

CINCINNATI FINANCIAL CORP

Form 10-Q

April 25, 2013

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

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended March 31, 2013.

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 0-4604

CINCINNATI FINANCIAL CORPORATION  
(Exact name of registrant as specified in its charter)

Ohio (State or other jurisdiction of incorporation or organization)	31-0746871 (I.R.S. Employer Identification No.)
---	---

6200 S. Gilmore Road, Fairfield, Ohio (Address of principal executive offices)	45014-5141 (Zip code)
---	--------------------------

Registrant's telephone number, including area code: (513) 870-2000

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

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

Large accelerated filer  Accelerated filer  Nonaccelerated filer  Smaller reporting company  
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes  No

As of April 22, 2013, there were 163,435,801 shares of common stock outstanding.

---

CINCINNATI FINANCIAL CORPORATION  
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2013

TABLE OF CONTENTS

<u>Part I – Financial Information</u>	<u>3</u>
<u>Item 1. Financial Statements (unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets</u>	<u>3</u>
<u>Condensed Consolidated Statements of Income</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Condensed Consolidated Statements of Shareholders’ Equity</u>	<u>6</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>7</u>
<u>Notes to Condensed Consolidated Financial Statements (unaudited)</u>	<u>8</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>24</u>
<u>Safe Harbor Statement</u>	<u>24</u>
<u>Introduction</u>	<u>26</u>
<u>Liquidity and Capital Resources</u>	<u>53</u>
<u>Other Matters</u>	<u>57</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>57</u>
<u>Fixed-Maturity Investments</u>	<u>57</u>
<u>Equity Investments</u>	<u>61</u>
<u>Unrealized Investment Gains and Losses</u>	<u>62</u>
<u>Item 4. Controls and Procedures</u>	<u>65</u>
<u>Part II – Other Information</u>	<u>65</u>
<u>Item 1. Legal Proceedings</u>	<u>65</u>
<u>Item 1A. Risk Factors</u>	<u>65</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>65</u>

<u>Item 3. Defaults upon Senior Securities</u>	<u>66</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>66</u>
<u>Item 5. Other Information</u>	<u>66</u>
<u>Item 6. Exhibits</u>	<u>66</u>

Cincinnati Financial Corporation First-Quarter 2013 10-Q  
Page 2

---

## Part I – Financial Information

## Item 1. Financial Statements (unaudited)

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions except per share data)

	March 31, 2013	December 31, 2012
<b>ASSETS</b>		
Investments		
Fixed maturities, at fair value (amortized cost: 2013—\$8,323; 2012—\$8,222)	\$9,169	\$9,093
Equity securities, at fair value (cost: 2013—\$2,416; 2012—\$2,369)	3,801	3,373
Other invested assets	67	68
Total investments	13,037	12,534
Cash and cash equivalents	380	487
Investment income receivable	117	115
Finance receivable	76	75
Premiums receivable	1,291	1,214
Reinsurance recoverable	620	615
Prepaid reinsurance premiums	26	26
Deferred policy acquisition costs	491	470
Land, building and equipment, net, for company use (accumulated depreciation: 2013—\$398; 2012—\$397)	216	217
Other assets	57	61
Separate accounts	726	734
Total assets	\$17,037	\$16,548
<b>LIABILITIES</b>		
Insurance reserves		
Loss and loss expense reserves	\$4,240	\$4,230
Life policy and investment contract reserves	2,310	2,295
Unearned premiums	1,875	1,792
Other liabilities	578	660
Deferred income tax	588	453
Note payable	104	104
Long-term debt and capital lease obligations	831	827
Separate accounts	726	734
Total liabilities	11,252	11,095
Commitments and contingent liabilities (Note 12)	—	—
<b>SHAREHOLDERS' EQUITY</b>		
Common stock, par value—\$2 per share; (authorized: 2013 and 2012—500 million shares; issued and outstanding: 2013 and 2012—197 million shares)	395	394
Paid-in capital	1,146	1,134
Retained earnings	4,109	4,021
Accumulated other comprehensive income	1,362	1,129
Treasury stock at cost (2013 and 2012—34 million shares)	(1,227	) (1,225
Total shareholders' equity	5,785	5,453
Total liabilities and shareholders' equity	\$17,037	\$16,548

Accompanying notes are an integral part of these condensed consolidated financial statements.



CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions except per share data)	Three months ended March 31,	
	2013	2012
<b>REVENUES</b>		
Earned premiums	\$931	\$839
Investment income, net of expenses	128	131
Total realized investment gains, net	41	13
Fee revenues	1	1
Other revenues	2	2
Total revenues	1,103	986
<b>BENEFITS AND EXPENSES</b>		
Insurance losses and policyholder benefits	568	582
Underwriting, acquisition and insurance expenses	300	274
Interest expense	13	14
Other operating expenses	5	4
Total benefits and expenses	886	874
<b>INCOME BEFORE INCOME TAXES</b>	217	112
<b>PROVISION FOR INCOME TAXES</b>		
Current	54	20
Deferred	9	6
Total provision for income taxes	63	26
<b>NET INCOME</b>	\$154	\$86
<b>PER COMMON SHARE</b>		
Net income—basic	\$0.95	\$0.53
Net income—diluted	0.94	0.53

Accompanying notes are an integral part of these condensed consolidated financial statements.

Cincinnati Financial Corporation First-Quarter 2013 10-Q

Page 4

---

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	Three months ended March 31,	
	2013	2012
NET INCOME	\$154	\$86
OTHER COMPREHENSIVE INCOME:		
Unrealized gains on investments available for sale, net of tax of \$124 and \$80, respectively	232	148
Amortization of pension actuarial loss and prior service cost, net of tax of \$1 and \$1, respectively	1	1
Change in life deferred acquisition costs, life policy reserves and other, net of tax of \$0 and (\$2), respectively	—	(3 )
Other comprehensive income, net of tax	233	146
COMPREHENSIVE INCOME	\$387	\$232

Accompanying notes are an integral part of these condensed consolidated financial statements.

Cincinnati Financial Corporation First-Quarter 2013 10-Q

Page 5

---



CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(In millions)	Common Stock		Paid-in Capital	Retained Earnings	Accumulated Other	Treasury Stock	Total Share- holders' Equity
	Outstanding Shares	Amount			Comprehensive Income		
Balance as reported December 31, 2011	162	\$393	\$1,096	\$3,885	\$901	\$(1,220 )	\$5,055
Cumulative effect of a change in accounting for deferred policy acquisition costs, net of tax	—	—	—	(22 )	—	—	(22 )
Balance as adjusted December 31, 2011	162	393	1,096	3,863	901	(1,220 )	5,033
Net income	—	—	—	86	—	—	86
Other comprehensive income, net	—	—	—	—	146	—	146
Dividends declared	—	—	—	(65 )	—	—	(65 )
Stock-based awards exercised and vested	—	—	—	—	—	1	1
Stock-based compensation	—	—	4	—	—	—	4
Purchases	—	—	—	—	—	—	—
Other	—	—	—	—	—	2	2
Balance March 31, 2012	162	\$393	\$1,100	\$3,884	\$1,047	\$(1,217 )	\$5,207
Balance December 31, 2012	163	\$394	\$1,134	\$4,021	\$1,129	\$(1,225 )	\$5,453
Net income	—	—	—	154	—	—	154
Other comprehensive income, net	—	—	—	—	233	—	233
Dividends declared	—	—	—	(66 )	—	—	(66 )
Stock-based awards exercised and vested	—	1	7	—	—	5	13
Stock-based compensation	—	—	5	—	—	—	5
Purchases	—	—	—	—	—	(9 )	(9 )
Other	—	—	—	—	—	2	2
Balance March 31, 2013	163	\$395	\$1,146	\$4,109	\$1,362	\$(1,227 )	\$5,785

Accompanying notes are an integral part of these condensed consolidated financial statements.

Cincinnati Financial Corporation First-Quarter 2013 10-Q

Page 6

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	Nine months ended months ended March 31, 2013	Three months ended 2012	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income	\$154	\$86	
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9	11	
Realized gains on investments, net	(41)	(13)	)
Stock-based compensation	5	4	
Interest credited to contract holders	11	9	
Deferred income tax expense	9	6	
Changes in:			
Investment income receivable	(2)	3	)
Premiums and reinsurance receivable	(82)	(19)	)
Deferred policy acquisition costs	(19)	(14)	)
Other assets	(2)	(5)	)
Loss and loss expense reserves	10	8	
Life policy reserves	13	15	
Unearned premiums	83	47	
Other liabilities	(88)	(10)	)
Current income tax receivable/payable	(3)	20	
Net cash provided by operating activities	57	148	
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Sale of fixed maturities	12	6	
Call or maturity of fixed maturities	221	195	
Sale of equity securities	98	99	
Purchase of fixed maturities	(325)	(304)	)
Purchase of equity securities	(108)	(96)	)
Investment in buildings and equipment, net	(1)	(2)	)
Investment in finance receivables	(8)	(9)	)
Collection of finance receivables	7	9	
Change in other invested assets, net	2	2	
Net cash used in investing activities	(102)	(100)	)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Payment of cash dividends to shareholders	(65)	(64)	)
Purchase of treasury shares	—	—	
Increase in notes payable	—	—	
Proceeds from stock options exercised	6	1	
Contract holders' funds deposited	24	31	
Contract holders' funds withdrawn	(31)	(28)	)
Excess tax benefits on stock-based compensation	8	1	
Other	(4)	(3)	)
Net cash used in financing activities	(62)	(62)	)
Net change in cash and cash equivalents	(107)	(14)	)
Cash and cash equivalents at beginning of year	487	438	
Cash and cash equivalents at end of period	\$380	\$424	

Edgar Filing: CINCINNATI FINANCIAL CORP - Form 10-Q

Supplemental disclosures of cash flow information:

Interest paid	\$—	\$—
Income taxes paid	54	—
Non-cash activities:		
Conversion of securities	\$43	\$3
Equipment acquired under capital lease obligations	12	6
Cashless exercise of stock options	9	—

Accompanying notes are an integral part of these condensed consolidated financial statements.

Cincinnati Financial Corporation First-Quarter 2013 10-Q

Page 7

---

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 — ACCOUNTING POLICIES

The condensed consolidated financial statements include the accounts of Cincinnati Financial Corporation and its consolidated subsidiaries, each of which is wholly owned. These statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. Our December 31, 2012, condensed consolidated balance sheet amounts are derived from the audited financial statements but do not include all disclosures required by GAAP.

Our March 31, 2013, condensed consolidated financial statements are unaudited. Certain financial information that is included in annual financial statements prepared in accordance with GAAP is not required for interim reporting and has been condensed or omitted. We believe that we have made all adjustments, consisting only of normal recurring accruals, that are necessary for fair presentation. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2012 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Adopted Accounting Updates

ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income

In February 2013, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. ASU 2013-02 requires entities to present in either a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. The company adopted this ASU during the first quarter of 2013, and it did not have a material impact on our company's financial position, cash flows or results of operations. See Note 7, Accumulated Other Comprehensive Income, for further details.

## NOTE 2 – INVESTMENTS

The following table provides cost or amortized cost, gross unrealized gains, gross unrealized losses and fair value for our invested assets:

(In millions)	Cost or amortized cost	Gross unrealized gains	gross unrealized losses	Fair value
At March 31, 2013				
Fixed maturities:				
States, municipalities and political subdivisions	\$3,006	\$233	\$1	