

INFINITY PROPERTY & CASUALTY CORP
Form 10-Q
August 08, 2005
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended June 30, 2005

Commission File No. 0-50167

INFINITY PROPERTY AND CASUALTY CORPORATION

**Incorporated under
the Laws of Ohio**

**IRS Employer Identification
Number 03-0483872**

3700 Colonnade Parkway, Birmingham, Alabama 35243

(205) 870-4000

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

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Indicate by check mark whether the Registrant is an accelerated filer. Yes No

As of August 1, 2005, there were 20,703,015 shares of the Registrant's Common Stock outstanding.

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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			Six months ended		
	June 30,			June 30,		
	2005	2004	% Change	2005	2004	% Change
Income:						
Earned premiums	\$ 248,028	\$ 218,791	13.4%	\$ 478,769	\$ 429,093	11.6%
Net investment income	16,124	17,096	(5.7)%	32,734	33,091	(1.1)%
Realized gains on investments	8,431	1,436	487.1%	20,511	3,046	573.4%
Other income	952	1,058	(10.0)%	2,160	3,341	(35.4)%
	<u>273,535</u>	<u>238,381</u>	<u>14.7%</u>	<u>534,174</u>	<u>468,571</u>	<u>14.0%</u>
Costs and Expenses:						
Losses and loss adjustment expenses	171,285	147,126	16.4%	332,504	298,197	11.5%
Commissions and other underwriting expenses	51,980	46,258	12.4%	101,102	87,352	15.7%
Interest expense	2,765	2,671	3.5%	5,530	5,074	9.0%
Corporate general and administrative expenses	1,566	1,543	1.5%	3,242	3,235	0.2%
Loss on retirement of long-term debt					3,436	
Other expenses	10,270	3,512	192.4%	19,524	8,691	124.6%
	<u>237,866</u>	<u>201,110</u>	<u>18.3%</u>	<u>461,902</u>	<u>405,985</u>	<u>13.8%</u>
Total expenses						
Earnings before income taxes	35,669	37,271	(4.3)%	72,272	62,586	15.5%
Provision for income taxes	11,979	12,449	(3.8)%	24,600	20,824	18.1%
	<u>\$ 23,690</u>	<u>\$ 24,822</u>	<u>(4.6)%</u>	<u>\$ 47,672</u>	<u>\$ 41,762</u>	<u>14.2%</u>
Net Earnings						

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Earnings per Common Share:						
Basic	\$ 1.15	\$ 1.21	(5.0)%	\$ 2.31	\$ 2.03	13.8%
Diluted	\$ 1.13	\$ 1.19	(5.0)%	\$ 2.28	\$ 2.00	14.0%
Average number of Common Shares:						
Basic	20,646	20,565	0.4%	20,627	20,549	0.4%
Diluted	20,882	20,857	0.1%	20,880	20,861	0.1%
Cash dividends per Common Share	\$.060	\$.055	9.1%	\$ 0.12	\$ 0.11	9.1%

See Notes to Consolidated Financial Statements

Table of Contents**INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q****INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****(In thousands)**

	June 30, 2005	December 31, 2004
	<u>(unaudited)</u>	
Assets		
Investments		
Fixed maturities - at market (amortized cost - \$1,161,105 and \$1,260,836)	\$ 1,180,822	\$ 1,304,080
Equity securities - at market (amortized cost - \$42,804 and \$21,529)	43,634	24,993
	<u>1,224,456</u>	<u>1,329,073</u>
Total investments	1,224,456	1,329,073
Cash and cash equivalents	227,269	112,052
Accrued investment income	15,156	16,732
Agents' balances and premiums receivable, net of allowances for doubtful accounts of \$11,812 and \$11,524	306,937	264,978
Prepaid reinsurance premiums	12,145	12,858
Recoverables from reinsurers	22,671	20,202
Deferred policy acquisition costs	79,183	68,454
Current and deferred income taxes	7,611	12,656
Prepaid expenses, deferred charges and other assets	27,398	32,658
Goodwill	75,275	75,275
	<u>1,998,101</u>	<u>1,944,938</u>
Total assets	\$ 1,998,101	\$ 1,944,938
Liabilities and Shareholders' Equity		
Unpaid losses and loss adjustment expenses	\$ 644,439	\$ 659,272
Unearned premiums	440,847	387,917
Payable to reinsurers	4,254	3,953
Long term debt (fair value - \$200,462 at June 30, 2005 and \$198,010 at December 31, 2004)	199,335	199,305
Commissions payable	29,920	25,257
Accounts payable, accrued expenses and other liabilities	102,802	121,813
	<u>1,421,597</u>	<u>1,397,517</u>
Total liabilities	1,421,597	1,397,517
Shareholders' Equity:		
Common stock, no par value		
-50,000,000 shares authorized		
-20,702,403 and 20,670,878 shares issued		
-20,698,109 and 20,670,878 shares outstanding	20,702	20,671
Additional paid-in capital	330,843	329,994
Retained earnings	211,900	166,710
Unearned compensation (restricted stock)	(149)	(314)

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Unrealized gain, net	13,346	30,360
Treasury stock, at cost (4,294 and 0 shares)	(138)	
	<u>576,504</u>	<u>547,421</u>
Total shareholders' equity	576,504	547,421
	<u>\$ 1,998,101</u>	<u>\$ 1,944,938</u>
Total liabilities and shareholders' equity	\$ 1,998,101	\$ 1,944,938

See Notes to Consolidated Financial Statements

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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	Treasury Stock	Paid-in Capital	Retained Earnings	Unrealized Gain (Loss) on Securities	Unearned Compensation	Total
Balance at December 31, 2003	\$ 20,484	\$	\$ 324,787	\$ 74,856	\$ 36,243	\$ (1,000)	\$ 455,370
Net earnings				41,762			41,762
Change in unrealized gain-investments					(18,779)		(18,779)
Change in unrealized gain-derivative					(215)		(215)
Comprehensive income							22,768
Dividends paid to common stockholders				(2,272)			(2,272)
Issuance of common stock	171		4,685				4,856
Amortization of unearned compensation						388	388
Other				284			284
Balance at June 30, 2004	\$ 20,655	\$	\$ 329,472	\$ 114,630	\$ 17,249	\$ (612)	\$ 481,394
Net earnings	\$	\$	\$	\$ 54,636	\$	\$	\$ 54,636
Change in unrealized gain-investments					13,111		13,111
Comprehensive income							67,747
Dividends paid to common stockholders				(2,272)			(2,272)
Employee stock purchases	2		63				65
Exercise of stock options	14		206				220
Amortization of unearned compensation			253			298	551
Other				(284)			(284)
Balance at December 31, 2004	\$ 20,671	\$	\$ 329,994	\$ 166,710	\$ 30,360	\$ (314)	\$ 547,421
Net earnings	\$	\$	\$	\$ 47,672	\$	\$	\$ 47,672
Change in unrealized gain-investments					(17,014)		(17,014)
Comprehensive income							30,658
Dividends paid to common stockholders				(2,482)			(2,482)
Employee stock purchases	5		137				142
Exercise of stock options	22		337				359
Stock granted to directors	4		121				125
Acquisition of treasury stock		(138)					(138)
Amortization of unearned compensation			254			165	419

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Balance at June 30, 2005	<u>\$ 20,702</u>	<u>\$ (138)</u>	<u>\$ 330,843</u>	<u>\$ 211,900</u>	<u>\$ 13,346</u>	<u>\$ (149)</u>	<u>\$ 576,504</u>
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See Notes to Consolidated Financial Statements

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	Three months ended	
	June 30,	
	2005	2004
Operating Activities:		
Net earnings	\$ 23,690	\$ 24,822
Adjustments:		
Depreciation and amortization	3,297	4,470
Realized gains on investing activities	(8,431)	(1,436)
Change in accrued investment income	399	(95)
Change in agents balances & premiums receivable	(5,026)	(1,888)
Change in reinsurance receivables	67	1,795
Change in deferred policy acquisition costs	(1,431)	(1,115)
Change in other assets	9,311	(6,328)
Change in insurance claims and reserves	2,738	(18,042)
Change in payable to reinsurers	380	(4,471)
Change in other liabilities	(9,905)	(7,955)
Other, net	(47)	(156)
Net cash provided by (used in) operating activities	15,042	(10,399)
Investing Activities:		
Purchases of and additional investments in:		
Fixed maturities	(84,605)	(78,751)
Equity securities	(19,192)	
Property and equipment	(2,091)	(962)
Maturities and redemptions of fixed maturity investments	34,564	48,790
Sales:		
Fixed maturities	185,161	35,994
Stock in subsidiary		
Equity securities	2,309	2,850
Property and equipment	270	11
Net cash provided by investing activities	116,416	7,932
Financing Activities:		
Debt issuance costs		(60)
Proceeds from stock option exercise and employee stock purchase plan	291	
Dividends paid to shareholders	(1,241)	(1,136)

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Net cash used in financing activities	(950)	(1,196)
Net Increase (Decrease) in Cash and Cash Equivalents	130,508	(3,663)
Cash and cash equivalents at beginning of period	96,761	129,595
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 227,269	\$ 125,932
	<u> </u>	<u> </u>

See Notes to Consolidated Financial Statements

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	Six months ended	
	June 30,	
	2005	2004
Operating Activities:		
Net earnings	\$ 47,672	\$ 41,762
Adjustments:		
Depreciation and amortization	7,396	8,663
Realized gains on investing activities	(20,511)	(3,046)
Change in accrued investment income	1,576	225
Change in agents balances & premiums receivable	(41,959)	(11,620)
Change in reinsurance receivables	(1,756)	17,994
Change in deferred policy acquisition costs	(10,729)	(11,224)
Change in other assets	17,343	3,231
Change in insurance claims and reserves	38,097	(13,602)
Change in payable to reinsurers	301	(15,357)
Change in other liabilities	(14,647)	4,762
Other, net	(44)	(156)
Net cash provided by operating activities	22,739	21,632
Investing Activities:		
Purchases of and additional investments in:		
Fixed maturities	(246,400)	(171,697)
Equity securities	(27,933)	
Property and equipment	(3,435)	(2,318)
Maturities and redemptions of fixed maturity investments	60,669	85,142
Sales:		
Fixed maturities	300,907	49,319
Stock in subsidiary		10,380
Equity securities	10,363	2,850
Property and equipment	301	1,383
Net cash provided by (used in) investing activities	94,472	(24,941)
Financing Activities:		
Repayment of long-term debt		(195,500)
Proceeds from senior notes		199,256
Debt issuance costs		(2,141)
Proceeds from issuance of common stock		4,856

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Proceeds from stock option exercise and employee stock purchase plan	626	
Acquisition of treasury stock	(138)	
Dividends paid to shareholders	(2,482)	(2,272)
	<u> </u>	<u> </u>
Net cash (used in) provided by financing activities	(1,994)	4,199
Net Increase in Cash and Cash Equivalents	115,217	890
Cash and cash equivalents at beginning of period	112,052	125,042
	<u> </u>	<u> </u>
Cash and cash equivalents at end of period	\$ 227,269	\$ 125,932
	<u> </u>	<u> </u>

See Notes to Consolidated Financial Statements

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 *Basis of Presentation*

The accompanying Consolidated Financial Statements are unaudited and should be read in conjunction with Infinity Property and Casualty Corporation's (Infinity or the Company) annual report on Form 10-K for the year ended December 31, 2004. This quarterly report on Form 10-Q, including the Notes to the Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations, focuses on Infinity's financial performance since the beginning of the year.

These financial statements reflect certain adjustments necessary for a fair presentation of Infinity's results of operations and financial position. Such adjustments consist of normal, recurring accruals recorded to accurately match expenses with their related revenue streams and to eliminate all significant inter-company transactions and balances. In addition, certain reclassification adjustments have been made to historical results to achieve consistency in presentation.

Certain accounts and balances within these financial statements are based upon management's estimates and assumptions. The amount of reserves for claims not yet paid, for example, is an item that can only be recorded by estimation. Unrealized capital gains and losses on investments are subject to market fluctuations and managerial judgment is required 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 effects on Infinity's results of operations could be material.

The results of operations for the periods presented may not be indicative of the Company's results for the entire year.

Table of Contents**INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED****Note 2 Stock-Based Compensation**

Infinity's Stock Option Plan and Restricted Stock Plan were established in 2002. There were 2,000,000 and 500,000 shares of Infinity common stock reserved for issuance under the Stock Option Plan and Restricted Stock Plan, respectively. Options generally become exercisable at the rate of 20% per year commencing one year after grant. For restricted stock awards, one-third of the shares vest on each of the first three anniversaries of the date of grant of the award.

<u>Options Outstanding</u>	<u>Number of Options</u>
As of December 31, 2004	603,480
Granted	
Exercised	(22,496)
Forfeited	(4,400)
As of June 30, 2005	576,584

Due to the delayed implementation date of SFAS No. 123 (revised), *Share Based Payment*, Infinity currently accounts for stock options and other stock-based compensation plans using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. The fair value of shares issued under Infinity's Restricted Stock Plan is recorded as unearned compensation and expensed over the vesting periods of the awards. Under Infinity's Stock Option Plan, options are granted to officers, directors and key employees at exercise prices equal to the fair value of the shares at the dates of grant. No compensation expense is recognized for stock option grants. For fiscal years beginning after June 15, 2005, SFAS 123 (revised), *Share Based Payment* requires the recognition of compensation expense for employee stock options. In accordance with SFAS 123 (revised), Infinity plans to expense stock options in 2006. Had the standard been effective for the periods presented, Infinity does not believe its actual results would have differed materially from the pro forma results shown below.

The following table illustrates the effect on net earnings (in thousands) and earnings per share had compensation cost related to stock options been determined and recognized based on fair values at grant dates consistent with the method prescribed by SFAS No. 123. For SFAS No. 123 purposes, the fair values were calculated using a modified version of the Black-Scholes option pricing model. There is no single reliable method to determine the actual value of options at grant date. Accordingly, the actual value of the option grants may be higher or lower than the SFAS No. 123 fair value.

Three months ended		Six months ended	
June 30,		June 30,	
2005	2004	2005	2004

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Net earnings, as reported	\$ 23,690	\$ 24,822	\$ 47,672	\$ 41,762
Pro forma stock option expense	(241)	(297)	(482)	(632)
Adjusted net earnings	\$ 23,449	\$ 24,525	\$ 47,190	\$ 41,130
Earnings per share (as reported):				
Basic	\$ 1.15	\$ 1.21	\$ 2.31	\$ 2.03
Diluted	\$ 1.13	\$ 1.19	\$ 2.28	\$ 2.00
Earnings per share (adjusted):				
Basic	\$ 1.14	\$ 1.19	\$ 2.29	\$ 2.00
Diluted	\$ 1.12	\$ 1.18	\$ 2.26	\$ 1.97

Table of Contents**INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

The following table illustrates the assumptions used to obtain the pro forma stock option expense figures.

	<u>As of June 30,</u>	
	<u>2005</u>	<u>2004</u>
Assumptions:		
Options outstanding	576,584	633,180
Weighted average fair value per option granted	\$ n/a(a)	\$ 8.62
Weighted average per outstanding option:		
Dividend yield	1.1%	1.2%
Expected volatility	33.0%	33.0%
Risk-free interest rate	4.1%	4.1%
Expected option life	7.5 years	7.5 years

(a) No options have been granted in 2005.

For 2005, Infinity's Board of Directors approved the implementation of a cash-based long-term incentive compensation plan for key management in lieu of the issuance of stock options or other stock-based incentive compensation.

In February 2005, 44,792 shares of restricted stock vested under Infinity's Restricted Stock Plan. Two executive officers holding restricted shares surrendered a total of 4,294 shares to the Company to satisfy their income tax obligation resulting from this event. As a result, the Company recorded this surrender as an acquisition of treasury stock at its fair market value.

In May 2005, Infinity's shareholders approved the Non-Employee Directors' Stock Ownership Plan (Directors Plan). The purpose of the Directors Plan is to include Infinity common stock as part of the compensation provided to its non-employee directors. Under the terms of the Directors Plan, shares are granted on or about June 1 of each year and are restricted from sale or transfer by any recipient for six months from the date of grant. On June 1, 2005, a total of 3,905 shares of Infinity common stock valued at \$125,000 were issued to Infinity's non-employee directors.

Note 3 Computations of Earnings Per Share

The following table illustrates the reconciliation of the denominators in Infinity's computations of basic and diluted earnings per common share (in thousands, except per share figures):

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	For the three months ended		For the six months ended	
	June 30,		June 30,	
	2005	2004	2005	2004
Net earnings	\$ 23,690	\$ 24,822	\$ 47,672	\$ 41,762
Average basic shares outstanding	20,646	20,565	20,627	20,549
Basic earnings per share	\$ 1.15	\$ 1.21	\$ 2.31	\$ 2.03
Average basic shares outstanding	20,646	20,565	20,627	20,549
Restricted stock not yet vested	45	89	57	102
Dilutive effect of assumed option exercises	191	203	196	210
Average diluted shares outstanding	20,882	20,857	20,880	20,861
Diluted earnings per share	\$ 1.13	\$ 1.19	\$ 2.28	\$ 2.00

Note 4 Long-Term Debt

In February 2004, Infinity issued \$200 million principal of senior notes (the Senior Notes) due 2014. The net proceeds of \$197.2 million were used to repay and extinguish the \$195.5 million balance due on a term loan and for general corporate purposes. Infinity recorded a \$3.4 million loss on the term loan extinguishment, which represented the unamortized balance of previously capitalized debt issuance costs. The Senior Notes accrue interest at an effective rate of 5.55% and bear a coupon of 5.5%, payable semiannually. Infinity capitalized \$2.1 million of debt issuance costs which are being amortized over the term of the Senior Notes. The fair value of the Senior Notes as of June 30, 2005 (\$200.5 million) was calculated using a 155 basis point spread to the ten-year U.S. Treasury Note yield of 3.915%, which was obtained from Bloomberg, a national broker quotation network.

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 5 Unrealized Gain on Marketable Securities

The change in unrealized gain on marketable securities for the six-month periods ended June 30 included the following (in thousands):

	Pretax			Net
	Fixed Maturities	Equity Securities	Tax Effects	
2005				
Unrealized holding gains (losses) on securities arising during the period	\$ (6,720)	\$ 1,071	\$ 1,967	\$ (3,682)
Realized (gains) losses included in net income	(16,806)	(3,705)	7,179	(13,332)
Change in unrealized gain on marketable securities, net	\$ (23,526)	\$ (2,634)	\$ 9,146	\$ (17,014)
2004				
Unrealized holding gains (losses) on securities arising during the period	\$ (27,398)	\$ 2,272	\$ 8,327	\$ (16,799)
Realized (gains) losses included in net income	(1,014)	(2,032)	1,066	(1,980)
Change in unrealized gain on marketable securities, net	\$ (28,412)	\$ 240	\$ 9,393	\$ (18,779)

Note 6 Effective Tax Rate

The following table reconciles Infinity's statutory federal income tax rate to its effective rates.

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
Statutory rate	35.0%	35.0%	35.0%	35.0%
Adjustments:				
Interest income on tax-exempt securities	(1.5)	(1.2)	(1.4)	(1.4)
Dividends received deduction	(0.2)	(0.2)	(0.2)	(0.2)
Other	0.3	(0.2)	0.6	(0.1)

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Effective tax rate	33.6%	33.4%	34.0%	33.3%
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Note 7 Supplemental Cash Flow Information

The Company made the following payments (in thousands) that are not separately disclosed in the Consolidated Statements of Cash Flows:

	For the three months ended		For the six months ended	
	June 30,		June 30,	
	2005	2004	2005	2004
Income tax payments	\$ 10,000	\$ 15,600	\$ 10,000	\$ 15,600
Interest payments on debt			\$ 5,500	\$ 1,113

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - CONTINUED

Note 8 Insurance Reserves

The following table provides an analysis of changes in the liability for losses and loss adjustment expenses on a GAAP basis (in millions):

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Gross unpaid losses and loss adjustment expenses (LAE)	\$ 644.9	\$ 700.5	\$ 659.3	\$ 713.5
Less: reinsurance recoverables	(18.2)	(27.5)	(17.8)	(29.5)
Balance at beginning of period	626.7	673.0	641.5	684.0
Provision for losses and LAE occurring in the current year	178.8	147.1	349.0	300.7
Net decrease in provision for claims of prior years	(7.5)		(16.5)	(2.5)
Total losses and LAE incurred	171.3	147.1	332.5	298.2
Payments for losses and LAE of:				
Current year	(93.3)	(79.3)	(146.2)	(124.6)
Prior years	(79.0)	(82.7)	(202.1)	(199.6)
Total payments	(172.3)	(162.1)	(348.3)	(324.2)
Balance at end of period	625.7	658.0	625.7	658.0
Add back reinsurance recoverables	18.7	25.9	18.7	25.9
Gross unpaid losses and LAE included in the Balance Sheet	\$ 644.4	\$ 683.9	\$ 644.4	\$ 683.9

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

ITEM 2

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

The information set forth below should be read in conjunction with Forward-Looking Statements below.

OVERVIEW

Overall, market conditions continued a trend of increased competitiveness during the second quarter. Infinity noted that a growing number of competitors were beginning to modestly reduce their overall rates with larger rate reductions in certain segments of the business. In California, some companies lowered their underwriting standards by giving policyholders credit for more than actual driving experience and lower than actual miles driven. Infinity, however, has chosen to remain focused on profitability and has resisted reducing rates or lowering underwriting standards. Consequently, growth experienced by Infinity in the first and second quarters in several of its Focus States (see *Results of Operations*) may slow in the second half of the year.

Infinity's gross written premiums grew 11.7% during the second quarter of 2005 as compared with the same quarter a year earlier as a result of the roll-out of new products, new agency appointments and increased marketing efforts in the past eighteen months. Premium growth contributed substantially to the 14.7% increase in overall revenues for the second quarter of 2005 as compared with the same period a year ago.

Although revenues increased in the second quarter, Infinity's profitability dropped slightly in the second quarter of 2005 as compared with the same period a year earlier. Diluted earnings per share and net income fell from \$1.19 and \$24.8 million, respectively, in the second quarter of 2004 to \$1.13 and \$23.7 million, respectively, in the second quarter of 2005. The decrease in earnings per share and net income resulted primarily from declines in underwriting and investment income, increases in premiums receivable write-offs and lower than average corporate litigation expenses in 2004.

Underwriting income, defined as earned premiums less loss and loss adjustment expenses (LAE) less commissions and other underwriting expenses, fell to \$24.8 million from \$25.4 million for the three months ended June 30, 2005 and 2004, respectively. Excluding the effect in the second quarter of 2005 of a \$7.5 million release of redundant loss reserves, the decline was more substantial and resulted from higher losses and LAE from the continued increase in new business writings in several key states. Loss and LAE ratios are expected to be higher on new business than on renewal business. In addition, as the result of heightened competitive conditions, Infinity continued to increase its marketing efforts, which also reduced underwriting income. Lastly, in several states, Infinity reduced down payments required on policies or, in general, liberalized payment terms. The increase in premium volume, coupled with these more liberal terms, resulted in an increase in premiums receivable write-offs during the second quarter of 2005.

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Infinity's investment income declined as a result of lower yields on its fixed income portfolio resulting from lower overall market interest rates.

Book value per share at June 30, 2005 was \$27.91 per share, an increase of 4.9% from that at December 31, 2004.

LIQUIDITY AND CAPITAL RESOURCES

Sources of Funds

Infinity is organized as a holding company with all of its operations being conducted by its insurance subsidiaries. Accordingly, Infinity has continuing cash needs for administrative expenses, the payment of principal and interest on borrowings, shareholder dividends, share repurchases and taxes. Administrative expenses at the holding company have averaged approximately \$6.4 to \$6.9 million annually since 2003. Interest payments of \$5.5 million are due each February and August through maturity on Infinity's Senior Notes (Refer to Note 4 of the Consolidated Financial Statements for more information on the Senior Notes). In January 2005, Infinity announced its intent to repurchase up to \$50 million of its common stock in the open market or through privately negotiated transactions over the next three years. As of June 30, 2005, no stock repurchases had been made. In February 2005, Infinity increased its quarterly dividend to \$.06 per share. This equates to a common stock dividend of approximately \$5.0 million per year.

Funds to meet these obligations come primarily from dividends from the insurance subsidiaries, as well as cash and investments held at the holding company. In 2005, Infinity's insurance subsidiaries may pay to Infinity up to \$62.7 million in ordinary dividends without prior regulatory approval. As of June 30, 2005, Infinity had \$81.8 million of cash and investments. Other sources of additional liquidity include an unused line of credit in the amount of \$20 million and capital funds that could be supplied by additional debt or equity offerings.

Infinity's insurance subsidiaries generate liquidity to satisfy their obligations, primarily by collecting and investing premiums in advance of paying claims. Infinity's insurance subsidiaries had positive cash flow from operations of approximately \$27 million and \$38 million for the six-month periods ended June 30, 2005 and 2004, respectively. In addition, to satisfy their obligations, Infinity's insurance subsidiaries generate cash from maturing securities from its \$1.1 billion fixed maturity portfolio. Management believes that cash balances, cash flows generated from operations and maturing investments are adequate to meet the future liquidity needs for Infinity and its insurance subsidiaries.

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Reinsurance

As a result of an increase in retained earnings since 2002 and capital from its 2003 debt offering, Infinity, since 2002, has reduced its reliance on the reinsurance market to manage its capital and surplus levels. In the first six months of 2004, Infinity's insurance subsidiaries (excluding the in-force personal insurance business assumed through a reinsurance contract from Great American Insurance Company (GAI)) (the Assumed Agency Business) ceded only 10% of their personal auto physical damage business on a funds withheld basis to American Re-Insurance Company (American Re). This can be contrasted with historical ceding percentages as high as 90%. Premiums ceded under the American Re Agreement were \$7.8 million and \$16.6 million for the three-month and six-month periods ended June 30, 2004, respectively. The American Re agreement was commuted on December 31, 2004 and was neither renewed nor replaced for 2005.

Investments

Infinity's investment portfolio at June 30, 2005 contained approximately \$1.2 billion in fixed maturity securities and \$43.6 million in equity securities, all carried at market value with unrealized gains and losses reported as a separate component of shareholders' equity on an after-tax basis. At June 30, 2005, Infinity had pre-tax net unrealized gains of \$19.7 million on fixed maturities and \$0.8 million on equity securities. Combined, these figures decreased by \$26.2 million for the six-month period ended June 30, 2005, primarily due to increased sales of securities with unrealized gain positions in order to take advantage of unused capital loss tax carryforwards.

Approximately 94% of Infinity's investments in fixed maturities at June 30, 2005 were rated investment grade. Investment grade securities generally bear lower yields and lower degrees of risk than those that are unrated or non-investment grade. Management believes that a high quality investment portfolio is more likely to generate a stable and predictable investment return.

Since all of these securities are carried at market value in the balance sheet, there is virtually no effect on liquidity or financial condition upon the sale and ultimate realization of unrealized gains and losses.

The average duration of Infinity's fixed maturity portfolio was 3.7 years at June 30, 2005.

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Summarized information for Infinity's investment portfolio follows (in thousands):

	June 30, 2005				% of Total Market Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value	
Fixed maturities	\$ 1,161,105	\$ 23,604	\$ (3,887)	\$ 1,180,822	96%
Equity securities	42,804	1,902	(1,072)	43,634	4%
Total	\$ 1,203,910	\$ 25,506	\$ (4,959)	\$ 1,224,456	100%

	December 31, 2004				% of Total Market Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Market Value	
Fixed maturities	\$ 1,260,836	\$ 45,744	\$ (2,501)	\$ 1,304,080	98%
Equity securities	21,529	3,597	(133)	24,993	2%
Total	\$ 1,282,365	\$ 49,341	\$ (2,634)	\$ 1,329,073	100%

	June 30, 2005	December 31, 2004
Number of positions held with unrealized:		
Gains	359	451
Losses	127	80
Number of positions held that individually exceed unrealized:		
gains of \$500,000	5	10
losses of \$500,000		
Percentage of positions held with unrealized:		

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gains that were investment grade	87%	89%
losses that were investment grade	91%	97%

The following table sets forth the amount of unrealized loss by age and severity at June 30, 2005.

<u>Age of unrealized loss:</u>	Total Gross			
	<u>Unrealized Losses</u>	<u>Less than 5%*</u>	<u>5% to 10%*</u>	<u>Greater than 10%*</u>
Less than or equal to:				
Three months	\$ (992)	\$ (502)	\$ (490)	\$
Six months	(1,255)	(927)	(328)	
Nine months	(674)	(600)	(74)	
Twelve months	(32)	(32)	0	
Greater than twelve months	(2,006)	(1,882)	(124)	
Total	\$ (4,959)	\$ (3,943)	\$ (1,016)	\$

*As compared to amortized cost.

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The table below sets forth the scheduled maturities of fixed maturity securities at June 30, 2005, based on their market values, in thousands. Securities that do not have a single maturity date are reported at average maturity. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid by the issuers.

	Securities with Unrealized Gains	Securities with Unrealized Losses	Securities with No Unrealized Gains or Losses	All Fixed Maturity Securities
<u>Maturity</u>				
One year or less	\$ 45,858	\$ 11,595	\$	\$ 57,453
After one year through five years	264,827	159,508	1,062	425,398
After five years through ten years	246,739	65,302	9,903	321,944
After ten years	97,104	12,210		109,314
Mortgage-backed securities	171,890	94,823		266,713
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total	\$ 826,419	\$ 343,438	\$ 10,965	\$ 1,180,822
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

RESULTS OF OPERATIONS***Underwriting*****Premiums**

Infinity's 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, it is generally understood to mean coverage to drivers who, due to their driving record, age or vehicle type, represent higher than normal risks and pay higher rates for comparable coverage.

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Infinity is licensed to write auto insurance in all 50 states, but is committed to growth in 17 Focus States. Management believes that these Focus States offer the greatest opportunity for premium growth and profitability. Infinity classifies the states in which it operates into three categories:

Top Five Focus States States included in this category are California, Florida, Georgia, Connecticut and Pennsylvania.

Remaining Focus States States included in this category are Alaska, Alabama, Arizona, Indiana, Mississippi, Missouri, Ohio, South Carolina, Tennessee, Texas, Wisconsin and Virginia.

Non-Focus States Infinity is either maintaining its renewal writings in these states while increasing insurance rates to achieve underwriting profitability or ceasing operations in these states.

Infinity also writes commercial vehicle insurance, insurance for classic collectible automobiles (Classic Collector), and a small book of homeowners insurance business, which is currently in runoff.

	Three months ended June 30,			
	2005	2004	Change	%
Net Earned Premiums (in thousands)				
Gross Written Premium				
Personal Auto Insurance:				
Top Five Focus States	\$ 199,968	\$ 175,843	\$ 24,124	13.7%
12 Remaining Focus States	32,524	24,626	7,899	32.1%
Non-Focus States	4,788	11,269	(6,481)	(57.5)%
Subtotal	237,280	211,738	25,542	12.1%
Commercial Vehicle	12,455	11,088	1,367	12.3%
Classic Collector/Other	6,145	6,177	(32)	(0.5)%
Total Gross Written Premiums	255,880	229,003	26,877	11.7%
Ceded Reinsurance	(2,839)	(10,301)	7,462	(72.4)%
Net Written Premiums	253,041	218,702	34,339	15.7%
Change in Unearned Premiums	(5,013)	88	(5,102)	(5,797.7)%
Net Earned Premiums	\$ 248,028	\$ 218,791	\$ 29,237	13.4%

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	2005	2004	Change	%
Net Earned Premiums excluding the effect of the physical damage quota share agreement	\$ 248,028	\$ 232,424	\$ 15,604	6.7%
Six months ended June 30,				
	2005	2004	Change	%
Net Earned Premiums (in thousands)				
Gross Written Premium				
Personal Auto Insurance:				
Top Five Focus States	\$ 417,847	\$ 371,712	\$ 46,135	12.4%
12 Remaining Focus States	76,168	48,028	28,140	58.6%
Non-Focus States	7,994	22,328	(14,334)	(64.2)%
Subtotal	502,009	442,068	59,941	13.6%
Commercial Vehicle	24,836	22,709	2,127	9.4%
Classic Collector/Other	10,302	10,396	(94)	(0.9)%
Total Gross Written Premiums	537,147	475,173	61,974	13.0%
Ceded Reinsurance	(4,736)	(14,306) ¹	9,570	(66.9)%
Net Written Premiums	532,411	460,867	71,544	15.5%
Change in Unearned Premiums	(53,642)	(31,774)	(21,868)	68.8%
Net Earned Premiums	\$ 478,769	\$ 429,093	\$ 49,676	11.6%
Net Earned Premiums excluding the effect of the physical damage quota share agreement	\$ 478,769	\$ 466,129	\$ 12,640	2.7%

¹ Includes \$7.2 million of negative ceded premiums from the commutation of the physical damage quota share treaty on the Great American business.

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	As of June 30,			
	2005	2004	Change	%
Policies-in-Force				
Personal Auto Insurance:				
Top Five Focus States	599,552	553,207	46,345	8.4%
12 Remaining Focus States	98,639	61,859	36,780	59.5%
Non-Focus States	11,666	25,163	(13,497)	(53.6)%
Subtotal	709,857	640,229	69,628	10.9%
Commercial Vehicle	14,573	13,900	673	4.8%
Classic Collector/Other	58,492	56,080	2,412	4.3%
Total	782,922	710,209	72,713	10.2%

Gross written premiums increased 11.7% and 13.0% during the second quarter and first six months of 2005, respectively, over the same periods last year. This growth is seen as a result of Infinity's continued success in appointing additional independent agents and brokers, success in the continued roll-out of its three-tiered product offering in its Focus States and additional marketing efforts. For the same reasons, policies-in-force also grew by 72,713, or 10.2%, at June 30, 2005 as compared with the same period in 2004. Growth in gross written premiums and policies-in-force has not been the result of sizeable rate decreases on Infinity's products. While 36 rate revisions were filed by Infinity and approved with various states for the first six months of 2005, most of which were refinements to previously filed rates, the overall rate impact of those filings was a modest 0.4% increase. During the second quarter, Infinity noted that some of its competitors had filed for selective rate decreases. As a result, second quarter growth in both premiums and policies-in-force has slowed compared to the robust growth in the first quarter.

Infinity's personal auto insurance writings in its Top Five Focus States grew 13.7% and 12.4% during the second quarter and first six months of 2005, respectively, over the same periods last year. Growth in personal automobile gross written premiums in California, Infinity's largest market, increased in the second quarter by 14.2%, up from 1.2% in the first quarter. Growth in personal automobile gross written premiums in Florida and Georgia were particularly strong at 42.6% and 18.9% during the second quarter and 56.3% and 19.1% for the first six months, respectively, over the same periods in 2004. Gross premiums actually fell in Pennsylvania by 12.8% for the quarter and 7.6% for the first six months, which Infinity believes was a result of competitors offering higher independent agent commissions than those offered by Infinity and a more competitive pricing environment. Gross written premiums for personal auto insurance in Connecticut also fell 17.2% for the quarter and 17.0% for the first six months of 2005 over the same period in 2004. While the replacement product for the Connecticut business written through GAI and assumed by Infinity was approved early in the second quarter, it typically takes several months to ramp up production at volumes sufficient to offset the decline in the product being replaced.

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Growth in gross written premiums in the twelve Remaining Focus States was significant at 32.1% and 58.6%, during the second quarter and first six months of the year, respectively. Growth in policies-in-force grew in similar fashion, at 59.5% at June 30, 2005 as compared with the same period in 2004. While growth in Texas and Arizona resulted in 39% and 59% of the premium growth in the second quarter and first six months of the year, respectively, Alabama, Missouri, Ohio and South Carolina all contributed double-digit growth in the period. In the second quarter, Infinity noted several competitors, particularly in Texas, taking two or three rate decreases in order to grow market share. Infinity will continue to refine its price segmentation but does not foresee reducing rates in an effort to achieve growth.

Gross written premiums in commercial vehicle business grew robustly in the second quarter as compared to the first quarter of 2005. Growth of 12.3% and 9.4% for the quarter and first six months of 2005, respectively, was primarily driven by increased premiums in Florida and California. Gross premiums in other lines fell modestly for the quarter and first six months of 2005 as growth in the Classic Collector insurance line was offset by the runoff of the homeowners line of business.

Premiums ceded under reinsurance coverages fell during the second quarter and first six months of the year as a result of the elimination at December 31, 2004 of the physical damage quota share agreement.

Earned premiums increased 13.4% and 11.6% for the quarter and six-month period, respectively, partially due to the elimination of the physical damage quota share agreement at December 31, 2004. Excluding the effect of this agreement, earned premiums grew at a more modest 6.7% for th