

CINCINNATI FINANCIAL CORP

Form 10-Q

July 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 June 30, 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 July 22, 2013, there were 163,668,282 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2013

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Part I – Financial Information

Item 1. Financial Statements (unaudited)

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions except per share data)	June 30, 2013	December 31, 2012
ASSETS		
Investments		
Fixed maturities, at fair value (amortized cost: 2013—\$8,428; 2012—\$8,222)	\$8,992	\$9,093
Equity securities, at fair value (cost: 2013—\$2,452; 2012—\$2,369)	3,875	3,373
Other invested assets	66	68
Total investments	12,933	12,534
Cash and cash equivalents	382	487
Investment income receivable	116	115
Finance receivable	79	75
Premiums receivable	1,350	1,214
Reinsurance recoverable	582	615
Prepaid reinsurance premiums	26	26
Deferred policy acquisition costs	546	470
Land, building and equipment, net, for company use (accumulated depreciation: 2013—\$405; 2012—\$397)	213	217
Other assets	94	61
Separate accounts	713	734
Total assets	\$17,034	\$16,548
LIABILITIES		
Insurance reserves		
Loss and loss expense reserves	\$4,284	\$4,230
Life policy and investment contract reserves	2,345	2,295
Unearned premiums	1,947	1,792
Other liabilities	597	660
Deferred income tax	512	453
Note payable	104	104
Long-term debt and capital lease obligations	833	827
Separate accounts	713	734
Total liabilities	11,335	11,095
Commitments and contingent liabilities (Note 12)	—	—
SHAREHOLDERS' EQUITY		
Common stock, par value—\$2 per share; (authorized: 2013 and 2012—500 million shares; issued and outstanding: 2013—198 million shares and 2012—197 million shares)	396	394
Paid-in capital	1,162	1,134
Retained earnings	4,152	4,021
Accumulated other comprehensive income	1,221	1,129
Treasury stock at cost (2013 and 2012—34 million shares)	(1,232)	(1,225)
Total shareholders' equity	5,699	5,453
Total liabilities and shareholders' equity	\$17,034	\$16,548

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

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CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(In millions except per share data)	Three months ended June 30,		Six months ended June 30,	
	2013	2012	2013	2012
REVENUES				
Earned premiums	\$954	\$877	\$1,885	\$1,716
Investment income, net of expenses	131	132	259	263
Total realized investment gains, net	14	6	55	19
Fee revenues	3	2	4	3
Other revenues	2	3	4	5
Total revenues	1,104	1,020	2,207	2,006
BENEFITS AND EXPENSES				
Insurance losses and policyholder benefits	631	687	1,199	1,269
Underwriting, acquisition and insurance expenses	307	287	607	561
Interest expense	14	13	27	27
Other operating expenses	4	4	9	8
Total benefits and expenses	956	991	1,842	1,865
INCOME BEFORE INCOME TAXES	148	29	365	141
PROVISION (BENEFIT) FOR INCOME TAXES				
Current	37	6	91	26
Deferred	1	(9	) 10	(3
Total provision (benefit) for income taxes	38	(3	) 101	23
NET INCOME	\$110	\$32	\$264	\$118
PER COMMON SHARE				
Net income—basic	\$0.67	\$0.20	\$1.62	\$0.73
Net income—diluted	0.66	0.20	1.60	0.72

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CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three months ended June 30,		Six months ended June 30,		
(In millions)	2013	2012	2013	2012	
NET INCOME	\$110	\$32	\$264	\$118	
OTHER COMPREHENSIVE INCOME					
Unrealized gains (losses) on investments available-for-sale, net of tax of (\$85), (\$19), \$39 and \$61, respectively	(159	) (34	) 73	114
Amortization of pension actuarial loss and prior service cost, net of tax of \$1, \$0, \$2 and \$1, respectively	2	1	3	2	
Change in life deferred acquisition costs, life policy reserves and other, net of tax of \$8, \$(1), \$8 and \$(3), respectively	16	(4) 16	(7)
Other comprehensive income (loss), net of tax	(141	) (37	) 92	109
COMPREHENSIVE INCOME (LOSS)	\$(31	) \$(5	) \$356	\$227

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

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

(In millions)	Common Stock		Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Treasury Stock	Total Shareholders' Equity
	Outstanding Shares	Amount					
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	—	—	—	118	—	—	118
Other comprehensive income, net	—	—	—	—	109	—	109
Dividends declared	—	—	—	(130)	—	—	(130)
Stock-based awards exercised and vested	—	—	1	—	—	1	2
Stock-based compensation	—	—	8	—	—	—	8
Purchases	—	—	—	—	—	—	—
Other	—	—	1	—	—	3	4
Balance June 30, 2012	162	\$393	\$1,106	\$3,851	\$1,010	\$(1,216)	\$5,144
Balance December 31, 2012	163	\$394	\$1,134	\$4,021	\$1,129	\$(1,225)	\$5,453
Net income	—	—	—	264	—	—	264
Other comprehensive income, net	—	—	—	—	92	—	92
Dividends declared	—	—	—	(133)	—	—	(133)
Stock-based awards exercised and vested	1	2	17	—	—	5	24
Stock-based compensation	—	—	10	—	—	—	10
Purchases	—	—	—	—	—	(15)	(15)
Other	—	—	1	—	—	3	4
Balance June 30, 2013	164	\$396	\$1,162	\$4,152	\$1,221	\$(1,232)	\$5,699

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

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CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	Six months ended June 30,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$264	\$118
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20	22
Realized gains on investments, net	(55)	(19)
Stock-based compensation	10	8
Interest credited to contract holders	22	18
Deferred income tax expense (benefit)	10	(3)
Changes in:		
Investment income receivable	(1)	1
Premiums and reinsurance receivable	(103)	(76)
Deferred policy acquisition costs	(39)	(26)
Other assets	(10)	(11)
Loss and loss expense reserves	54	57
Life policy reserves	33	33
Unearned premiums	155	129
Other liabilities	(39)	7
Current income tax receivable	(70)	7
Net cash provided by operating activities	251	265
CASH FLOWS FROM INVESTING ACTIVITIES		
Sale of fixed maturities	14	28
Call or maturity of fixed maturities	459	360
Sale of equity securities	157	124
Purchase of fixed maturities	(666)	(603)
Purchase of equity securities	(190)	(210)
Investment in buildings and equipment, net	(3)	(4)
Investment in finance receivables	(18)	(18)
Collection of finance receivables	14	16
Change in other invested assets, net	3	3
Net cash used in investing activities	(230)	(304)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of cash dividends to shareholders	(130)	(128)
Proceeds from stock options exercised	12	3
Contract holders' funds deposited	45	56
Contract holders' funds withdrawn	(55)	(62)
Excess tax benefits on stock-based compensation	9	1
Other	(7)	(6)
Net cash used in financing activities	(126)	(136)
Net change in cash and cash equivalents	(105)	(175)
Cash and cash equivalents at beginning of year	487	438
Cash and cash equivalents at end of period	\$382	\$263
Supplemental disclosures of cash flow information:		
Interest paid	\$27	\$27
Income taxes paid	158	19

Non-cash activities:

Conversion of securities	\$54	\$13
Equipment acquired under capital lease obligations	17	9
Cashless exercise of stock options	15	—

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

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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 June 30, 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	losses	Fair value
At June 30, 2013				
Fixed maturities:				
States, municipalities and political subdivisions	\$3,044	\$162	\$18	\$3,188
Convertibles and bonds with warrants attached	16	—	—	16
United States government	7	—	—	7
Government-sponsored enterprises	208	—	13	195
Foreign government	10	—	—	10
Commercial mortgage-backed securities	63	—	3	60
Corporate securities	5,080	459	23	5,516
Subtotal	8,428	621	57	8,992
Equity securities:				
Common equities	2,375	1,398	12	3,761
Preferred equities	77	37	—	114
Subtotal	2,452	1,435	12	3,875
Total	\$10,880	\$2,056	\$69	\$12,867
At December 31, 2012				
Fixed maturities:				
States, municipalities and political subdivisions	\$3,040	\$250	\$1	\$3,289
Convertibles and bonds with warrants attached	31	—	—	31
United States government	7	1	—	8
Government-sponsored enterprises	164	—	—	164
Foreign government	3	—	—	3
Commercial mortgage-backed securities	27	1	—	28
Corporate securities	4,950	622	2	5,570
Subtotal	8,222	874	3	9,093
Equity securities:				
Common equities	2,270	977	9	3,238
Preferred equities	99	37	1	135
Subtotal	2,369	1,014	10	3,373
Total	\$10,591	\$1,888	\$13	\$12,466

The net unrealized investment gains in our fixed-maturity portfolio are primarily the result of the current low interest rate environment that increased the fair value of our fixed-maturity portfolio. The three largest net unrealized investment gains in our common stock portfolio are from Exxon Mobil Corporation (NYSE:XOM), Chevron Corporation (NYSE:CVX) and The Procter & Gamble Company (NYSE:PG), which had a combined net gain position of \$283 million. At At June 30, 2013, we had \$16 million fair value of hybrid securities included in fixed maturities that follow Accounting Standards Codification (ASC) 815-15-25, Accounting for Certain Hybrid Financial Instruments, compared with \$31 million fair value of hybrid securities at December 31, 2012. The hybrid securities are carried at fair value, and the changes in fair value are included in realized investment gains and losses.

The table below provides fair values and unrealized losses by investment category and by the duration of the securities' continuous unrealized loss position:

(In millions)	Less than 12 months		12 months or more		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
At June 30, 2013						
Fixed maturities:						
States, municipalities and political subdivisions	\$377	\$18	\$—	\$—	\$377	\$18
United States government	1	—	—	—	1	—
Foreign government	10	—	—	—	10	—
Government-sponsored enterprises	185	13	—	—	185	13
Commercial mortgage-backed securities	51	3	—	—	51	3
Corporate securities	580	22	13	1	593	23
Subtotal	1,204	56	13	1	1,217	57
Equity securities:						
Common equities	202	12	—	—	202	12
Preferred equities	4	—	—	—	4	—
Subtotal	206	12	—	—	206	12
Total	\$1,410	\$68				