CSS INDUSTRIES INC
Form 8-K
January 30, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 8-K

Current Report

Pursuant to Section 13 or 15(d) of
The Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): January 29, 2013

CSS Industries, Inc.
(Exact name of registrant as specified in its charter)

Delaware	1-2661	13-1920657
(State or other jurisdiction of incorporation)	(Commission File Number)	(IRS Employer Identification No.)

1845 Walnut Street, Philadelphia, PA	19103
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (215) 569-9900

Not Applicable
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02 Results of Operations and Financial Condition.

On January 29, 2013, the Company issued a press release announcing its financial results for the quarter ended December 31, 2012. A copy of this press release is attached hereto as Exhibit 99.1 and is incorporated herein by reference.

The information in this Form 8-K and the Exhibit attached hereto shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of such section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, except as shall be expressly set forth by specific reference in such filing.

Item 9.01 Financial Statements and Exhibits.

(d) Exhibits.

The following exhibit is being furnished herewith:

Exhibit No.	Description
99.1	Press Release dated January 29, 2013.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

CSS Industries, Inc.
(Registrant)

By: /s/ Vincent A. Paccapaniccia
Vincent A. Paccapaniccia
Vice President-Finance and
Chief Financial Officer

Date: January 29, 2013

EXHIBIT INDEX

Exhibit No.	Description
99.1	Press Release dated January 29, 2013.

Obligation to fund investments
15,580

Total
$
64,167

The Company does not have any implicit support arrangements with any VIE and has not provided non-contractual support as of March 31, 2016.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This document, including information incorporated by reference, contains "forward-looking statements" (within the meaning of the Private Securities Litigation Reform Act of 1995). All statements, trend analyses and other information contained in this Form 10-Q relative to markets for our products and trends in our operations or financial results, as well as other statements including words such as "may," "target," "anticipate," "believe," "plan," "estimate," "expec "intend," "project," and other similar expressions, constitute forward-looking statements. We made these statements based on our plans and current analyses of our business and the insurance industry as a whole. We caution that these statements may and often do vary from actual results and the differences between these statements and actual results can be material. Factors that could contribute to these differences include, among other things:

- general economic conditions, weakness of the financial markets and other factors, including prevailing interest rate levels and stock and credit market performance, which may affect or continue to affect (among other things) our ability to sell our products and to collect amounts due to us, our ability to access capital resources and the costs associated with such access to capital and the market value of our investments;
- our ability to obtain adequate premium rates and manage our growth strategy;
- performance of securities markets;
- our ability to attract and retain independent agents and brokers;
- customer response to new products and marketing initiatives;
- tax law and accounting changes;
- increasing competition in the sale of our insurance products and services and the retention of existing customers;
- changes in legal environment;
- legal actions brought against us;
- regulatory changes or actions, including those relating to the regulation of the sale, underwriting and pricing of insurance products and services and capital requirements;
- damage to our reputation;
- levels of natural catastrophes, terrorist events, incidents of war and other major losses;
- technology or network security disruptions;
- adequacy of insurance reserves; and
- availability of reinsurance and ability of reinsurers to pay their obligations.

The forward-looking statements herein are made only as of the date of this report. We assume no obligation to publicly update any forward-looking statements.

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General

We underwrite and sell traditional and alternative risk transfer ("ART") property and casualty insurance products primarily to the passenger transportation industry, the trucking industry and moving and storage transportation companies, general commercial insurance to small businesses in Hawaii and Alaska and personal insurance to owners of recreational vehicles throughout the United States.

We have five property and casualty insurance subsidiaries: National Interstate Insurance Company ("NIIC"), Vanliner Insurance Company ("VIC" or "Vanliner"), National Interstate Insurance Company of Hawaii, Inc. ("NIIC-HI"), Triumphe Casualty Company ("TCC"), and Hudson Indemnity, Ltd. ("HIL") and six active agency and service subsidiaries. We write our insurance policies on a direct basis through NIIC, VIC, NIIC-HI and TCC. NIIC and VIC are licensed in all 50 states and the District of Columbia. NIIC-HI is licensed in Ohio, Hawaii, Michigan and New Jersey. TCC holds licenses for multiple lines of authority, including auto-related lines, in 43 states and the District of Columbia. HIL is domiciled in the Cayman Islands and provides reinsurance for NIIC, VIC, NIIC-HI and TCC, primarily for the ART component. Insurance products are marketed through multiple distribution channels, including independent agents and brokers, program administrators, affiliated agencies and agent internet initiatives. We sell and service our insurance business through our active agency and service subsidiaries.

As of March 31, 2016, Great American Insurance Company ("Great American") owned 51.0% of our outstanding common shares.

Results of Operations

Overview

Through the operations of our subsidiaries, we are engaged in property and casualty insurance operations. We focus on niche insurance markets where we offer specialized insurance products, services and programs designed to meet the unique needs of targeted insurance buyers that we believe are underserved by the insurance industry. Our underwriting approach is to price our products to attain an underwriting profit even if we forgo volume as a result.

We derive our revenues primarily from premiums generated by our insurance policies and income from our investment portfolio. Our expenses consist primarily of losses and loss adjustment expenses ("LAE"), commissions and other underwriting expenses and other operating and general expenses.

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Our net income, determined in accordance with U.S. generally accepted accounting principles (“GAAP”), includes after-tax net realized (losses) gains from investments that may not be indicative of our ongoing operations. The following tables reconcile net income to net income from operations, a non-GAAP financial measure that we believe is a useful tool for investors and analysts in analyzing ongoing operating trends.

	Three Months Ended March 31,			
	2016		2015	
	Amount	Per Share	Amount	Per Share
	(Dollars in thousands, except per share data)			
Net income from operations	$7,584	$ 0.38	$6,414	$ 0.33
After-tax net realized (losses) gains from investments	(744)	(0.04)	695	0.03
Net income	$6,840	$ 0.34	$7,109	$ 0.36

We recorded net income for the three months ended March 31, 2016 of $6.8 million ($0.34 per share diluted) compared to net income of $7.1 million ($0.36 per share diluted) for the same period in 2015. The decrease in net income was primarily due to after-tax other-than-temporary impairment (“OTTI”) charges on investments, whereas the prior period was favorably impacted by after-tax net realized gains on investments. The OTTI charges were primarily from securities related to the financial services and energy sectors, where management is uncertain of the timing and the extent of ultimate recovery. Partially offsetting this decrease to net income was an increase in net investment income due to higher average invested assets. Additionally, our loss and LAE ratio of 77.3% for the three months ended March 31, 2016 compared to 78.9% for the same period in 2015 contributed favorably to net income. The decrease in the loss and LAE ratio was attributable to the absence of development on prior year loss reserves compared to unfavorable development reported in the same period last year. The unfavorable development reported last year was concentrated in our commercial auto liability line of business and was primarily attributable to products we no longer offer or customers which we no longer insure, as well as from assigned risk policies that we are obligated to write as part of the involuntary insurance market.

Our net income from operations for the three months ended March 31, 2016 was $7.6 million ($0.38 per share diluted) compared to net income of $6.4 million ($0.33 per share diluted) for the same period in 2015. The primary drivers for the period-over-period fluctuations are the same as those discussed above for the change in net income for the respective periods.

Gross Premiums Written

We operate our business as one segment, property and casualty insurance. We manage this segment through a product management structure. The following tables set forth an analysis of gross premiums written by the broader business component description, which were determined based primarily on similar economic characteristics, products and services.

	Three Months Ended March 31,			
	2016		2015	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Alternative Risk Transfer	$92,818	56.4 %	$91,193	59.0 %
Transportation	53,522	32.5 %	46,519	30.1 %
Specialty Personal Lines	9,800	6.0 %	9,220	6.0 %
Hawaii and Alaska	4,357	2.6 %	4,095	2.6 %
Other	4,203	2.5 %	3,511	2.3 %
Gross premiums written	$164,700	100.0%	$154,538	100.0%

Three months ended March 31, 2016 compared to March 31, 2015. During the first three months of 2016, our gross premiums written increased $10.2 million, or 6.6%, compared to the same period in 2015 primarily due to growth within our transportation component. Gross premiums written reflect overall average rate increases on renewed business of approximately 5.0% in the current period. Gross premiums written in our transportation component

increased $7.0 million, or 15.1%, during the first three months of 2016 compared to the same period in 2015 primarily due to the addition of new business written in our traditional trucking, ambulance and crane insurance products, as well as obtaining new business and adding coverage to our expanded limits coverage offered to trucking customers. Gross premiums written in our ART component increased $1.6 million, or 1.8%, primarily due to new business written in several of our group ART captive programs, which includes several former accounts that returned to our company, as well as exposure growth in one of our national account ART programs. These increases were largely offset by a national account program that was not renewed and another was lost due to an acquisition in the market. The other component,

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which is comprised of premium from assigned risk policies that we receive from involuntary state insurance plans from the states in which our insurance company subsidiaries operate and over which we have no control, increased $0.7 million, or 19.7%, compared to the same period in 2015.

Our ART programs, which focus on specialty or niche businesses, provide various services and coverages tailored to meet specific requirements of defined client groups and their members. These services include risk management consulting, claims administration and handling, loss control and prevention and reinsurance placement, along with providing various types of property and casualty insurance coverage. Insurance coverage is provided primarily to companies with similar risk profiles and to specified classes of business of our agent partners.

As part of our ART programs, we analyze, on a quarterly basis, members' loss performance on a policy year basis to determine if there would be an assessment premium (loss results are unfavorable to expectations) or if there would be a return of premium (loss results are favorable to expectations) to participants. Assessment premium and return of premium are recorded as adjustments to premiums written (assessments increase premiums written; returns of premium reduce premiums written). For the three months ended March 31, 2016 and 2015, we recorded net premium assessments of $1.0 million and $2.4 million, respectively.

Premiums Earned

We operate our business as one segment, property and casualty insurance. We manage this segment through a product management structure. The following tables show premiums earned summarized by the broader business component description, which were determined based primarily on similar economic characteristics, products and services.

	Three Months Ended March 31,		Change	
	2016	2015	Amount	Percent
	(Dollars in thousands)			
Premiums earned:				
Alternative Risk Transfer	$86,491	$74,002	$12,489	16.9 %
Transportation	46,145	48,252	(2,107)	(4.4)%
Specialty Personal Lines	7,461	7,550	(89)	(1.2)%
Hawaii and Alaska	5,176	4,648	528	11.4 %
Other	4,141	3,371	770	22.8 %
Total premiums earned	$149,414	$137,823	$11,591	8.4 %

Three months ended March 31, 2016 compared to March 31, 2015. Our premiums earned increased $11.6 million, or 8.4%, to $149.4 million during the three months ended March 31, 2016 compared to $137.8 million for the same period in 2015. The increase in premiums earned was primarily attributable to our ART component, which grew $12.5 million, or 16.9%. Our ART component growth was primarily from the addition of one large insured to our national account ART product during the third quarter of 2015, as well as rate and exposure increases on renewed business within our group ART programs. This growth was partially offset by a slight decline in our transportation component of $2.1 million, or 4.4%, primarily due to underwriting actions taken during the past two years in our traditional trucking and tow businesses. We have experienced growth due to new business and rate increases in our newer traditional product offerings including our home delivery, ambulance and crane and heavy haul products. The increase in our Hawaii and Alaska component of $0.5 million, or 11.4%, is primarily due to rate increases on renewed business and new business written. Our other component, which is comprised of premium from assigned risk plans from the states in which our insurance company subsidiaries operate and over which we have no control, increased $0.8 million, or 22.8%, compared to the same period in 2015.

Underwriting and Loss Ratio Analysis

Underwriting profitability, as opposed to overall profitability or net earnings, is measured by the combined ratio. The combined ratio is the sum of the loss and LAE ratio and the underwriting expense ratio. A combined ratio under 100% is indicative of a pre-tax underwriting profit.

Losses and LAE are a function of the amount and type of insurance contracts we write and of the loss experience of the underlying risks. We seek to establish case reserves at the maximum probable exposure based on our historical claims experience. Our ability to accurately estimate losses and LAE at the time of pricing our contracts is a critical

factor in determining our profitability. The amount reported under losses and LAE in any period includes payments in the period net of the change in reserves for unpaid losses and LAE between the beginning and the end of the period. Our underwriting expense ratio includes commissions and other underwriting expenses and other operating and general expenses, offset by other income. Commissions and other underwriting expenses consist principally of brokerage and agent commissions

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reduced by ceding commissions received from reinsurers, and vary depending upon the amount and types of contracts written and, to a lesser extent, premium taxes.

The premium generated by each of our ART insurance programs includes the premium charged related to the development of the participants' loss fund. The loss fund represents the amount of premium needed to cover the participants' expected losses in the layer of risk being ceded to the captive reinsurer. Typically, the premium and losses incurred through the funding of our captive participant's loss layer are comparable period-over-period. However, increased member participation or assessment of premium charged on the loss fund layer through Hudson Indemnity, Ltd. ("HIL") has the potential to unfavorably impact our loss and LAE ratio, and conversely, have a favorable impact on our underwriting expense ratio, when comparing results to a prior period.

Our underwriting approach is to price our products to attain an underwriting profit even if we forgo volume as a result. We continue to achieve rate level increases on renewed business, which have averaged approximately 5.0% in the current quarter and we are applying the same pricing disciplines to our new business opportunities. We believe that the current rate level increases we are obtaining on renewal business, along with improved pricing on new business, are at levels that adequately consider industry loss cost trends.

The table below presents our net premiums earned and combined ratios for the periods indicated.

	Three Months Ended March 31,	
	2016	2015
	(Dollars in thousands)	
Gross premiums written	$164,700	$154,538
Ceded reinsurance	(34,742)	(30,441)
Net premiums written	129,958	124,097
Change in unearned premiums, net of ceded	19,456	13,726
Total premiums earned	$149,414	$137,823
Combined ratios:		
Loss and LAE ratio excluding prior year development (accident year)	77.3 %	75.6 %
Prior year loss and LAE development	0.0 %	3.3 %
Loss and LAE ratio (calendar year) (1)	77.3 %	78.9 %
Underwriting expense ratio (2)	21.0 %	20.6 %
GAAP Combined ratio	98.3 %	99.5 %
Accident year combined ratio developed through March 31, 2016	98.3 %	97.9 %

(1) The ratio of losses and LAE to premiums earned.

(2) The ratio of the sum of commissions and other underwriting expenses and other operating expenses less other income to premiums earned.

Three months ended March 31, 2016 compared to March 31, 2015. Our loss and LAE ratio for the three months ended March 31, 2016 improved 1.6 combined ratio points to 77.3% compared to 78.9% during the same period in 2015. For the three months ended March 31, 2016, we did not record any development on prior years' loss reserves compared to $4.6 million, or 3.3 combined ratio points, during the same period last year. The development recorded in the first quarter of 2015 was concentrated in our commercial auto liability line of business and was primarily attributable to products we no longer offer or customers which we no longer insure, as well as from assigned risk policies that we are obligated to write as part of the involuntary insurance market. Our accident year loss and LAE ratio, which represents our GAAP loss and LAE ratio less prior year development, reported during the first three months of 2016 and 2015 was 77.3% and 75.6%, respectively. Consistent with much of the industry, our current year accident loss ratio reflects results in the commercial auto liability line that are elevated primarily due to higher average claims severity.

Our current accident year loss and LAE ratio at March 31, 2016 of 77.3% compared to the developed full-year 2015 accident year loss and LAE ratio of 78.1% shows continued improvement from recent accident years and reflects the cumulative impact of rate increases on renewed business since 2013, as well as improved pricing discipline applied to new business. Our underwriting strategy involves only those business opportunities that meet our stringent pricing and

risk selection standards and we continue to take rate actions or other corrective measures on underperforming accounts or businesses. In addition to our underwriting criteria, we continuously seek to enhance our claims management and risk management tools to improve pricing and risk selection, as well as focusing on being disciplined and well managed in our reserving practices.

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The underwriting expense ratio for the three month period ended March 31, 2016 of 21.0% was comparable to the ratio for the same period in 2015 of 20.6%.

Net Investment Income

2016 compared to 2015. Net investment income increased $0.8 million, or 7.9%, to $10.4 million in the first quarter of 2016 compared to $9.7 million for the first quarter of 2015. The increase in net investment income is primarily due to higher average invested assets.

Net Realized (Losses) Gains on Investments

2016 compared to 2015. Pre-tax net realized losses on investments were $1.1 million for the three months ended March 31, 2016 compared to pre-tax net realized gains of $1.1 million for the same period in 2015. The pre-tax net realized losses for the first quarter of 2016 were primarily due to OTTI charges of $3.8 million and were concentrated on securities within the financial services and energy sectors, where management is uncertain of the timing and the extent of ultimate recovery. Partially offsetting these losses for the three months ended March 31, 2016 were net gains generated by other invested assets and from the sales or redemptions of securities of $1.9 million and $0.8 million, respectively. The pre-tax net realized gains for the first quarter of 2015 were partially generated from sales of securities totaling $0.7 million, as well as net gains associated with other invested assets of $0.4 million.

Commissions and Other Underwriting Expenses

2016 compared to 2015. For the three months ended March 31, 2016 and 2015, commissions and other underwriting expenses were $24.5 million and $23.0 million, or 16.4% and 16.7% as a percentage of premiums earned, respectively. The improvement in commissions and other underwriting expenses as a percentage of premiums earned reflects changes in our mix of business written.

Other Operating and General Expenses

2016 compared to 2015. For the three months ended March 31, 2016 and 2015, other operating and general expenses were $7.6 million and $6.2 million, respectively. The increase in these expenses is primarily attributable to an increase in personnel and information technology resources to support business decisions and to sustain continued growth. As a percentage of premiums earned, such expenses were 5.1% and 4.5% for the three months ended March 31, 2016 and 2015, respectively.

Expense on Amounts Withheld

2016 compared to 2015. We invest funds in the participant loss layer for several of our ART programs. We earn investment income and generate realized gains or losses, and incur an equal expense on the amounts owed to ART participants. "Expense on amounts withheld" represents both investment income and realized gains or losses that we remit back to ART participants. The related investment income and realized gains or losses are included in the "Net investment income" and "Net realized (losses) gains on investments" lines, respectively, on our Consolidated Statements of Income. For the three months ended March 31, 2016 and 2015, expense on amounts withheld were $1.9 million and $1.5 million, respectively, increasing 26.2%. Such increase was primarily due to growth experienced in our ART programs participant loss layer.

Income Taxes

2016 compared to 2015. The effective tax rate in the first quarter is adjusted to equal the estimated full-year effective tax rate of 30.7%, compared to 27.6% for the same period in 2015. The 3.1% increase in the effective tax rate is primarily driven by the estimated full-year increase in pre-tax net income over the prior period.

Financial Condition

Investments

At March 31, 2016, our investment portfolio contained $1.1 billion in fixed maturity securities and $82.8 million in equity securities, all carried at fair value, with unrealized gains and losses reported as a separate component of shareholders' equity, and $48.6 million in other invested assets, which are limited partnership investments accounted for in accordance with the equity method. At March 31, 2016, we had pre-tax net unrealized gains of $20.0 million on fixed maturities and $16.0 thousand on equity securities. Consistent with the guidelines in our investment policy, our investment portfolio allocation is based on diversification among primarily high quality fixed maturity investments.

At March 31, 2016, 89.3% of the fixed maturities in our portfolio were rated "investment grade" (credit rating of AAA to BBB-) by nationally recognized rating agencies. Investment grade securities generally bear lower degrees of risk

and corresponding lower yields than those that are unrated or non-investment grade. Although we cannot provide any assurances, we believe that, in normal market conditions, our high quality investment portfolio should generate a stable and predictable investment return.

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Included in fixed maturities at March 31, 2016 were $312.1 million of state and local government obligations, which represented approximately 28.4% of our fixed maturity portfolio, with approximately $272.5 million, or 87.3%, of our state and local government obligations held in special revenue obligations, and the remaining amount held in general obligations. Our state and local government obligations portfolio is high quality, as 98.5% of such securities were rated investment grade at March 31, 2016. We had no state and local government obligations for any state, municipality or political subdivision that comprised 10% or more of the total amortized cost or fair value of such obligations at March 31, 2016.

Included in fixed maturities at March 31, 2016 were $184.1 million of residential and commercial mortgage-backed securities ("MBS"). MBS are subject to significant prepayment risk due to the fact that, in periods of declining interest rates, mortgages may be repaid more rapidly than scheduled as borrowers refinance higher rate mortgages to take advantage of lower rates. Summarized information for our MBS at March 31, 2016 is shown in the table below. Agency-backed securities are those issued by a U.S. government-backed agency; Alt-A mortgages are those with risk profiles between prime and subprime. The majority of the Alt-A securities and substantially all of the subprime securities are backed by fixed-rate mortgages.

	Amortized Cost	Fair Value	Fair Value as % of Cost	Unrealized Gain
	(Dollars in thousands)			
Collateral Type				
Residential:				
Agency-backed	$83,514	$84,925	101.7%	$ 1,411
Non-agency prime	18,991	19,720	103.8%	729
Alt-A	26,563	27,613	104.0%	1,050
Subprime	35,097	36,567	104.2%	1,470
Commercial	14,505	15,266	105.2%	761
	$178,670	$184,091	103.0%	$ 5,421

The National Association of Insurance Commissioners ("NAIC") assigns creditworthiness designations on a scale of 1 to 6 with 1 being the highest quality and 6 being the lowest quality. The NAIC retained third-party investment management firms to assist in the determination of appropriate NAIC designations for MBS based not only on the probability of loss (which is the primary basis of ratings by the major ratings firms), but also on the severity of loss and the statutory carrying value. At March 31, 2016, 99.0% (based on statutory carrying value of $178.7 million) of our MBS had an NAIC designation of 1 or 2.

Certain European countries, including the so-called "peripheral countries" (Greece, Portugal, Ireland, Italy and Spain) have been experiencing varying degrees of financial stress over the past few years and there remains uncertainty as to future developments and the impact on global financial markets. At March 31, 2016, less than 5% of our investments consisted of European debt and we owned no sovereign debt issued by the peripheral countries.

At March 31, 2016, our fixed maturity securities issued by energy and commodity related entities were $53.9 million, or 4.9% of our fixed maturity portfolio, with an unrealized loss of $2.7 million. Approximately 70% of the fair market value of these securities were investment grade rated. Our equity securities portfolio holds $5.1 million, or 6.2%, of energy and commodity related securities with an unrealized loss $0.3 million.

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Summary information for securities with unrealized gains or losses at March 31, 2016 is shown in the following table. Approximately $17.3 million of fixed maturities and $3.3 million of equity securities had no unrealized gains or losses at March 31, 2016.

	Securities with Unrealized Gains	Securities with Unrealized Losses
	(Dollars in thousands)	
Fixed Maturities:		
Fair value of securities	$844,074	$ 239,329
Amortized cost of securities	815,336	248,112
Gross unrealized gain or (loss)	$28,738	$ (8,783)
Fair value as a % of amortized cost	103.5 %	96.5 %
Number of security positions held	731	273
Number individually exceeding $50,000 gain or (loss)	150	44
Concentration of gains or (losses) by type or industry:		
U.S. Government and government agencies	$2,980	$ (4)
State, municipalities and political subdivisions	12,766	(62)
Residential mortgage-backed securities	5,496	(829)
Commercial mortgage-backed securities	769	(15)
Other debt obligations	812	(2,742)
Financial institutions, insurance and real estate	2,118	(1,034)
Industrial and other	3,797	(4,097)
Percent rated investment grade (a)	93.3 %	75.0 %
Equity Securities:		
Fair value of securities	$39,508	$ 40,030
Cost of securities	34,271	45,251
Gross unrealized gain or (loss)	$5,237	$ (5,221)
Fair value as a % of cost	115.3 %	88.5 %
Number individually exceeding $50,000 gain or (loss)	36	27

(a) Investment grade of AAA to BBB- by nationally recognized rating agencies.

The table below sets forth the scheduled maturities of available-for-sale fixed maturity securities at March 31, 2016, based on their fair values. Other debt obligations, which are primarily comprised of asset-backed securities other than mortgage-backed securities, and other securities with sinking funds, are categorized based on their 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
Maturity:		
One year or less	5.2 %	2.1 %
After one year through five years	36.2 %	46.5 %
After five years through ten years	34.5 %	27.4 %
After ten years	8.6 %	1.9 %
	84.5 %	77.9 %
Mortgage-backed securities	15.5 %	22.1 %
	100.0 %	100.0 %

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The table below summarizes the unrealized gains and losses on fixed maturities and equity securities by dollar amount.

	At March 31, 2016		
	Aggregate Fair Value	Aggregate Unrealized Gain (Loss)	Fair Value as % of Cost Basis
	(Dollars in thousands)		
Fixed Maturities:			
Securities with unrealized gains:			
Exceeding $50,000 and for:			
Less than one year (56 issues)	$95,352	$ 4,022	104.4 %
One year or longer (94 issues)	204,005	15,399	108.2 %
$50,000 or less (581 issues)	544,717	9,317	101.7 %
	$844,074	$ 28,738	
Securities with unrealized losses:			
Exceeding $50,000 and for:			
Less than one year (39 issues)	$36,278	$ (4,493)	89.0 %
One year or longer (5 issues)	3,367	(1,310)	72.0 %
$50,000 or less (229 issues)	199,684	(2,980)	98.5 %
	$239,329	$ (8,783)	
Equity Securities:			
Securities with unrealized gains:			
Exceeding $50,000 and for:			
Less than one year (29 issues)	$15,899	$ 2,427	118.0 %
One year or longer (7 issues)	6,882	1,705	132.9 %
$50,000 or less (48 issues)	16,727	1,105	107.1 %
	$39,508	$ 5,237	
Securities with unrealized losses:			
Exceeding $50,000 and for:			
Less than one year (27 issues)	$24,912	$ (4,632)	84.3 %
$50,000 or less (36 issues)	15,118	(589)	96.3 %
	$40,030	$ (5,221)	

When a decline in the value of a specific investment is considered to be other-than-temporary, a provision for impairment is charged to earnings (accounted for as a realized loss) and the cost basis of that investment is reduced. The determination of whether unrealized losses are other-than-temporary requires judgment based on subjective, as well as, objective factors. Factors considered and resources used by management include those discussed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Other-Than-Temporary Impairment.”

Liquidity and Capital Resources

Our cash flows from operating, investing and financing activities as detailed in our Consolidated Statements of Cash Flows are shown below (in thousands):

	Three Months Ended March 31,	
	2016	2015
Net cash provided by operating activities	$25,221	$30,507
Net cash used in investing activities	(43,704)	(17,297)
Net cash used in financing activities	(3,061)	(2,267)
Net (decrease) increase in cash and cash equivalents	$(21,544)	$10,943

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The liquidity requirements of our insurance subsidiaries relate primarily to the liabilities associated with their products, as well as operating costs and payments of dividends and taxes to us from insurance subsidiaries. Historically, and during the three months ended March 31, 2016, cash flows from premiums and investment income have provided sufficient funds to meet these requirements without requiring significant liquidation of investments. If our cash flows change dramatically from historical patterns, for example as a result of a decrease in premiums, an increase in claims paid or operating expenses, or financing an acquisition, we may be required to sell securities before their maturity and possibly at a loss. Our insurance subsidiaries generally hold a significant amount of highly liquid, short-term investments or cash and cash equivalents to meet their liquidity needs. Our historic pattern of using receipts from current premium writings for the payment of liabilities incurred in prior periods provides us with the option to extend the maturities of our investment portfolio beyond the estimated settlement date of our loss reserves. Funds received in excess of cash requirements are generally invested in additional marketable securities.

We believe that our insurance subsidiaries maintain sufficient liquidity to pay claims and operating expenses, as well as meet commitments in the event of unforeseen events such as reserve deficiencies, inadequate premium rates or reinsurer insolvencies. Our principal sources of liquidity are our existing cash and cash equivalents. Cash and cash equivalents decreased $21.5 million from $71.9 million at December 31, 2015 to $50.4 million at March 31, 2016. We generated net cash from operations of $25.2 million for the three months ended March 31, 2016, compared to $30.5 million during the same period in 2015, which is primarily due to an increase in cash payments made for loss and loss adjustment expenses year-over-year partially offset by an increase in cash collected on premiums written.

Net cash used in investing activities was $43.7 million and $17.3 million for the three months ended March 31, 2016 and 2015, respectively. The increase in net cash used in investing activities was primarily attributable to fixed maturity security purchases exceeding sales, maturities and redemptions. Purchases of and proceeds from the redemption of fixed maturity securities were $89.2 million and $45.4 million, respectively, for the period ending March 31, 2016, compared to $59.0 million and $42.4 million, respectively, for the same period last year. The increase in purchases of fixed maturity securities was concentrated in U.S. government agency bonds and residential MBS and was primarily driven by reinvesting funds in excess of cash requirements.

Net cash used in financing activities was $3.1 million and $2.3 million for the three months ended March 31, 2016 and 2015, respectively. Our financing activities include those related to share-based compensation activity and dividends paid on our common shares.

We have continuing cash needs for administrative expenses, the payment of principal and interest on borrowings, shareholder dividends and taxes. Funds to meet these obligations come primarily from parent company cash, dividends and other payments from our insurance company subsidiaries.

We have a $100.0 million unsecured credit agreement (the “Credit Agreement”) that terminates in November 2017, which includes a sublimit of $10.0 million for letters of credit. We have the ability to increase the line of credit to $125.0 million subject to the Credit Agreement’s accordion feature. Amounts borrowed bear interest at either (1) a LIBOR rate plus an applicable margin ranging from 0.75% to 1.00% based on our A.M. Best insurance group rating, or (2) a rate per annum equal to the greater of (a) the administrative agent’s prime rate, (b) 0.50% in excess of the federal funds effective rate, or (c) 1.00% in excess of the one-month LIBOR rate. At March 31, 2016, we had $12.0 million outstanding under the Credit Agreement. Based on our A.M. Best insurance group rating of “A” at March 31, 2016, the interest rate on this debt is equal to the six-month LIBOR (0.524% at March 31, 2016) plus 87.5 basis points, with interest payments due quarterly.

The Credit Agreement requires us to maintain specified financial covenants measured on a quarterly basis, including minimum consolidated net worth and a maximum debt to capital ratio. In addition, the Credit Agreement contains certain affirmative and negative covenants customary for facilities of this type, including negative covenants that limit or restrict our ability to, among other things, pay dividends, incur additional indebtedness, effect mergers or consolidations, make investments, enter into asset sales, create liens, enter into transactions with affiliates and other restrictions customarily contained in such agreements. As of March 31, 2016, we were in compliance with all covenants.

We believe that funds generated from operations, including dividends from insurance subsidiaries, parent company cash and funds available under our Credit Agreement, will provide sufficient resources to meet our liquidity

requirements for at least the next 12 months. However, if these funds are insufficient to meet fixed charges in any period, we would be required to generate cash through additional borrowings, sale of assets, sale of portfolio securities or similar transactions. If we were required to sell portfolio securities early for liquidity purposes rather than holding them to maturity, we would recognize gains or losses on those securities earlier than anticipated. If we find it necessary to borrow additional funds under our Credit Agreement in order to meet liquidity needs, we would incur additional interest expense, which could have a negative impact on our earnings. Since our ability to meet our obligations in the long-term (beyond a 12-month period) is dependent upon factors such as market changes, insurance regulatory changes and economic conditions, no assurance can be given that the available net cash flow will be sufficient to meet our long-term operating needs. We are not aware of any trends or uncertainties affecting our liquidity, including any significant future reliance on short-term financing arrangements.

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Critical Accounting Policies

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect amounts reported in the financial statements. As more information becomes known, these estimates and assumptions could change and impact amounts reported in the future. Management believes that the establishment of losses and LAE reserves and the determination of “other-than-temporary” impairment on investments are the two areas whereby the degree of judgment required in determining amounts recorded in the financial statements make the accounting policies critical. For a more detailed discussion of these policies, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2015.

Losses and LAE Reserves

Significant periods of time can elapse between the occurrence of an insured loss, the reporting of that loss to us and our final payment of that loss and its related LAE. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities. At both March 31, 2016 and December 31, 2015, we had $1.0 billion of gross loss and LAE reserves, representing management’s best estimate of the ultimate loss. Management records, on a monthly and quarterly basis, its best estimate of loss reserves.

For purposes of computing the recorded loss and LAE reserves, management utilizes various data inputs as noted below, including analysis that is derived from our internal actuary, as well as a review of quarterly results performed by actuaries employed by Great American. In addition, on an annual basis, actuaries from Great American provide a Statement of Actuarial Opinion, required annually in accordance with state insurance regulations, on the statutory reserves recorded by National Interstate Insurance Company (“NIIC”), Vanliner Insurance Company (“VIC”), National Interstate Insurance Company of Hawaii, Inc. (“NIIC-HI”) and Triumphe Casualty Company (“TCC”). The actuarial analysis of NIIC’s, VIC’s, NIIC-HI’s and TCC’s net reserves as of March 31, 2016 and December 31, 2015 reflected point estimates that were within 2% of management’s recorded net reserves as of such dates. Using actuarial data along with other data inputs, management concluded that the recorded reserves appropriately reflect management’s best estimates of the liability as of March 31, 2016 and December 31, 2015.

The quarterly reviews of unpaid loss and LAE reserves by Great American actuaries are prepared using standard actuarial techniques. These may include (but may not be limited to):

- the Case Incurred Development Method;
- the Paid Development Method; and
- the Bornhuetter-Ferguson Method.

The period of time from the occurrence of a loss through the settlement of the liability is referred to as the “tail.” Generally, the same actuarial methods are considered for both short-tail and long-tail lines of business because most of them work properly for both. The methods are designed to incorporate the effects of the differing length of time to settle particular claims. For short-tail lines, more weight tends to be given to the Case Incurred and Paid Development methods, although the various methods tend to produce similar results. For long-tail lines, more judgment is involved and more weight may be given to the Bornhuetter-Ferguson method. Liability claims for long-tail lines are more susceptible to litigation and can be significantly affected by changing contract interpretation and the legal environment. Therefore, the estimation of loss reserves for these classes is more complex and subject to a higher degree of variability.

Supplementary statistical information is reviewed by the actuaries to determine which methods are most appropriate and whether adjustments are needed to particular methods. This information includes:

- open and closed claim counts;
- average case reserves and average incurred on open claims;
- closure rates and statistics related to closed and open claim percentages;
- average closed claim severity;
- ultimate claim severity;
- reported loss ratios;
- projected ultimate loss ratios; and
- loss payment patterns.

Other-Than-Temporary Impairment

Our investments are exposed to at least one of three primary sources of investment risk: credit, interest rate and market valuation risks. The financial statement risks are those associated with the recognition of impairments and income, as well as the determination

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of fair values. We evaluate whether impairments have occurred on a case-by-case basis. Management considers a wide range of factors about the security's issuer and uses its best judgment in evaluating the cause and amount of decline in the estimated fair value of the security and in assessing the prospects for near-term recovery. Inherent in management's evaluation of the security are assumptions and estimates about the operations of the issuer and its future earnings potential. Considerations that we use in the impairment evaluation process include, but are not limited to:

- the length of time and the extent to which the market value has been below amortized cost;
- whether the issuer is experiencing significant financial difficulties;
- economic stability of an entire industry sector or subsection;
- whether the issuer, series of issuers or industry has a catastrophic type of loss;
- the extent to which the unrealized loss is credit-driven or a result of changes in market interest rates;
- historical operating, balance sheet and cash flow data;
- internally and externally generated financial models and forecasts;
- our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value; and
- other subjective factors, including concentrations and information obtained from regulators and rating agencies.

Under other-than-temporary impairment accounting guidance, if management can assert that it does not intend to sell an impaired fixed maturity security and it is not more likely than not that it will have to sell the security before recovery of its amortized cost basis, then an entity may separate the other-than-temporary impairments into two components: 1) the amount related to credit losses (recorded in earnings) and 2) the amount related to all other factors (recorded in other comprehensive income). The credit related portion of an other-than-temporary impairment is measured by comparing a security's amortized cost to the present value of its current expected cash flows discounted at its effective yield prior to the impairment charge. Both components are required to be shown in the Consolidated Statements of Income. If management intends to sell an impaired security, or it is more likely than not that it will be required to sell the security before recovery, an impairment charge is required to reduce the amortized cost of that security to fair value. Additional disclosures required by this guidance are contained in Note 4 - “Investments.”

We closely monitor each investment that has a fair value that is below its amortized cost and make a determination each quarter for other-than-temporary impairment for each of those investments. During the three months ended March 31, 2016, we recorded other-than-temporary impairment charges of $3.8 million in earnings on both equity and fixed maturity securities, primarily within the energy and financial services sectors. The impairment charges on equity securities of $2.5 million were due to the uncertainty surrounding the timing and extent of ultimate recovery while impairment charges on fixed maturity securities of $1.3 million occurred as management is uncertain of full principal repayment. There were no material other-than-temporary charges during the three months ended March 31, 2015. While it is not possible to accurately predict if or when a specific security will become impaired, given the inherent uncertainty in the market, charges for other-than-temporary impairment could be material to net income in subsequent quarters. Management believes it is not likely that future impairment charges will have a significant effect on our liquidity. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations - Financial Condition - Investments.”

Contractual Obligations/Off-Balance Sheet Arrangements

During the first three months of 2016, our contractual obligations did not change materially from those discussed in our Annual Report on Form 10-K for the year ended December 31, 2015.

We do not have any relationships with unconsolidated entities of financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

As of March 31, 2016, there were no material changes to the information provided in our Annual Report on Form 10-K for the year ended December 31, 2015 under Item 7A “Quantitative and Qualitative Disclosures About Market

Risk."
ITEM 4. Controls and Procedures
Our management is responsible for establishing and maintaining effective disclosure controls and procedures, as defined under Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Our management, with participation of our Chief Executive

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Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e)) as of March 31, 2016. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of March 31, 2016, to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's ("SEC") rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There have been no changes in our internal controls over financial reporting or in other factors that have occurred during the quarter ended March 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. In the ordinary course of business, we routinely enhance our information systems by either updating systems or implementing new systems such as switching to a new vendor for our human resource, payroll and benefit software needs in the first quarter of 2016.

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PART II – OTHER INFORMATION
ITEM 1. Legal Proceedings
There are no material changes from the legal proceedings previously reported in our Annual Report on Form 10-K for the year ended December 31, 2015. For more information regarding such legal matters please refer to Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2015, Note 15 – "Commitments and Contingencies" to the Consolidated Financial Statements included therein and Note 10 – "Commitments and Contingencies" to the Consolidated Financial Statements contained in this quarterly report.
ITEM 1A. Risk Factors
There are no material changes to the risk factors previously reported in our Annual Report on Form 10-K for the year ended December 31, 2015. For more information regarding such risk factors, please refer to Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015.
ITEM 5. Other Information

As previously announced on our Form 8-K filed with the SEC on March 11, 2016, we will hold the 2016 Annual Meeting of Shareholders ("the 2016 Annual Meeting") on Thursday, May 5, 2016, at 9:00 a.m., Eastern Time. The record date for determining shareholders entitled to notice of, and to vote at, the 2016 Annual Meeting was March 15, 2016.

Because the 2016 Annual Meeting will be held more than 30 days before the anniversary of the 2015 annual meeting of shareholders, any shareholder proposal or director nomination for consideration at our 2016 Annual Meeting had to be submitted to the Secretary of the Company no later than 5:00 p.m., Eastern Time, on March 21, 2016. Any such shareholder proposal or director nomination had to comply with our Code of Regulations as well as all applicable statutes, rules, and regulations promulgated by the SEC or any other applicable governing body. We did not receive any shareholder proposals or director nominations for the 2016 Annual Meeting.
ITEM 6. Exhibits

3.1 Amended and Restated Articles of Incorporation (1)
3.2 Amended and Restated Code of Regulations (1)
31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101 The following financial information from National Interstate Corporation's Form 10-Q for the quarter ended March 31, 2016 formatted in XBRL (Extensible Business Reporting Language):
(i) Consolidated Balance Sheet
(ii) Consolidated Statements of Income
(iii) Consolidated Statements of Comprehensive Income
(iv) Consolidated Statements of Shareholders' Equity
(v) Consolidated Statements of Cash Flows
(vi) Notes to Consolidated Financial Statements

(1) These exhibits are incorporated by reference to our Registration Statement on Form S-1 (Registration No. 333-119270).

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SIGNATURES

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

NATIONAL INTERSTATE CORPORATION

Date: May 4, 2016 /s/ David W. Michelson
David W. Michelson
Chief Executive Officer
(Duly Authorized Officer and Principal Executive Officer)

Date: May 4, 2016 /s/ Julie A. McGraw
Julie A. McGraw
Vice President and Chief Financial Officer
(Duly Authorized Officer and Principal Financial Officer)

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