

INFINITY PROPERTY & CASUALTY CORP

Form 10-Q/A

November 10, 2011

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(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, 2011

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)

03-0483872

(I.R.S. Employer

Identification No.)

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, 2011 there were 11,834,589 shares of the registrant's common stock outstanding.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

EXPLANATORY NOTE

On November 3, 2011, we filed our Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 (the "Original Filing") with the Securities and Exchange Commission (the "SEC"). The Original Filing is being amended to correct a typographical error contained in the certification of the Company's CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. As required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, we are also filing new certifications under Section 302(a) of the Sarbanes-Oxley Act of 2002.

Except as described above, this Amendment No. 1 on Form 10-Q/A (this "Amendment") speaks as of the date of the Original Filing, does not reflect events that may have occurred subsequent to such original filing date, and does not modify or update in any way disclosures made in the Original Filing. Accordingly, this Amendment should be read in conjunction with the Original Filing and our filings made with the SEC subsequent to the date of the Original Filing.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

INDEX

	Page
<u>PART I – FINANCIAL INFORMATION</u>	
Item 1	<u>Financial Statements</u>
	<u>Consolidated Statements of Earnings</u> 4
	<u>Consolidated Balance Sheets</u> 5
	<u>Consolidated Statements of Changes in Shareholders’ Equity</u> 6
	<u>Consolidated Statements of Cash Flows</u> 7
	<u>Condensed Notes to Consolidated Financial Statements</u> 9
Item 2	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> 25
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 42
Item 4	<u>Controls and Procedures</u> 42
<u>PART II – OTHER INFORMATION</u>	
Item 1	<u>Legal Proceedings</u> 43
Item 1A	<u>Risk Factors</u> 43
Item 2	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 43
Item 6	<u>Exhibits</u> 44
	<u>Signature</u> 45
EXHIBIT INDEX	
Exhibit 10	Amended Stock Option Plan
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	XBRL Instance Documents

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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,		
	2011	2010	% Change	2011	2010	% Change
Revenues:						
Earned premium	\$255,138	\$232,503	9.7 %	\$745,703	\$670,159	11.3 %
Net investment income	10,166	11,090	(8.3)%	31,117	33,968	(8.4)%
Net realized gains on investments*	722	7,991	(91.0)%	5,604	7,580	(26.1)%
Other income	101	85	19.6 %	201	206	(2.2)%
Total revenues	266,127	251,669	5.7 %	782,625	711,913	9.9 %
Costs and Expenses:						
Losses and loss adjustment expenses	195,275	152,304	28.2 %	566,685	452,227	25.3 %
Commissions and other underwriting expenses	58,124	53,339	9.0 %	170,689	155,356	9.9 %
Interest expense	2,702	2,701	0.0 %	8,105	8,101	0.0 %
Corporate general and administrative expenses	1,729	2,057	(16.0)%	5,654	6,155	(8.1)%
Other expenses	1,026	(373)	(374.9)%	1,425	2,174	(34.4)%
Total costs and expenses	258,856	210,028	23.2 %	752,558	624,014	20.6 %
Earnings before income taxes	7,271	41,641	(82.5)%	30,067	87,899	(65.8)%
Provision for income taxes	1,139	10,810	(89.5)%	5,343	25,169	(78.8)%
Net Earnings	\$6,132	\$30,831	(80.1)%	\$24,724	\$62,730	(60.6)%
Earnings per Common Share:						
Basic	\$0.51	\$2.45	(79.2)%	\$2.02	\$4.83	(58.2)%
Diluted	0.50	2.39	(79.1)%	1.97	4.72	(58.3)%
Average Number of Common Shares:						
Basic	12,070	12,576	(4.0)%	12,230	12,980	(5.8)%
Diluted	12,344	12,913	(4.4)%	12,524	13,292	(5.8)%
Cash Dividends per Common Share	\$0.18	\$0.14	28.6 %	\$0.54	\$0.42	28.6 %
* Net realized gains before impairment losses	\$1,146	\$8,141	(85.9)%	\$6,873	\$9,530	(27.9)%
Total other-than-temporary impairment (OTTI) losses	(442)	(49)	799.9 %	(2,121)	(191)	NM
Non-credit portion in other comprehensive income	19	0	0.0 %	1,036	0	0.0 %
	(1)	(101)	(98.9)%	(185)	(1,760)	(89.5)%

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OTTI losses reclassified from other
comprehensive income

Net impairment losses recognized in earnings	(424)	(150)	181.8	%	(1,270)	(1,951)	(34.9)%
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Total net realized gains on investments	\$722		\$7,991		(91.0)%	\$5,604		\$7,580		(26.1)%
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NM = Not meaningful

See Condensed Notes to Consolidated Financial Statements.

4

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Investments:		
Fixed maturities – at fair value (amortized cost \$1,136,287 and \$1,153,802)	\$1,177,290	\$1,177,718
Equity securities – at fair value (cost \$26,344 and \$29,333)	33,104	42,301
Total investments	\$1,210,395	\$1,220,019
Cash and cash equivalents	52,157	63,605
Accrued investment income	11,224	12,033
Agents' balances and premium receivable, net of allowances for doubtful accounts of \$12,781 and \$12,323	389,700	336,676
Property and equipment, net of accumulated depreciation of \$43,155 and \$43,731	38,975	25,132
Prepaid reinsurance premium	2,262	1,890
Recoverables from reinsurers (includes \$87 and \$289 on paid losses and LAE)	14,841	16,809
Deferred policy acquisition costs	92,034	79,398
Current and deferred income taxes	15,851	14,867
Receivable for securities sold	5,541	0
Other assets	5,445	6,653
Goodwill	75,275	75,275
Total assets	\$1,913,699	\$1,852,357
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$493,531	\$477,833
Unearned premium	480,741	417,371
Payable to reinsurers	0	42
Long-term debt (fair value \$207,388 and \$199,132)	194,790	194,729
Commissions payable	22,030	18,960
Payable for securities purchased	12,772	419
Other liabilities	58,510	81,819
Total liabilities	\$1,262,373	\$1,191,173
Commitments and contingencies (See Note 10)		
Shareholders' equity:		
Common stock, no par value (50,000,000 shares authorized; 21,329,834 and 21,167,947 shares issued)	\$21,319	\$21,228
Additional paid-in capital	354,034	349,742
Retained earnings	643,598	625,492
Accumulated other comprehensive income, net of tax	31,528	24,488
Treasury stock, at cost (9,450,658 and 8,698,962 shares)	(399,153)	(359,766)
Total shareholders' equity	\$651,326	\$661,184
Total liabilities and shareholders' equity	\$1,913,699	\$1,852,357
See Condensed Notes to Consolidated Financial Statements.		

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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, 2009	\$21,064	\$344,031	\$541,167	\$19,500	\$(307,602)	\$618,160
Net earnings	—	—	62,730	—	—	62,730
Net change in postretirement benefit liability	—	—	—	(52)	—	(52)
Change in unrealized gain on investments	—	—	—	14,002	—	14,002
Change in non-credit component of impairment losses on fixed maturities	—	—	—	3,620	—	3,620
Comprehensive income	—	—	—	—	—	\$80,300
Dividends paid to common shareholders	—	—	(5,449)	—	—	(5,449)
Shares issued and share-based compensation expense, including tax benefit	132	4,395	—	—	—	4,527
Acquisition of treasury stock	—	—	—	—	(45,815)	(45,815)
Balance at September 30, 2010	\$21,195	\$348,426	\$598,449	\$37,069	\$(353,417)	\$651,723
Net earnings	\$—	\$—	\$28,792	\$—	\$—	\$28,792
Net change in postretirement benefit liability	—	—	—	(68)	—	(68)
Change in unrealized gain on investments	—	—	—	(13,130)	—	(13,130)
Change in non-credit component of impairment losses on fixed maturities	—	—	—	617	—	617
Comprehensive income	—	—	—	—	—	\$16,212
Dividends paid to common shareholders	—	—	(1,749)	—	—	(1,749)
Shares issued and share-based compensation expense, including tax benefit	32	1,316	—	—	—	1,348
Acquisition of treasury stock	—	—	—	—	(6,350)	(6,350)
Balance at December 31, 2010	\$21,228	\$349,742	\$625,492	\$24,488	\$(359,766)	\$661,184
Net earnings	\$—	\$—	\$24,724	\$—	\$—	\$24,724
Net change in postretirement benefit liability	—	—	—	(31)	—	(31)
Change in unrealized gain on investments	—	—	—	6,102	—	6,102
Change in non-credit component of impairment losses on fixed maturities	—	—	—	969	—	969
Comprehensive income	—	—	—	—	—	\$31,764
Dividends paid to common shareholders	—	—	(6,618)	—	—	(6,618)
Shares issued and share-based compensation expense, including tax benefit	91	4,291	—	—	—	4,383

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Acquisition of treasury stock	—	—	—	—	(39,387)	(39,387)
Balance at September 30, 2011	\$21,319	\$354,034	\$643,598	\$31,528	\$(399,153)	\$651,326

See Condensed Notes to Consolidated Financial Statements.

6

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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

(in thousands)

(unaudited)

	Three months ended September 30,	
	2011	2010
Operating Activities:		
Net earnings	\$6,132	\$30,831
Adjustments:		
Depreciation	1,850	2,590
Amortization	2,038	1,704
Net realized gains on investments	(722)	(7,991)
Loss on disposal of property and equipment	160	4
Share-based compensation expense	967	1,139
Excess tax benefits from share-based payment arrangements	(169)	0
Non-cash activity related to rabbi trust	(65)	0
Increase in accrued investment income	(5)	(8)
Increase in agents' balances and premium receivable	(14,928)	(13,224)
Decrease in reinsurance receivables	186	1,253
Increase in deferred policy acquisition costs	(1,519)	(3,689)
Decrease in other assets	5,579	4,253
Increase (decrease) in unpaid losses and loss adjustment expenses	10,422	(4,813)
Increase in unearned premium	14,409	10,039
Decrease in other liabilities	(5,848)	(2,419)
Net cash provided by operating activities	18,488	19,668
Investing Activities:		
Purchases of and additional investments in:		
Fixed maturities	(46,844)	(178,622)
Equity securities	(2,000)	0
Property and equipment	(2,705)	(1,205)
Maturities and redemptions of fixed maturities	22,416	34,692
Sales of:		
Fixed maturities	49,360	145,219
Equity securities	0	0
Net cash provided by investing activities	20,228	84
Financing Activities:		
Proceeds from stock options exercised and employee stock purchases, including tax benefit	271	652
Excess tax benefits from share-based payment arrangements	169	0
Acquisition of treasury stock	(21,284)	(16,436)
Dividends paid to shareholders	(2,170)	(1,762)
Net cash used in financing activities	(23,014)	(17,547)
Net increase in cash and cash equivalents	15,702	2,205
Cash and cash equivalents at beginning of period	36,455	63,147
Cash and cash equivalents at end of period	\$52,157	\$65,352
See Condensed Notes to Consolidated Financial Statements.		

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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

(in thousands)

(unaudited)

	Nine months ended September 30,	
	2011	2010
Operating Activities:		
Net earnings	\$24,724	\$62,730
Adjustments:		
Depreciation	6,676	7,864
Amortization	5,869	4,710
Net realized gains on investments	(5,604)	(7,580)
Loss on disposal of property and equipment	362	7
Share-based compensation expense	2,383	3,182
Excess tax benefits from share-based payment arrangements	(169)	0
Non-cash activity related to rabbi trust	(47)	0
Decrease (increase) in accrued investment income	809	(625)
Increase in agents' balances and premium receivable	(53,024)	(52,979)
Decrease in reinsurance receivables	1,596	214
Increase in deferred policy acquisition costs	(12,635)	(12,994)
Increase in other assets	(3,582)	(7,641)
Increase (decrease) in unpaid losses and loss adjustment expenses	15,698	(11,660)
Increase in unearned premium	63,370	61,993
Decrease in payable to reinsurers	(42)	(58)
(Decrease) increase in other liabilities	(20,328)	15,712
Net cash provided by operating activities	26,057	62,876
Investing Activities:		
Purchases of and additional investments in:		
Fixed maturities	(242,707)	(371,671)
Equity securities	(2,000)	0
Property and equipment	(20,881)	(6,906)
Maturities and redemptions of fixed maturities	113,081	105,828
Sales of:		
Fixed maturities	150,231	225,403
Equity securities	7,871	0
Net cash provided by (used in) investing activities	5,596	(47,346)
Financing Activities:		
Proceeds from stock options exercised and employee stock purchases, including tax benefit	1,999	1,344
Excess tax benefits from share-based payment arrangements	169	0
Acquisition of treasury stock	(38,650)	(45,775)
Dividends paid to shareholders	(6,618)	(5,449)
Net cash used in financing activities	(43,100)	(49,879)
Net decrease in cash and cash equivalents	(11,447)	(34,349)
Cash and cash equivalents at beginning of period	63,605	99,700
Cash and cash equivalents at end of period	\$52,157	\$65,352

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

INDEX TO NOTES

- | | |
|--------------------------------------|-----------------------------------|
| 1. Reporting and Accounting Policies | 7. Income Taxes |
| 2. Share-Based Compensation | 8. Additional Information |
| 3. Computation of Earnings Per Share | 9. Insurance Reserves |
| 4. Fair Value | 10. Commitments and Contingencies |
| 5. Investments | 11. Subsequent Events |
| 6. Long-Term Debt | |

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, 2010. 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 have evaluated events that occurred after September 30, 2011 for recognition or disclosure in our financial statements and the notes to the financial statements.

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.

Pending Accounting Standards

In October 2010, the FASB issued guidance that modifies the accounting for the deferral of costs associated with the successful acquisition or renewal of insurance contracts. The new guidance is effective for reporting periods beginning after December 15, 2011 and should be applied prospectively, with retrospective application permitted. We are in the process of evaluating the impact of adoption on our results of operations and financial position.

Reclassifications

We have reclassified certain amounts in the prior period consolidated financial statements to conform to the current period presentation. These reclassifications had no effect on total shareholders' equity, net cash flow or net earnings as previously reported.

Schedules may not foot due to rounding.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

Note 2 Share-Based Compensation

Restricted Stock Plan

We established the Restricted Stock Plan in 2002 and amended it on July 31, 2007. There are 500,000 shares of our common stock reserved for issuance under the Restricted Stock Plan, of which we have issued 278,843 shares as of September 30, 2011. We expense the fair value of shares issued under the Restricted Stock Plan over the vesting periods of the awards based on the market value of our stock on the date of grant.

On July 31, 2007, our Compensation Committee (“Committee”) approved the grant of 72,234 shares of restricted stock to certain officers under the Restricted Stock Plan. These shares of restricted stock vested in full on July 31, 2011. On August 2, 2011, the Committee approved the grant of an additional 72,234 shares of restricted stock to certain officers under the Restricted Stock Plan. These shares will vest in full on August 2, 2014. During the vesting period, the shares of restricted stock will not have voting rights and will accrue dividends, which we will not pay until the shares have vested. We treat the restricted shares as issued and outstanding for calculation of diluted earnings per share only. Until fully vested, we will not consider the shares issued and outstanding for purposes of the basic earnings per share calculation.

Non-employee Directors’ Stock Ownership Plan

In May 2005, our shareholders approved the Non-employee Directors’ Stock Ownership Plan (“Directors’ Plan”). The purpose of the Directors’ Plan is to include our common stock as part of the compensation provided to our non-employee directors and to provide for stock ownership requirements for our non-employee directors. There are 200,000 shares of our common stock reserved for issuance under the Directors’ Plan, of which we have issued 43,959 shares as of September 30, 2011. Under the terms of the Directors’ Plan, we grant shares on or about June 1 of each year and we restrict these shares from sale or transfer by any recipient for six months from the date of grant. In June 2011, we issued 6,657 shares of our common stock, valued pursuant to the Directors’ Plan at \$350,000, to our non-employee directors. In June 2010, we issued 7,672 shares of our common stock, valued pursuant to the Directors’ Plan at \$350,000, to our non-employee directors. We treat participants’ shares as issued and outstanding for basic and diluted earnings per share calculations.

Employee Stock Purchase Plan

We established our Employee Stock Purchase Plan (“ESPP”) in 2004, amended and restated it on August 3, 2010. Under the ESPP, all eligible full-time employees may purchase shares of our common stock at a 15% discount to the current market price. Employees may allocate up to 25% of their base salary with a maximum annual participation amount of \$25,000. If a participant sells any shares purchased under the ESPP within one year, we preclude that employee from participating in the ESPP for one year from the date of sale. The source of shares issued to participants is treasury shares or authorized but previously unissued shares. The maximum number of shares that we may issue under the ESPP may not exceed 1,000,000, of which we have issued 46,238 as of September 30, 2011. Our ESPP is qualified under Section 423 of the Internal Revenue Code of 1986, as amended. We treat participants’ shares as issued and outstanding for basic and diluted earnings per share calculations.

Performance Share Plan

Our shareholders approved the Performance Share Plan (“PSP”) on May 20, 2008 and an amended and restated PSP on May 26, 2010. The purpose of the PSP is to align further the interest of management with our long-term shareholders by including performance-based compensation, payable in shares of common stock, as a component of an executive’s annual compensation. The Committee administers the PSP and will (i) establish the performance goals, which may include but are not limited to, combined ratio, premium growth, growth within certain specific geographic areas and earnings per share or return on equity over the course of the upcoming three year period, (ii) determine the PSP

participants, (iii) set the performance share units to be awarded to such participants, and (iv) set the rate at which performance share units will convert to shares of common stock based upon attainment of the performance goals. The number of shares of common stock that we may issue under the PSP is limited to 500,000 shares. In April 2011, we issued 32,957 shares under the PSP.

Stock Option Plan

We amended our Stock Option Plan (“SOP”) to prohibit any future grant of stock options from the plan after May 20, 2008. We amended the plan again on August 2, 2011. We have granted no options since 2004. We generally granted options with an exercise price equal to the closing price of our stock at the date of grant and these options have a 10-year contractual life. All of

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

the options under the SOP have fully vested. Subject to specific limitations contained in the SOP, our Board of Directors has the ability to amend, suspend or terminate the plan at any time without shareholder approval. The SOP will continue in effect until the exercise or expiration of all options granted under the plan.

As permitted by the Stock Compensation topic of the FASB Accounting Standards Codification, we used the modified Black-Scholes model with the assumptions noted below to estimate the value of employee stock options on the date of grant. Expected volatilities are based on historical volatilities of our stock. We selected the expected option life to be 7.5 years, which represents the midpoint between the last vesting date and the end of the contractual term. The risk-free interest rate for periods within the contractual life of the options is based on the yield on 10-year Treasury notes in effect at the time of grant. The dividend yield was based on expected dividends at the time of grant. We estimated the weighted-average grant date fair values of options granted during 2004 and 2003 using the modified Black-Scholes valuation model and the following weighted-average assumptions:

	2004 Grants		2003 Grants	
Weighted-average grant date fair value	\$13.87		\$5.97	
Dividend yield	0.7	%	1.4	%
Expected volatility	33.0	%	33.0	%
Risk-free interest rate	4.3	%	4.0	%
Expected life	7.5	years	7.5	years
Weighted-average grant exercise price	\$33.56		\$16.11	
Outstanding as of September 30, 2011	79,050		113,405	

The following table describes activity for our Stock Option Plan:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Term (in years)	Aggregate Intrinsic Value (a) (in millions)
Outstanding at December 31, 2010	238,758	\$ 22.52		
Granted	0	0		
Exercised	(46,303)	\$ 18.88		
Forfeited	0	0		
Outstanding at September 30, 2011	192,455	\$ 23.40	1.80	\$5.6
Vested as of September 30, 2011	192,455	\$ 23.40	1.80	\$5.6
Exercisable as of September 30, 2011	192,455	\$ 23.40	1.80	\$5.6

(a) We calculated the intrinsic value for the stock options based on the difference between the exercise price of the underlying awards and our closing stock price as of the reporting date.

The Stock Compensation topic of the FASB Accounting Standards Codification requires the recognition of share-based compensation for the number of awards that we ultimately expect to vest. As of September 30, 2011, we used an estimated forfeiture rate of 0%. We will reassess estimated forfeitures in subsequent periods and may change this rate based on new facts and circumstances.

Cash received from option exercises for the nine months ended September 30, 2011 and 2010 was approximately \$0.9 million and \$1.1 million, respectively. The actual tax benefit realized for the tax deductions from options exercised totaled \$0.5 million and \$0.1 million for the nine months ended September 30, 2011 and September 30, 2010,

respectively. The total intrinsic value of options exercised during the nine months ended September 30, 2011 and 2010 was approximately \$1.8 million and \$0.7 million, respectively.

We have a policy of issuing new stock for the exercise of stock options.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

The amount of total compensation cost, by plan, for share-based compensation arrangements was as follows (in thousands):

	For the three months ended September 30,				For the nine months ended September 30,			
	2011		2010		2011		2010	
	Expense Recognized in Income	Tax Benefit	Expense Recognized in Income	Tax Benefit	Expense Recognized in Income	Tax Benefit	Expense Recognized in Income	Tax Benefit
Restricted Stock Plan	\$265	\$93	\$199	\$70	\$662	\$232	\$596	\$209
Directors' Plan	0	0	0	0	350	123	350	123
ESPP	11	4	10	3	30	11	26	9
PSP	702	246	940	329	1,371	480	2,235	782
Total	\$978	\$342	\$1,148	\$402	\$2,414	\$845	\$3,208	\$1,123

Note 3 Computation of Earnings per Share

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Net earnings for basic and diluted earnings per share	\$6,132	\$30,831	\$24,724	\$62,730
Average basic shares outstanding	12,070	12,576	12,230	12,980
Basic earnings per share	\$0.51	\$2.45	\$2.02	\$4.83
Average basic shares outstanding	12,070	12,576	12,230	12,980
Restricted stock not yet vested	71	72	72	72
Dilutive effect of assumed option exercises	104	141	119	141
Dilutive effect of Performance Share Plan	100	124	102	98
Average diluted shares outstanding	12,344	12,913	12,524	13,292
Diluted earnings per share	\$0.50	\$2.39	\$1.97	\$4.72

Note 4 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).

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

The following table presents for each of the fair value hierarchy levels our assets and liabilities that are measured at fair value on a recurring basis at September 30, 2011 (in thousands):

	Fair Value			Total	
	Level 1	Level 2	Level 3		
Cash and cash equivalents	\$52,157	\$0	\$0	\$52,157	
Fixed maturity securities:					
U.S. government	128,001	476	4,476	132,953	
Government-sponsored entities	0	27,543	0	27,543	
State and municipal	0	409,330	0	409,330	
Mortgage-backed securities:					
Residential	0	247,822	0	247,822	
Commercial	0	25,444	0	25,444	
Total mortgage-backed securities	\$0	\$273,267	\$0	\$273,267	
Collateralized mortgage obligations	0	33,823	520	34,343	
Asset-backed securities	0	49,091	0	49,091	
Corporates	0	240,535	10,229	250,764	
Total fixed maturities	\$128,001	\$1,034,064	\$15,225	\$1,177,290	
Equity securities	33,104	1	0	33,104	
Total	\$213,262	\$1,034,065	\$15,225	\$1,262,552	
Percentage of total	16.9	% 81.9	% 1.2	% 100.0	%

Level 1 includes cash and cash equivalents, U.S. Treasury securities, an exchange-traded fund and equities invested 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, other than those backed by the U.S. Government, that are not rated by a nationally recognized statistical rating organization. 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 periodically review the third party pricing methodologies and test for significant differences between the market price used to value the security and recent sales activity.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

The following table presents the changes in the Level 3 fair value category (in thousands):

	Three months ended September 30, 2011					
	U.S. Government	State and Municipal	Mortgage- Backed Securities	Collateralized Mortgage Obligations	Corporates	Total
Balance at beginning of period	\$4,572	\$2,186	\$1,767	\$589	\$10,545	\$19,660
Total gains or (losses), unrealized or realized						
Included in net earnings	0	0	0	0	(102)	(102)
Included in other comprehensive income	34	0	0	4	(47)	(10)
Purchases	0	0	0	0	0	0
Settlements	(130)	0	0	(73)	(166)	(369)
Transfers out	0	(2,186)	(1,767)	0	0	(3,954)
Balance at end of period	\$4,476	\$0	\$0	\$520	\$10,229	\$15,225
	Nine months ended September 30, 2011					
	U.S. Government	State and Municipal	Mortgage- Backed Securities	Collateralized Mortgage Obligations	Corporates	Total
Balance at beginning of period	\$4,950	\$0	\$0	\$1,043	\$21,482	\$27,476
Total gains or (losses), unrealized or realized						
Included in net earnings	0	0	0	(2)	(207)	(209)
Included in other comprehensive income	79	24	39	17	852	1,011
Purchases	0	2,162	0	0	0	2,162
Settlements	(552)	0	(19)	(539)	(1,221)	(2,331)
Transfers in	0	0	1,747	0	0	1,747
Transfers out	0	(2,186)	(1,767)	0	(10,677)	(14,631)
Balance at end of period	\$4,476	\$0	\$0	\$520	\$10,229	\$15,225

Of the \$15.2 million fair value of securities in Level 3, which consists of 15 securities, we priced 13 based on non-binding broker quotes. We manually calculated the price of the remaining securities, which have a combined fair value of \$1.0 million, based on expected principal repayments from Bloomberg, the zero spot Treasury curve at September 30, 2011 and the average spreads to Treasury for the type and rating of the security being priced.

We transferred approximately \$4.0 million of securities in Level 3 at June 30, 2011 to Level 2 during the three months ended September 30, 2011 because we obtained a price for those securities from a third party nationally recognized pricing service. We transferred approximately \$14.6 million of securities in Level 3 at December 31, 2010 to Level 2 during the nine months ended September 30, 2011 because we obtained a price for those securities from a third party nationally recognized pricing service. We transferred approximately \$1.7 million of securities into Level 3 from Level 2 during the nine months ended September 30, 2011 because we could not obtain a price from a third party nationally recognized pricing service. There were no transfers between Levels 1 and 2 during the nine months ended September

30, 2011.

The gains or losses included in net earnings are included in the line item net realized gains on investments in the Consolidated Statements of Earnings. We recognize the net gains or losses included in other comprehensive income in 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.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 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, 2011		December 31, 2010	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Cash and cash equivalents	\$52,157	\$52,157	\$63,605	\$63,605
Available-for-sale securities				
Fixed maturities	1,177,290	1,177,290	1,177,718	1,177,718
Equity securities	33,104	33,104	42,301	42,301
Total cash and investments	\$1,262,552	\$1,262,552	\$1,283,624	\$1,283,624
Liabilities:				
Long-term debt	\$194,790	\$207,388	\$194,729	\$199,132

See Note 5 to the Consolidated Financial Statements for additional information on investments and Note 6 for additional information on long-term debt.

Note 5 Investments

We consider all fixed maturity and equity securities 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, 2011 were \$49.4 million and \$158.1 million, respectively. These proceeds are net of \$5.5 million of receivable for securities sold during the third quarter of 2011 that had not settled at September 30, 2011. The proceeds from sales of securities for the three and nine months ended September 30, 2010 were \$145.2 million and \$225.4 million, respectively. Gains or losses on securities are determined on a specific identification basis.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

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

	September 30, 2011			OTTI	Fair Value
	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	Recognized in Accumulated OCI	
Fixed maturities:					
U.S. government	\$129,098	\$3,872	\$(17	) \$0	\$132,953
Government-sponsored entities	26,605	938	0	0	27,543
State and municipal	392,858	16,554	(82	) 0	409,330
Mortgage-backed securities:					
Residential	236,751	11,072	0	0	247,822
Commercial	24,930	741	(227	) 0	25,444
Total mortgage-backed securities	\$261,681	\$11,813	\$(227	) \$0	\$273,267
Collateralized mortgage obligations	33,406	1,035	(2	) (95	) 34,343
Asset-backed securities	48,604	548	(61	) 0	49,091
Corporates	244,037	8,504	(1,723	) (54	) 250,764
Total fixed maturities	\$1,136,287	\$43,265	\$(2,112	) \$(150	) \$1,177,290
Equity securities	26,344	6,827	(67	) 0	33,104
Total	\$1,162,632	\$50,092	\$(2,179	) \$(150	) \$1,210,395
	December 31, 2010				
	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	OTTI Recognized in Accumulated OCI	Fair Value
Fixed maturities:					
U.S. government	\$167,729	\$2,897	\$(340	) \$0	\$170,286
Government-sponsored entities	40,025	1,231	(104	) 0	41,152
State and municipal	392,057	8,395	(3,170	) (287	) 396,995
Mortgage-backed securities:					
Residential	195,003	4,561	(1,533	) (416	) 197,615
Commercial	34,095	1,083	(107	) 0	35,070
Total mortgage-backed securities	\$229,098	\$5,644	\$(1,640	) \$(416	) \$232,685
Collateralized mortgage obligations	41,530	1,011	(30	) (112	) 42,398
Asset-backed securities	27,286	266	(64	) (1	) 27,486
Corporates	256,079	11,080	(442	) 0	266,717
Total fixed maturities	\$1,153,802	\$30,523	\$(5,790	) \$(817	) \$1,177,718
Equity securities	29,333	12,987	(20	) 0	42,301
Total	\$1,183,135	\$43,510	\$(5,810	) \$(817	) \$1,220,019

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

The following table sets 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, 2011									
Fixed maturities:									
U.S. government	2	\$6,865	\$(17)	0.2 %	0	\$0	\$0	0.0 %	
Government-sponsored entities	0	0	0	0.0 %	0	0	0	0.0 %	
State and municipal	9	15,100	(48)	0.3 %	4	5,697	(35)	0.6 %	
Mortgage-backed securities:									
Residential	0	0	0	0.0 %	0	0	0	0.0 %	
Commercial	2	2,149	(16)	0.7 %	4	4,613	(211)	4.4 %	
Total mortgage-backed securities	2	\$2,149	\$(16)	0.7 %	4	\$4,613	\$(211)	4.4 %	
Collateralized mortgage obligations	1	996	(2)	0.2 %	1	520	(95)	15.5 %	
Asset-backed securities	5	8,471	(60)	0.7 %	1	433	(1)	0.2 %	
Corporates	78	66,752	(1,758)	2.6 %	1	4,611	(19)	0.4 %	
Total fixed maturities	97	\$100,332	\$(1,901)	1.9 %	11	\$15,874	\$(361)	2.2 %	
Equity securities	0	0	0	0.0 %	0	0	0	0.0 %	
Total	97	\$100,332	\$(1,901)	1.9 %	11	\$15,874	\$(361)	2.2 %	

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

	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, 2010									
Fixed maturities:									
U.S. government	5	\$ 13,700	\$(340)	2.4 %	0	\$0	\$0	0.0 %	
Government-sponsored entities	3	4,442	(104)	2.3 %	0	0	0	0.0 %	
State and municipal	65	125,781	(3,457)	2.7 %	0	0	0	0.0 %	
Mortgage-backed securities:									
Residential	15	73,059	(1,949)	2.6 %	0	0	0	0.0 %	
Commercial	6	9,846	(99)	1.0 %	3	343	(8)	2.3 %	
Total mortgage-backed securities	21	\$82,904	\$(2,048)	2.4 %	3	\$343	\$(8)	2.3 %	
Collateralized mortgage obligations	3	4,433	(30)	0.7 %	2	1,043	(112)	9.7 %	
Asset-backed securities	2	1,487	(15)	1.0 %	2	455	(50)	9.9 %	
Corporates	22	29,475	(442)	1.5 %	0	0	0	0.0 %	
Total fixed maturities	121	\$262,222	\$(6,436)	2.4 %	7	\$1,841	\$(170)	8.5 %	
Equity securities	0	0	0	0.0 %	0	0	0	0.0 %	
Total	121	\$262,222	\$(6,436)	2.4 %	7	\$1,841	\$(170)	8.5 %	

The table above excludes unrealized losses on equities invested in a rabbi trust of \$66.9 thousand and \$20.0 thousand at September 30, 2011 and December 31, 2010, respectively.

Gross unrealized losses at September 30, 2011 were attributable to widening credit spreads to treasuries for corporate securities.

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 include:

- 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;
- 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;
- 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 any of the following: a fair value of less than 95% of its book value, an unrealized loss that equals or exceeds \$100,000 or one or more impairment charges recorded in the past. In addition, we review positions held related to an issuer of a previously impaired security.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 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, 2011	December 31, 2010		
Number of positions held with unrealized:				
Gains	532	466		
Losses	108	128		
Number of positions held that individually exceed unrealized:				
Gains of \$500,000	5	4		
Losses of \$500,000	0	0		
Percentage of positions held with unrealized:				
Gains that were investment grade	89	% 75		%
Losses that were investment grade	53	% 91		%
Percentage of fair value held with unrealized:				
Gains that were investment grade	97	% 93		%
Losses that were investment grade	78	% 98		%

The following table sets forth the amount of unrealized loss, excluding the rabbi trust, by age and severity at September 30, 2011 (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%*
Less than or equal to:					
Three months	\$86,150	\$(1,496	) \$(1,046	) \$(450	) \$0
Six months	7,218	(191	) (94	) (50	) (47
Nine months	4,454	(117	) (42	) (75	) 0
Twelve months	5,282	(126	) (43	) 0	(82
Greater than twelve months	13,102	(332	) (237	) 0	(95
Total	\$116,207	\$(2,262	) \$(1,462	) \$(575	) \$(225

* As a percentage of amortized cost or cost.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

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

	Pre-tax Fixed Maturities	Equity Securities	Tax Effects	Net
Nine months ended September 30, 2011				
Unrealized holding gains (losses) on securities arising during the period	\$ 19,943	\$ (3,460	) \$ (5,769	) \$ 10,714
Realized (gains) losses on securities sold	(4,126	) (2,748	) 2,406	(4,468
Impairment loss recognized in earnings	1,270	0	(444	) 825
Change in unrealized gains (losses) on marketable securities, net	\$ 17,087	\$ (6,207	) \$ (3,808	) \$ 7,072
Nine months ended September 30, 2010				
Unrealized holding gains (losses) on securities arising during the period	\$ 33,290	\$ 1,399	\$ (12,141	) \$ 22,548
Realized (gains) losses on securities sold	(9,530	) 0	3,336	(6,194
Impairment loss recognized in earnings	1,947	4	(683	) 1,268
Change in unrealized gains (losses) on marketable securities, net	\$ 25,706	\$ 1,403	\$ (9,488	) \$ 17,621

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 to amortized cost, we separate the amount of the impairment into a credit loss component and the amount due to all other factors. 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):

At December 31, 2010	\$ 1,828
Additions for:	
Previously impaired securities	37
Newly impaired securities	694
Reductions for:	
Securities sold and pay downs	(519
At September 31, 2011	) \$ 2,040

The table below sets forth the scheduled maturities of fixed maturity securities at September 30, 2011, 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.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

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	\$ 100,726	\$ 10	\$ 3,000	\$ 103,736	\$ 102,179
After one year through five years	339,580	56,181	382	396,143	382,655
After five years through ten years	211,283	38,248	471	250,002	239,512
After ten years	63,907	4,586	2,216	70,709	68,251
Mortgage-backed, asset-backed and collateralized mortgage obligations	339,519	17,181	0	356,700	343,690
	\$ 1,055,014	\$ 116,207	\$ 6,069	\$ 1,177,290	\$ 1,136,287

Note 6 Long-Term Debt

In February 2004, we issued \$200 million principal of senior notes due February 2014 (the "Senior Notes"). The Senior Notes accrue interest at an effective yield of 5.55% and bear a coupon of 5.5%, payable semiannually. At the time we issued the notes, we capitalized \$2.1 million of debt issuance costs, which we are amortizing over the term of the Senior Notes. During 2009, we repurchased \$5.0 million of our debt, bringing the outstanding principal to \$195.0 million. We calculated the September 30, 2011 fair value of \$207.4 million using a 231 basis point spread to the three-year U.S. Treasury Note of 0.403%.

In August 2011, 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, 2011, there were no borrowings outstanding under the Credit Agreement.

Note 7 Income Taxes

The provision for income taxes for the three and nine months ended September 30, 2011 was \$1.1 million and \$5.3 million, respectively, compared to \$10.8 million and \$25.2 million, respectively, for the same periods of 2010. The following table reconciles our income taxes at statutory rates to our effective provision for income taxes (in thousands):

	For the three months ended September 30,		For the nine months ended September 30,	
	2011	2010	2011	2010
Earnings before income taxes	\$7,271	\$41,641	\$30,067	\$87,899
Income taxes at statutory rates	\$2,545	\$ 14,574	\$ 10,523	\$ 30,765
Effect of:				
Dividends-received deduction	(35)	(43)	(101)	(117)
Tax-exempt interest	(887)	(895)	(2,647)	(2,667)
Adjustment to valuation allowance	(510)	(2,849)	(2,454)	(2,872)
Other	25	23	21	60
Provision for income taxes	\$ 1,139	\$ 10,810	\$ 5,343	\$ 25,169

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GAAP effective tax rate	15.7	%	26.0	%	17.8	%	28.6	%
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During the nine months ended September 30, 2011, we decreased our tax valuation allowance by approximately \$2.5 million. This adjustment is due to both a decrease in the reserve for other-than-temporary impaired securities and utilization of our capital loss carryforward.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

Note 8 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,	
	2011	2010	2011	2010
Income tax payments	\$0	\$9,400	\$9,203	\$31,000
Interest payments on debt	5,363	5,363	10,725	10,725

Negative Cash Book Balances

Negative cash book balances, included in the line item "Other liabilities" in the Consolidated Balance Sheets, were \$0.6 million and \$27.7 million, respectively, at September 30, 2011 and December 31, 2010.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

Note 9 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,	
	2011	2010	2011	2010
Balance at Beginning of Period				
Unpaid losses on known claims	\$ 188,189	\$ 170,692	\$ 180,334	\$ 164,134
IBNR losses	160,992	185,553	164,140	193,790
LAE	133,928	146,022	133,359	151,191
Total unpaid losses and LAE	483,108	502,267	477,833	509,114
Reinsurance recoverables	(14,880)	(18,574)	(16,521)	(17,715)
Unpaid losses and LAE, net of reinsurance recoverables	468,228	483,693	461,312	491,399
Current Activity				
Loss and LAE incurred:				
Current accident year	190,459	169,094	561,846	505,982
Prior accident years	4,816	(16,790)	4,839	(53,755)
Total loss and LAE incurred	195,275	152,304	566,685	452,227
Loss and LAE payments:				
Current accident year	(131,711)	(114,387)	(301,638)	(262,287)
Prior accident years	(53,016)	(41,376)	(247,582)	(201,105)
Total loss and LAE payments	(184,727)	(155,763)	(549,220)	(463,393)
Balance at End of Period				
Unpaid losses and LAE, net of reinsurance recoverables	478,777	480,234	478,777	480,234
Add back reinsurance recoverables	14,754	17,221	14,754	17,221
Total unpaid losses and LAE	\$ 493,531	\$ 497,454	\$ 493,531	\$ 497,454
Unpaid losses on known claims	\$ 194,164	\$ 173,542	\$ 194,164	\$ 173,542
IBNR losses	162,809	182,666	162,809	182,666
LAE	136,557	141,247	136,557	141,247
Total unpaid losses and LAE	\$ 493,531	\$ 497,454	\$ 493,531	\$ 497,454

Increases in severities in both liability coverage in California as well as personal injury protection coverage in Florida relating to accident year 2010 were the primary source of the unfavorable development during the third quarter of 2011. An increase in severity in Florida personal injury protection coverage related to accident year 2010 was the primary source of the unfavorable development during the nine months ended September 30, 2011.

Bodily injury and property damage coverage in California, Florida, Pennsylvania, Texas and Connecticut as well as the Commercial Vehicle product related to accident years 2009, 2008 and 2007 were the primary source of the \$53.8 million of favorable reserve development during the nine months ended September 30, 2010.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

Note 10 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, 2010 and the Form 10-Q for the quarter ended June 30, 2011. 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, 2010 and to Note 10 Commitments and Contingencies in the Form 10-Q for the quarter ended June 30, 2011.

Contingencies

There have been no material changes from the contingencies discussed in the Form 10-K for the year ended December 31, 2010. For a description of our previously reported contingencies, refer to Note 14 Commitments and Contingencies, in the Form 10-K for the year ended December 31, 2010.

Note 11 Subsequent Events

Effective October 27, 2011 we entered into a definitive agreement to sell two inactive shell insurance subsidiaries to an unaffiliated third party for statutory surplus plus \$4.0 million. The sale is expected to close by December 31, 2011, pending regulatory approval. In the future, we intend to sell or dissolve other inactive shell companies. The primary reason for the sale of these shell companies is to reduce the administrative costs to maintain licenses in companies not needed to support our insurance operations.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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), rising bodily injury loss cost trends, undesired business mix or risk profile for new business, elevated unemployment rates and the proliferation of illegal immigration legislation in 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 twelve months ended December 31, 2010.

OVERVIEW

We continued to generate strong premium growth in the third quarter of 2011. This quarter marks the eighth consecutive quarter that we have experienced growth in written premiums. This increase is a result of multiple factors, including agency incentives, a shift in business mix towards policies offering broader coverage, rate decreases in certain states and competitors' rate increases in certain states. 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, 2011 were \$6.1 million and \$0.50, respectively, compared to \$30.8 million and \$2.39, respectively, for the three months ended September 30, 2010. Net earnings and diluted earnings per share for the nine months ended September 30, 2011 were \$24.7 million and \$1.97, respectively, compared to \$62.7 million and \$4.72, respectively, for the nine months ended September 30, 2010. The decrease in diluted earnings per share for the three and nine months ended September 30, 2011 is primarily due to unfavorable development in 2011 versus favorable development in 2010.

We had a net realized gain on investments of \$0.7 million for the three months ended September 30, 2011 and a net realized gain of \$8.0 million for the three months ended September 30, 2010. We had a net realized gain on investments of \$5.6 million for the first nine months of 2011, compared to a net realized gain of \$7.6 million for the same period of 2010. Included in the net realized gain for the third quarter of 2011 is \$0.4 million of other-than-temporary impairments on fixed income securities compared with \$0.2 million of impairments on fixed income securities during the third quarter of 2010. Included in the net realized gain for the first nine months of 2011 is \$1.3 million of other-than-temporary impairments on fixed income securities compared with \$2.0 million of impairments on fixed income and equity securities during the first nine months of 2010.

Included in net earnings for the three and nine months ended September 30, 2011 were \$3.1 million (\$4.8 million pre-tax) and \$3.1 million (\$4.8 million pre-tax), respectively, of unfavorable development on prior accident year loss and LAE reserves. This compares to \$10.9 million (\$16.8 million pre-tax) and \$34.9 million (\$53.8 million pre-tax), respectively, of favorable development for the three and nine months ended September 30, 2010. The following table displays combined ratio results by accident year developed through September 30, 2011.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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

Accident Year	Accident Year Combined Ratio Developed Through				Prior Accident Year Favorable / (Unfavorable) Development		(\$ in millions) Prior Accident Year Favorable / (Unfavorable) Development	
	Dec. 2009	Dec. 2010	June 2011	Sep. 2011	Q3 2011	YTD 2011	Q3 2011	YTD 2011
Prior							\$(0.9)	\$(0.8)
2004	85.4 %	85.0 %	85.0 %	84.9 %	0.0 %	0.1 %	0.2 %	0.8
2005	88.6 %	88.1 %	88.0 %	88.0 %	0.0 %	0.1 %	0.4 %	1.4
2006	91.3 %	90.6 %	90.5 %	90.4 %	0.1 %	0.2 %	0.8 %	2.2
2007	94.0 %	92.8 %	92.6 %	92.5 %	0.0 %	0.3 %	0.5 %	2.9
2008	94.1 %	92.1 %	91.8 %	91.8 %	0.0 %	0.3 %	(0.1) %	2.8
2009	96.2 %	93.0 %	93.0 %	93.0 %	0.0 %	0.0 %	0.1 %	(0.2)
2010		97.7 %	98.6 %	99.3 %	(0.7) %	(1.5) %	(6.0) %	(14.0)
2011 YTD			98.7 %	98.2 %	%		\$(4.8)	\$(4.8)

Recent accident years are less developed than prior years and must be interpreted with caution. However, the upward trend in the 2010 and 2011 accident year combined ratios reflects an increase in new business during 2010 and 2011. Our new business combined ratios typically run 20 to 30 points higher than renewal business combined ratios due to higher commission and acquisition expenses as well as typically higher loss ratios.

Increases in severities in both liability coverage in California as well as personal injury protection coverage in Florida relating to accident year 2010 were the primary source of the unfavorable development during the third quarter of 2011. An increase in severity in Florida personal injury protection coverage related to accident year 2010 was the primary source of the unfavorable development during the nine months ended September 30, 2011. See Results of Operations – Underwriting – Profitability for a more detailed discussion of our underwriting results.

Our book value per share increased 3.4% from \$53.03 at December 31, 2010 to \$54.83 at September 30, 2011. This increase was primarily due to earnings, net of shareholder dividends, for the nine months ended September 30, 2011.

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 (“Urban Zones”) identified within selected Focus States that we believe offer the greatest opportunity for premium growth and profitability.

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

• “Focus States” – We have identified Urban Zones in these states, which include Arizona, California, Florida, Georgia, Illinois, Nevada, Pennsylvania and Texas.

- “Maintenance States” – We are maintaining our writings in these states, which include Alabama, Colorado, South Carolina and Tennessee. We believe each state offers us an opportunity for underwriting profit.
- “Other States” – Includes eight states where we maintain a renewal book of personal auto business.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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

We further classify territories within the Focus States into two categories:

•“Urban Zones” – include the following urban areas:

Arizona – Phoenix and Tucson

California – Bay Area, Los Angeles, Sacramento, San Diego, and San Joaquin Valley

Florida – Jacksonville, Miami, Orlando, Sarasota and Tampa

Georgia – Atlanta

Illinois – Chicago

Nevada – Las Vegas

Pennsylvania – Allentown and Philadelphia

Texas – Dallas, Fort Worth, Houston and San Antonio

•“Non-urban Zones” – include all remaining areas in the Focus States located outside of a designated Urban Zone.

We continually evaluate our market opportunities; thus, the Focus States, Urban Zones, Maintenance States and Other States may change over time as new market opportunities arise, as the allocation of resources changes or as regulatory environments change. In the tables below, we have restated 2010 premium, policies in force and combined ratios to be consistent with the 2011 definition of Urban Zones, Focus States, Maintenance States and Other States.

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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,			
	2011	2010	Change	% Change
Net earned premium				
Gross written premium				
Personal Auto				
Focus States				
Urban Zones	\$216,951	\$195,341	\$21,610	11.1
Non-urban Zones	29,929	26,524	3,405	12.8
Total Focus States	246,880	221,866	25,014	11.3
Maintenance States	4,072	4,173	(101)	(2.4)
Other States	1,629	1,940	(312)	(16.1)
Total Personal Auto	252,581	227,979	24,602	10.8
Commercial Vehicle	15,538	13,048	2,490	19.1
Classic Collector	3,010	2,822	188	6.6
Total gross written premium	271,129	243,850	27,279	11.2
Ceded reinsurance	(1,575)	(1,433)	(142)	9.9
Net written premium	269,554	242,417	27,137	11.2
Change in unearned premium	(14,417)	(9,914)	(4,502)	45.4
Net earned premium	\$255,138	\$232,503	\$22,635	9.7
	Nine months ended September 30,			
	2011	2010	Change	% Change
Net earned premium				
Gross written premium				
Personal Auto				
Focus States				
Urban Zones	\$649,123	\$581,201	\$67,923	11.7
Non-urban Zones	90,082	83,947	6,135	7.3
Total Focus States	739,205	665,148	74,057	11.1
Maintenance States	12,551	12,866	(315)	(2.4)
Other States	5,534	6,694	(1,160)	(17.3)
Total Personal Auto	757,290	684,708	72,583	10.6
Commercial Vehicle	47,878	43,266	4,612	10.7
Classic Collector	8,456	7,936	520	6.6
Total gross written premium	813,625	735,909	77,715	10.6
Ceded reinsurance	(4,810)	(4,073)	(736)	18.1
Net written premium	808,815	731,836	76,979	10.5
Change in unearned premium	(63,112)	(61,677)	(1,435)	2.3
Net earned premium	\$745,703	\$670,159	\$75,544	11.3

Table of Contents

INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

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

The following table summarizes our policies in force:

	At September 30,				
	2011	2010	Change	% Change	
Policies in Force					
Personal Auto					
Focus States					
Urban Zones	703,657	665,330	38,327	5.8	%
Non-urban Zones	88,335	83,510	4,825	5.8	%
Total Focus States	791,992	748,840	43,152	5.8	%
Maintenance States	15,214	14,911	303	2.0	%
Other States	4,123	5,560	(1,437)	(25.8))%
Total Personal Auto	811,329	769,311	42,018	5.5	%
Commercial Vehicle	35,042	31,761	3,281	10.3	%
Classic Collector	35,167	33,970	1,197	3.5	%
Total policies in force	881,538	835,042	46,496	5.6	%

Gross written premium grew 11.2% and 10.6% during the third quarter and first nine months of 2011, respectively, compared with the same periods of 2010. During the first nine months of 2011, Infinity implemented rate revisions in various states with an overall rate increase of 1.5%. Policies in force at September 30, 2011 increased 5.6% compared with the same period in 2010. Gross written premium grew more than policies in force due to a shift in business mix toward policies offering broader coverage. These policies typically generate a higher premium per policy than those with coverage that is more restricted.

During the third quarter and first nine months of 2011, personal auto insurance gross written premium in our Focus States grew 11.3% and 11.1%, respectively, when compared with the same periods of 2010. The increase in gross written premium is primarily due to growth in California, Florida, Georgia and Texas.

California gross written premium grew 8.4% and 11.2% during the third quarter and first nine months of 2011, respectively. Increased agency incentives, rate actions taken by competitors and a shift in business mix to policies offering broader coverage have stimulated premium growth in the state.

Florida gross written premium grew 35.3% and 12.3% during the third quarter and first nine months of 2011, respectively. This growth is primarily a result of higher business retention and competitor rate increases.

Georgia gross written premium grew 24.0% and 21.7% during the third quarter and first nine months of 2011, respec