6,262 |
| Nine months ended September 30, 2013 | | | | | |
| Unrealized holding gains (losses) on securities arising during the period | \$(25,913) | \$8,449 | \$1 | \$6,112 | \$(11,351) |
| Realized (gains) losses on securities sold | (4,602) | (660) | 0 | 1,842 | (3,420) |
| Impairment loss recognized in earnings | 1,190 | 0 | 0 | (416) | 773 |
| | \$(29,325) | \$7,790 | \$1 | \$7,537 | \$(13,997) |

Change in unrealized gains (losses) on marketable securities, net

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

For fixed maturity securities that are other-than-temporarily impaired, we assess our intent to sell and the likelihood that we will be required to sell the security before recovery of our amortized cost. If a fixed maturity security is considered other-than-temporarily impaired but we do not intend to and are not more than likely to be required to sell the security before our recovery of amortized cost, we separate the amount of the impairment into a credit loss component and the amount due to all other factors ("non-credit component"). The excess of the amortized cost over the present value of the expected cash flows determines the credit loss component of an impairment charge on a fixed maturity security. The present value is determined using the best estimate of cash flows discounted at (1) the effective interest rate implicit at the date of acquisition for non-structured securities or (2) the book yield for structured securities. The techniques and assumptions for determining the best estimate of cash flows vary depending on the type of security. We recognize the credit loss component of an impairment charge in net earnings and the non-credit component in accumulated other comprehensive income. If we intend to sell or will, more likely than not, be required to sell a security, we treat the entire amount of the impairment as a credit loss.

The following table is a progression of credit losses on fixed maturity securities that were bifurcated between a credit and non-credit component (\$ in thousands):

| | Nine months ended September 30, | |
|--------------------------------|---------------------------------|--------|
| | 2014 | 2013 |
| Beginning balance | \$956 | \$487 |
| Additions for: | | |
| Previously impaired securities | 19 | 0 |
| Newly impaired securities | 15 | 541 |
| Reductions for: | | |
| Securities sold and paid down | (110 |) (189 |
| Ending balance | \$881 | \$839 |

The table below sets forth the scheduled maturities of fixed maturity securities at September 30, 2014, based on their fair values (\$ in thousands). We report securities that do not have a single maturity date at average maturity. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid by the issuers.

| Maturity | Fair Value | | | Amortized Cost | |
|---|----------------------------------|-----------------------------------|---|-------------------------------|-------------------------------|
| | Securities with Unrealized Gains | Securities with Unrealized Losses | Securities with No Unrealized Gains or Losses | All Fixed Maturity Securities | All Fixed Maturity Securities |
| One year or less | \$87,114 | \$0 | \$5,325 | \$92,439 | \$91,535 |
| After one year through five years | 466,028 | 129,653 | 1,671 | 597,351 | 586,340 |
| After five years through ten years | 180,426 | 86,244 | 0 | 266,670 | 262,126 |
| After ten years | 10,125 | 2,587 | 0 | 12,712 | 12,053 |
| Mortgage-backed and asset-backed securities | 233,506 | 226,275 | 780 | 460,561 | 459,305 |
| Total | \$977,200 | \$444,759 | \$7,776 | \$1,429,734 | \$1,411,360 |

Note 5 Long-Term Debt

In September 2012, we issued \$275 million principal of senior notes due September 2022 (the “5.0% Senior Notes”). The 5.0% Senior Notes accrue interest at 5.0%, payable semiannually. At the time we issued the 5.0% Senior Notes, we capitalized \$2.2 million of debt issuance costs, which we are amortizing over the term of the 5.0% Senior Notes. We calculated the September 30, 2014 fair value of \$288.8 million using a 176 basis point spread to the ten-year U.S. Treasury Note of 2.491%.

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Condensed Notes to Consolidated Financial Statements

In August 2014, we renewed our agreement for a \$50 million three-year revolving credit facility (the “Credit Agreement”) that requires us to meet certain financial and other covenants. We are currently in compliance with all covenants under the Credit Agreement. At September 30, 2014, there were no borrowings outstanding under the Credit Agreement.

Note 6 Income Taxes

The following is a reconciliation of income taxes at the statutory rate of 35.0% to the effective provision for income taxes as shown in the Consolidated Statements of Earnings (\$ in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | | |
|--|----------------------------------|---------|---------------------------------|----------|---|
| | 2014 | 2013 | 2014 | 2013 | |
| Earnings before income taxes | \$21,727 | \$9,643 | \$51,516 | \$31,877 | |
| Income taxes at statutory rate | 7,604 | 3,375 | 18,031 | 11,157 | |
| Effect of: | | | | | |
| Dividends-received deduction | (90 |) (70 |) (341 |) (249 | |
| Tax-exempt interest | (700 |) (664 |) (2,103 |) (2,129 | |
| Other | 58 | (193 |) 81 | (166 | |
| Provision for income taxes as shown on the Consolidated Statements of Earnings | \$6,872 | \$2,448 | \$15,667 | \$8,612 | |
| GAAP effective tax rate | 31.6 | % 25.4 | % 30.4 | % 27.0 | % |

Note 7 Additional Information

Supplemental Cash Flow Information

We made the following payments that we do not separately disclose in the Consolidated Statements of Cash Flows (\$ in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|---------------------------|----------------------------------|---------|---------------------------------|---------|
| | 2014 | 2013 | 2014 | 2013 |
| Income tax payments | \$6,200 | \$5,100 | \$12,400 | \$5,100 |
| Interest payments on debt | 6,875 | 6,875 | 13,750 | 13,826 |

Negative Cash Book Balances

Negative cash book balances, included in the line item “Other liabilities” in the Consolidated Balance Sheets, were \$55.3 million and \$50.5 million, respectively, at September 30, 2014 and December 31, 2013.

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Condensed Notes to Consolidated Financial Statements

Note 8 Insurance Reserves

Insurance reserves include liabilities for unpaid losses, both known and estimated for incurred but not reported (“IBNR”), and unpaid loss adjustment expenses (“LAE”). The following table provides an analysis of changes in the liability for unpaid losses and LAE on a GAAP basis (\$ in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|----------------------------------|-------------|---------------------------------|-------------|
| | 2014 | 2013 | 2014 | 2013 |
| Balance at Beginning of Period | | | | |
| Unpaid losses on known claims | \$225,040 | \$222,138 | \$221,447 | \$205,589 |
| IBNR losses | 274,830 | 232,546 | 262,660 | 218,552 |
| LAE | 165,352 | 157,320 | 162,469 | 148,753 |
| Total unpaid losses and LAE | 665,222 | 612,004 | 646,577 | 572,894 |
| Reinsurance recoverables | (13,717) |) (13,819) |) (14,431) |) (13,678) |
| Unpaid losses and LAE, net of reinsurance recoverables | 651,505 | 598,184 | 632,146 | 559,215 |
| Current Activity | | | | |
| Loss and LAE incurred: | | | | |
| Current accident year | 253,847 | 254,381 | 767,721 | 760,530 |
| Prior accident years | (5,364) |) 859 | (8,601) |) 2,160 |
| Total loss and LAE incurred | 248,483 | 255,240 | 759,120 | 762,690 |
| Loss and LAE payments: | | | | |
| Current accident year | (171,210) |) (171,924) |) (405,800) |) (400,114) |
| Prior accident years | (69,462) |) (62,844) |) (326,150) |) (303,133) |
| Total loss and LAE payments | (240,673) |) (234,767) |) (731,951) |) (703,248) |
| Balance at End of Period | | | | |
| Unpaid losses and LAE, net of reinsurance recoverables | 659,316 | 618,658 | 659,316 | 618,658 |
| Add back reinsurance recoverables | 13,883 | 14,203 | 13,883 | 14,203 |
| Total unpaid losses and LAE | 673,198 | 632,860 | 673,198 | 632,860 |
| Unpaid losses on known claims | 229,425 | 219,330 | 229,425 | 219,330 |
| IBNR losses | 278,572 | 249,213 | 278,572 | 249,213 |
| LAE | 165,200 | 164,317 | 165,200 | 164,317 |
| Total unpaid losses and LAE | \$673,198 | \$632,860 | \$673,198 | \$632,860 |

The \$8.6 million of favorable reserve development during the nine months ended September 30, 2014 was primarily due to a decrease in severity in accident year 2013 in Florida bodily injury and in California property damage.

Note 9 Commitments and Contingencies

Commitments

There have been no material changes from the commitments discussed in the Form 10-K for the year ended December 31, 2013. For a description of our previously reported commitments, refer to Note 14 Commitments and Contingencies in the Form 10-K for the year ended December 31, 2013.

Contingencies

From time to time, we and our subsidiaries are named as defendants in various lawsuits incidental to our insurance operations. We consider legal actions relating to claims made in the ordinary course of seeking indemnification for a loss covered by the insurance policy in establishing loss and LAE reserves. We also face in the ordinary course of

business lawsuits that seek damages beyond policy limits, commonly known as extra-contractual or “bad faith” claims, as well as class action and individual lawsuits that involve issues not unlike those facing other insurance companies and employers. We continually

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Condensed Notes to Consolidated Financial Statements

evaluate potential liabilities and reserves for litigation of these types using the criteria established by the Contingencies topic of the FASB. Under this guidance, we may only record reserves for a loss if the likelihood of occurrence is probable and we can reasonably estimate the amount. If a material loss, while not probable, is judged to be reasonably possible we will disclose the nature of the contingency and a possible range of loss if estimable.

In *Reyes v. Infinity Indemnity Insurance Company*, formerly reported as *Estate of Jorge Luis Arroyo, Jr., et al. v. Gustavo M. Rodriguez, et al.*, (Circuit Court of Miami-Dade County, Florida), a third party claimant is attempting to recover from Infinity a \$30 million consent judgment obtained against an Infinity policyholder for personal injuries suffered by plaintiff. Infinity believes any claims of bad faith are unfounded and has denied any and all liability to plaintiff. While the outcome of this case, as with litigation generally, cannot be predicted with certainty, at this stage of the litigation we do not believe that the likelihood of a material loss is probable.

For a description of previously reported contingencies, refer to Note 14 Commitments and Contingencies in the Form 10-K for the year ended December 31, 2013.

Note 10 Accumulated Other Comprehensive Income

The components of other comprehensive income before and after tax are as follows (\$ in thousands):

| | Three months ended September 30, | | | | | |
|---|----------------------------------|------------|----------|------------|------------|-----------|
| | 2014 | | | 2013 | | |
| | Before Tax | Income Tax | Net | Before Tax | Income Tax | Net |
| Accumulated change in postretirement benefit liability, beginning of period | \$ 593 | \$ (208) | \$ 385 | \$ (868) | \$ 304 | \$ (564) |
| Effect on other comprehensive income | (3) | 1 | (2) | 50 | (17) | 32 |
| Accumulated change in postretirement benefit liability, end of period | 590 | (207) | 384 | (818) | 286 | (532) |
| Accumulated unrealized gains on investments, net, beginning of period | 46,517 | (16,281) | 30,236 | 14,964 | (5,237) | 9,727 |
| Other comprehensive income before reclassification | (10,232) | 3,581 | (6,651) | 9,847 | (3,447) | 6,401 |
| Reclassification adjustment for other-than-temporary impairments included in net income | 21 | (7) | 14 | 819 | (287) | 532 |
| Reclassification adjustment for realized gains included in net income | (1,034) | 362 | (672) | (273) | 96 | (178) |
| Effect on other comprehensive income | (11,245) | 3,936 | (7,309) | 10,393 | (3,638) | 6,755 |
| Accumulated unrealized gains on investments, net, end of period | 35,272 | (12,345) | 22,927 | 25,357 | (8,875) | 16,482 |
| Accumulated other comprehensive income, beginning of period | 47,110 | (16,488) | 30,621 | 14,096 | (4,934) | 9,163 |
| Change in postretirement benefit liability | (3) | 1 | (2) | 50 | (17) | 32 |
| Change in unrealized gains on investments, net | (11,245) | 3,936 | (7,309) | 10,393 | (3,638) | 6,755 |
| Effect on other comprehensive income | (11,247) | 3,937 | (7,311) | 10,443 | (3,655) | 6,788 |

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| | | | | | | |
|--|-----------|-------------|-----------|-----------|------------|-----------|
| Accumulated other comprehensive income, end of period | \$ 35,863 | \$(12,552) | \$ 23,311 | \$ 24,539 | \$(8,589) | \$ 15,950 |
|--|-----------|-------------|-----------|-----------|------------|-----------|

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| | Nine months ended September 30, 2014 | | | 2013 | | |
|---|---|-------------|----------|------------|------------|-----------|
| | Before Tax | Income Tax | Net | Before Tax | Income Tax | Net |
| Accumulated change in postretirement benefit liability, beginning of period | \$(62) | \$22 | \$(40) | \$(967) | \$339 | \$(629) |
| Effect on other comprehensive income | 652 | (228) | 424 | 150 | (52) | 97 |
| Accumulated change in postretirement benefit liability, end of period | 590 | (207) | 384 | (818) | 286 | (532) |
| Accumulated unrealized gains on investments, net, beginning of period | 25,638 | (8,973) | 16,665 | 46,892 | (16,412) | 30,480 |
| Other comprehensive income before reclassification | 13,138 | (4,598) | 8,539 | (17,463) | 6,112 | (11,351) |
| Reclassification adjustment for other-than-temporary impairments included in net income | 55 | (19) | 36 | 1,190 | (416) | 773 |
| Reclassification adjustment for realized gains included in net income | (3,558) | 1,245 | (2,313) | (5,262) | 1,842 | (3,420) |
| Effect on other comprehensive income | 9,634 | (3,372) | 6,262 | (21,534) | 7,537 | (13,997) |
| Accumulated unrealized gains on investments, net, end of period | 35,272 | (12,345) | 22,927 | 25,357 | (8,875) | 16,482 |
| Accumulated other comprehensive income, beginning of period | 25,576 | (8,952) | 16,624 | 45,924 | (16,073) | 29,851 |
| Change in postretirement benefit liability | 652 | (228) | 424 | 150 | (52) | 97 |
| Change in unrealized gains on investments, net | 9,634 | (3,372) | 6,262 | (21,534) | 7,537 | (13,997) |
| Effect on other comprehensive income | 10,287 | (3,600) | 6,686 | (21,385) | 7,485 | (13,900) |
| Accumulated other comprehensive income, end of period | \$35,863 | \$(12,552) | \$23,311 | \$24,539 | \$(8,589) | \$15,950 |

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INFINITY PROPERTY AND CASUALTY CORPORATION FORM 10-Q

Condensed Notes to Consolidated Financial Statements

Management's Discussion and Analysis of Financial Condition and Results of Operations

ITEM 2

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain "forward-looking statements" which anticipate results based on our estimates, assumptions and plans that are subject to uncertainty. We make these statements subject to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. All statements in this report not dealing with historical results or current facts are forward-looking and we base them on estimates, assumptions and projections. Statements which include the words "assumes," "believes," "seeks," "expects," "may," "should," "intends," "likely," "targets," "plans," "anticipates," "estimates" or the negative version of those words and similar statements of a future or forward-looking nature identify forward-looking statements. Examples of such forward-looking statements include statements relating to expectations concerning market conditions, premium growth, earnings, investment performance, expected losses, rate changes and loss experience.

The primary events or circumstances that could cause actual results to differ materially from what we expect include determinations with respect to reserve adequacy, realized gains or losses on the investment portfolio (including other-than temporary impairments for credit losses), loss cost trends, undesired business mix or risk profile for new business and competitive conditions in our key Focus States. We undertake no obligation to publicly update or revise any of the forward-looking statements. For a more detailed discussion of some of the foregoing risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements see "Risk Factors" contained in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013.

OVERVIEW

During 2014, we have focused on growing premium in California, Florida and Texas personal auto and countrywide Commercial Vehicle while improving the profitability in Arizona, Georgia, Nevada and Pennsylvania. Although we have seen improvement in the combined ratios, we have determined that our personal auto business in Georgia, Nevada and Pennsylvania, which accounted for 6.1% of our total gross written premium as of September 30, 2014, no longer meets our long-term strategic and financial objectives. As a result, we will no longer accept new business beginning January 1, 2015 and will maintain only a renewal book in these three states. In conjunction with the planned reduction in premium in these states, we expect to reduce staff and incur severance charges of approximately \$1.7 million during the fourth quarter of 2014. In addition, we will evaluate strategic alternatives for our Classic Collector book of business, which was 1.1% of our business as of September 30, 2014.

In the third quarter and first nine months of 2014, our total gross written premium grew 5.8% and 3.1%, respectively, compared with the same periods of 2013. In the third quarter and first nine months of 2014, gross written premium in Arizona, California, Florida, and Texas personal auto and Commercial Vehicle grew 9.7% and 7.5%, respectively, compared with the same periods of 2013. See Results of Operations – Underwriting – Premium for a more detailed discussion of our gross written premium growth.

Net earnings and diluted earnings per share for the three months ended September 30, 2014 were \$14.9 million and \$1.29, respectively, compared with \$7.2 million and \$0.62, respectively, for the three months ended September 30, 2013. Net earnings and diluted earnings per share for the nine months ended September 30, 2014 were \$35.8 million and \$3.10, respectively, compared with \$23.3 million and \$1.99, respectively, for the nine months ended September 30, 2013. The increase in diluted earnings per share for the three and nine months ended September 30, 2014 was primarily due to an improvement in underwriting profitability.

Included in net earnings for the three and nine months ended September 30, 2014 were \$3.5 million (\$5.4 million pre-tax) and \$5.6 million (\$8.6 million pre-tax) of favorable development on prior accident year loss and LAE reserves. The development was primarily due to a decrease in severity in accident year 2013 in Florida bodily injury and in California property damage. Included in net earnings for the three and nine months ended September 30, 2013 were \$0.6 million (\$0.9 million pre-tax) and \$1.4 million (\$2.2 million pre-tax) of unfavorable development on prior

accident year loss and LAE reserves.

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The following table displays combined ratio results by accident year developed through September 30, 2014.

| Accident Year | Accident Year Combined Ratio Developed Through | | | | Prior Accident Year Favorable / (Unfavorable) Development | | (\$ in millions) Prior Accident Year Favorable / (Unfavorable) Development | |
|---------------|--|----------|----------|-----------|---|----------|--|-----------|
| | Dec 2013 | Mar 2014 | Jun 2014 | Sept 2014 | Q3 2014 | YTD 2014 | Q3 2014 | YTD 2014 |
| Prior | | | | | | | \$ (0.1) | \$ (0.2) |
| 2006 | 90.3 | % 90.3 | % 90.2 | % 90.2 | % 0.0 | % 0.1 | % 0.0 | 0.6 |
| 2007 | 92.2 | % 92.2 | % 92.2 | % 92.1 | % 0.0 | % 0.0 | % 0.2 | 0.3 |
| 2008 | 91.3 | % 91.3 | % 91.3 | % 91.3 | % 0.0 | % 0.1 | % 0.1 | 0.5 |
| 2009 | 92.3 | % 92.3 | % 92.3 | % 92.4 | % (0.1) | % (0.1) | % (1.0) | (0.9) |
| 2010 | 99.6 | % 99.5 | % 99.3 | % 99.3 | % 0.0 | % 0.3 | % 0.3 | 2.7 |
| 2011 | 100.3 | % 100.2 | % 100.4 | % 100.2 | % 0.2 | % 0.1 | % 1.6 | 0.6 |
| 2012 | 99.8 | % 100.1 | % 100.2 | % 100.1 | % 0.1 | % (0.3) | % 0.6 | (3.2) |
| 2013 | 97.7 | % 97.4 | % 97.4 | % 97.1 | % 0.3 | % 0.6 | % 3.6 | 8.1 |
| 2014 YTD | | 97.8 | % 97.4 | % 97.1 | % 0.3 | % | \$5.4 | \$8.6 |

See Results of Operations – Underwriting – Profitability for a more detailed discussion of our underwriting results. Pre-tax net investment income for the three months ended September 30, 2014 was \$8.8 million compared with \$8.1 million for the three months ended September 30, 2013. Pre-tax net investment income for the nine months ended September 30, 2014 was \$26.7 million compared with \$25.1 million for the nine months ended September 30, 2013. The increase in pre-tax net investment income is a result of a 4.0% increase in average invested assets (at cost). Average investments have increased as a result of positive cashflow from operations due to growth in premiums and improved margins.

Our book value per share increased 3.8% from \$57.09 at December 31, 2013 to \$59.25 at September 30, 2014. This increase was primarily due to an increase in unrealized gains and earnings partially offset by dividends for the nine months ended September 30, 2014.

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RESULTS OF OPERATIONS

Underwriting

Premium

Our insurance subsidiaries provide personal automobile insurance products with a concentration on nonstandard auto insurance. While there is no industry-recognized definition of nonstandard auto insurance, we believe that it is generally understood to mean coverage for drivers who, because of their driving record, age or vehicle type, represent higher than normal risks and pay higher rates for comparable coverage. We also write commercial vehicle insurance and insurance for classic collectible automobiles ("Classic Collector").

We offer three primary products to individual drivers: the Low Cost product, which offers the most restrictive coverage, the Value Added product, which offers broader coverage and higher limits, and the Premier product, which we designed to offer the broadest coverage for standard and preferred risk drivers.

We are licensed to write insurance in all 50 states and the District of Columbia, but we focus our operations in targeted urban areas identified in selected Focus States that we believe offer the greatest opportunity for premium growth and profitability.

We classify the states in which we operate into two categories:

• "Focus States" – These states include Arizona, California, Florida, and Texas.

• "Other States" – Includes Georgia, Nevada and Pennsylvania where we will be offering renewals only beginning January 1, 2015, as well as nine states where we are currently running off our writings.

Georgia, Nevada and Pennsylvania were previously included in the Focus States category. All prior period data has been adjusted to reflect the updated state classification.

We continually evaluate our market opportunities; thus, the Focus States and Other States may change over time as new market opportunities arise, as the allocation of resources changes or as regulatory environments change.

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Management's Discussion and Analysis of Financial Condition and Results of Operations

Our net earned premium was as follows (\$ in thousands):

| | Three months ended September 30, | | | |
|-----------------------------|----------------------------------|-----------|----------|-----------|
| | 2014 | 2013 | Change | % Change |
| Net earned premium | | | | |
| Gross written premium | | | | |
| Personal Auto | | | | |
| Focus States | \$294,187 | \$272,478 | \$21,709 | 8.0 |
| Other States | 21,799 | 31,443 | (9,643) | (30.7) |
| Total Personal Auto | 315,986 | 303,921 | 12,065 | 4.0 |
| Commercial Vehicle | 27,654 | 21,004 | 6,650 | 31.7 |
| Classic Collector | 3,900 | 3,630 | 270 | 7.4 |
| Total gross written premium | 347,540 | 328,556 | 18,985 | 5.8 |
| Ceded reinsurance | (3,478) | (2,529) | (949) | 37.5 |
| Net written premium | 344,063 | 326,026 | 18,036 | 5.5 |
| Change in unearned premium | (11,086) | 1,052 | (12,137) | (1,154.3) |
| Net earned premium | \$332,977 | \$327,078 | \$5,899 | 1.8 |

| | Nine months ended September 30, | | | |
|-----------------------------|---------------------------------|-----------|----------|----------|
| | 2014 | 2013 | Change | % Change |
| Net earned premium | | | | |
| Gross written premium | | | | |
| Personal Auto | | | | |
| Focus States | \$896,451 | \$845,821 | \$50,630 | 6.0 |
| Other States | 69,060 | 106,707 | (37,647) | (35.3) |
| Total Personal Auto | 965,511 | 952,528 | 12,983 | 1.4 |
| Commercial Vehicle | 81,630 | 63,675 | 17,954 | 28.2 |
| Classic Collector | 11,262 | 10,407 | 855 | 8.2 |
| Total gross written premium | 1,058,403 | 1,026,611 | 31,792 | 3.1 |
| Ceded reinsurance | (9,944) | (7,439) | (2,505) | 33.7 |
| Net written premium | 1,048,458 | 1,019,172 | 29,287 | 2.9 |
| Change in unearned premium | (54,779) | (42,290) | (12,489) | 29.5 |
| Net earned premium | \$993,680 | \$976,882 | \$16,798 | 1.7 |

The following table summarizes our policies in force:

| | At September 30, | | | |
|-------------------------|------------------|---------|----------|----------|
| | 2014 | 2013 | Change | % Change |
| Policies in Force | | | | |
| Personal Auto | | | | |
| Focus States | 773,408 | 774,637 | (1,229) | (0.2) |
| Other States | 57,070 | 92,122 | (35,052) | (38.0) |
| Total Personal Auto | 830,478 | 866,759 | (36,281) | (4.2) |
| Commercial Vehicle | 44,047 | 40,420 | 3,627 | 9.0 |
| Classic Collector | 40,665 | 38,865 | 1,800 | 4.6 |
| Total policies in force | 915,190 | 946,044 | (30,854) | (3.3) |

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Gross written premium grew 5.8% and 3.1% during the third quarter and first nine months of 2014, respectively, compared with the same periods of 2013. During the first nine months of 2014, Infinity implemented rate revisions in various states with an overall rate increase of 3.8%. Excluding the effect of rate changes in California and Florida, our largest states, the overall rate increase was 2.8%. Policies in force at September 30, 2014 decreased 3.3% compared with the same period in 2013. Gross written premium grew despite the decline in policies in force due primarily to growth in our Florida business, which has a higher average premium per policy than our other states.

During the third quarter and first nine months of 2014, personal auto insurance gross written premium in our Focus States grew 8.0% and 6.0%, respectively, when compared with the same periods of 2013. The increase in gross written premium is primarily due to growth in California, Florida, and Texas, which grew a combined 8.6% and 6.8% during the third quarter and first nine months of 2014, respectively. The growth during the third quarter of 2014 in California was primarily due to higher average premium and new business growth. During the nine months ended September 30, 2014, average written premiums in Florida and Texas increased, along with an increase in new business.

The growth in the Focus States during the third quarter and first nine months of 2014 was partially offset by declining gross written premium in the Other States as we continue to focus on improving profitability. Upon management's strategic review, beginning in 2015, we will no longer write new business in Georgia, Nevada, and Pennsylvania, previously included in "Focus States", and will maintain renewal business only in these states.

Commercial Vehicle gross written premium grew 31.7% and 28.2% during the third quarter and first nine months of 2014, respectively, when compared with the same periods of 2013. This growth is primarily due to higher average premium and growth in new business.

Gross written premium in our Classic Collector product grew 7.4% and 8.2% during the third quarter and first nine months of 2014, respectively, when compared with the same periods of 2013. This growth is primarily due to growth in renewal business. As we narrow our focus in 2015, we will look for strategic alternatives for our Classic Collector book of business.

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Profitability

A key operating performance measure of insurance companies is underwriting profitability, as opposed to overall profitability or net earnings. We measure underwriting profitability by the combined ratio. When the combined ratio is under 100%, we consider underwriting results profitable; when the ratio is over 100%, we consider underwriting results unprofitable. The combined ratio does not reflect investment income, other income, interest expense, corporate general and administrative expenses, other expenses or federal income taxes.

While we report financial results in accordance with GAAP for shareholder and other users' purposes, we report it on a statutory basis for insurance regulatory purposes. We evaluate underwriting profitability based on a combined ratio calculated using statutory accounting principles. The statutory and combined ratios represent the sum of the following ratios: (i) losses and LAE incurred as a percentage of net earned premium and (ii) underwriting expenses incurred, net of installment and other fees, as a percentage of net written premium. Certain expenses are treated differently under statutory and GAAP accounting principles. Under GAAP, commissions, premium taxes and other variable costs incurred in connection with writing new and renewal business are capitalized as deferred policy acquisition costs and amortized on a pro rata basis over the period in which the related premium is earned; on a statutory basis these items are expensed as incurred. Additionally, bad debt charge-offs on agent balances and premium receivables are included only in the GAAP combined ratios.

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Management's Discussion and Analysis of Financial Condition and Results of Operations

The following tables present the statutory and GAAP combined ratios:

| | Three months ended September 30, 2014 | | | | | | 2013 | | | | | | % Point Change | |
|--|--|-----------------------|-------------------|------------------------|-----------------------|-------------------|------------------------|-----------------------|-------------------|------------------------|-----------------------|-------------------|----------------|--|
| | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | | |
| Personal Auto: | | | | | | | | | | | | | | |
| Focus States | 74.6 | % 18.4 | % 93.1 | % 78.3 | % 17.6 | % 95.9 | % (3.7 |)% 0.8 | % (2.8 |)% | | | | |
| Other States | 71.9 | % 17.7 | % 89.5 | % 78.7 | % 17.6 | % 96.3 | % (6.8 |)% 0.1 | % (6.8 |)% | | | | |
| Total Personal Auto | 74.4 | % 18.4 | % 92.8 | % 78.4 | % 17.6 | % 96.0 | % (4.0 |)% 0.8 | % (3.2 |)% | | | | |
| Commercial Vehicle | 81.3 | % 17.4 | % 98.7 | % 77.5 | % 16.5 | % 94.1 | % 3.8 | % 0.9 | % 4.6 | % | | | | |
| Classic Collector | 58.7 | % 31.3 | % 90.0 | % 55.6 | % 36.7 | % 92.3 | % 3.1 | % (5.4 |)% (2.3 |)% | | | | |
| Total statutory ratios | 74.8 | % 18.5 | % 93.2 | % 78.2 | % 17.7 | % 95.8 | % (3.4 |)% 0.8 | % (2.6 |)% | | | | |
| Total statutory ratios excluding development | 78.3 | % 18.5 | % 96.7 | % 79.7 | % 17.7 | % 97.4 | % (1.4 |)% 0.8 | % (0.7 |)% | | | | |
| GAAP ratios | 74.6 | % 20.2 | % 94.8 | % 78.0 | % 19.7 | % 97.7 | % (3.4 |)% 0.5 | % (2.9 |)% | | | | |
| GAAP ratios excluding development | 78.2 | % 20.2 | % 98.4 | % 79.6 | % 19.7 | % 99.3 | % (1.4 |)% 0.5 | % (0.9 |)% | | | | |

| | Nine months ended September 30, 2014 | | | | | | 2013 | | | | | | % Point Change | |
|--|---|-----------------------|-------------------|------------------------|-----------------------|-------------------|------------------------|-----------------------|-------------------|------------------------|-----------------------|-------------------|----------------|--|
| | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | Loss & LAE Ratio | Underwriting Ratio | Combined Ratio | | |
| Personal Auto: | | | | | | | | | | | | | | |
| Focus States | 77.0 | % 17.9 | % 94.9 | % 78.2 | % 17.5 | % 95.8 | % (1.2 |)% 0.4 | % (0.9 |)% | | | | |
| Other States | 74.6 | % 17.7 | % 92.3 | % 81.8 | % 17.7 | % 99.5 | % (7.2 |)% 0.0 | % (7.2 |)% | | | | |
| Total Personal Auto | 76.8 | % 17.9 | % 94.7 | % 78.7 | % 17.5 | % 96.2 | % (1.9 |)% 0.4 | % (1.5 |)% | | | | |
| Commercial Vehicle | 77.0 | % 17.5 | % 94.5 | % 74.6 | % 16.6 | % 91.1 | % 2.4 | % 0.9 | % 3.4 | % | | | | |
| Classic Collector | 53.8 | % 32.0 | % 85.8 | % 51.3 | % 35.3 | % 86.6 | % 2.5 | % (3.3 |)% (0.8 |)% | | | | |
| Total statutory ratios | 76.5 | % 18.1 | % 94.6 | % 78.2 | % 17.7 | % 95.9 | % (1.7 |)% 0.4 | % (1.3 |)% | | | | |
| Total statutory ratios excluding development | 77.4 | % 18.1 | % 95.4 | % 78.0 | % 17.7 | % 95.7 | % (0.6 |)% 0.4 | % (0.3 |)% | | | | |
| GAAP ratios | 76.4 | % 19.8 | % 96.2 | % 78.1 | % 19.8 | % 97.9 | % (1.7 |)% 0.0 | % (1.7 |)% | | | | |
| GAAP ratios excluding development | 77.3 | % 19.8 | % 97.1 | % 77.9 | % 19.8 | % 97.7 | % (0.6 |)% 0.0 | % (0.6 |)% | | | | |

In evaluating the profit performance of our business, we review underwriting profitability using statutory combined ratios. Accordingly, the discussion of underwriting results that follows will focus on these ratios and the components thereof, unless otherwise indicated.

The statutory combined ratio for the three and nine months ended September 30, 2014 decreased by 2.6 points and 1.3 points from the same periods of 2013. The third quarter and first nine months of 2014 included \$5.4 million and \$8.6 million of favorable development on prior accident year loss and LAE reserves, respectively, while the third quarter and first nine months of 2013 included \$0.9 million and \$2.2 million of unfavorable development on prior accident year loss and LAE reserves, respectively. The third quarters of 2014 and 2013 include \$6.4 million and \$6.0 million, respectively, of favorable development from the first two accident quarters of each respective year. Excluding the effect of development, the statutory combined ratio decreased 0.7 point and 0.3 point, respectively, for the three and nine months ended September 30, 2014 compared with the same periods of 2013.

The GAAP combined ratio for the three and nine months ended September 30, 2014 decreased by 2.9 points and 1.7 points, respectively, from the same periods of 2013. Excluding the effect of development, the GAAP combined ratio decreased by 0.9

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point and 0.6 point, respectively, for the three and nine months ended September 30, 2014, compared with the same periods of 2013.

Losses from catastrophes were \$0.4 million and \$2.2 million for the three and nine months ended September 30, 2014, respectively, compared with \$0.1 million and \$1.7 million for the same periods of 2013.

The 3.7 points and 1.2 points decline in the Focus States loss & LAE ratio for the three and nine months ended September 30, 2014 is primarily due to improvement in the California calendar year loss ratio as a result of favorable development from prior accident year loss and LAE reserves as well as an increase in average earned premiums.

The combined ratio in the Other States decreased by 6.8 points and 7.2 points, respectively, during the three and nine months ended September 30, 2014. The improvement is primarily due to the fact that the business in Georgia, Nevada and Pennsylvania is primarily renewal business only, which has a lower combined ratio. Earned premium and losses in these states are expected to continue to decline as we focus on renewal business only.

The combined ratio in Commercial Vehicle increased by 4.6 points and 3.4 points, during the three and nine months ended September 30, 2014, respectively, compared with the same periods of 2013 primarily due to an increase in the loss and LAE ratio due to new business growth in 2014.

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Net Investment Income

Net investment income is comprised of gross investment income and investment management fees and expenses, as shown in the following table (\$ in thousands):

| | Three months ended September 30, | | Nine months ended September 30, | | |
|--|----------------------------------|-------------|---------------------------------|-------------|---|
| | 2014 | 2013 | 2014 | 2013 | |
| Investment income: | | | | | |
| Interest income on fixed maturities, cash and cash equivalents | \$8,887 | \$8,403 | \$26,683 | \$25,605 | |
| Dividends on equity securities | 432 | 337 | 1,636 | 1,195 | |
| Gross investment income | 9,319 | 8,740 | 28,318 | 26,800 | |
| Investment expenses | (565) | (599) | (1,655) | (1,699) | |
| Net investment income | 8,754 | 8,141 | 26,663 | 25,101 | |
| Average investment balance, at cost | \$1,563,093 | \$1,506,332 | \$1,559,967 | \$1,500,383 | |
| Annualized returns excluding realized gains and losses | 2.2 | % 2.2 | % 2.3 | % 2.2 | % |
| Annualized returns including realized gains and losses | 2.5 | % 2.0 | % 2.6 | % 2.6 | % |

Changes in investment income reflect fluctuations in market rates and changes in average invested assets. Net investment income for the three and nine months ended September 30, 2014 increased compared to the same periods of 2013 primarily due to growth in average investment balances.

The book yield on our portfolio continues to exceed our new money rates. Therefore, we expect that investment returns will continue to decline gradually as proceeds from maturing or prepaid investments are expected to be reinvested at yields lower than the average book yield for the total portfolio.

The following table provides information about our fixed maturity investments at September 30, 2014, which are sensitive to interest rate risk. The table shows expected principal cash flows by expected maturity date for each of the five subsequent years and collectively for all years thereafter. Callable bonds and notes are included based on call date or maturity date depending upon which date produces the most conservative yield. MBS and sinking fund issues are included based on maturity year adjusted for expected payment patterns.

| (in thousands) | Expected Principal Cash Flows | | | Maturing Book Yield |
|------------------------------------|-------------------------------|----------------------------|--------------|---------------------|
| | MBS, CMO and ABS only | Excluding MBS, CMO and ABS | Total | |
| For the period ending December 31, | | | | |
| 2014 | \$ 15,924 | \$ 13,936 | \$ 29,860 | 2.6 % |
| 2015 | 71,372 | 140,854 | 212,226 | 2.4 % |
| 2016 | 76,764 | 158,392 | 235,155 | 2.4 % |
| 2017 | 65,293 | 195,959 | 261,252 | 2.2 % |
| 2018 | 36,273 | 93,564 | 129,837 | 2.7 % |
| Thereafter | 175,854 | 292,320 | 468,175 | 3.0 % |
| Total | \$ 441,480 | \$ 895,025 | \$ 1,336,505 | 2.6 % |

The cash flows presented take into consideration historical relationships of market yields and prepayment rates. However, the actual prepayment rate may differ from historical trends, resulting in actual principal cash flows that differ from those presented above.

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Realized Gains (Losses) on Investments

We recorded impairments for unrealized losses deemed other-than-temporary and realized gains and losses on sales and disposals, as follows (before tax, \$ in thousands):

| | Three months ended September 30, 2014 | | | Three months ended September 30, 2013 | | |
|------------------------|---------------------------------------|--------------------------------------|-------------------------------|---------------------------------------|--------------------------------------|-------------------------------|
| | Impairments Recognized in Earnings | Net Realized Gains (Losses) on Sales | Total Realized Gains (Losses) | Impairments Recognized in Earnings | Net Realized Gains (Losses) on Sales | Total Realized Gains (Losses) |
| Fixed maturities | \$(21) | \$1,034 | \$1,013 | \$(819) | \$273 | \$(546) |
| Equities | 0 | 0 | 0 | 0 | 0 | 0 |
| Short-term investments | 0 | 0 | 0 | 0 | 0 | 0 |
| Total | \$(21) | \$1,034 | \$1,013 | \$(819) | \$273 | \$(546) |
| | Nine months ended September 30, 2014 | | | Nine months ended September 30, 2013 | | |
| | Impairments Recognized in Earnings | Net Realized Gains (Losses) on Sales | Total Realized Gains (Losses) | Impairments Recognized in Earnings | Net Realized Gains (Losses) on Sales | Total Realized Gains (Losses) |
| Fixed maturities | \$(55) | \$2,280 | \$2,225 | \$(1,190) | \$4,602 | \$3,412 |
| Equities | 0 | 1,273 | 1,273 | 0 | 660 | 660 |
| Short-term investments | 0 | 5 | 5 | 0 | 0 | 0 |
| Total | \$(55) | \$3,558 | \$3,503 | \$(1,190) | \$5,262 | \$4,072 |

For our securities held with unrealized losses, we believe, based on our analysis, that (i) we will recover our cost basis in these securities and (ii) we do not intend to sell the securities nor is it more likely than not that there will be a requirement to sell the securities before they recover in value. Should either of these beliefs change with regard to a particular security, a charge for impairment would likely be required. While it is not possible to predict accurately if or when a specific security will become impaired, charges for other-than-temporary impairments could be material to results of operations in a future period.

Interest Expense

At September 30, 2014, we had \$275 million of Senior Notes outstanding that accrue interest at 5.0% (the "5.0% Senior Notes"). We recognized \$3.4 million and \$10.3 million of interest expense on the Senior Notes in the Consolidated Statements of Earnings for the three and nine months ended September 30, 2014, respectively, compared to \$3.4 million and \$10.4 million for the same periods of 2013. Refer to Note 5 to the Consolidated Financial Statements for additional information on the Senior Notes.

Income Taxes

Our GAAP effective tax rate for the three and nine months ended September 30, 2014 was 31.6% and 30.4%, respectively, compared with 25.4% and 27.0% for the same periods of 2013. The GAAP effective tax rate has increased in 2014 as a result of an improvement in the underwriting profit, which is taxed at 35%. Refer to Note 6 to the Consolidated Financial Statements for additional information on income taxes.

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LIQUIDITY AND CAPITAL RESOURCES

Sources of Funds

We are a holding company and our insurance subsidiaries conduct our operations. Accordingly, we will have continuing cash needs for administrative expenses, the payment of interest on borrowings, shareholder dividends, share repurchases and taxes.

Funds to meet expenditures at the holding company level come primarily from dividends and tax payments from the insurance subsidiaries, as well as cash and investments held by the holding company. As of September 30, 2014, the holding company had \$124.4 million of cash and investments. In 2014, our insurance subsidiaries may pay us up to \$66.8 million in ordinary dividends without prior regulatory approval. For the nine months ended September 30, 2014, our insurance subsidiaries have paid us ordinary dividends of \$45.0 million.

Our insurance subsidiaries generate liquidity to satisfy their obligations primarily by collecting and investing premium in advance of paying claims and generating investment income on their \$1.4 billion investment portfolio. Our insurance subsidiaries generated positive cash flows from operations of \$38.7 million and \$101.2 million, respectively, during the three and nine months ended September 30, 2014 compared to positive operating cash flows of \$46.5 million and \$127.7 million, respectively, during the three and nine months ended September 30, 2013.

At September 30, 2014, we had \$275 million principal outstanding of Senior Notes. The Senior Notes accrue interest at 5.0%, payable semiannually each March and September. Refer to Note 5 to the Consolidated Financial Statements for more information on our long-term debt.

In August 2014, we renewed our agreement for a \$50 million three-year revolving credit facility (the "Credit Agreement") that requires us to meet certain financial and other covenants. We are currently in compliance with all covenants under the Credit Agreement. At September 30, 2014 there were no borrowings outstanding under the credit agreement.

In June 2013, we filed a "shelf" registration statement with the Securities and Exchange Commission registering \$300.0 million of our securities, which will allow us to sell any combination of senior or subordinated debt securities, common stock, preferred stock, warrants, depositary shares and units in one or more offerings should we choose to do so in the future.

Uses of Funds

In February 2014, we increased our quarterly dividend to \$0.36 per share from \$0.30 per share. At this current amount, our 2014 annualized dividend payments would be approximately \$16.6 million.

Our Board of Directors have authorized a share and debt repurchase program. The current program, of which we have \$39.3 million of repurchase authority remaining, is set to expire on December 31, 2014. On November 4, 2014, our Board of Directors increased the authority to a total of \$75 million and extended the date to execute the program to December 31, 2016. During the third quarter of 2014, we repurchased 20,100 shares at an average cost, excluding commissions, of \$66.69. Through the first nine months of 2014, we have repurchased 66,300 shares at an average cost, excluding commissions, of \$68.28.

We believe that cash balances, cash flows generated from operations or borrowings, and maturities and sales of investments are adequate to meet our future liquidity needs and those of our insurance subsidiaries.

Reinsurance

We use excess of loss, catastrophe and extra-contractual loss reinsurance to mitigate the financial impact of large or catastrophic losses. During 2014, our catastrophe reinsurance protection covers 100% of \$55 million in excess of \$5 million. Our excess of loss reinsurance provides protection for commercial auto losses up to \$700,000 for claims in excess of \$300,000 per occurrence. Our extra-contractual loss reinsurance provides protection for losses up to \$10 million in excess of \$5 million for any single extra-contractual loss. We also use reinsurance to mitigate losses on our Classic Collector business.

Premium ceded under all reinsurance agreements for the three and nine months ended September 30, 2014 was \$3.5 million and \$9.9 million, respectively, compared with \$2.5 million and \$7.4 million for the same periods of 2013.

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Investments

Our consolidated investment portfolio at September 30, 2014 contained approximately \$1.4 billion in fixed maturity securities, \$90.6 million in equity securities and \$0.8 million in short-term investments. All of these are carried at fair value with unrealized gains and losses reported in accumulated other comprehensive income, a separate component of shareholders' equity, on an after-tax basis. At September 30, 2014, we had pre-tax net unrealized gains of \$18.4 million on fixed maturities and pre-tax net unrealized gains of \$16.9 million on equity securities. Combined, the pre-tax net unrealized gain increased by \$9.6 million for the nine months ended September 30, 2014. This increase occurred primarily in the fixed portfolio due to lower market interest rates. The average option adjusted duration of our fixed maturity portfolio was 3.5 years at September 30, 2014 compared with 3.6 years at December 31, 2013. Since we carry all of these securities at fair value in our balance sheet, there is virtually no effect on liquidity or financial condition upon the sale and ultimate realization of unrealized gains and losses.

Approximately 90.7% of our fixed maturity investments at September 30, 2014 were rated "investment grade," and as of the same date, the average credit rating of our fixed maturity portfolio was AA-. Investment grade securities generally bear lower yields and have lower degrees of risk than those that are unrated or non-investment grade. We believe that a high quality investment portfolio is more likely to generate a stable and predictable investment return.

Fair values of instruments are based on (i) quoted prices in active markets for identical assets (Level 1), (ii) quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all significant inputs are observable in active markets (Level 2) or (iii) valuations derived from valuation techniques in which one or more significant inputs are unobservable in the marketplace (Level 3).

Level 1 securities are U.S. Treasury securities, an exchange-traded fund and equity securities held in a rabbi trust.

Level 2 securities are comprised of securities whose fair value was determined using observable market inputs. Level

3 securities are comprised of (i) securities for which there is no active or inactive market for similar instruments,

(ii) securities whose fair value is determined based on unobservable inputs and (iii) securities that nationally recognized statistical rating organizations do not rate.

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Summarized information for our investment portfolio at September 30, 2014 was as follows (\$ in thousands):

| | Amortized Cost | Fair Value | % of Total Fair Value | |
|--|-------------------|-------------|-----------------------------|---|
| Fixed Maturities: | | | | |
| U.S. government | \$65,416 | \$65,738 | 4.3 | % |
| State and municipal | 490,333 | 502,672 | 33.0 | % |
| Mortgage-backed and asset-backed: | | | | |
| Residential mortgage-backed securities | 351,137 | 352,412 | 23.2 | % |
| Commercial mortgage-backed securities | 46,360 | 46,253 | 3.0 | % |
| Asset-backed securities ("ABS"): | | | | |
| Auto loans | 48,831 | 48,894 | 3.2 | % |
| Equipment leases | 7,584 | 7,590 | 0.5 | % |
| Home equity | 505 | 515 | 0.0 | % |
| Credit card receivables | 4,515 | 4,518 | 0.3 | % |
| Tax liens | 263 | 262 | 0.0 | % |
| Student loans | 110 | 117 | 0.0 | % |
| Total ABS | 61,808 | 61,896 | 4.1 | % |
| Total mortgage-backed and ABS | 459,305 | 460,561 | 30.3 | % |
| Corporates | | | | |
| Investment grade | 263,521 | 267,752 | 17.6 | % |
| Non-investment grade | 132,784 | 133,012 | 8.7 | % |
| Total corporates | 396,305 | 400,763 | 26.3 | % |
| Total fixed maturities | 1,411,360 | 1,429,734 | 94.0 | % |
| Equity securities | 73,739 | 90,638 | 6.0 | % |
| Short-term investments | 813 | 813 | 0.1 | % |
| Total investments | \$1,485,912 | \$1,521,184 | 100.0 | % |

We categorize securities by rating based upon ratings issued by Moody's, Standard & Poor's or Fitch, where available. If all three ratings are available but not equivalent, we exclude the lowest rating and the lower of the remaining ratings is used. If ratings are only available from two agencies, the lowest is used. This methodology is consistent with that used by the major bond indices.

The following table presents the credit rating and fair value of our fixed maturity portfolio by major security type at September 30, 2014 (\$ in thousands):

| | Rating | | | | Non- investment Grade | Total Fair Value | % of Total Exposure |
|-------------------------------------|-----------|-----------|-----------|-----------|-----------------------------|---------------------|---------------------------|
| | AAA | AA | A | BBB | | | |
| U.S. government | \$65,738 | \$0 | \$0 | \$0 | \$0 | \$65,738 | 4.6 % |
| State and municipal | 105,777 | 295,446 | 101,449 | 0 | 0 | 502,672 | 35.2 % |
| Mortgage-backed and asset-backed | 426,266 | 28,881 | 5,414 | 0 | 0 | 460,561 | 32.2 % |
| Corporates | 0 | 18,483 | 116,738 | 132,530 | 133,012 | 400,763 | 28.0 % |
| Total fair value | \$597,781 | \$342,811 | \$223,601 | \$132,530 | \$133,012 | \$1,429,734 | 100.0 % |
| % of total fair value | 41.8 | % 24.0 | % 15.6 | % 9.3 | % 9.3 | % 100.0 | % |

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Our fixed income portfolio contains no securities issued by any single issuer that exceed 1% of the fair value of the fixed income portfolio.

The following table presents the credit rating and fair value of our state and municipal bond portfolio, by state, at September 30, 2014 (\$ in thousands):

| State | Rating | | | | Non-investment Grade | Total Fair Value | % of Total Exposure | |
|-----------------------|-----------|-----------|-----------|-------|----------------------|------------------|---------------------|---|
| | AAA | AA | A | BBB | | | | |
| NY | \$8,773 | \$49,574 | \$16,906 | \$0 | \$0 | \$75,253 | 15.0 | % |
| CA | 0 | 32,408 | 5,886 | 0 | 0 | 38,294 | 7.6 | % |
| TX | 11,614 | 11,680 | 5,689 | 0 | 0 | 28,983 | 5.8 | % |
| GA | 11,715 | 1,120 | 12,062 | 0 | 0 | 24,898 | 5.0 | % |
| NC | 14,135 | 10,223 | 0 | 0 | 0 | 24,358 | 4.8 | % |
| VA | 7,759 | 13,538 | 0 | 0 | 0 | 21,297 | 4.2 | % |
| MD | 13,753 | 7,172 | 0 | 0 | 0 | 20,925 | 4.2 | % |
| WA | 737 | 18,212 | 1,690 | 0 | 0 | 20,639 | 4.1 | % |
| PA | 0 | 11,531 | 8,170 | 0 | 0 | 19,701 | 3.9 | % |
| MA | 2,474 | 13,365 | 152 | 0 | 0 | 15,991 | 3.2 | % |
| All other states | 34,817 | 126,622 | 50,893 | 0 | 0 | 212,332 | 42.2 | % |
| Total fair value | \$105,777 | \$295,446 | \$101,449 | \$0 | \$0 | \$502,672 | 100.0 | % |
| % of total fair value | 21.0 | % 58.8 | % 20.2 | % 0.0 | % 0.0 | % 100.0 | % | |

The following table presents the fair value of our state and municipal bond portfolio, by state and type of bond, at September 30, 2014 (\$ in thousands):

| State | Type | | | Certificate of Participation | Other | Total Fair Value | % of Total Exposure | |
|-----------------------|--------------------|----------|-----------|------------------------------|---------|------------------|---------------------|---|
| | General Obligation | | | | | | | |
| | State | Local | Revenue | | | | | |
| NY | \$7,653 | \$8,431 | \$59,169 | \$0 | \$0 | \$75,253 | 15.0 | % |
| CA | 7,920 | 14,412 | 15,962 | 0 | 0 | 38,294 | 7.6 | % |
| TX | 1,434 | 11,416 | 16,134 | 0 | 0 | 28,983 | 5.8 | % |
| GA | 11,715 | 1,120 | 12,062 | 0 | 0 | 24,898 | 5.0 | % |
| NC | 1,032 | 9,038 | 14,288 | 0 | 0 | 24,358 | 4.8 | % |
| VA | 1,026 | 6,668 | 13,603 | 0 | 0 | 21,297 | 4.2 | % |
| MD | 4,107 | 13,890 | 2,928 | 0 | 0 | 20,925 | 4.2 | % |
| WA | 5,668 | 3,012 | 11,960 | 0 | 0 | 20,639 | 4.1 | % |
| PA | 7,951 | 789 | 10,961 | 0 | 0 | 19,701 | 3.9 | % |
| MA | 7,127 | 2,009 | 6,855 | 0 | 0 | 15,991 | 3.2 | % |
| All other states | 42,263 | 20,565 | 143,015 | 4,546 | 1,945 | 212,332 | 42.2 | % |
| Total fair value | \$97,895 | \$91,349 | \$306,937 | \$4,546 | \$1,945 | \$502,672 | 100.0 | % |
| % of total fair value | 19.5 | % 18.2 | % 61.1 | % 0.9 | % 0.4 | % 100.0 | % | |

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The following table presents the fair value of the revenue category of our state and municipal bond portfolio, by state and further classification, at September 30, 2014 (\$ in thousands):

| State | Revenue Bonds | | | | Total Fair Value | % of Total Exposure | |
|-----------------------|----------------|-----------|-----------|-----------|------------------|---------------------|---|
| | Transportation | Utilities | Education | Other | | | |
| NY | \$27,128 | \$0 | \$7,049 | \$24,992 | \$59,169 | 19.3 | % |
| TX | 2,142 | 2,929 | 4,050 | 7,013 | 16,134 | 5.3 | % |
| CA | 8,158 | 5,666 | 0 | 2,139 | 15,962 | 5.2 | % |
| NJ | 1,996 | 0 | 4,571 | 8,106 | 14,674 | 4.8 | % |
| NC | 0 | 4,065 | 0 | 10,223 | 14,288 | 4.7 | % |
| VA | 0 | 0 | 3,450 | 10,153 | 13,603 | 4.4 | % |
| CO | 0 | 0 | 8,035 | 5,284 | 13,318 | 4.3 | % |
| MN | 0 | 1,656 | 1,008 | 9,829 | 12,493 | 4.1 | % |
| GA | 6,568 | 4,384 | 0 | 1,110 | 12,062 | 3.9 | % |
| WA | 0 | 8,484 | 0 | 3,475 | 11,960 | 3.9 | % |
| All other states | 27,492 | 11,118 | 19,134 | 65,530 | 123,275 | 40.2 | % |
| Total fair value | \$73,484 | \$38,302 | \$47,297 | \$147,854 | \$306,937 | 100.0 | % |
| % of total fair value | 23.9 | % 12.5 | % 15.4 | % 48.2 | % 100.0 | % | |

The following table presents the credit rating and fair value of our residential mortgage-backed securities at September 30, 2014 by deal origination year (\$ in thousands):

| Deal Origination Year | Rating | | | | Non-investment Grade | Total Fair Value | % of Total Exposure | |
|-----------------------|-----------|-------|-------|-------|----------------------|------------------|---------------------|---|
| | AAA | AA | A | BBB | | | | |
| 2002 | \$102 | \$0 | \$0 | \$0 | \$0 | \$102 | 0.0 | % |
| 2003 | 3,378 | 0 | 0 | 0 | 0 | 3,378 | 1.0 | % |
| 2004 | 3,826 | 0 | 0 | 0 | 0 | 3,826 | 1.1 | % |
| 2005 | 8,714 | 0 | 0 | 0 | 0 | 8,714 | 2.5 | % |
| 2006 | 4,398 | 0 | 0 | 0 | 0 | 4,398 | 1.2 | % |
| 2007 | 5,147 | 0 | 0 | 0 | 0 | 5,147 | 1.5 | % |
| 2008 | 10,408 | 0 | 0 | 0 | 0 | 10,408 | 3.0 | % |
| 2009 | 27,257 | 0 | 0 | 0 | 0 | 27,257 | 7.7 | % |
| 2010 | 43,897 | 0 | 0 | 0 | 0 | 43,897 | 12.5 | % |
| 2011 | 41,780 | 0 | 0 | 0 | 0 | 41,780 | 11.9 | % |
| 2012 | 72,259 | 0 | 0 | 0 | 0 | 72,259 | 20.5 | % |
| 2013 | 72,807 | 0 | 0 | 0 | 0 | 72,807 | 20.7 | % |
| 2014 | 58,442 | 0 | 0 | 0 | 0 | 58,442 | 16.6 | % |
| Total fair value | \$352,412 | \$0 | \$0 | \$0 | \$0 | \$352,412 | 100.0 | % |
| % of total fair value | 100.0 | % 0.0 | % 0.0 | % 0.0 | % 0.0 | % 100.0 | % | |

All of the \$352.4 million of residential mortgage-backed securities were issued by government-sponsored enterprises ("GSE").

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The following table presents the credit rating and fair value of our commercial mortgage-backed securities at September 30, 2014 by deal origination year (\$ in thousands):

| Deal Origination Year | Rating | | | | Non-investment Grade | Total Fair Value | % of Total Exposure | |
|-----------------------|----------|---------|-------|-------|----------------------|------------------|---------------------|---|
| | AAA | AA | A | BBB | | | | |
| 2005 | \$4,578 | \$0 | \$0 | \$0 | \$0 | \$4,578 | 9.9 | % |
| 2006 | 14,488 | 0 | 0 | 0 | 0 | 14,488 | 31.3 | % |
| 2007 | 9,780 | 2,735 | 0 | 0 | 0 | 12,516 | 27.1 | % |
| 2008 | 0 | 738 | 0 | 0 | 0 | 738 | 1.6 | % |
| 2010 | 3,752 | 0 | 0 | 0 | 0 | 3,752 | 8.1 | % |
| 2011 | 1,209 | 0 | 0 | 0 | 0 | 1,209 | 2.6 | % |
| 2012 | 3,999 | 0 | 0 | 0 | 0 | 3,999 | 8.6 | % |
| 2013 | 1,445 | 0 | 0 | 0 | 0 | 1,445 | 3.1 | % |
| 2014 | 3,528 | 0 | 0 | 0 | 0 | 3,528 | 7.6 | % |
| Total fair value | \$42,779 | \$3,473 | \$0 | \$0 | \$0 | \$46,253 | 100.0 | % |
| % of total fair value | 92.5 | % 7.5 | % 0.0 | % 0.0 | % 0.0 | % 100.0 | % | |

None of the \$46.3 million of commercial mortgage-backed securities were issued by GSEs.

The following table presents the credit rating and fair value of our ABS portfolio at September 30, 2014 by deal origination year (\$ in thousands):

| Deal Origination Year | Rating | | | | Non-investment Grade | Total Fair Value | % of Total Exposure | |
|-----------------------|----------|----------|---------|-------|----------------------|------------------|---------------------|---|
| | AAA | AA | A | BBB | | | | |
| 2001 | \$81 | \$0 | \$0 | \$0 | \$0 | \$81 | 0.1 | % |
| 2003 | 434 | 0 | 0 | 0 | 0 | 434 | 0.7 | % |
| 2011 | 374 | 248 | 0 | 0 | 0 | 622 | 1.0 | % |
| 2012 | 10,068 | 5,934 | 442 | 0 | 0 | 16,444 | 26.6 | % |
| 2013 | 16,856 | 11,410 | 2,375 | 0 | 0 | 30,641 | 49.5 | % |
| 2014 | 3,261 | 7,815 | 2,598 | 0 | 0 | 13,674 | 22.1 | % |
| Total fair value | \$31,074 | \$25,408 | \$5,414 | \$0 | \$0 | \$61,896 | 100.0 | % |
| % of total fair value | 50.2 | % 41.0 | % 8.7 | % 0.0 | % 0.0 | % 100.0 | % | |

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The following table presents the credit rating and fair value of our corporate bond portfolio, by industry sector and rating of bond, at September 30, 2014 (\$ in thousands):

| Industry Sector | Rating | | | | Non-investment Grade | Total Fair Value | % of Total Exposure | |
|------------------------|--------|----------|-----------|-----------|----------------------|------------------|---------------------|---|
| | AAA | AA | A | BBB | | | | |
| Basic Materials | \$0 | \$0 | \$575 | \$5,140 | \$5,392 | \$11,108 | 2.8 | % |
| Communications | 0 | 0 | 2,756 | 22,381 | 23,928 | \$49,065 | 12.2 | % |
| Consumer, Cyclical | 0 | 0 | 4,486 | 10,315 | 20,491 | \$35,292 | 8.8 | % |
| Consumer, Non-cyclical | 0 | 3,750 | 17,702 | 19,034 | 25,368 | \$65,853 | 16.4 | % |
| Energy | 0 | 0 | 5,912 | 9,150 | 17,281 | \$32,342 | 8.1 | % |
| Financial | 0 | 14,733 | 80,830 | 46,207 | 14,461 | \$156,232 | 39.0 | % |
| Industrial | 0 | 0 | 0 | 7,736 | 14,813 | \$22,549 | 5.6 | % |
| Technology | 0 | 0 | 1,715 | 3,288 | 7,902 | \$12,905 | 3.2 | % |
| Utilities | 0 | 0 | 2,763 | 9,280 | 3,376 | \$15,418 | 3.8 | % |
| Total fair value | \$0 | \$18,483 | \$116,738 | \$132,530 | \$133,012 | \$400,763 | 100.0 | % |
| % of total fair value | 0.0 | % 4.6 | % 29.1 | % 33.1 | % 33.2 | % 100.0 | % | |

Included in our investments in corporate fixed income securities at September 30, 2014 are \$42.6 million of dollar-denominated investments with issuers or guarantors in foreign countries, as follows (\$ in thousands):

| Issuer or Guarantor | Rating | | | | Non-investment Grade | Total Fair Value | % of Total Exposure | |
|-----------------------|--------|----------|----------|-------|----------------------|------------------|---------------------|---|
| | AAA | AA | A | BBB | | | | |
| Britain | \$0 | \$6,292 | \$10,969 | \$0 | \$0 | \$17,261 | 40.5 | % |
| Switzerland | 0 | 0 | 5,775 | 0 | 0 | \$5,775 | 13.5 | % |
| Canada | 0 | 3,540 | 1,717 | 0 | 431 | \$5,687 | 13.3 | % |
| France | 0 | 2,060 | 2,683 | 0 | 0 | \$4,744 | 11.1 | % |
| Australia | 0 | 1,684 | 2,778 | 0 | 0 | \$4,462 | 10.5 | % |
| Japan | 0 | 0 | 2,633 | 0 | 0 | \$2,633 | 6.2 | % |
| Sweden | 0 | 1,670 | 0 | 0 | 0 | \$1,670 | 3.9 | % |
| Cayman Islands | 0 | 0 | 0 | 0 | 411 | \$411 | 1.0 | % |
| Total fair value | \$0 | \$15,246 | \$26,555 | \$0 | \$842 | \$42,643 | 100.0 | % |
| % of total fair value | 0.0 | % 35.8 | % 62.3 | % 0.0 | % 2.0 | % 100.0 | % | |

We do not own any investments that are denominated in a currency other than the U.S. dollar.

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ITEM 3

Quantitative and Qualitative Disclosures about Market Risk

As of September 30, 2014, there were no material changes to the information provided in our Form 10-K for the year ended December 31, 2013 under the caption “Exposure to Market Risk” in Management’s Discussion and Analysis of Financial Condition and Results of Operations. Refer to Item 2 Management’s Discussion and Analysis under the caption “Investments” for updates to disclosures made under the sub caption “Credit Risk” in our Form 10-K for the year ended December 31, 2013.

ITEM 4

Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of the Company’s management, including its Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Securities Exchange Act Rules 13a-15(e) and 15d-15(e)) as of September 30, 2014. Based on that evaluation, we concluded that the controls and procedures are effective in providing reasonable assurance that material information required to be disclosed in our reports filed with or submitted to the Securities and Exchange Commission (“SEC”) under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate.

Changes in Internal Control over Financial Reporting

During the fiscal quarter ended September 30, 2014, there have been no changes to our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II

OTHER INFORMATION

ITEM 1

Legal Proceedings

We have not become a party to any material legal proceedings nor have there been any material developments in our legal proceedings disclosed in our Form 10-K for the year ended December 31, 2013. For a description of our previously reported legal proceedings, refer to Part I, Item 3, Legal Proceedings, in the Form 10-K for the year ended December 31, 2013.

ITEM 1A

Risk Factors

There have been no material changes in our risk factors as disclosed in our Form 10-K for the year ended December 31, 2013. For a description of our previously reported risk factors, refer to Part I, Item 1A, Risk Factors, in the Form 10-K for the year ended December 31, 2013.

ITEM 2

Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

| Period | Total Number of Shares Purchased (a) | Average Price Paid per Share (b) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (c) | Approximate Dollar Value that May Yet Be Purchased Under the Plans or Programs (c) |
|--|--------------------------------------|----------------------------------|--|--|
| July 1, 2014 - July 31, 2014 | 7,500 | \$ 65.63 | 7,500 | \$ 40,131,555 |
| August 1, 2014 - August 31, 2014 | 40,351 | 66.18 | 6,300 | 39,707,641 |
| September 1, 2014 - September 30, 2014 | 6,300 | 67.37 | 6,300 | 39,283,007 |
| Total | 54,151 | \$ 66.24 | 20,100 | \$ 39,283,007 |

(a) Includes 34,051 shares surrendered to cover the withholding taxes related to the issuance of shares under the performance share plan.

(b) Average price paid per share excludes commissions.

(c) On November 4, 2014, our Board of Directors increased the authority under our current share and debt repurchase plan to a total \$75.0 million and extended the date to execute the program to December 31, 2016 from December 31, 2014.

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ITEM 6

Exhibit 31.1 - Certification of the Chief Executive Officer under Exchange Act Rule 13a-14(a)

Exhibit 31.2 - Certification of the Chief Financial Officer under Exchange Act Rule 13a-14(a)

Exhibit 32 - Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350

Exhibit 101.INS - XBRL Instance Document

Exhibit 101.SCH - XBRL Taxonomy Extension Schema Document (1)

Exhibit 101.CAL - XBRL Taxonomy Extension Calculation Linkbase Document (1)

Exhibit 101.DEF - XBRL Taxonomy Extension Definition Linkbase Document (1)

Exhibit 101.LAB - XBRL Taxonomy Extension Label Linkbase Document (1)

Exhibit 101.PRE - XBRL Taxonomy Extension Presentation Linkbase Document (1)

(1) Furnished with this report, in accordance with Rule 406T of Regulation S-T, the information in these exhibits shall not be deemed to be "filed" for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, or otherwise subject to liability under that section, and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.

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Signature

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

Infinity Property and Casualty Corporation

BY: /s/ ROGER SMITH

Roger Smith

Executive Vice President, Chief Financial Officer and Treasurer
(principal financial and accounting officer)

November 6, 2014