INFINITY PROPERTY & CASUALTY CORP
Form 10-Q
May 03, 2012
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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 31, 2012
OR
o 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	03-0483872
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

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 x 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 x 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	x
Non-accelerated filer	o (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 x
As of April 30, 2012 there were 11,811,143 shares of the registrant's common stock outstanding.

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	EXHIBIT INDEX
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.
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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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

PART I
FINANCIAL INFORMATION

ITEM 1
Financial Statements

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(in thousands, except per share data)
(unaudited)

	Three months ended March 31,		
	2012	2011 (as adjusted)	% Change
Revenues:			
Earned premium	$277,149	$238,981	16.0 %
Net investment income	9,746	10,332	(5.7)%
Net realized gains on investments[1]	238	2,923	(91.9)%
Other income	269	52	417.1 %
Total revenues	287,402	252,288	13.9 %
Costs and Expenses:			
Losses and loss adjustment expenses	214,778	178,957	20.0 %
Commissions and other underwriting expenses	62,140	56,265	10.4 %
Interest expense	2,702	2,701	0.0 %
Corporate general and administrative expenses	2,016	1,738	16.0 %
Other expenses	244	20	1,095.6 %
Total costs and expenses	281,880	239,681	17.6 %
Earnings before income taxes	5,522	12,607	(56.2)%
Provision for income taxes	1,228	2,376	(48.3)%
Net Earnings	$4,294	$10,231	(58.0)%
Net Earnings per Common Share:			
Basic	$0.37	$0.83	(55.4)%
Diluted	0.35	0.81	(56.8)%
Average Number of Common Shares:			
Basic	11,728	12,345	(5.0)%
Diluted	12,100	12,685	(4.6)%
Cash Dividends per Common Share	$0.225	$0.180	25.0 %
[1]Net realized gains before impairment losses	$886	$3,547	(75.0)%
Total other-than-temporary impairment (OTTI) losses	(616)	(1,608)	(61.7)%
Non-credit portion in other comprehensive income	1	1,017	(99.9)%
OTTI losses reclassified from other comprehensive income	(32)	(33)	(1.4)%
Net impairment losses recognized in earnings	(648)	(624)	3.8 %
Total net realized gains on investments	$238	$2,923	(91.9)%

See Condensed Notes to Consolidated Financial Statements.

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three months ended March 31,	
	2012	2011 (as adjusted)
Net earnings	$4,294	$10,231
Other comprehensive income (loss) before tax:		
Net change in postretirement benefit liability	(6)	(16)
Unrealized gains (losses) on investments:		
Unrealized holding gains arising during the period	6,663	1,377
Less: Reclassification adjustments for gains included in net income	(238)	(2,923)
Unrealized gains (losses) on investments, net	6,425	(1,546)
Other comprehensive income (loss), before tax	6,419	(1,562)
Income tax (expense) benefit related to components of other comprehensive income	(2,247)	547
Other comprehensive income (loss), net of tax	4,173	(1,015)
Comprehensive income	$8,467	$9,215

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	March 31, 2012	December 31, 2011
	(unaudited)	(as adjusted)
Assets		
Investments:		
Fixed maturities – at fair value (amortized cost $1,180,646 and $1,144,687)	$1,225,837	$1,187,987
Equity securities – at fair value (cost $26,488 and $26,413)	41,539	36,930
Total investments	$1,267,376	$1,224,917
Cash and cash equivalents	61,295	83,767
Accrued investment income	11,368	10,761
Agents' balances and premium receivable, net of allowances for doubtful accounts of $13,084 and $13,497	435,243	382,621
Property and equipment, net of accumulated depreciation of $39,479 and $37,551	40,968	38,694
Prepaid reinsurance premium	2,198	2,131
Recoverables from reinsurers (includes $88 and $79 on paid losses and LAE)	15,792	14,719
Deferred policy acquisition costs	91,106	80,071
Current and deferred income taxes	7,426	10,728
Receivable for securities sold	75	1,152
Other assets	7,822	5,535
Goodwill	75,275	75,275
Total assets	$2,015,944	$1,930,371
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	$513,930	$495,403
Unearned premium	541,605	474,528
Payable to reinsurers	185	45
Long-term debt (fair value $204,937 and $207,246)	194,831	194,810
Commissions payable	34,519	30,605
Payable for securities purchased	7,665	10,818
Other liabilities	55,225	62,373
Total liabilities	$1,347,961	$1,268,582
Commitments and contingencies (See Note 10)		
Shareholders' equity:		
Common stock, no par value (50,000,000 shares authorized; 21,346,577 and 21,331,006 shares issued)	$21,407	$21,358
Additional paid-in capital	357,521	355,911
Retained earnings	654,061	652,423
Accumulated other comprehensive income, net of tax	39,491	35,319
Treasury stock, at cost (9,547,169 and 9,524,369 shares)	(404,497)	(403,221)
Total shareholders' equity	$667,983	$661,789
Total liabilities and shareholders' equity	$2,015,944	$1,930,371

See 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, 2010	$21,228	$349,742	$625,492	$24,488	$(359,766)	$661,184
Cumulative effect of change in accounting principle	—	—	(6,157)	—	—	(6,157)
Net earnings	—	—	10,231	—	—	10,231
Net change in postretirement benefit liability	—	—	—	(10)	—	(10)
Change in unrealized gain on investments	—	—	—	(929)	—	(929)
Change in non-credit component of impairment losses on fixed maturities	—	—	—	(76)	—	(76)
Comprehensive income						$9,215
Dividends paid to common shareholders	—	—	(2,232)	—	—	(2,232)
Shares issued and share-based compensation expense, including tax benefit	61	2,031	—	—	—	2,091
Acquisition of treasury stock	—	—	—	—	(6,898)	(6,898)
Balance at March 31, 2011, as adjusted	$21,288	$351,773	$627,333	$23,473	$(366,665)	$657,203
Net earnings	$—	$—	$31,602	$—	$—	$31,602
Net change in postretirement benefit liability	—	—	—	(166)	—	(166)
Change in unrealized gain on investments	—	—	—	10,650	—	10,650
Change in non-credit component of impairment losses on fixed maturities	—	—	—	1,362	—	1,362
Comprehensive income						$43,448
Dividends paid to common shareholders	—	—	(6,513)	—	—	(6,513)
Shares issued and share-based compensation expense, including tax benefit	69	4,138	—	—	—	4,207
Acquisition of treasury stock	—	—	—	—	(36,556)	(36,556)
Balance at December 31, 2011, as adjusted	$21,358	$355,911	$652,423	$35,319	$(403,221)	$661,789
Net earnings	$—	$—	$4,294	$—	$—	$4,294
Net change in postretirement benefit liability				(4)		(4)
Change in unrealized gain on investments	—	—	—	3,891	—	3,891
Change in non-credit component of impairment losses on fixed maturities	—	—	—	285	—	285
Comprehensive income						$8,467
Dividends paid to common shareholders	—	—	(2,656)	—	—	(2,656)

Shares issued and share-based compensation expense, including tax benefit	49	1,610	—	—	—	1,660
Acquisition of treasury stock	—	—	—	—	(1,277)	(1,277)
Balance at March 31, 2012	$21,407	$357,521	$654,061	$39,491	$(404,497)	$667,983

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)

	Three months ended March 31, 2012	2011 (as adjusted)
Operating Activities:		
Net earnings	$4,294	$10,231
Adjustments:		
Depreciation	1,928	2,544
Amortization	2,203	2,073
Net realized gains on investments	(238)	(2,923)
Loss on disposal of property and equipment	25	201
Share-based compensation expense	1,177	641
Activity related to rabbi trust	52	15
(Increase) decrease in accrued investment income	(607)	637
Increase in agents’ balances and premium receivable	(52,622)	(32,669)
Increase in reinsurance receivables	(1,141)	(302)
Increase in deferred policy acquisition costs	(11,035)	(7,712)
(Increase) decrease in other assets	(1,233)	505
Increase (decrease) in unpaid losses and loss adjustment expenses	18,526	(4,305)
Increase in unearned premium	67,077	42,716
Increase (decrease) in payable to reinsurers	140	(42)
(Decrease) increase in other liabilities	(6,945)	7,597
Net cash provided by operating activities	21,602	19,208
Investing Activities:		
Purchases of and additional investments in:		
Fixed maturities	(124,018)	(142,612)
Property and equipment	(642)	(1,915)
Maturities and redemptions of fixed maturities	47,207	67,353
Sales of:		
Fixed maturities	36,818	52,855
Equity securities	0	4,877
Net cash used in investing activities	(40,635)	(19,441)
Financing Activities:		
Proceeds from stock options exercised and employee stock purchases, including tax benefit	482	1,450
Acquisition of treasury stock	(1,266)	(7,069)
Dividends paid to shareholders	(2,656)	(2,232)
Net cash used in financing activities	(3,440)	(7,851)
Net decrease in cash and cash equivalents	(22,473)	(8,084)
Cash and cash equivalents at beginning of period	83,767	63,605
Cash and cash equivalents at end of period	$61,295	$55,521

See Condensed Notes to Consolidated Financial Statements.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2012
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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, 2011. 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 March 31, 2012 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.
Recently Adopted Accounting Standards

Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts
In October 2010, the Financial Accounting Standards Board ("FASB") issued an accounting standards update related to the
accounting for the deferral of costs associated with successful acquisition or renewal of insurance contracts (deferred policy acquisition costs). This standard is intended to reduce diversity in practice. We adopted this standard as of January 1, 2012. Pursuant to the guidance, we elected to adopt this standard on a retrospective basis and recognized an adjustment to beginning retained earnings for the earliest period shown of $6.2 million, net of taxes.

The following table illustrates the effect of adopting this standard on the Consolidated Balance Sheets (in millions):

Condensed Notes to Consolidated Financial Statements

	December 31, 2011		
	As Reported	As Adjusted	Difference
Deferred policy acquisition costs	$89.9	$80.1	$(9.8)
Current and deferred income taxes	7.3	10.7	3.4
Total assets	1,936.8	1,930.4	(6.4)
Shareholders' equity	668.2	661.8	(6.4)

The following table illustrates the effect of adopting this standard on the Consolidated Statements of Earnings (in millions, except per share amounts):

	Three months ended March 31, 2011		
	As Reported	As Adjusted	Difference
Commissions and other underwriting expenses	$55.1	$56.3	$1.2
Provision for income taxes	2.8	2.4	(0.4)
Net earnings	11.0	10.2	(0.7)
Net earnings per common share:			
Basic	$0.89	$0.83	$(0.06)
Diluted	0.87	0.81	(0.06)

We also adjusted the Consolidated Statement of Cash Flows for these changes for the three months ended March 31, 2011.

Presentation of Comprehensive Income

In June and December 2011, the FASB issued guidance amending the presentation of comprehensive income and its components. We adopted this standard as of January 1, 2012. Under the new guidance, a reporting entity has the option to present comprehensive income in a single continuous statement or in two separate but consecutive statements, as we elected. The impact of adoption was not material to our results of operations or financial position.

Amendments to Fair Value Measurement and Disclosure Requirements

In May 2011, the FASB issued guidance that clarifies the application of existing fair value measurement and disclosure requirements and amends certain fair value measurement principles, requirements and disclosures. We adopted this standard as of January 1, 2012. The impact of adoption was not material to our results of operations or financial position. Additional disclosures required by this standard are located in Note 4 to the Consolidated Financial Statements.

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.

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 March 31, 2012. 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 March 31, 2012. 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. 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 and 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 48,881 as of March 31, 2012. 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 2012 and 2011, we issued 49,098 and 32,957 shares, respectively, 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 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:

Condensed Notes to Consolidated Financial Statements

	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 at March 31, 2012	79,050		99,305	

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, 2011	192,455	$ 23.40		
Granted	0	0		
Exercised	(14,100)	$ 16.00		
Forfeited	0	0		
Outstanding at March 31, 2012	178,355	$ 23.98	1.33	$5.1
Vested at March 31, 2012	178,355	$ 23.98	1.33	$5.1
Exercisable at March 31, 2012	178,355	$ 23.98	1.33	$5.1

(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.

Cash received from option exercises for the three months ended March 31, 2012 and 2011 was approximately $0.2 million and $0.8 million, respectively. The actual tax benefit realized for the tax deductions from options exercised totaled $0.2 million and $0.5 million for the three months ended March 31, 2012 and March 31, 2011, respectively. The total intrinsic value of options exercised during the three months ended March 31, 2012 and 2011 was approximately $0.5 million and $1.8 million, respectively.

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

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

	Three months ended March 31,			
	2012		2011	
	Expense Recognized in Income	Tax Benefit	Expense Recognized in Income	Tax Benefit
Restricted Stock Plan	$298	$104	$199	$70
ESPP	11	0	10	0
PSP	880	308	443	155
Total	$1,188	$412	$651	$224

Note 3 Computation of Net Earnings per Share

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

	Three months ended March 31,	
	2012	2011
Net earnings for basic and diluted net earnings per share	$4,294	$10,231
Average basic shares outstanding	11,728	12,345
Basic net earnings per share	$0.37	$0.83
Average basic shares outstanding	11,728	12,345
Restricted stock not yet vested	72	72
Dilutive effect of assumed option exercises	110	143
Dilutive effect of Performance Share Plan	189	125
Average diluted shares outstanding	12,100	12,685
Diluted net earnings per share	$0.35	$0.81

Note 4 Fair Value

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).

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 March 31, 2012 (in thousands):

	Fair Value Level 1		Level 2		Level 3		Total	
Cash and cash equivalents	$61,295		$0		$0		$61,295	
Fixed maturity securities:								
U.S. government	106,033		394		3,897		110,324	
Government-sponsored enterprises	0		70,630		0		70,630	
State and municipal	0		417,749		0		417,749	
Mortgage-backed securities:								
Residential	0		241,962		0		241,962	
Commercial	0		16,644		0		16,644	
Total mortgage-backed securities	$0		$258,606		$0		$258,606	
Collateralized mortgage obligations	0		27,011		499		27,510	
Asset-backed securities	0		62,899		0		62,899	
Corporates	0		268,474		9,644		278,118	
Total fixed maturities	$106,033		$1,105,764		$14,040		$1,225,837	
Equity securities	41,539		0		0		41,539	
Total	$208,866		$1,105,764		$14,040		$1,328,671	
Percentage of total	15.7	%	83.2	%	1.1	%	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

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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.

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

	Three months ended March 31, 2012					
	U.S. Government	State and Municipal	Mortgage-Backed Securities	Collateralized Mortgage Obligations	Corporates	Total
Balance at beginning of period	$4,438	$0	$0	$509	$10,426	$15,374
Total gains or (losses), unrealized or realized						
Included in net earnings	0	0	0	0	(582)	(582)
Included in other comprehensive income	(85)	0	0	2	605	522
Purchases	0	0	0	0	0	0
Sales	0	0	0	0	(253)	(253)
Settlements	(456)	0	0	(12)	(350)	(818)
Transfers in	0	0	0	0	867	867
Transfers out	0	0	0	0	(1,070)	(1,070)
Balance at end of period	$3,897	$0	$0	$499	$9,644	$14,040

Of the $14.0 million fair value of securities in Level 3, which consists of 13 securities, we priced 5 based on non-binding broker quotes. We manually calculated the price of 2 securities, which have a combined fair value of $0.9 million. Quantitative information about about the significant unobservable inputs used in the fair value measurement of these manually priced securities at March 31, 2012 is as follows (in millions):

	Fair Value	Valuation Technique	Unobservable Input	Value Used
Corporate bond	$0.1	Recovery rate[1]	Probability of default	100%
Corporate bond	0.8	Discounted cash flow	Comparable credit rating	Ba1
Total	$0.9			

[1] Recovery rate for senior unsecured bonds as indicated in Moody's Investor's Service Annual Default Study: Corporate Default and Recovery Rates, 1920-2011.

The significant unobservable inputs used in the fair value measurement of our manually-priced corporate bonds are a probability of default assumption and an assigned credit rating. Significant increases (decreases) in either of these inputs in isolation could result in a significantly lower (higher) fair value measurement. Generally, a reduction in probability of default would increase security valuation. A change in the credit rating assumption would change the yield spread associated with that bond, and thus the yield used in discounting the cash flows to arrive at the security’s valuation.

We transferred approximately $1.1 million of securities in Level 3 at December 31, 2011 to Level 2 during the three months ended March 31, 2012 because we obtained a price for those securities from a nationally recognized pricing service. We transferred approximately $0.9 million of securities into Level 3 from Level 2 during the three months ended March 31, 2012 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 three months ended March 31, 2012.

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 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.

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

	March 31, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Cash and cash equivalents	$61,295	$61,295	$83,767	$83,767
Available-for-sale securities				
Fixed maturities	1,225,837	1,225,837	1,187,987	1,187,987
Equity securities	41,539	41,539	36,930	36,930
Total cash and investments	$1,328,671	$1,328,671	$1,308,684	$1,308,684
Liabilities:				
Long-term debt	$194,831	$204,937	$194,810	$207,246

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

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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 months ended March 31, 2012 and 2011 were $36.8 million and $57.7 million, respectively. These proceeds are net of $0.1 million of receivable for securities sold that had not settled at March 31, 2012 . Gains or losses on securities are determined on a specific identification basis.

Condensed Notes to Consolidated Financial Statements

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

	March 31, 2012				
	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	OTTI Recognized in Accumulated OCI	Fair Value
Fixed maturities:					
U.S. government	$107,818	$2,602	$(95)	$0	$110,324
Government-sponsored enterprises	69,608	1,038	(16)	0	70,630
State and municipal	399,977	17,887	(115)	0	417,749
Mortgage-backed securities:					
Residential	231,420	10,597	(56)	0	241,962
Commercial	15,844	844	(44)	(1)	16,644
Total mortgage-backed securities	$247,264	$11,442	$(100)	$(1)	$258,606
Collateralized mortgage obligations	26,935	698	(32)	(91)	27,510
Asset-backed securities	62,641	456	(198)	0	62,899
Corporates	266,402	11,973	(221)	(35)	278,118
Total fixed maturities	$1,180,646	$46,095	$(776)	$(127)	$1,225,837
Equity securities	26,488	15,050	0	0	41,539
Total	$1,207,134	$61,145	$(776)	$(127)	$1,267,376

	December 31, 2011				
	Amortized Cost or Cost	Gross Unrealized Gains	Gross Unrealized Losses	OTTI Recognized in Accumulated OCI	Fair Value
Fixed maturities:					
U.S. government	$124,378	$3,428	$(8)	$0	$127,798
Government-sponsored enterprises	55,220	958	(9)	0	56,170
State and municipal	391,436	18,016	(63)	0	409,388
Mortgage-backed securities:					
Residential	225,506	10,878	(14)	0	236,370
Commercial	19,751	760	(142)	0	20,369
Total mortgage-backed securities	$245,257	$11,638	$(156)	$0	$256,739
Collateralized mortgage obligations	27,447	757	(9)	(93)	28,103
Asset-backed securities	48,403	368	(143)	0	48,628
Corporates	252,546	9,688	(1,004)	(68)	261,162
Total fixed maturities	$1,144,687	$44,853	$(1,391)	$(161)	$1,187,987
Equity securities	26,413	10,554	(38)	0	36,930
Total	$1,171,100	$55,408	$(1,429)	$(161)	$1,224,917

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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
March 31, 2012								