

INFINITY PROPERTY & CASUALTY CORP

Form S-4

May 06, 2004

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As filed with the Securities and Exchange Commission on May 6, 2004

Registration No. 333-

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM S-4**  
**REGISTRATION STATEMENT**

*under*

*THE SECURITIES ACT OF 1933*

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**INFINITY PROPERTY AND CASUALTY**  
**CORPORATION**

(Exact name of registrants as specified in their charters)

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**Ohio**  
(State or other jurisdiction of  
incorporation or organization)

**6331**  
(Primary Standard Industrial  
Classification Code Number)

**03-0483872**  
(IRS Employer  
Identification Number)

2204 Lakeshore Drive

Birmingham, Alabama 35209

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(205) 870-4000

(Address, including zip code, and telephone number, including area code, of Registrants principal executive offices)

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**Samuel J. Simon, Esq.**

**Senior Vice President, General Counsel and Secretary**

**Infinity Property and Casualty Corporation**

**2204 Lakeshore Drive**

**Birmingham, Alabama 35209**

**Telephone: (205) 870-4000**

**Facsimile: (205) 803-8585**

(Name, address, including zip code, and telephone number, including area code, of agent for service)

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*With a copy to:*

**Mark A. Weiss**

**Keating, Muething & Klekamp, P.L.L.**

**1400 Provident Tower**

**One East Fourth Street**

**Cincinnati, Ohio 45202**

**Telephone: (513) 579-6599**

**Facsimile: (513) 579-6956**

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after the effective date of this Registration Statement.

If the securities being registered on this Form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. "

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If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. "

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### CALCULATION OF REGISTRATION FEE

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| <b>Title Of Each Class Of<br/>Securities To Be Registered</b> | <b>Amount<br/>to be<br/>Registered</b> | <b>Proposed<br/>Maximum<br/>Offering<br/>Price<br/>Per Share</b> | <b>Proposed<br/>Maximum<br/>Aggregate<br/>Offering Price(1)</b> | <b>Amount Of<br/>Registration<br/>Fee</b> |
|---|--|--|---|---|
| 5.50% Senior Notes due 2014                                   | \$ 200,000,000                         | 100%   | \$ 200,000,000  | \$ 25,340                                 |

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(1) Estimated pursuant to Rule 457(f) under the Securities Act of 1933 solely for the purpose of calculating the registration fee.

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**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933, or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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**The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.**

**SUBJECT TO COMPLETION DATED MAY 6, 2004**

# **Infinity Property and Casualty Corporation**

## **Offer to Exchange**

### **5.50% Series B Senior Notes due 2014**

#### **For Any and All Outstanding**

### **5.50% Senior Notes due 2014**

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We are offering to exchange our 5.50% Series B Senior Notes due February 18, 2014 which have been registered under the Securities Act of 1933, which we refer to as the exchange notes, for our currently outstanding 5.50% Senior Notes due February 18, 2014, which we refer to as the existing notes. The terms of the exchange notes are identical in all material respects to the terms of the existing notes, except that the exchange notes have been registered under the Securities Act, and the transfer restrictions and registration rights relating to the existing notes do not apply to the exchange notes. The exchange notes will represent the same debt as the existing notes and will be issued under the same indenture. We refer to notes in this prospectus when describing both the existing notes and the exchange notes.

To exchange your existing notes for exchange notes:

you are required to make the representations described on page 64 to us.

you must complete and send the letter of transmittal that accompanies this prospectus to the exchange agent, American Stock Transfer & Trust Company, by 5:00 p.m., New York time on \_\_\_\_\_, 2004.

you should read the section called "The Exchange Offer" for further information on how to exchange your existing notes for exchange notes.

**For a discussion of the material risks involved in investing in the exchange notes, see "Risk Factors" beginning on page 12.**

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the exchange notes or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.**

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\_\_\_\_\_, 2004

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In this prospectus, we, us, our and Infinity refer to Infinity Property and Casualty Corporation.

We are offering to exchange existing notes for exchange notes only in places where offers and sales are permitted.

You should rely only on the information contained or incorporated by reference in this prospectus. No one has been authorized to give any information or to make any representations, other than those contained or incorporated by reference in this prospectus, in connection with any offer made by this prospectus. If anyone provides you with different or inconsistent information, you should not rely on it. You should not assume that the information contained or incorporated by reference into this prospectus is accurate as of any date other than the date of the prospectus or document incorporated by reference, as the case may be.

Each broker-dealer that receives exchange notes for its own account pursuant to the exchange offer must acknowledge that it will deliver a prospectus in connection with any resale of such exchange notes. The letter of transmittal states that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act of 1933. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of exchange notes received in exchange for outstanding notes where such outstanding notes were acquired by such broker-dealer as a result of market-making activities or other trading activities. We have agreed that, starting on the expiration date of the exchange offer and ending 60 days after such date, this prospectus will be made available to any broker-dealer for use in connection with any such resale. See Plan of Distribution.

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Our principal executive offices are located at 2204 Lakeshore Drive, Birmingham, Alabama, 35209. Our telephone number is (205) 870-4000.

**FORWARD-LOOKING STATEMENTS**

The Private Securities Litigation Reform Act of 1995 provides a safe harbor from civil litigation for forward-looking statements. Some of the statements in this prospectus and in the information incorporated by reference may include forward-looking statements which reflect our current views with respect to future events and financial performance. These statements include forward-looking statements both with respect to us and the insurance industry. Statements which include the words believes, expects, may, will, should, seeks, intends, plans, estimates, the negative version of those words or other comparable terminology and similar statements of a future or forward-looking nature identify forward-looking statements.

These are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Examples of such forward-looking statements include statements relating to: expectations concerning market and other conditions, future premiums, revenues, earnings and investment activities, expected losses, rate increases and improved loss experience. Actual results could differ materially from those we expect depending on certain risks and uncertainties including but not limited to:

changes in economic conditions and financial markets (including interest rates);

the adequacy or accuracy of our pricing methodologies;

the presence of competitors with greater financial resources and the impact of competitive pricing;

the ability to obtain timely approval for requested rate changes;

judicial and regulatory developments adverse to the automobile insurance industry;

the outcome of pending litigation against us;

weather conditions (including the severity and frequency of storms, hurricanes, snowfalls, hail and winter conditions);

changes in driving patterns and loss trends;

acts of war and terrorist activities; and

the challenges posed by consolidating the operations of our insurance subsidiaries.

All forward-looking statements address matters that involve risks and uncertainties. Accordingly, there are or will be important factors that could cause actual results to differ materially from those indicated in these statements. We undertake no obligation to publicly update or review any

forward-looking statement, whether as a result of new information, future developments or otherwise.

**WHERE YOU CAN FIND MORE INFORMATION**

We file annual, quarterly and special reports, proxy statements, and other documents with the SEC under the Exchange Act. Our SEC filings are available to the public at the SEC's website at <http://www.sec.gov>. You may also read and copy any document we file at the SEC public reference room:

Public Reference Room

450 Fifth Street, N.W.

Washington, D.C. 20549



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You may obtain information regarding the operation of the public reference room by calling the SEC at 1-800-SEC-0330. You may find additional information about us at our website at <http://www.ipacc.com>. The information on our website is not a part of this prospectus.

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**PROSPECTUS SUMMARY**

*This is a summary that highlights information contained in this prospectus and is therefore not complete and does not contain all the information you should consider before investing in the notes. You should read the following summary together with the more detailed information included in this prospectus, including our consolidated financial statements and the accompanying notes.*

**INFINITY PROPERTY AND CASUALTY CORPORATION**

Infinity Property and Casualty Corporation is a holding company, which, through subsidiaries, provides personal automobile insurance on a national level with emphasis on nonstandard auto insurance. As of February 29, 2004, we employed approximately 2,200 persons. Our address is 2204 Lakeshore Drive, Birmingham, Alabama 35209; our phone number is (205) 870-4000. SEC filings, news releases and other information may be accessed free of charge through our Internet site at: [www.ipacc.com](http://www.ipacc.com). The information on our website is not a part of this prospectus.

We were incorporated as an Ohio corporation in September 2002 as an indirect wholly-owned subsidiary of American Financial Group, Inc. ( AFG ) to acquire and conduct, as a separate public company, AFG 's personal lines business written through independent agents. On December 31, 2002, AFG transferred to us all of the issued and outstanding capital stock of the following personal auto insurance subsidiaries: Atlanta Casualty Company, Infinity Insurance Company, Leader Insurance Company and Windsor Insurance Company (collectively, the NSA Group ). In exchange, AFG received all of the issued and outstanding shares of our common stock and a \$55 million promissory note. In February 2003, AFG sold 12.5 million shares (61%) of our common stock in an initial public offering and in December of 2003 sold its remaining interest (7.9 million shares) in a secondary public offering.

As of January 1, 2003, we acquired the in-force personal insurance business written through independent agents (the Assumed Agency Business ) of AFG 's principal property and casualty subsidiary, Great American Insurance Company ( GAI ). Because this business is not a separate legal entity, the acquisition was effected through a reinsurance agreement under which one of our subsidiaries assumed the in-force business, services the policyholders and handles the claims. GAI, in turn, transferred to us assets (primarily investment securities) with a market value of \$125.3 million and permits us to continue to write standard and preferred insurance on policies issued by the same GAI companies that had previously issued such policies.

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**THE EXCHANGE OFFER**

|  |  |
|--|--|
| Notes Offered                              | We are offering to exchange up to \$200,000,000 of our 5.5% Series B Senior Notes due February 18, 2014. The terms of the exchange notes are identical in all material respects to the terms of the existing notes, except that the exchange notes have been registered under the Securities Act and the transfer restrictions and registration rights relating to the existing notes do not apply to the exchange notes.  |
| Exchange and Registration Rights Agreement | Simultaneously with the initial sale of the existing notes, we and the initial purchasers entered into an exchange and registration rights agreement for the exchange offer. The exchange and registration rights agreement requires, among other things, that we use our reasonable best efforts to complete a registered exchange offer for the existing notes or cause to become effective a shelf registration statement for resales of the existing notes. The exchange offer is intended to satisfy our obligations under the exchange and registration rights agreement. After the exchange offer is complete, we will not have any further obligations, except under limited circumstances, to provide for any exchange or registration rights of your existing notes.   |
| The Exchange Offer                         | We are offering to issue the exchange notes in exchange for a like principal amount of your existing notes. We are offering to issue the exchange notes to satisfy our obligations contained in the exchange and registration rights agreement entered into when the existing notes were sold in transactions permitted by Rule 144A under the Securities Act and therefore not registered with the SEC. For procedures for tendering, see The Exchange Offer.   |
| Tenders, Expiration Date, Withdrawal       | The exchange offer will expire at 5:00 p.m. New York City time on _____, 2004 unless it is extended. If you decide to exchange your existing notes for exchange notes, you must acknowledge that you are not engaging in, and do not intend to engage in, a distribution of the exchange notes. If you decide to tender your existing notes in the exchange offer, you may withdraw them at any time prior to _____, 2004. If we decide for any reason not to accept any existing notes for exchange, your existing notes will be returned to you without expense to you promptly after the exchange offer expires. <b>The method of delivery of existing notes, letters of transmittal and notices of guaranteed delivery is at your election and risk. If delivery is by mail, we recommend that registered mail, properly insured, with return receipt requested, be used. In all cases, sufficient time should be allowed to assure timely delivery. No letters of transmittal or existing notes should be sent to us.</b> |

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|                                  |   |
|----------------------------------|---|
| Conditions of the Exchange Offer | The exchange offer is subject to the following conditions, which we may waive:<br><br>the exchange offer, or the making of any exchange by a holder of existing notes, will not violate any applicable law or interpretation by the staff of the SEC; and<br><br>no action may be pending or threatened in any court or before any governmental agency with respect to the exchange offer that may impair our ability to proceed with the exchange offer.   |
| Federal Income Tax Consequences  | Your exchange of existing notes for exchange notes in the exchange offer will not result in any income, gain or loss to you for Federal income tax purposes. See Material United States Federal Income Tax Consequences of the Exchange Offer.  |
| Use of Proceeds                  | We will not receive any proceeds from the issuance of the exchange notes in the exchange offer.   |
| Exchange Agent                   | American Stock Transfer & Trust Company is the exchange agent for the exchange offer.   |
| Resales                          | We believe that the exchange notes issued in the exchange offer may be offered for resale, resold and otherwise transferred by you without compliance with the registration and prospectus delivery provisions of the Securities Act, provided that:<br><br>you acquire the exchange notes in the ordinary course of your business;<br><br>you are not participating, do not intend to participate, and have no arrangement or understanding with any person to participate, in the distribution of the exchange notes issued in the exchange offer; and<br><br>you are not an affiliate of ours.<br><br>If any of these conditions is not satisfied and you transfer any exchange notes issued to you in the exchange offer without delivering a prospectus meeting the requirements of the Securities Act or without an exemption from registration of your exchange notes from those requirements, you may incur liability under the Securities Act. We will not assume nor indemnify you against any such liability.<br><br>Each broker-dealer that is issued exchange notes in the exchange offer for its own account in exchange for outstanding notes, where such outstanding notes were acquired by that broker-dealer as a result of market-making or other trading activities, must acknowledge that it will deliver a prospectus meeting the requirements of the Securities Act in connection with any resale of the exchange notes. See Plan of Distribution. |

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Procedures for Tendering Outstanding Notes

If you wish to accept the exchange offer, you must complete, sign and date the letter of transmittal, or a facsimile of the letter of transmittal, in accordance with the instructions contained in this prospectus and in the letter of transmittal. You should then mail or otherwise deliver the letter of transmittal, or facsimile, together with the existing notes to be exchanged and any other required documentation, to the exchange agent at the address set forth in this prospectus and in the letter of transmittal.

By executing the letter of transmittal, you will represent to us that, among other things:

you, or the person or entity receiving the related exchange notes, are acquiring the exchange notes in the ordinary course of business;

neither you nor any person or entity receiving the related exchange notes is engaging in or intends to engage in a distribution of the exchange notes within the meaning of the federal securities laws;

neither you nor any person or entity receiving the related exchange notes has an arrangement or understanding with any person or entity to participate in any distribution of the exchange notes;

neither you nor any person or entity receiving the related exchange notes is our affiliate, as defined in Rule 405 under the Securities Act;

if you are a broker-dealer, you will receive the exchange notes for your own account in exchange for outstanding existing notes acquired as the result of market making activities or other trading activities and that you will deliver a prospectus in connection with any resale of the exchange notes; and

you are not acting on behalf of any person or entity that could not truthfully make these statements.

Alternatively, you may tender your outstanding existing notes by following the procedures for book-entry delivery or by complying with the guaranteed delivery procedures each described in this prospectus. See *The Exchange Offer Procedures for Tendering Existing Notes*.

Failure to Tender Your Existing Notes

If you fail to tender your existing notes in the exchange offer, you will not have any further rights under the registration rights agreement. Because the existing notes are not registered under the Securities Act of 1933, the existing notes and the exchange notes will not be

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interchangeable. Consequently, if you fail to tender your existing notes in the exchange offer, you will not be able to trade your existing notes in any market that may develop for the exchange notes. There can be no assurance as to the development of any such market. If most of the existing notes are tendered in the exchange offer, holders of existing notes that have not been exchanged will likely have little trading liquidity.

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**EXCHANGE NOTES**

*The terms of the exchange notes and the existing notes are identical in all material respects, except that the exchange notes have been registered under the Securities Act, and the transfer restrictions and registration rights relating to the existing notes do not apply to the exchange notes.*

*The following summary contains basic information about the notes and is not intended to be complete. It does not contain all the information that is important to you. For a more complete understanding of the notes, please refer to the section of this document entitled *Description of Notes*.*

|                                 |   |
|---------------------------------|---|
| Issuer                          | Infinity Property and Casualty Corporation.   |
| Notes Offered                   | \$200,000,000 aggregate principal amount of 5.50% Series B Senior Notes due 2014.   |
| Maturity Date                   | The notes will mature on February 18, 2014.   |
| Interest Payment Dates          | Each February 18 and June 18.   |
| Optional Redemption             | The notes will be redeemable, at our option, at any time in whole or in part, at a redemption price equal to the greater of (i) 100% of their principal amount and (ii) the sum of the present values of the remaining scheduled payments of principal and interest thereon discounted, on a semi-annual basis, at the treasury rate plus 20 basis points, plus accrued interest to the date of redemption.   |
| Ranking                         | <p>The notes will be our senior unsecured obligations and will rank equally in right of payment with any of our existing and future unsecured and unsubordinated indebtedness.</p> <p>The notes will be effectively subordinated to any of our future secured indebtedness to the extent of the value of the assets securing that indebtedness.</p> <p>As of the date of this prospectus, our aggregate principal amount of indebtedness was approximately \$200 million (excluding intercompany liabilities), consisting of the existing notes.</p> <p>We are a holding company and conduct our operations through our subsidiaries. However, the notes will not be guaranteed by any of our subsidiaries and will therefore be structurally subordinated to all indebtedness and other obligations, including trade payables and insurance liabilities, of our subsidiaries. As of December 31, 2003, our subsidiaries had approximately \$1,250 million of liabilities (including trade payables, capital lease obligations and insurance liabilities but excluding intercompany liabilities).</p> |
| Absence of Market for the Notes | The exchange notes are a new issue of securities with no established trading market. We currently have no intention to apply to list the exchange notes on a securities exchange or seek their admission to trading on an automated quotation system. We cannot provide any assurance as to the development or liquidity of any   |

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market for the exchange notes. See Plan of Distribution.

Form and Denomination

The Depository Trust Company ( DTC ) will act as securities depository for the exchange notes, which will be issued only as fully registered global securities registered in the name of DTC or its nominee for credit to an account of a direct or indirect participant in DTC, except in certain circumstances. One or more fully registered global notes will be issued to DTC for the exchange notes. The exchange notes will be issued in denominations of \$1,000 and integral multiples thereof.



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**RISK FACTORS**

*Your decision whether or not to participate in the exchange offer and own existing notes or exchange notes involves risk. You should be aware of, and carefully consider, the following risk factors, along with all of the other information provided in this prospectus, before deciding whether or not to participate in the exchange offer.*

**Risks Related to Our Business**

***Completion of our ongoing consolidation of the operations of our insurance subsidiaries may not be successful.***

We are combining the operations of several insurance companies that were operated previously as independent business units. The process of consolidating the operations of insurance subsidiaries, while complete in many respects, poses managerial, strategic, and technological challenges, particularly in connection with the integration of historically separate information systems to a single system. The prospective costs and benefits of the consolidation may not result in equivalent or greater operating efficiencies and savings than those that have already been achieved. Such consolidation may negatively impact our revenues.

***Because we are primarily a personal automobile insurer, our business may be adversely affected by conditions in that business.***

Approximately 95% of our gross written premiums for the twelve month periods ended December 31, 2002 and 2003 were generated from personal automobile insurance policies. Adverse developments in the market for personal automobile insurance, or the personal automobile insurance industry in general, could cause the results of operations to suffer. This industry is exposed to the risks of severe weather conditions, such as rainstorms, snowstorms, hail and ice storms, hurricanes, tornadoes, earthquakes and, to a lesser degree, explosions, terrorist attacks and riots. The automobile insurance business is also affected by cost trends that impact profitability. Factors which negatively affect cost trends include inflation in automobile repair costs, automobile parts costs, used car prices and medical care. Increased litigation of claims may also negatively affect loss costs.

***Our results may fluctuate as a result of cyclical changes in the personal auto insurance industry.***

The personal automobile insurance industry historically is cyclical in nature. The industry has been characterized by periods of price competition and excess capacity followed by periods of high premium rates and shortages of underwriting capacity. Adverse future fluctuations in the business cycle would be likely to negatively impact future revenues.

***Intense competition could adversely affect our profitability.***

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The personal automobile insurance business is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. We compete with both large national writers and smaller regional companies. Some of our competitors have more capital and greater resources, and may offer a broader range of products and lower prices. Some competitors that are direct writers may have certain competitive advantages, including increased name recognition, direct relationships with policyholders rather than with independent agents and, potentially, lower cost structures.

*We are vulnerable to a reduction in the amount of business written by independent agents.*

Reliance on the independent agency market makes us vulnerable to a reduction in the amount of business written by independent agents. Many competitors share our significant reliance on the independent agency market. Approximately two-thirds of all personal automobile insurance sold in the United States is sold direct or through captive agents (agents employed by one company or selling only one company's products) and approximately one-third is sold by independent agents. A material reduction in the amount of business independent agents sell would negatively impact future revenues.

*If we are not able to attract and retain independent agents, revenues could be negatively affected.*

We must compete with other insurance carriers for independent agents' business. Some competitors offer a larger variety of products, lower prices for insurance coverage, higher commissions, or more attractive non-cash

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incentives. Although we believe that the products, pricing, commissions and services offered to agents are competitive, we may not be able to continue to attract and retain independent agents to sell our insurance products, in which case revenues could be negatively affected.

*We are subject to comprehensive regulations and our ability to earn profits may be restricted by these regulations.*

We are subject to comprehensive regulation by government agencies in the states where our insurance company subsidiaries are domiciled (California, Indiana, Ohio, Oklahoma and Texas) and where these subsidiaries issue policies and handle claims. We are subject to regulations involving:

the payment of dividends;

the acquisition or disposition of an insurance company or of any company controlling an insurance company;

approval or filing of premium rates and policy forms;

involuntary assignments of high-risk policies, participation in reinsurance facilities and underwriting associations, assessments and other governmental charges;

minimum amounts of capital and surplus that must be maintained;

limitations on types and amounts of investments;

limitation of the right to cancel or non-renew policies;

regulation of the right to withdraw from markets or terminate involvement with agencies;

licensing of insurers and agents;

reporting with respect to financial condition; and

transactions between an insurance company and any of its affiliates.

In addition, state insurance department examiners perform periodic financial and market conduct examinations of insurance companies. Such regulation is generally intended for the protection of policyholders rather than security holders.

*Regulation may become more extensive in the future.*

Existing insurance-related laws and regulations may become more restrictive in the future, and new restrictive laws may be enacted. New or more restrictive regulation in the future could make it more expensive to conduct business, restrict the premiums we are able to charge or otherwise change the way we do business. See Business Regulatory Environment.

*Our insurance subsidiaries are subject to minimum capital and surplus requirements. A failure to meet these requirements could subject us to regulatory action.*

Our insurance subsidiaries are subject to minimum capital and surplus requirements imposed under the laws of California, Indiana, Ohio, Oklahoma and Texas. Any failure by an insurance subsidiary to meet the minimum capital and surplus requirements imposed by applicable state law will subject it to corrective action, including requiring the adoption of a comprehensive financial plan, examination and the issuance of a corrective order by the applicable state insurance department, revocation of its license to sell insurance products or placing the subsidiary under state regulatory control. Any new minimum capital and surplus requirements adopted in the future may require increases in our capital and surplus levels, which may not be possible. As of December 31, 2003, each insurance company subsidiary had capital and surplus substantially in excess of the currently required amounts.

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***A failure to maintain a commercially acceptable financial strength rating would significantly and negatively affect our ability to implement our business strategy successfully.***

Financial strength ratings are an important factor in establishing the competitive position of insurance companies and may be expected to have an effect on an insurance company's sales. A.M. Best has currently assigned our insurance company subsidiaries a group rating of A (Excellent). According to A.M. Best, A ratings are assigned to insurers which have, on balance, excellent balance sheet strength, operating performance and business profile when compared to the standards established by A.M. Best and, in A.M. Best's opinion, have a strong ability to meet their ongoing obligations to policyholders. A.M. Best bases its ratings on factors that concern policyholders and not upon factors concerning investor protection. Such ratings are subject to change and are not recommendations to buy, sell or hold securities. There can be no assurance that our rating or future changes to our rating will not affect our competitive position.

***New claim and coverage issues are continually emerging, and these new issues could negatively impact our revenues or our method of doing business.***

As automobile insurance industry practices and regulatory, judicial and consumer conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues can have a negative effect on our business by either extending coverage beyond our underwriting intent or by increasing the size of claims. Recent examples of emerging claims and coverage issues include:

the use of an applicant's credit rating as a factor in making risk selection and pricing decisions;

the availability of coverages which pay different commission levels to agents depending upon premium level; and

a growing trend of plaintiffs targeting automobile insurers, including us, in purported class action litigation relating to claim-handling practices such as total loss evaluation methodology.

The effects of these and other unforeseen emerging claim and coverage issues could negatively impact our revenues or methods of doing business. See Business Legal Proceedings.

***If reserves are inadequate, our financial results could be negatively affected.***

We record reserve liabilities for the estimated payment of losses and loss adjustment expenses for both reported and unreported claims. Due to the inherent uncertainty of estimating reserves, it has been necessary in the past, and may continue to be necessary in the future, to revise estimated liabilities as reflected in reserves for claims and related expenses. To the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period in which the deficiency is recognized. The historic development of reserves for losses and loss adjustment expense may not necessarily reflect future trends in the development of these amounts. Accordingly, it is not appropriate to extrapolate redundancies or deficiencies based on historical information.

***We are dependent on key executives.***

Our success will depend in part upon the continued service of Chief Executive Officer and President, James R. Gober, Executive Vice President, John R. Miner, Senior Vice President and General Counsel, Samuel J. Simon, Senior Vice President and Chief Financial Officer, Roger Smith and Senior Vice President, Joseph A. Pietrangelo. We have employment agreements with Mr. Gober, Mr. Miner, Mr. Simon, and Mr. Smith. We do not have key person insurance on the lives of any of these individuals. Future success will also depend on our ability to attract and retain additional executives and personnel. The loss of key personnel could cause disruption in our business. As we grow, we will need to recruit and retain additional qualified personnel, and we may not be able to do so.

*Adverse securities market conditions can have significant and negative effects on our investment portfolio.*

Our results of operations depend in part on the performance of our invested assets. As of December 31, 2003, 98% of our investment portfolio was invested in fixed maturity securities and 2% in equity securities. Certain risks are inherent in connection with fixed maturity securities including loss upon default and price volatility in

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reaction to changes in interest rates and general market factors. An increase in interest rates lowers prices on fixed maturity securities, and any sales during a period of increasing interest rates may result in losses. Conversely, investment income earned from future investments in fixed maturity securities will decrease if interest rates decrease.

*Our results may be adversely affected by conditions in the states where our business is concentrated.*

For the year ended December 31, 2003, we generated approximately 87% of gross written premiums in our top 15 states. California, our largest market, generated approximately 34% and 46%, respectively, of our gross written premiums in 2002 and 2003. Revenues and profitability are therefore subject to prevailing regulatory, legal, economic, demographic, competitive and other conditions in these states. Changes in any of these conditions could make it less attractive to do business in those states. Adverse regulatory developments in any of these states, which could include, among others, reductions in the rates permitted to be charged, inadequate rate increases, an inability to reduce the amount of insurance we write in those states, or more fundamental changes in the design or implementation of the automobile insurance regulatory framework, could negatively affect premium revenue or make it more expensive or less profitable to conduct business.

### **Risks Related to Exchanging Your Notes**

*As a holding company, we depend on our subsidiaries for funds to meet our payment obligations under the notes. The ability of our insurance subsidiaries to make payments of dividends and distributions is limited by law.*

As a holding company, we conduct all of our operations through our insurance company subsidiaries. As of December 31, 2003, our insurance company subsidiaries had approximately 96% of our consolidated assets and \$1,250 million of liabilities (including trade payables, capital lease obligations and insurance liabilities but excluding intercompany liabilities). For the year ended December 31, 2003, our insurance company subsidiaries generated virtually all of our net income. Our insurance company subsidiaries and affiliates are separate and distinct legal entities and do not guarantee the notes. These entities have no obligation to pay interest or principal due on the notes or to make funds available to us for that purpose, whether in the form of loans, dividends or other distributions. We are dependent, however, on our subsidiaries' ability to make dividend or other payments to us in order to meet our obligations under the notes. Our insurance subsidiaries' ability to make dividend or other payments to us is subject to regulatory restrictions or, in some cases, prior approval by regulatory authorities.

*Because of our holding company structure, the notes are structurally subordinated to the claims of creditors of our subsidiaries.*

Because we are a holding company and conduct all our operations through our subsidiaries, payments to holders of the notes are structurally subordinated to present and future debt and other obligations, including trade payables and insurance liabilities, of our subsidiaries. In the event of bankruptcy, insolvency, liquidation or similar proceedings affecting a subsidiary of ours, the proceeds from the sale of the assets of that subsidiary will be available to pay obligations on the notes only after all of the liabilities (including trade payables and insurance liabilities) of that subsidiary have been paid in full. In the event of a default by any subsidiary of ours under any credit arrangement or other indebtedness, its creditors could accelerate that debt so that all amounts become due and payable prior to that subsidiary distributing amounts to us that we could have used to make payments on the notes. In addition, if we caused any insurance company subsidiary to pay a dividend to us to pay obligations on the notes, and such dividend were determined to have been either made in breach of the relevant corporate laws or a fraudulent transfer, holders of the notes would be required to return the payment to such subsidiaries' creditors, as applicable.

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As of the date of this prospectus, our aggregate principal amount of indebtedness (excluding intercompany liabilities) consisted solely of \$200 million of existing notes. The notes are not guaranteed by any of our subsidiaries and are therefore structurally subordinated to all indebtedness and other obligations, including trade payables and insurance liabilities, of our subsidiaries. As of December 31, 2003, our subsidiaries had approximately \$1,250 million of total liabilities (including trade payables, capital lease obligations and insurance liabilities but excluding intercompany liabilities).



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***Payments on the notes are effectively subordinated to claims of our future secured creditors to the extent of the value of the assets securing that indebtedness.***

The notes represent our senior unsecured obligations. Accordingly, our secured creditors have claims that are superior to your claims as holders of the notes to the extent of the value of the assets securing that other indebtedness. In the event of any foreclosure, dissolution, winding-up, liquidation, reorganization, or other bankruptcy proceeding, the proceeds from the sale of the collateral that secures our indebtedness will be available to pay obligations on the notes only after all indebtedness under our secured debt has been paid in full. If any of the foregoing events occur, we cannot assure you that there will be sufficient assets to pay amounts due on the notes. Holders of the notes will participate ratably with all other holders of our senior unsecured and unsubordinated indebtedness, including all of our other general trade creditors, based upon the respective amounts owed to each holder or creditor, in our remaining assets. As of the date of this prospectus, we have no outstanding secured debt.

***The indenture governing the terms of the notes contains only limited protection for holders of the notes in the event we are involved in a highly leveraged transaction, reorganization, restructuring, merger or similar transaction in the future.***

The indenture under which the existing notes were issued and the exchange notes will be issued may not sufficiently protect holders of notes in the event we are involved in a highly leveraged transaction, reorganization, restructuring, merger or similar transaction. The indenture does not contain:

any provision restricting us or any of our subsidiaries from purchasing or redeeming capital stock;

subject to the covenant described below in Description of Notes Certain Covenants Limitation on Disposition of Stock of Significant Subsidiaries, any prohibition on the ability of our subsidiaries to issue securities that would be senior to the common stock of the subsidiary held by us;

any financial ratios or specified level of net worth to which we or our subsidiaries must adhere; or

any restrictions on our ability to contribute our assets to our insurance subsidiaries.

***If you do not properly tender your existing notes, your ability to transfer your existing notes will be adversely affected.***

We will only issue exchange notes in exchange for existing notes that are timely received by the exchange agent, together with all required documents, including a properly completed and signed letter of transmittal. Therefore, you should allow sufficient time to ensure timely delivery of the existing notes and you should carefully follow the instructions on how to tender your existing notes. Neither we nor the exchange agent are required to tell you of any defects or irregularities with respect to your tender of the existing notes. If you do not tender your existing notes or if your tender of existing notes is not accepted because you did not tender your existing notes properly, then, after consummation of the exchange offer, you will continue to hold existing notes that are subject to the existing transfer restrictions. After the exchange offer is consummated, if you continue to hold any existing notes, you may have difficulty selling them because there will be fewer existing notes remaining, and the market for such existing notes, if any, will be much more limited than it is currently. In particular, the trading market for unexchanged existing notes could become more limited than the current trading market for the existing notes and could cease to exist altogether due to the reduction in the amount of the existing notes remaining upon consummation of the exchange offer. A more limited trading market might adversely affect the liquidity, market price and price volatility of such untendered existing notes.

*If you are a broker-dealer or participating in a distribution of the exchange notes, you may be required to deliver prospectuses and comply with other requirements.*

If you tender your existing notes for the purpose of participating in a distribution of the exchange notes, you will be required to comply with the registration and prospectus delivery requirements of the Securities Act of 1933 in connection with any resale of the exchange notes. If you are a broker-dealer that receives exchange notes for your own account in exchange for outstanding notes that you acquired as a result of market-making activities or

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other trading activities, you will be required to acknowledge that you will deliver a prospectus in connection with any resale of such exchange notes.

*You may be unable to sell your exchange notes if a trading market for the exchange notes does not develop.*

The exchange notes will be new securities for which there is currently no established trading market, and none may develop. The liquidity of any market for the exchange notes will depend on the number of holders of the exchange notes, the interest of securities dealers in making a market in the exchange notes and other factors. Accordingly, there can be no assurance as to the development or liquidity of any market for the exchange notes. If an active trading market does not develop, the market price and liquidity of the exchange notes may be adversely affected. If the exchange notes are traded, they may trade at a discount from their initial offering price depending upon prevailing interest rates, the market for similar securities, general economic conditions, our performance and business prospects and certain other factors. In addition, if a large amount of existing notes are not tendered or are tendered improperly, the limited amount of exchange notes that would be issued and outstanding after consummation of the exchange offer could lower the market price of such exchange notes.

**USE OF PROCEEDS**

We will not receive any proceeds from the issuance of the exchange notes in the exchange offer.

**RATIO OF EARNINGS TO FIXED CHARGES**

For purposes of calculating the ratios, earnings have been computed by adding to pro forma pretax earnings the pro forma fixed charges, including interest as reported in pro forma earnings for the respective period. Pro forma fixed charges include interest on the senior notes and a portion of rental expense deemed to be representative of the interest factor.

|  | Year ended<br>December 31,<br>2003 | Year ended<br>December 31,<br>2002 |
|--|------------------------------------|------------------------------------|
| Pro Forma Ratio of Earnings to Fixed Charges | 5.6                                | 4.7                                |

**CAPITALIZATION**

The following table sets forth our consolidated capitalization as of December 31, 2003, and should be read in conjunction with our consolidated financial statements included in this prospectus.

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|  | December 31,<br>2003                                    |              |
|--|---|--------------|
|  | As  |              |
|  | Actual  | Adjusted     |
|  | (dollars in<br>millions except<br>per share<br>amounts) |              |
| Term Loan  | 195.5   | 0.0          |
| Senior Notes   | 0.0   | 199.3        |
| Shareholders' equity:  |   |              |
| Preferred stock; 10,000,000 shares authorized; no shares issued or outstanding                           | 0.0   | 0.0          |
| Common stock and paid-in capital; 50,000,000 shares authorized; 20,483,958 shares issued and outstanding | 344.3   | 344.3        |
| Unrealized gain on marketable securities   | 36.2  | 36.2         |
| Retained earnings  | 74.9  | 72.6         |
| <b>Total shareholders' equity</b>  | <b>455.4</b>  | <b>453.1</b> |
| Total capitalization   | 650.9   | 652.4        |
| <b>Book value per common share</b>   | <b>22.37</b>  | <b>22.27</b> |
| Ratio of Debt to Total Capitalization  | 30.00%  | 30.50%       |

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At December 31, 2002, AFG transferred the NSA Group to us. Financial information for periods prior to the date of transfer represents the combined information of the NSA Group. We also acquired the Assumed Agency Business from GAI through a reinsurance transaction effective January 1, 2003. The historical financial information shown below (in millions) as of and for each of the four years ended December 31, 1999 through 2002 was derived from audited financial statements and excludes Assumed Agency Business. Our financial data as of and for the twelve months ended December 31, 2003 include the combined results of the NSA Group and the Assumed Agency Business. This information should be read in conjunction with the more detailed information contained in the consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations in this prospectus.

**Infinity Property and Casualty Corporation****Consolidated Condensed Statements of Income****(In thousands)**

|  | Year Ended December 31, |             |             |            |            |
|--|-------------------------|-------------|-------------|------------|------------|
|  | 2003                    | 2002        | 2001        | 2000       | 1999       |
| <b>Infinity</b>                                  |                         |             |             |            |            |
| <i>Earnings Statement Data:</i>                  |                         |             |             |            |            |
| Earned Premiums                                  | \$ 698.7                | \$ 645.9(a) | \$ 916.4(a) | \$ 1,043.3 | \$ 944.5   |
| Total Revenues                                   | 769.0                   | 704.5       | 990.0       | 1,110.8    | 1,044.9    |
| Net Earnings (Loss)                              | 58.2                    | 45.9        | 9.7         | (50.1)     | 50.9       |
| Net Earnings per Common Share:                   |                         |             |             |            |            |
| Basic  | \$ 2.86                 | n/a         | n/a         | n/a        | n/a        |
| Diluted  | \$ 2.83                 |             |             |            |            |
| Cash Dividends Declared per Common Share         | \$ 0.165                |             |             |            |            |
| <i>Balance Sheet Data:</i>                       |                         |             |             |            |            |
| Cash and Investments                             | \$ 1,392.2              | \$ 1,061.3  | \$ 1,188.1  | \$ 1,216.2 | \$ 1,095.6 |
| Total Assets                                     | 1,900.1                 | 1,550.9     | 1,760.4     | 1,787.9    | 1,594.9    |
| Unpaid Losses and Loss Adjustment Expenses       | 709.9                   | 604.0       | 645.2       | 640.3      | 553.3      |
| Long-Term Debt                                   | 195.5                   |             |             |            |            |
| Total Liabilities                                | 1,444.8                 | 1,164.1     | 1,197.7     | 1,173.7    | 1,060.9    |
| Shareholders' Equity                             | 455.4                   | 386.8       | 562.8       | 614.2      | 534.0      |
| <b>Assumed Agency Business(c)</b>                |                         |             |             |            |            |
| <i>Earnings Statement Data:</i>                  |                         |             |             |            |            |
| Earned Premiums                                  |                         | \$ 107.2(b) | \$ 149.9    | \$ 128.9   | \$ 138.5   |
| Underwriting Gain (Loss)                         |                         | (10.0)      | (14.7)      | (3.6)      | 18.6       |
| <i>Balance Sheet Data:</i>                       |                         |             |             |            |            |
| Assets (excluding investments) to be Transferred |                         | \$ 53.5     | \$ 78.8     | \$ 65.2    | \$ 55.4    |
| Investments to be Transferred                    |                         | 125.3       |             |            |            |
| Unpaid Losses and Loss Adjustment Expenses       |                         | 125.6       | 115.9       | 105.9      | 118.3      |
| Liabilities to be Transferred                    |                         | 178.8       | 200.5       | 173.3      | 183.1      |

(a) The decline in earned premiums during 2001 and 2002 is due primarily to a reinsurance agreement pursuant to which we ceded 90% of the automobile physical damage business written by it as more fully discussed in Management's Discussion and Analysis of Financial

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### Condition and Results of Operations.

- (b) The decline in earned premiums during 2002 reflects the inclusion of the Assumed Agency Business in the reinsurance agreement discussed above effective January 1, 2002.
- (c) The results of the Assumed Agency's Business's operations and its balance sheet data are included in the figure as of and for the twelve month period ended December 31, 2003.

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**MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATION**

**General**

Following is a discussion and analysis of our financial statements and the financial statements of the agency business that we assumed from GAI on January 1, 2003. Together, these businesses comprise our operations since that date. References in this discussion to us include the NSA Group and the Assumed Agency Business unless the context indicates otherwise. This discussion should be read in conjunction with the audited financial statements, and following, the financial statements of the Assumed Agency Business as of and for the twelve month periods ended December 31, 2002 and 2001, which are included with this prospectus.

We were incorporated in the state of Ohio in September 2002 as an indirect wholly-owned subsidiary of AFG. On December 31, 2002, AFG transferred to us all of the outstanding common stock of the NSA Group.

Through a reinsurance transaction effective January 1, 2003, we acquired the Assumed Agency Business consisting of the personal lines business written through independent agents by AFG's principal property and casualty subsidiary, GAI. The Assumed Agency Business had net earned premiums of \$107 million in 2002 consisting primarily of standard and preferred private passenger automobile insurance. The Assumed Agency Business is not included in our historical financial statements for periods prior to 2003.

The acquisition of the NSA Group and the assumption of the Assumed Agency Business have been accounted for at AFG's historical carrying amounts as transfers of net assets between entities under common control in accordance with Statement of Financial Accounting Standards (SFAS) No. 141.

**Critical Accounting Policies**

The preparation of financial statements requires management to make estimates and assumptions that can have a significant effect on amounts reported in the financial statements. As more information becomes known, these estimates and assumptions could change and thus impact amounts reported in the future. Management believes that the establishment of insurance reserves, the determination of other than temporary impairment on investments, and accruals for litigation are the areas where the degree of judgment required to determine amounts recorded in the financial statements make the accounting policies critical.

***Insurance Reserves***

Insurance reserves, or Unpaid Losses and Loss Adjustment Expenses, are management's best estimate of the ultimate amounts that will be paid for all claims that have been reported up to the date of the current accounting period but that have not yet been paid, plus an estimate of claims that have occurred but have not yet been reported to the company (incurred but not reported, or IBNR), and the expenses to be paid to settle

claims (allocated and unallocated loss adjustment expenses, or ALAE and ULAE ).

Liabilities for the costs of losses and loss adjustment expenses ( LAE ) for both reported and unreported claims are estimated based on historical trends adjusted for changes in loss cost trends, underwriting standards, policy provisions, product mix and other factors. Estimating dollar amounts for unpaid losses and LAE is inherently judgmental and is influenced by factors, which are subject to significant variation. Changes in underlying estimates or assumptions and the resulting adjustments to reserves are reflected in the results of operations in the periods in which estimates change.

Management analyzes the adequacy of reserves using actuarial data and analytical reserve development techniques, including projections of ultimate paid losses, to determine the ultimate amounts of reserves. Historical medical, hospitalization, material repair and replacement costs, general economic trends and the legal environment are examples of major factors taken into account in developing these estimates.

In developing IBNR reserve amounts, quarterly estimates are made of ultimate frequency, or number of claims per earned car year, and severity, or claim cost per earned car year. Frequency can be affected by factors such as driving patterns, gas prices, changes in classes of insured drivers, and weather events. Factors affecting the severity trend include medical cost and product repair cost trends, and litigation expense patterns.  
Management



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believes that our relatively low average policy limit and concentration on the nonstandard auto driver classification help stabilize fluctuations in frequency and severity.

An increase in either frequency or severity of 1% for the current accident year would decrease earnings per share by \$0.14.

### ***Other Than Temporary Losses on Investments***

Changes in the market values of investment securities are usually recorded as changes in unrealized gains or losses on investments, a component of shareholders' equity. Net earnings are not affected until the disposition of a given security or, if an unrealized loss is deemed to be other than temporary, an impairment charge is recorded as a realized capital loss and the cost basis of the security 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:

Whether the unrealized loss is credit-driven or a result of changes in market interest rates,

the extent to which market value is less than cost basis,

historical operating, balance sheet and cash flow data contained in issuer SEC filings,

issuer news releases,

near-term prospects for improvement in the issuer and/or its industry,

industry research and communications with industry specialists,

third party research and credit rating reports,

internally generated financial models and forecasts,

discussions with issuer management, and

ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

We recorded pretax impairment charges on securities as follows (in thousands):

|                  | Twelve months ended |                 |
|------------------|---------------------|-----------------|
|                  | December 31,        |                 |
|                  | 2003                | 2002            |
| Fixed maturities | \$ 3,877            | \$ 6,315        |
| Equities         | 566                 | 3,095           |
| <b>Total</b>     | <b>\$ 4,443</b>     | <b>\$ 9,410</b> |

The following chart summarizes our security positions with unrealized losses which were less than twelve months old and greater than twelve months old as of December 31, 2003 (in thousands):

|                   | Less than twelve months |                   |                   |                 |
|-------------------|-------------------------|-------------------|-------------------|-----------------|
|                   | Number                  |                   |                   |                 |
|                   | Of                      | Amortized         | Market            | Unrealized      |
|                   | Securities              | Cost              | Value             | Loss            |
| Fixed Maturities  | 52                      | \$ 187,885        | \$ 185,752        | \$ 2,133        |
| Equity securities | 4                       | 6,325             | 6,268             | 57              |
| <b>Total</b>      | <b>56</b>               | <b>\$ 194,210</b> | <b>\$ 192,020</b> | <b>\$ 2,190</b> |

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|                   | Greater than twelve months |                  |                  |               |
|-------------------|----------------------------|------------------|------------------|---------------|
|                   | Number                     |                  |                  |               |
|                   | Of                         | Amortized        | Market           | Unrealized    |
|                   | Securities                 | Cost             | Value            | Loss          |
| Fixed Maturities  | 9                          | \$ 12,320        | \$ 11,883        | \$ 437        |
| Equity securities |                            |                  |                  |               |
| <b>Total</b>      | <b>9</b>                   | <b>\$ 12,320</b> | <b>\$ 11,883</b> | <b>\$ 437</b> |

Management regularly evaluates potential impairment for each security position that (i) has a market value of less than 80% of its book value or (ii) exceeds \$100,000, as well as each position held for which one or more impairment charges have been recorded in the past. The process of evaluation includes assessments of each bullet point listed above. For the unrealized loss positions in the chart, the majority of the evidence that management gathered and considered indicated near term recovery, resulting in conclusions that these particular unrealized losses were more likely of a temporary nature. Should the preponderance of evidence turn negative for one or all of these positions in the future, impairment charges would likely be recorded. Since it is not possible to accurately predict if or when a specific security will become other-than-temporarily impaired, total impairment charges could be material to the results of operations in a future period. Management believes that it is not likely, however, that such impairment charges will have a significant effect on our liquidity.

**Accruals for Litigation**

We continually evaluate potential liabilities and reserves for litigation using the criteria established by SFAS No. 5, *Accounting for Contingencies*. Under this guidance, reserves for loss may only be recorded if the likelihood of occurrence is probable and the amount is reasonably estimable. Management considers each legal action using this guidance and records reserves for losses as appropriate. We believe the current assumptions and other considerations used to estimate potential liability for litigation are appropriate. While it is not possible to know with certainty the ultimate outcome of these claims or lawsuits, management does not expect them to have a material effect on our financial condition, liquidity, or results of operations.

**Liquidity and Capital Resources****Ratios**

The National Association of Insurance Commissioners (NAIC) model law for risk-based capital (RBC) provides formulas to determine the amount of capital that an insurance company needs to ensure that it has an acceptable expectation of not becoming financially impaired. At December 31, 2003, the capital ratios of all of our insurance companies substantially exceeded the RBC requirements.

**Sources of Funds**

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We are organized as a holding company with all of our operations being conducted by our insurance subsidiaries. Accordingly, we will have continuing cash needs for administrative expenses, the payment of principal and interest on borrowings, shareholder dividends, and taxes. Funds to meet these obligations will come primarily from dividends and distributions from the insurance subsidiaries.

We plan to file a consolidated federal income tax return including all 80%-owned U.S. subsidiaries for periods after our initial public offering. We have executed a tax allocation agreement with our eligible subsidiaries under which each subsidiary agrees to pay our taxes computed on a separate company taxable income basis. We agree to pay each subsidiary for the tax benefit, if any, of net losses used by other members of the consolidated group. The resulting provision or credit will be currently payable to or from the parent company, Infinity Property and Casualty Corporation.

In July 2003, we secured a \$200 million, seven-year amortizing term loan and added a revolving credit line of \$20 million in the fourth quarter of 2003. Proceeds of \$110 million were contributed to our insurance

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subsidiaries to support future growth of their business and reduce their reliance on reinsurance. The remaining proceeds were used to repay a \$55 million promissory note issued in connection with our initial public offering and for general corporate purposes. The term loan was collateralized by our assets including a pledge of stock of our insurance subsidiaries and contained various covenants that require us to meet certain minimum net worth and financial ratio standards. Principal payments of \$4.5 million were made in 2003 and a required supplemental payment of \$2.5 million was made in January 2004 from the proceeds of the over allotment share issuance in connection with the secondary stock offering.

In February 2004, we issued the existing notes. Interest payments due in 2004 are \$5.5 million. The proceeds of this offering were used to repay in full the principal balance of the term loan. Refer to Note 14 of the consolidated financial statements included in this prospectus for more information on this transaction.

Our insurance subsidiaries generate liquidity primarily by collecting and investing premiums in advance of paying claims. We had positive cash flow from operations of approximately \$69 million in 2003, \$45 million in 2002, and \$33 million in 2001.

As of December 31, 2003, we had \$64.5 million of cash and investments, of which \$11.1 million was owed to our subsidiaries.

In 2003, our operating subsidiaries paid us \$39 million in ordinary dividends. In 2004, they may pay to us up to \$46 million in ordinary dividends without prior regulatory approval. Management believes that our cash and investment balances and cash flows generated from operations, including dividends and distributions from our subsidiaries, are adequate to meet our future liquidity needs.

## ***Quota Share Agreement***

We utilize the reinsurance market to manage our capital and surplus levels relative to our reserve liabilities, supporting our capacity for growth (as well as manage our risk). Throughout 2002, our insurance subsidiaries ceded 90% of their personal auto physical damage business on a funds withheld basis to Inter-Ocean Reinsurance Company Ltd. ( Inter-Ocean ). We renewed this agreement for 2003 on terms substantially equivalent to those in effect in 2002 except that we added the flexibility to elect, on a quarterly basis, the percentage of business to be ceded under the reinsurance agreement. The allowable range was between 90% and 20%.

Because we obtained the \$200 million term loan facility, the amount of premiums ceded under this agreement was reduced from 90% to 20% for the third and fourth quarters of 2003. Premiums ceded under this agreement for the twelve month periods ended December 31, 2003 and 2002 were \$169.5 million and \$296.1 million, respectively.

In September 2002, the Inter-Ocean agreement was amended to include coverage of GAI's personal lines that we would otherwise assume as part of the Assumed Agency Business. Accordingly, GAI's participation in the Inter-Ocean reinsurance agreement reduces the size of the Assumed Agency Business. Premiums ceded by GAI under this agreement were \$22.2 million and \$78.5 million for the twelve-month periods ended December 31, 2003 and 2002, respectively.

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Effective January 1, 2004, we entered into a new reinsurance agreement with American Re-insurance Company ( American Re ) under essentially the same terms as the Inter-Ocean agreement except the minimum amount of physical damage premiums permitted to be ceded is 10% and the agreement does not cover the Assumed Agency Business. We are ceding 10% of physical damage premiums for the first six months of 2004.

### *Investments*

Our investment portfolio at December 31, 2003 contained \$1,245.8 million in fixed maturity securities and \$21.4 million in equity securities, all carried at market value with unrealized gains and losses reported as a separate component of shareholder 's equity on an after-tax basis. At December 31, 2003, we had pretax net unrealized gains of \$53 million on fixed maturities and \$2 million on equity securities.

Approximately 92% of the fixed maturities that we held were rated investment grade (credit rating of AAA to BBB) by nationally recognized rating agencies at December 31, 2003. Investment grade securities

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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.

Investments in mortgage-backed securities ( MBSs ) represented approximately one-fifth of our fixed maturities at December 31, 2003. MBSs 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. When these prepayments occur faster than planned, market rates are usually lower for new investments than those that were prepaid. For both twelve month periods ended December 31, 2003 and 2002, prepayments on MBSs were approximately \$45 million. Approximately 98% of our MBSs are rated AAA and all are investment grade.

Individual portfolio securities are sold creating gains or losses as market opportunities exist. Since all of these securities are carried at market value on 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 our fixed maturity portfolio was 4.6 years at December 31, 2003.

Summarized information for securities with unrealized gains and losses in our balance sheet at December 31, 2003 is shown in the following table (dollars in millions). Approximately \$6.8 million of Fixed Maturities and \$3.3 million of Equity Securities had no unrealized gains or losses at December 31, 2003.

Summarized information for our investment portfolio follows (in millions):

|                   | Gross             |                | Gross         |                   | % of Total  |
|-------------------|-------------------|----------------|---------------|-------------------|-------------|
|                   | Amortized         | Unrealized     | Unrealized    | Market            |             |
|                   | Cost              | Gains          | Losses        | Value             |             |
| December 31, 2003 |                   |                |               |                   |             |
| Fixed Maturities  | \$ 1,192.4        | \$ 55.6        | \$ 2.3        | \$ 1,245.8        | 98%         |
| Common Stocks     | 19.2              | 2.2            |               | 21.4              | 2%          |
| <b>Total</b>      | <b>\$ 1,211.6</b> | <b>\$ 57.8</b> | <b>\$ 2.3</b> | <b>\$ 1,267.2</b> | <b>100%</b> |

|                   | Gross           |                | Gross          |                 | % of Total  |
|-------------------|-----------------|----------------|----------------|-----------------|-------------|
|                   | Amortized       | Unrealized     | Unrealized     | Market          |             |
|                   | Cost            | Gains          | Losses         | Value           |             |
| December 31, 2002 |                 |                |                |                 |             |
| Fixed Maturities  | \$ 917.1        | \$ 50.9        | \$ 12.4        | \$ 955.6        | 98%         |
| Common Stocks     | 19.1            | .4             | 1.9            | 17.6            | 2%          |
| <b>Total</b>      | <b>\$ 936.2</b> | <b>\$ 51.3</b> | <b>\$ 14.3</b> | <b>\$ 973.2</b> | <b>100%</b> |

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|   | December 31, | December 31, |
|---|--------------|--------------|
|   | <u>2003</u>  | <u>2002</u>  |
| Number of positions held with unrealized:                     |              |              |
| Gains   | 456          | 345          |
| Losses  | 69           | 61           |
| Number of positions held that individually exceed unrealized: |              |              |
| Gains of \$500,000  | 9            | 14           |
| Losses of \$500,000   |              | 7            |
| Percentage of positions held with unrealized:                 |              |              |
| Gains that were investment grade                              | 89%          | 98%          |
| Losses that were investment grade                             | 84%          | 44%          |

Our investment portfolio had gross unrealized losses of \$2.3 million at December 31, 2003. There was no single industry segment concentration that accounted for more than \$1 million of these losses at that date. At December 31, 2002, our investment portfolio included \$14.3 million of gross unrealized losses; \$4.7 million of these losses were in securities issued by companies in the airline industry and \$1.8 million was in securities issued by an



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electric service industry firm. No other industry segment accounted for more than \$1 million of unrealized losses at December 31, 2002.

The table below sets forth the scheduled maturities of fixed maturity securities at December 31, 2003 based on their market values (in millions). 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.

| <u>Maturity</u>                    | <u>Securities</u>            |                               |   | <u>All Fixed Maturities</u> |
|------------------------------------|------------------------------|-------------------------------|---|-----------------------------|
|                                    | <u>With Unrealized Gains</u> | <u>With Unrealized Losses</u> | <u>With No Unrealized Gains or Losses</u> |                             |
| One year or less                   | \$ 26                        | \$                            | \$  | \$ 26                       |
| After one year through five years  | 340                          | 35                            |   | 375                         |
| After five years through ten years | 409                          | 80                            | 4   | 493                         |
| After ten years                    | 99                           | 11                            | 1   | 111                         |
| Mortgage-backed securities         | 155                          | 85                            | 1   | 241                         |
|                                    | <u>\$ 1,029</u>              | <u>\$ 211</u>                 | <u>\$ 6</u>                               | <u>\$ 1,246</u>             |

**Contractual Obligations**

Our contractual obligations as of December 31, 2003 are (in thousands):

| <u>Due in:</u> | <u>Long-Term Debt (a)</u> | <u>Operating Leases</u> | <u>Total (b)</u>  |
|----------------|---------------------------|-------------------------|-------------------|
|                | 2004                      | \$ 22,210               |                   |
| 2005-2006      | 60,570                    | 27,757                  | 88,326            |
| 2007-2008      | 106,979                   | 17,705                  | 124,684           |
| 2009 and after | 131,763                   | 24,600                  | 156,363           |
| <b>Total</b>   | <b>\$ 321,522</b>         | <b>\$ 89,462</b>        | <b>\$ 410,984</b> |

- (a) Includes an additional payment of \$2,475,000 made on January 8, 2004, pertaining to the transaction described in Note 4 of the consolidated financial statements. In February 2004, this loan arrangement was replaced with a term loan offering, with the following payment commitment schedule:

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|                |                  |
|----------------|------------------|
| 2004           | \$ 5.5 million   |
| 2005-2006      | \$ 22.0 million  |
| 2007-2008      | \$ 22.0 million  |
| 2009 and after | \$ 260.5 million |
|                | <hr/>            |
| Total          | \$ 310.0 million |

- (b) Not included are total reserves for losses for known and unknown claims, which totaled \$709.9 million at December 31, 2003. It is not possible to reliably predict the timing of payment for these liabilities.

***Exposure to Market Risk***

Market risk represents the potential economic loss arising from adverse changes in the fair value of financial instruments. Our exposures to market risk relate primarily to our investment portfolio which is exposed to interest rate risk and, to a lesser extent, equity price risk.

**Table of Contents****Fixed Maturity Portfolio**

The fair value of our fixed maturity portfolio is directly impacted by changes in market interest rates. Our fixed maturity portfolio is comprised of substantially all fixed rate investments with primarily short-term and intermediate-term maturities. This practice allows flexibility in reacting to fluctuations of interest rates. The portfolios of our insurance companies are managed with an attempt to achieve an adequate risk-adjusted return while maintaining sufficient liquidity to meet policyholder obligations.

The following table provides information about our fixed maturity investments at December 31, 2003 and 2002, which are sensitive to interest rate risk. The table shows expected principal cash flows (in millions) by expected maturity date for each of the five subsequent years and collectively for all years thereafter. Callable bonds and notes are included based on call date or maturity date depending upon which date produces the most conservative yield. MBSs and sinking fund issues are included based on maturity year adjusted for expected payment patterns. Actual cash flows may differ from those expected.

|            | <b>Principal Cash Flows</b> |            | <b>Principal Cash Flows</b> |  |
|------------|-----------------------------|------------|-----------------------------|--|
|            | <b>December 31, 2003</b>    |            | <b>December 31, 2002</b>    |  |
|            | <u>                    </u> |            | <u>                    </u> |  |
| 2004       | \$ 66.9                     | 2003       | \$ 105.0                    |  |
| 2005       | 93.8                        | 2004       | 76.6                        |  |
| 2006       | 120.4                       | 2005       | 122.9                       |  |
| 2007       | 123.3                       | 2006       | 100.3                       |  |
| 2008       | 157.1                       | 2007       | 97.9                        |  |
| Thereafter | 608.3                       | Thereafter | 404.1                       |  |
|            | <u>                    </u> |            | <u>                    </u> |  |
| Total      | \$ 1,169.8                  | Total      | \$ 906.8                    |  |
|            | <u>                    </u> |            | <u>                    </u> |  |
| Fair Value | \$ 1,245.8                  | Fair Value | \$ 955.6                    |  |
|            | <u>                    </u> |            | <u>                    </u> |  |

**Equity Price Risk**

Equity price risk is the potential economic loss from adverse changes in equity security prices. Although our investment in equity securities is only 2% of total investments, it is concentrated in a relatively limited number of positions; approximately half of the total is in three investments; two of these three are electric utilities. While this approach allows management to more closely monitor the companies and industries in which they operate, it does increase risk exposure to adverse price declines in a major position.

**Results of Operations****Underwriting**

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Our insurance subsidiaries sell nonstandard, standard and preferred personal auto insurance and, to a lesser extent, nonstandard commercial auto coverage and a complement of other personal lines insurance products. Nonstandard coverage is a product designed for drivers who, due to their driving record, age or vehicle type, represent higher than normal risks and pay higher rates for comparable coverage.

Underwriting profitability is measured by the combined ratio, which is the sum of the ratios of losses, LAE and underwriting expenses to earned premiums. When the combined ratio is under 100%, underwriting results are generally considered profitable; when the ratio is over 100%, underwriting results are generally considered unprofitable. The combined ratio does not reflect investment income, other income or federal income taxes.

While losses on claims reported are generally determinable, the process of determining overall loss and LAE reserves is also highly dependent upon the use of estimates in the case of losses incurred or expected but not yet reported or developed. Actuarial procedures and projections are used to obtain best estimates which are then included in the overall results. These estimates are subject to changes in claim amounts and frequency and are periodically reviewed and adjusted, as additional information becomes known. In accordance with industry practices, such adjustments are reflected in current year underwriting results. As a result, the ratio of loss and LAE expenses component of the combined ratio includes development of prior year reserves in addition to provision for losses and LAE occurring in the current year.

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Underwriting expenses include expenses that vary directly with premium volume (commissions and premium taxes) as well as expenses that are relatively fixed (administrative expenses). Accordingly, underwriting expenses tend to move in the same direction as premiums but at a slower rate. As a result, the underwriting expense ratio tends to decrease when premiums grow and increase when premiums decline.

Since early 2000, our insurance subsidiaries have been increasing their premium rates with a goal of achieving underwriting profits, even if it entails foregoing volume. As with all property and casualty companies, the beneficial impact of these price increases is reflected in our financial results over time. We implement price increases on our in-force policies as they are renewed, which generally takes between six and twelve months for the entire book of business. We recognize increased premiums on particular policies as the premiums are earned, generally over the course of the six to twelve months after the policy is effective.

Net earned premiums and combined ratios for us and the Assumed Agency Business were (in millions):

|   | <u>2003</u>     | <u>2002</u>     | <u>2001</u>     |
|---|-----------------|-----------------|-----------------|
| <b>Net Earned Premiums (GAAP)</b>                       |                 |                 |                 |
| <b>NSA Group:</b>                                       |                 |                 |                 |
| Gross written premiums                                  | \$ 868.3        | \$ 914.6        | \$ 962.3        |
| Ceded reinsurance                                       | (187.5)         | (301.6)         | (224.7)         |
| Net written premiums                                    | 680.8           | 613.0           | 737.6           |
| Change in unearned premiums                             | (75.2)          | 32.9            | 178.8           |
| Net earned premiums                                     | <u>\$ 605.6</u> | <u>\$ 645.9</u> | <u>\$ 916.4</u> |
| <b>Assumed Agency Business:</b>                         |                 |                 |                 |
| Net written premiums gross of the Inter-Ocean agreement | \$ 159.1        | \$ 152.8        | \$ 165.3        |
| Ceded premiums under the Inter-Ocean agreement          | (22.3)          | (78.5)          |                 |
| Net written premiums net of the Inter-Ocean agreement   | 136.8           | 74.3            | 165.3           |
| Change in unearned premiums                             | (43.7)          | 32.9            | (15.4)          |
| Net earned premiums                                     | <u>\$ 93.1</u>  | <u>\$ 107.2</u> | <u>\$ 149.9</u> |
| <b>Combined Ratios (GAAP)</b>                           |                 |                 |                 |
| <b>NSA Group:</b>                                       |                 |                 |                 |
| Loss and LAE ratio                                      | 79.5%           | 81.8%           | 82.1%           |
| Underwriting expense ratio                              | 10.3%           | 12.2%           | 22.1%           |
| Combined ratio  | <u>89.8%</u>    | <u>94.0%</u>    | <u>104.2%</u>   |
| <b>Assumed Agency Business:</b>                         |                 |                 |                 |
| Loss and LAE ratio                                      | 81.4%           | 84.9%           | 81.2%           |
| Underwriting expense ratio                              | 28.0%           | 24.4%           | 28.6%           |
| Combined ratio  | <u>109.4%</u>   | <u>109.3%</u>   | <u>109.8%</u>   |

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| <b>Weighted Average of Infinity and Agency:</b> |       |       |        |
|---|-------|-------|--------|
| Loss and LAE ratio                              | 79.8% | 82.2% | 82.0%  |
| Underwriting expense ratio                      | 12.7% | 13.9% | 22.9%  |
|   | —     | —     | —      |
| Combined ratio                                  | 92.5% | 96.1% | 104.9% |
|   | —     | —     | —      |
| Combined ratio gross of Inter-Ocean agreement   | 94.3% | 97.3% | 104.5% |
|   | —     | —     | —      |

*2003 compared to 2002*

The NSA Group's net earned premiums fell \$40.3 million, or 6.2%, in the twelve month period ended December 31, 2003 compared to the twelve month period ended December 31, 2002 primarily as a result of actions taken to discontinue writing inadequately priced business in certain focus states. Earned premiums excluding the effect of the Inter-Ocean reinsurance agreement declined 12% to \$833 million, due primarily to a reduction in business volume partially offset by rate increases. The loss and LAE ratio improved by 2.3% points for the twelve month period ended December 31, 2003 from the same period in 2002. Excluding the effects of the Inter-Ocean reinsurance agreement, the loss and LAE ratio improved 1.7% points. The expense ratio improved by 1.9% points in

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2003 compared to 2002 primarily as a result of savings from consolidation efforts taken. Excluding the effect of the Inter-Ocean agreement, the expense ratio improved 1.6% points from 22.1% in the twelve month period ended December 31, 2002 to 20.5% in the same period in 2003.

The Assumed Agency Business's net earned premiums decreased \$14.1 million, or 13.2%, for the twelve month period ended December 31, 2003 compared to the twelve month period ended December 31, 2002 primarily as a result of a reduction in business volume. Earned premiums excluding the effect of the Inter-Ocean reinsurance agreement declined \$29.9 million, or a reduction of 18.4%, due primarily to a reduction in business volume partially offset by rate increases. The loss and LAE ratios for the Assumed Agency Business improved from 84.9% during the twelve month period ended December 31, 2002 to 81.4% as a result of increases in rates, lower frequency of claims per auto insured and moderate increases in the average cost per claim as well as a reduction in business in the non-focus states. Excluding the effects of the Inter-Ocean reinsurance agreement, the loss and LAE ratio improved from 77.8% to 74.4%. The expense ratio increased 3.6% points from 24.4% for the twelve month period ended December 31, 2002 to 28.0% for the same period in 2003. Excluding the effects of the Inter-Ocean reinsurance agreement, the expense ratio increased by 1.3% points from 28.3% for the twelve months of 2002 to 29.6% for 2003. This increase was attributable to a charge of \$4.0 million from an increase in the rate of amortization of deferred acquisition costs following a periodic review of the deferability of specific acquisition costs. Excluding this charge, the expense ratio fell 1.7% points for the twelve month period ended December 31, 2003 from the same period in 2002.

*2002 compared to 2001*

Our net earned premiums decreased \$271 million (30%) during 2002 due primarily to the Inter-Ocean reinsurance agreement, effective April 1, 2001, under which we ceded 90% of the personal automobile physical damage business written by our insurance subsidiaries during 2002. Excluding the effect of this agreement, net earned premiums declined approximately 9%, reflecting lower business volume partially offset by the impact of rate increases. Policies in-force declined 16% from approximately 734,000 on December 31, 2001 to 616,000 on December 31, 2002. The decline in policy counts was due to rate increases and actions taken to reduce business in certain non-focus or non-profitable states as well as decisions by insureds not to renew. During 2002, we increased personal auto rates about 12% over rates in effect at year-end 2001. Underwriting expenses in 2002 included the effect of \$130.4 million in ceding commissions earned under the Inter-Ocean reinsurance agreement. Commissions earned under this agreement generally vary directly with the loss and LAE ratio on the business ceded. Accordingly, our expense ratio reflected the benefit of strong underwriting results in the business ceded to Inter-Ocean. Overall, our combined ratio improved 10.2 points over 2001 due primarily to recent rate increases. Excluding the effect of the Inter-Ocean agreement, our combined ratio for 2002 was 95.9% compared to 103.7% in 2001.

Net earned premiums of the Assumed Agency Business decreased \$43 million (28%) in 2002 reflecting the impact of the Inter-Ocean reinsurance agreement, effective January 1, 2002, under which 90% of GAI's personal automobile physical damage business written through independent agents was ceded. Excluding the effect of this agreement, net earned premiums increased \$12.1 million (8%) reflecting rate increases implemented in the later part of 2001, partially offset by a reduction in volume from certain unprofitable business. The combined ratio was flat as an increase in prior year development was offset by the shift away from underperforming business and the increase in rates over the past year. Underwriting expenses fell \$16.6 million in 2002 compared to 2001 reflecting GAI's \$19.7 million ceding commission earned on premiums ceded under the Inter-Ocean reinsurance agreement.

*The remaining discussion of results of operations relates to our Consolidated Statement of Operations.*

***Investment Income***

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Changes in investment income reflect fluctuations in market rates and changes in average invested assets. Fluctuations in average invested assets reflect primarily the timing of dividends and capital contributions as capital requirements and our cash needs change.

The Assumed Agency Business represents a portion of GAI's personal lines business and is not a separate legal entity; accordingly, it does not have a separate investment portfolio and related investment income.



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*2003 compared to 2002*

Net investment income decreased \$4.1 million for the twelve month period ended December 31, 2003 versus the comparable 2002 period due to lower yields available for newly invested funds, and to a lesser extent due to a reallocation to tax advantaged securities, partially offset by an increase in average invested assets of 10.4%. Average invested assets increased as a result of the transfer at January 1, 2003 of \$125.3 million of securities and cash in conjunction with our assumption of insurance liabilities of the Assumed Agency Business, as well as proceeds received in July 2003 from the term loan.

*2002 compared to 2001*

Net investment income decreased \$14.0 million in 2002 compared to 2001 due primarily to (i) a \$4.6 million increase in interest expense (included in net investment income) on funds held from the aforementioned automobile reinsurance agreement (ii) a decrease in interest rates and (iii) an 8% decrease in average invested assets. Average invested assets decreased due primarily to dividends paid in the fourth quarter of 2001 and the last three quarters of 2002.

***Realized Gains (Losses) on Investments***

*2003 compared to 2002*

We recorded impairments for unrealized losses deemed other-than-temporary and realized gains on sales and disposals as follows (before tax, in thousands):

|                  | <b>Twelve months ended December 31, 2003</b> |                          |                             |
|------------------|--|--------------------------|-----------------------------|
|                  | <b>Impairments on</b>                        | <b>Realized Gains on</b> | <b>Total Realized Gains</b> |
|                  | <b>Securities Held</b>                       | <b>Sales</b>             | <b>(Losses)</b>             |
| Fixed maturities | (\$3,879)                                    | \$5,124                  | \$1,245                     |
| Equities         | (564)  | 278                      | (286)                       |
| <b>Total</b>     | <b>(\$4,443)</b>                             | <b>\$5,402</b>           | <b>\$959</b>                |

*2002 compared to 2001*

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Realized gains (losses) on investments include provisions for other than temporary impairment of securities still held of \$9.4 million in 2002 and \$16.2 million in 2001. Increased impairment charges in recent years reflect, among other things, a rise in corporate defaults in the marketplace.

We owned warrants to buy the common stock of a publicly traded company in 2002. Under generally accepted accounting principles, these investments are considered derivatives and marked to market resulting in realized gains and losses. Realized gains (losses) on investments include a loss of \$281,000 in 2002 to adjust the carrying value of these warrants to their market value of \$883,000 at December 31, 2002.

### *Other Income*

Other income increased \$8.1 million for the twelve month period ended December 31, 2003 from the corresponding 2002 period, primarily due to a nonrecurring gain of \$6.7 million on the commutation of service and indemnity agreements with AFG and increased finance and service charge income.

### *Interest Expense*

Interest expense was accrued at a fixed rate of 8.5% on the \$55 million note due to AFG until its repayment in mid-July, 2003 using a portion of the proceeds of the \$200 million term loan. The term loan accrued interest at a variable rate, which averaged 3.7% from the date of issue through December 31, 2003. The risk of variability in future interest expense was partially hedged by the interest rate swap. Refer to Note 4 of the consolidated financial statements included in this prospectus for more information on this instrument.

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For the twelve month period ended December 31, 2003, interest expense was (in thousands):

|                              |          |
|------------------------------|----------|
| \$55 million note due to AFG | \$ 2,545 |
| \$200 million term loan      | 3,422    |
| Interest rate swap           | 565      |
|                              | <hr/>    |
| Total                        | \$ 6,532 |
|                              | <hr/>    |

***Other Operating and General Expenses****2003 compared to 2002*

Corporate general and administrative expenses include costs associated with the new parent company beginning in February 2003. Other expenses fell \$4.4 million for the twelve month period ended December 31, 2003 from the same period in 2002 due primarily to a \$5.3 million litigation settlement in 2002.

*2002 compared to 2001*

Other operating and general expenses for 2001 include goodwill amortization of \$2.2 million. Under SFAS No. 142, which was implemented January 1, 2002, goodwill is no longer amortized. Excluding 2001 goodwill amortization, other operating and general expenses increased \$9.2 million due primarily to a \$5.3 million litigation settlement in 2002.

***Income Taxes***

Our effective tax rate was 33.4% in 2003, 35% in 2002, and 38% in 2001. See Note 6 to our consolidated financial statements included with this prospectus for an analysis of items affecting the effective tax rate.

**Table of Contents****BUSINESS****General**

We are a holding company which, through subsidiaries, provides personal automobile insurance on a national level with emphasis on nonstandard auto insurance. We employ approximately 2,200 persons. Our address is 2204 Lakeshore Drive, Birmingham, Alabama 35209; our phone number is (205) 870-4000. SEC filings, news releases and other information may be accessed free of charge through our Internet site at: [www.ipacc.com](http://www.ipacc.com).

We were incorporated as an Ohio corporation in September 2002 as an indirect wholly-owned subsidiary of American Financial Group, Inc. ( AFG ) to acquire and conduct, as a separate public company, AFG's personal lines business written through independent agents. On December 31, 2002, AFG transferred to us all of the issued and outstanding capital stock of the following personal auto insurance subsidiaries: Atlanta Casualty Company, Infinity Insurance Company, Leader Insurance Company and Windsor Insurance Company (collectively the NSA Group ). In exchange, AFG received all of the issued and outstanding shares of our Common Stock and a \$55 million promissory note. In February 2003, AFG sold 12.5 million shares (61%) of our Common Stock in an initial public offering and in December of 2003 sold its remaining interest (7.9 million shares) in a secondary public offering.

As of January 1, 2003, we acquired the in-force personal insurance business written through independent agents (the Assumed Agency Business ) by AFG's principal property and casualty subsidiary, Great American Insurance Company ( GAI ). Because this business is not a separate legal entity, the acquisition was effected through a reinsurance agreement under which one of our subsidiaries assumed the inforce business, services the policyholders and handles the claims. GAI, in turn, transferred to us assets (primarily investment securities) with a market value of \$125.3 million and permits us to continue to write standard and preferred insurance on policies issued by the same GAI companies that had previously issued such policies.

**Operations**

We estimate that approximately 90% of our personal auto business is nonstandard auto insurance. While there is no precise, 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. Based on data published by A.M. Best, we believe that we are the second largest provider of nonstandard auto coverage through independent agents in the United States. We also write standard and preferred personal auto insurance, nonstandard commercial auto insurance and complementary personal lines insurance products.

Our summarized historical financial data is presented below (in millions). Data for periods prior to 2003 include only the NSA Group.

|                       | <b>Twelve months ended December 31,</b> |             |             |
|-----------------------|---|-------------|-------------|
|                       | <b>2003</b>                             | <b>2002</b> | <b>2001</b> |
| Gross written premium | \$ 1,005.1                              | \$ 914.6    | \$ 962.3    |

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|                     |         |         |        |
|---------------------|---------|---------|--------|
| Net written premium | 817.6   | 613.0   | 737.6  |
| Net earnings        | \$ 58.2 | \$ 45.9 | \$ 9.7 |

as of December 31,

|                            | 2003       | 2002       | 2001       |
|----------------------------|------------|------------|------------|
| Total assets               | \$ 1,900.1 | \$ 1,551.9 | \$ 1,760.4 |
| Total liabilities          | 1,444.7    | 1,164.1    | 1,197.7    |
| Total shareholders' equity | \$ 455.4   | \$ 386.8   | \$ 562.8   |

We have a history of favorable underwriting results. The following table compares our statutory combined ratio in past years with those of the personal lines insurance industry as a whole. The statutory combined ratio is the sum of the loss ratio (the ratio of losses and loss adjustment expenses to net earned premiums) and the expense ratio (when calculated on a statutory accounting basis, the ratio of underwriting expenses to net written premiums).

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When the combined ratio is under 100%, underwriting results are generally considered profitable; when the ratio is over 100%, underwriting results are generally considered unprofitable. The combined ratio does not reflect investment income, other income or federal income taxes.

|  | <u>2003</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> | <u>1999</u> | <u>1999-2003</u> | <u>1994-2003</u> |
|--|-------------|-------------|-------------|-------------|-------------|------------------|------------------|
| Infinity                               | 94.9%       | 92.7%       | 104.6%      | 108.7%      | 98.7%       | 100.9%           | 101.0%           |
| Industry (*)                           | 99.5%       | 105.3%      | 110.9%      | 109.9%      | 104.5%      | 105.7%           | 104.5%           |
| Percentage points better than industry | 4.6%        | 12.6%       | 6.3%        | 1.2%        | 5.8%        | 4.8%             | 3.5%             |

(\*) Industry combined ratios were obtained from A.M. Best

**Products**

*Personal Automobile* is our primary insurance product. It provides coverage to individuals for liability to others for bodily injury and property damage and for physical damage to an insured's own vehicle from collision and various other perils. In addition, many states require policies to provide for first party personal injury protection, frequently referred to as no-fault coverage. We offer personal automobile insurance to nonstandard, standard and preferred customers. Personal automobile insurance accounted for approximately 95% of our gross written premiums for the twelve-month periods ended December 31, 2003 and 2002.

*Nonstandard Commercial Automobile* provides coverage to businesses for liability to others for bodily injury and property damage and for physical damage to businesses' vehicles from collision and various other perils. We offer nonstandard commercial automobile insurance to businesses that employ one or more nonstandard risk drivers. Target businesses include fleets of 12 or fewer vehicles. Businesses which are involved in what are considered to be hazardous operations or interstate commerce are generally avoided. Nonstandard commercial automobile insurance accounted for approximately 4% of gross written premiums for the twelve-month periods ended December 31, 2003 and 2002.

*Homeowners and Other* includes homeowners insurance and several other personal lines insurance products. We write homeowners insurance for dwellings, condominiums and rental property contents on a limited basis in selected markets. Homeowners insurance provides protection against losses from a wide variety of perils, as well as coverage for liability arising from ownership or occupancy. We also write coverage on a limited basis for personal watercraft, personal articles, such as jewelry, and umbrella liability protection. Homeowners and other insurance accounted for less than 1% of gross written premiums for the twelve-month periods ended December 31, 2003 and 2002. We are taking steps to exit these lines of business and do not expect these actions to materially affect our results of operations.

**The Personal Automobile Market**

Personal auto insurance is the largest line of property and casualty insurance, accounting for approximately 35% of the \$418 billion of annual industry premiums. Personal auto insurance provides coverage to drivers for liability to others for both bodily injury and property damage and for physical damage to an insured's own vehicle from collision and other perils. Personal auto insurance is comprised of preferred, standard and nonstandard risks. Nonstandard insurance is intended for drivers who, due to their driving record, age or vehicle type, represent a higher than normal risk. As a result, customers that purchase nonstandard auto insurance generally pay higher premiums for similar coverage than drivers qualifying for standard or preferred policies. While there is no established industry-recognized demarcation between nonstandard policies and all other personal auto policies, we believe that nonstandard auto risks generally constitute between 15% and 20% of the personal automobile insurance market, with this range fluctuating according to competitive conditions in the market. Approximately one-third of all personal automobile insurance is sold by independent agents. The remainder is sold by exclusive agents or directly by insurance companies to their

customers.

The personal auto insurance industry is cyclical, characterized by periods of price competition and excess capacity followed by periods of high premium rates and shortages of underwriting capacity. In the late 1990s, many automobile insurers attempted to capture more business by reducing rates. We believe that these industry-wide rate reductions combined with increased severity trends during the years 1999 through 2001 contributed to the deterioration of industry loss ratios in that period. We reacted by increasing personal auto rates across the NSA Group and Assumed Agency Business by 14% in 2000, 15% in 2001, 12% in 2002 and 2% in 2003. Since that time, most of the industry, including some of the largest companies, have raised rates and tightened underwriting

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standards in order to address poor results. Other insurance companies withdrew from the market because of their inability to compete successfully, impaired capital positions, or because of a decrease in the availability of reinsurance. In the second half of 2003, competitors who remained in the marketplace began to compete more aggressively for independent agents' business by offering modestly increased sales and commission incentives. In 2003, we have not observed widespread rate reductions such as those seen in the years 1999 through 2001 that contributed to the deterioration of industry-wide underwriting results during those years.

The personal auto insurance industry is highly competitive and, except for regulatory considerations, there are relatively few barriers to entry. We generally compete with other insurers on the basis of price, coverages offered, claims handling, customer service, agent commission, geographic coverage and financial strength ratings. We compete with both large national writers and smaller regional companies. In 2002, the five largest automobile insurance companies accounted for approximately 48% of the industry's net written premiums and the largest ten accounted for approximately 62%. Approximately 390 insurance groups compete in the personal auto insurance industry, according to A.M. Best. Some of these groups specialize in nonstandard auto insurance, while others provide a broad spectrum of personal auto insurance.

## **Pricing and Product Management**

The pricing segmentation approach that we utilize requires the extensive involvement of product managers who are responsible for the underwriting profitability of a specific state or region with the direct oversight of rate level structure by senior managers. Product managers work closely with the pricing and business development departments to generate rate level indications and other relevant data. This data enables product managers to change the rate structure by evaluating detailed information, such as loss experience based on driver characteristics, financial responsibility scores and make/model of vehicles. Product managers are also responsible for obtaining approval of rate filings from state insurance departments. This approach has permitted a quicker response to adverse loss trends such as those experienced in 1999 and 2000 and allows us to obtain faster approval for rate filings.

Beyond the detailed pricing analysis, product managers are responsible for developing innovative products which meet the needs of our customers and provide a competitive advantage in the marketplace. We have had success in designing products that provide the basic required coverage for nonstandard customers, and products that include expanded coverage for preferred customers.

## **Distribution and Marketing**

We distribute our products primarily through a network of approximately 14,000 independent agencies and strategic partnerships. Independent agencies were responsible for approximately 94.5% of our gross written premiums for the twelve-month period ended December 31, 2003. In 2003, no one independent agency accounted for more than 2% of our gross written premiums, and only three agencies accounted for more than 1% of our gross written premiums. Another mode of distribution includes relationships, or strategic partnerships, with some non-affiliated property and casualty insurers that have their own captive agency forces. These companies usually provide standard and preferred auto coverage through one of their own companies while utilizing our companies for their nonstandard risks. We believe these are mutually beneficial relationships since our partners gain access to our nonstandard auto expertise and we gain access to a new distribution channel. This channel represented approximately 5.5% of gross written premiums in 2003.

We hold licenses to write auto insurance in all 50 states, but we are committed to growth in 15 focus states believed to provide the greatest opportunity for profitable growth considering the market size and the current legal and regulatory environment. Our operating states fall into four categories:



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**Franchise States** These states provide the best opportunity for profitable growth. They are California, Connecticut, Florida, Georgia, and Pennsylvania.

**Resource States** We intend to strengthen operations in these 10 states and implement the operating model currently in place in California which stresses the strategies discussed above. Combined with Franchise States, these states represent the Focus States.

**Maintenance States** We are seeking to maintain renewal business in these 7 states while rate increases are implemented to achieve underwriting profitability. We are accepting no new

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business in these states due to what is perceived to be the current lack of opportunity for profitable growth.

Exit States We have discontinued or intend to discontinue writing insurance in these 28 states.

The following table sets forth the distribution of our gross premiums written by state for the Franchise States, as well as the other categories, as a percent of total gross written premiums for the periods indicated:

|                            | Year Ended December 31, |      |      |      |
|----------------------------|-------------------------|------|------|------|
|                            | 2003                    | 2002 | 2001 | 2000 |
| Franchise States:          |                         |      |      |      |
| California                 | 43%                     | 34%  | 25%  | 23%  |
| Florida                    | 10%                     | 10%  | 10%  | 10%  |
| Connecticut                | 10%                     | 8%   | 8%   | 7%   |
| Pennsylvania               | 7%                      | 7%   | 7%   | 6%   |
| Georgia                    | 6%                      | 7%   | 8%   | 8%   |
| Sub-Total Franchise States | 76%                     | 66%  | 58%  | 54%  |
| Next 10 Resource States    | 11%                     | 14%  | 17%  | 17%  |
| Sub-Total 15 Focus States  | 87%                     | 80%  | 75%  | 71%  |
| Maintenance States         | 9%                      | 13%  | 14%  | 17%  |
| Exit States                | 4%                      | 7%   | 11%  | 12%  |
| All States                 | 100%                    | 100% | 100% | 100% |

Our business development department is responsible for the distribution and sale of our products through independent agencies and strategic partners. This department is split into two key areas, field operations and corporate business development. The responsibilities of our field business development representatives include selecting agencies and strategic partners for appointment, training them to sell our products, and monitoring their operations to ensure compliance with our production and profitability standards. While most of the field activity occurs face-to-face in the producer's office, we have had success with other approaches such as group seminars that focus on promoting our products and conducting training for agents.

Our corporate business development staff is responsible for our branding initiatives, cooperative advertising with our independent agents, sales promotions and agents' incentives. In addition, this team is actively engaged in building agency relationships via telephone, e-mail, fax and direct mail.

We foster our agent relationships by providing our agents with our software applications along with programs and services designed to strengthen and expand their marketing, sales and service capabilities. Our internet-based software applications provide many of our agents with real-time underwriting, claims and policy information. We believe the array of services that we offer to our agents adds significant value to their businesses. For example, Our PASS Program (Providing Agents Service and Support) is an incentive-based program through which our agents earn savings on service and support needs including technology, training, financial services, office supplies, advertising, promotion and travel.

We develop innovative products and service niche markets across the entire range of automobile insurance segments. We focus particular attention on developing relationships with Latino agents, especially in Southern California. Over the past decade, Latinos have been the fastest growing segment of the United States population according to U.S. Census Bureau data. In our Franchise States, Latinos constitute an estimated 21% of the population. Over the past decade, we have actively developed close relationships with Latino agents by supporting their businesses and customers in their local communities. We have developed products and services that support their particular needs and interests such as translating important documents to Spanish and providing bilingual customer service and claims personnel. We consider our position in this unique niche of the market, including the Infinity brand, to be a significant competitive advantage.

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Our distribution and marketing efforts are implemented with a focus on maintaining a low cost structure. Controlling expenses allows us to price competitively and achieve better underwriting returns. Over the five years ended 2002, our statutory ratio of underwriting expenses to premiums written has averaged 23.2%, which is 4.4% points better than the personal lines industry average of 27.6% for the same period.

## **Claims Handling**

Our claims organization employs approximately 1,200 people and has 37 field branch offices and three regional offices. We provide a 24-hour, seven days per week toll-free service for our customers to report claims. We use predominantly our own local adjusters who typically respond to claims within 24 hours of a report.

We are committed to the field handling of claims and believe it provides better service to our customers and better control of the claim resolution process than alternative methods. We open claims branch offices in areas where we believe the volume of business will support them. Customer interactions can occur with generalists (multi-line claim representatives) and specialists (staff appraisers, field casualty representatives and special investigators) based on local market volume, density and performance. Nationally, over 65% of our claims are handled face-to-face. We strive for accuracy, consistency and fairness in our claim resolutions. Our claims audit program measures performance in investigations, damage documentation and other relevant areas.

Our claims organization is committed to defending against non-meritorious claims. This is done through referrals to our special investigations team. This team, made up of claims and former law enforcement professionals, works in concert with field operations to resolve questionable claims.

## **Reinsurance**

We reinsure a portion of our business with other insurance companies. Ceding reinsurance permits diversification of risk and limits the maximum loss arising from large or unusually hazardous risks or catastrophic events. We are subject to credit risk with respect to our reinsurers, as the ceding of risk to reinsurers generally does not relieve us of our liability to insureds until claims are fully settled. To attempt to mitigate this credit risk, we cede business only to reinsurers that meet our credit ratings criteria. Excess of loss and catastrophe reinsurance protection is utilized for both personal and commercial automobile risks.

In April 2001, we entered into a 90% quota share agreement on the personal auto physical damage business written by the NSA Group with Inter-Ocean, an unaffiliated company which is rated A (Excellent) by A.M. Best. Under this agreement, credit risk was minimized by withholding premiums, in exchange for a fee, until all claims were resolved or the parties mutually agreed to terminate the agreement. This quota share agreement, which was later amended to include coverage of GAI's personal lines that would otherwise be included in the Assumed Agency Business for both policies in effect since January 1, 2002 and unearned premium at December 31, 2001, covered business written through December 31, 2002. This agreement was renewed for 2003 on terms substantially equivalent to those in effect in 2002, except that we added the flexibility to elect, on a quarterly basis, the percentage of business to be added under the reinsurance agreement. The amount ceded under this agreement was reduced from 90% to 20% for the remainder of 2003. We then entered into a new agreement for 2004 with American Re, an unaffiliated company rated A+ (Superior) by A.M. Best, under substantially the same terms, except that the minimum ceding threshold is 10% and the agreement no longer includes the Assumed Agency Business.

**Loss and Loss Adjustment Expense Reserves**

Loss and LAE reserves represent our estimate of our ultimate liability for unpaid claims and related adjustment expenses. We estimate liabilities for the costs of losses and LAE for both reported and unreported claims based on historical trends adjusted for changes in loss cost trends, underwriting standards, policy provisions, product mix and other factors. Estimating the liability for unpaid losses and loss adjustment expense is inherently judgmental and is influenced by factors which are subject to significant variation. We monitor items such as the effect of inflation on medical, hospitalization, material repair and replacement costs, general economic trends and the legal environment. While the ultimate liability may be greater or lower than recorded loss reserves, the reserve tail for personal auto coverage is shorter than that associated with many other property and casualty coverages and can, therefore, be established with less uncertainty than coverages having longer reserve tails.

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We review loss reserve adequacy quarterly and our independent auditors also review the adequacy of loss reserves as part of their audit procedures. Loss and expense reserves are also certified to state regulators annually. Reserves are adjusted as additional information becomes known. Such adjustments are reflected in current year operations.

The internal actuarial staff reviews our reserves quarterly by accident year at a state and coverage level and at the coverage level for the Assumed Agency Business. Quarterly reviews allow for timely adjustments to reserves based on additional information. As part of these quarterly reviews, the actuarial staff performs various tests to estimate ultimate average severity and frequency of claims. Severity represents the average cost per claim and frequency represents the number of claims per policy. As an overall review, the staff then evaluates loss and LAE ratios by accident year by state and by coverage for reasonableness. Actual frequency is fairly stable because policyholders generally report auto accidents within days of occurrence. Factors that can significantly affect actual frequency include, among others, changes in weather and class of driver. Estimates of average frequency can be affected by changes in claims settlement and reserving practices, but are generally reliable. Loss severity is not as readily estimable, and can be affected by auto repair and medical cost inflation, jury awards and changes in policy limit profiles. For the nonstandard book of business, the challenge of estimating average severity is somewhat mitigated by state-mandated minimum policy limits for bodily injury and property damage on over 90% of our policies. These low limits tend to reduce the exposure of the loss reserves on this coverage to medical cost inflation on severe injuries since the minimum policy limits will cap the total payout. Estimation of LAE reserves is subject to variation from factors such as use of outside adjusters, frequency of lawsuits, claims staffing and experience levels.

The following tables present the development of our loss reserves, net of reinsurance, on a GAAP basis for the calendar years 1993 through 2003. The Infinity table includes the loss reserves of the NSA Group through December 31, 2002, then the addition of the Assumed Agency Business for 2003. The top line of each table shows the estimated liability (in millions) for unpaid losses and LAE recorded at the balance sheet date for the indicated years. The next line, captioned Liability for Unpaid Losses and Loss Adjustment Expenses as re-estimated at December 31, 2003, shows the re-estimated liability as of December 31, 2003. The remainder of the table presents intervening development as percentages of the initially estimated liability. The development results from additional information and experience in subsequent years. The middle line shows a cumulative deficiency (redundancy) which represents the aggregate percentage increase (decrease) in the liability initially estimated. The lower portion of the table indicates the cumulative amounts paid as of successive periods as a percentage of the original loss reserve liability.

These tables do not present accident or policy year development data. Furthermore, in evaluating the re-estimated liability and cumulative deficiency (redundancy), it should be noted that each percentage includes the effects of changes in amounts for prior periods. Conditions and trends that have affected development of the liability in the past may not necessarily exist in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on these tables.

**INFINITY**

|   | <u>1993</u> | <u>1994</u> | <u>1995</u> | <u>1996</u> | <u>1997</u> | <u>1998</u> | <u>1999</u> | <u>2000</u> | <u>2001</u> | <u>2002</u> | <u>2003</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Liability for unpaid losses & loss adjustment expenses: |             |             |             |             |             |             |             |             |             |             |             |
| As originally estimated                                 | \$ 385      | \$ 489      | \$ 569      | \$ 511      | \$ 525      | \$ 589      | \$ 543      | \$ 627      | \$ 608      | \$ 571      | \$ 679      |
| Addition of Assumed Agency                              |             |             |             |             |             |             |             |             |             | 126         |             |
|   |             |             |             |             |             |             |             |             |             | <u>697</u>  |             |
| As re-estimated at December 31, 2003                    | 347         | 495         | 568         | 533         | 537         | 553         | 516         | 672         | 647         | 711         | N/A         |
| Liability re-estimated:                                 |             |             |             |             |             |             |             |             |             |             |             |

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|  |        |        |        |        |        |        |        |        |        |        |     |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|-----|
| One year later                         | 89.6%  | 96.8%  | 97.8%  | 99.5%  | 100.8% | 95.0%  | 95.3%  | 98.5%  | 100.2% | 102.1% |     |
| Two years later                        | 89.3%  | 100.4% | 98.6%  | 101.9% | 103.3% | 93.6%  | 92.9%  | 101.1% | 106.4% |        |     |
| Three years later                      | 89.7%  | 101.1% | 99.2%  | 104.7% | 102.5% | 91.0%  | 93.6%  | 107.1% |        |        |     |
| Four years later                       | 90.2%  | 100.9% | 100.3% | 104.3% | 100.9% | 92.5%  | 95.0%  |        |        |        |     |
| Five years later                       | 90.1%  | 101.5% | 100.0% | 103.5% | 101.7% | 94.0%  |        |        |        |        |     |
| Six years later                        | 90.4%  | 101.3% | 99.5%  | 103.9% | 102.3% |        |        |        |        |        |     |
| Seven years later                      | 90.6%  | 100.9% | 99.7%  | 104.3% |        |        |        |        |        |        |     |
| Eight years later                      | 90.1%  | 101.0% | 99.8%  |        |        |        |        |        |        |        |     |
| Nine years later                       | 90.1%  | 101.1% |        |        |        |        |        |        |        |        |     |
| Ten years later                        | 90.1%  |        |        |        |        |        |        |        |        |        |     |
| Cumulative deficiency<br>(redundancy): | (9.9%) | 1.1%   | (.2%)  | 4.3%   | 2.3%   | (6.0%) | (5.0%) | 7.1%   | 6.4%   | 2.1%   | N/A |

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|                        |       |        |       |        |        |       |       |       |       |       |
|------------------------|-------|--------|-------|--------|--------|-------|-------|-------|-------|-------|
| Cumulative paid as of: |       |        |       |        |        |       |       |       |       |       |
| One year later         | 58.8% | 64.1%  | 63.8% | 62.9%  | 59.3%  | 54.5% | 53.0% | 53.5% | 51.5% | 49.1% |
| Two years later        | 76.9% | 87.2%  | 85.0% | 83.9%  | 81.3%  | 73.2% | 69.6% | 76.6% | 79.2% |       |
| Three years later      | 84.6% | 95.2%  | 93.2% | 94.3%  | 90.8%  | 80.6% | 81.4% | 91.5% |       |       |
| Four years later       | 87.5% | 98.2%  | 96.6% | 98.7%  | 94.8%  | 86.5% | 88.7% |       |       |       |
| Five years later       | 88.7% | 99.6%  | 98.3% | 100.4% | 98.0%  | 90.1% |       |       |       |       |
| Six years later        | 89.4% | 100.5% | 98.4% | 101.9% | 100.2% |       |       |       |       |       |
| Seven years later      | 89.9% | 100.3% | 98.8% | 103.1% |        |       |       |       |       |       |
| Eight years later      | 89.6% | 100.6% | 99.3% |        |        |       |       |       |       |       |
| Nine years later       | 89.8% | 100.7% |       |        |        |       |       |       |       |       |
| Ten years later        | 89.8% |        |       |        |        |       |       |       |       |       |

The following is a reconciliation of our net liability to the gross liability for unpaid losses and loss adjustment expense.

|  | 1993   | 1994   | 1995   | 1996   | 1997   | 1998   | 1999   | 2000   | 2001   | 2002   | 2003   |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| As originally estimated                  |        |        |        |        |        |        |        |        |        |        |        |
| Net liability shown above                | \$ 385 | \$ 489 | \$ 569 | \$ 511 | \$ 525 | \$ 589 | \$ 543 | \$ 627 | \$ 608 | \$ 571 | \$ 679 |
| Addition of Assumed Agency               |        |        |        |        |        |        |        |        |        | 126    |        |
|  |        |        |        |        |        |        |        |        |        | 697    |        |
| Add reinsurance                          |        |        |        |        |        |        |        |        |        |        |        |
| Recoverables                             | 11     | 7      | 5      | 12     | 6      | 10     | 10     | 13     | 37     | 33     | 31     |
| Gross liability                          | \$ 396 | \$ 496 | \$ 574 | \$ 523 | \$ 531 | \$ 599 | \$ 553 | \$ 640 | \$ 645 | \$ 730 | \$ 710 |
| As re-estimated at December 31, 2003:    |        |        |        |        |        |        |        |        |        |        |        |
| Net liability shown above                | \$ 347 | \$ 495 | \$ 568 | \$ 533 | \$ 537 | \$ 553 | \$ 516 | \$ 672 | \$ 647 | \$ 711 |        |
| Add reinsurance                          |        |        |        |        |        |        |        |        |        |        |        |
| Recoverables                             | 21     | 15     | 13     | 25     | 20     | 15     | 18     | 18     | 46     | 41     |        |
| Gross liability                          | \$ 368 | \$ 510 | \$ 581 | \$ 558 | \$ 557 | \$ 568 | \$ 534 | \$ 690 | \$ 693 | \$ 752 | N/A    |
| Gross cumulative deficiency (redundancy) | (6.9%) | 2.7%   | 1.1%   | 6.6%   | 4.9%   | (5.3%) | (3.5%) | 7.7%   | 7.4%   | 3.1%   | N/A    |

The following table presents the development of loss reserves for the Assumed Agency Business (in millions) through December 31, 2002. Development for 2003 for the Assumed Agency Business is included in the Infinity table on the prior page. Under the reinsurance agreement entered into with GAI, our insurance subsidiaries assumed the net reserves from GAI. Accordingly, gross reserves and net reserves are the same.

**ASSUMED AGENCY BUSINESS**

|   | 1993   | 1994   | 1995   | 1996   | 1997   | 1998   | 1999   | 2000   | 2001   | 2002   |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Liability for unpaid losses & loss adjustment expenses: |        |        |        |        |        |        |        |        |        |        |
| As originally estimated                                 | \$ 171 | \$ 181 | \$ 189 | \$ 213 | \$ 190 | \$ 150 | \$ 118 | \$ 106 | \$ 116 | \$ 126 |
|   | 184    | 204    | 206    | 196    | 145    | 121    | 117    | 111    | 126    | N/A    |



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As re-estimated at December 31,  
2003

Liability re-estimated:

|                   |        |        |        |        |       |       |        |        |        |
|-------------------|--------|--------|--------|--------|-------|-------|--------|--------|--------|
| One year later    | 104.2% | 104.0% | 114.4% | 106.2% | 88.9% | 84.1% | 102.9% | 104.9% | 106.3% |
| Two years later   | 104.3% | 114.1% | 118.0% | 99.3%  | 78.0% | 86.2% | 100.6% | 106.9% | 108.5% |
| Three years later | 108.9% | 115.7% | 113.6% | 93.9%  | 79.5% | 82.3% | 101.2% | 104.8% |        |
| Four years later  | 109.4% | 113.7% | 110.2% | 93.3%  | 76.6% | 81.8% | 99.4%  |        |        |
| Five years later  | 108.2% | 112.3% | 109.3% | 91.7%  | 76.6% | 80.3% |        |        |        |
| Six years later   | 107.7% | 111.1% | 108.0% | 92.2%  | 76.1% |       |        |        |        |
| Seven years later | 106.7% | 110.6% | 108.7% | 92.3%  |       |       |        |        |        |
| Eight years later | 106.1% | 111.6% | 109.1% |        |       |       |        |        |        |
| Nine years later  | 107.2% | 112.4% |        |        |       |       |        |        |        |
| Ten years later   | 107.2% |        |        |        |       |       |        |        |        |

Cumulative deficiency  
(redundancy):

|  |      |       |      |        |         |         |       |      |      |
|--|------|-------|------|--------|---------|---------|-------|------|------|
|  | 7.2% | 12.7% | 9.1% | (7.7%) | (23.9%) | (19.7%) | (.6%) | 4.8% | 8.5% |
|--|------|-------|------|--------|---------|---------|-------|------|------|

Cumulative paid as of:

|                   |        |        |        |       |       |       |       |       |       |
|-------------------|--------|--------|--------|-------|-------|-------|-------|-------|-------|
| One year later    | 56.7%  | 60.5%  | 57.6%  | 51.4% | 37.8% | 38.6% | 47.5% | 47.0% | 43.6% |
| Two years later   | 81.3%  | 85.7%  | 86.0%  | 71.1% | 55.2% | 57.9% | 69.5% | 70.8% | 60.2% |
| Three years later | 94.9%  | 100.7% | 97.7%  | 80.6% | 65.2% | 69.4% | 83.3% | 80.8% |       |
| Four years later  | 103.0% | 106.4% | 102.6% | 85.6% | 70.2% | 75.3% | 88.1% |       |       |
| Five years later  | 105.3% | 108.9% | 104.5% | 88.1% | 73.3% | 76.4% |       |       |       |
| Six years later   | 106.5% | 108.8% | 105.8% | 90.2% | 73.8% |       |       |       |       |
| Seven years later | 105.2% | 109.5% | 107.4% | 90.3% |       |       |       |       |       |
| Eight years later | 105.8% | 111.0% | 107.5% |       |       |       |       |       |       |
| Nine years later  | 107.2% | 111.1% |        |       |       |       |       |       |       |
| Ten years later   | 107.2% |        |        |       |       |       |       |       |       |

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During 2002, the NSA Group settled a state class action lawsuit for \$5.1 million involving the issue of whether there is an inherent diminished value in a damaged automobile that should be accounted for when calculating claim payments. The settlement increased the reserve deficiency for the 2001 calendar year-end reserves by \$5.1 million. Excluding this, our NSA Group experienced an overall redundancy for the calendar year-end 2001 reserves of about \$4 million. During 2003, \$14 million of adverse LAE reserve development occurred primarily due to business from New York, partially offset by other reserve releases.

**Investments****General**

We employ a conservative approach to investment and capital management intended to ensure that there is sufficient capital to support our business. The investment portfolio is managed by American Money Management Corporation, a subsidiary of AFG. Our board of directors sets investment guidelines and periodically reviews the portfolio performance for compliance with such guidelines.

The following table presents the percentage distribution of our year-end investment portfolio (excluding investment in equity securities of affiliate corporations). The December 31, 2002 percentage distribution of the NSA Group's investment portfolio was adjusted to include the investments transferred to us (approximately \$125 million) in connection with the January 1, 2003 acquisition of GAI's Assumed Agency Business.

|                               | <u>2003</u>   | <u>2002</u>   | <u>2001</u>   |
|-------------------------------|---------------|---------------|---------------|
| Cash and Cash Equivalents     | 9.0%          | 8.3%          | 5.1%          |
| Fixed Maturities:             |               |               |               |
| U.S. Government and Agencies  | 7.2           | 7.9           | 8.9           |
| State and Municipal           | 13.3          | 5.6           | 4.2           |
| Public Utilities              | 8.3           | 10.7          | 10.7          |
| Mortgage-Backed Securities    | 15.1          | 12.3          | 11.7          |
| Corporate and Other           | 41.0          | 49.7          | 54.8          |
| Redeemable Preferred Stocks   | .8            | .8            | .6            |
|                               | <u>85.7</u>   | <u>87.0</u>   | <u>90.9</u>   |
| Net Unrealized Gains (Losses) | 4.0           | 3.2           | .2            |
|                               | <u>89.7</u>   | <u>90.2</u>   | <u>91.1</u>   |
| Equity Securities             | 1.3           | 1.5           | 3.8           |
|                               | <u>100.0%</u> | <u>100.0%</u> | <u>100.0%</u> |

The following table presents the yields of our investment portfolios as reflected in our consolidated financial statements included in this prospectus.

|  | <b>For the Years Ended</b> |             |             |
|--|----------------------------|-------------|-------------|
|  | <b>2003</b>                | <b>2002</b> | <b>2001</b> |
| <b>Yield on Fixed Income Securities:</b> |                            |             |             |
| Excluding realized gains and losses      | 5.5%                       | 6.4%        | 6.7%        |
| Including realized gains and losses      | 5.6%                       | 6.3%        | 6.8%        |
| <b>Yield on Equity Securities:</b>       |                            |             |             |
| Excluding realized gains and losses      | 4.8%                       | 3.4%        | 2.8%        |
| Including realized gains and losses      | 3.5%                       | (12.6)%     | (10.7)%     |
| <b>Yield on All Investments:</b>         |                            |             |             |
| Excluding realized gains and losses      | 5.5%                       | 6.3%        | 6.6%        |
| Including realized gains and losses      | 5.5%                       | 5.7%        | 6.1%        |

### ***Fixed Maturity Investments***

Our fixed maturity portfolio is invested primarily in taxable bonds. The NAIC assigns quality ratings which range from Class 1 (highest quality) to Class 6 (lowest quality). The following table shows our bonds and

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redeemable preferred stocks, by NAIC designation and comparable Standard & Poor's Corporation rating as of December 31, 2003.

| NAIC                       |                       | Amortized  |            |        |
|----------------------------|-----------------------|------------|------------|--------|
| Rating                     | Comparable S&P Rating | Cost       | Amount     | %      |
| 1                          | AAA, AA, A            | \$ 844.6   | \$ 875.7   | 70.3%  |
| 2                          | BBB                   | 253.8      | 270.2      | 21.7%  |
| Total investment grade     |                       | 1,098.5    | 1,145.9    | 92.0%  |
| 3                          | BB                    | 53.8       | 56.6       | 4.5%   |
| 4                          | B                     | 37.0       | 39.7       | 3.2%   |
| 5                          | CCC, CC, C            | 2.1        | 2.2        | .2%    |
| 6                          | D                     | 1.1        | 1.5        | .1%    |
| Total non-investment grade |                       | 94.3       | 99.9       | 8.0%   |
| Total                      |                       | \$ 1,192.4 | \$ 1,245.8 | 100.0% |

Fixed income investment funds are generally invested in securities with short-term and intermediate-term maturities with an objective of optimizing total return while allowing flexibility to react to changes in market conditions and maintaining sufficient liquidity to meet policyholder obligations. At December 31, 2003, the average duration of our fixed maturities was about 4.6 years. See Note 3 to our consolidated financial statements included in this prospectus for the composition of our fixed income portfolio by scheduled maturity. For additional information regarding our investment portfolio and results, see Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Investments.

**Ratings**

A.M. Best has currently assigned our insurance company subsidiaries a group rating of A (Excellent). According to A.M. Best, A ratings are assigned to insurers which have, on balance, excellent balance sheet strength, operating performance and business profile when compared to the standards established by A.M. Best and, in A.M. Best's opinion, have an excellent ability to meet their ongoing obligations to policyholders.

**Regulatory Environment**

Our insurance company subsidiaries are generally subject to regulation and supervision by insurance departments of the jurisdictions in which they are domiciled or licensed to transact business. State insurance departments have broad administrative power relating to licensing insurers and agents, regulating premium rates and policy forms, establishing reserve requirements, prescribing statutory accounting methods and the form and content of statutory financial reports, regulating certain transactions involving the insurers and prescribing the type and amount of investments. Under state insolvency and guaranty laws, regulated insurers can be assessed or required to contribute to state guaranty funds to cover policyholder losses resulting from insurer insolvencies. Insurers are also required by many states, as a condition of doing business in the state, to participate in various assigned risk pools, reinsurance facilities or underwriting associations, which provide various insurance coverages to individuals that otherwise, are unable to purchase that coverage in the voluntary market. Participation in these involuntary plans is generally in proportion to voluntary writings of related lines of business in that state. The underwriting results of these plans traditionally have been

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unprofitable. The amount of premiums we might be required to assume in a given state in connection with an involuntary plan may be reduced because of credits we may receive for nonstandard policies that we write voluntarily. Many states have laws and regulations that limit an insurer's ability to exit a market. For example, certain states limit an automobile insurer's ability to cancel and non-renew policies.

State insurance departments that have jurisdiction over our insurance subsidiaries may conduct on-site visits and examinations of the insurers' affairs. These examinations have from time to time given rise to, and are likely to give rise to in the future, regulatory orders requiring remedial, injunctive, or other action on the part of an insurance subsidiary or assessing fines or other penalties against our insurance subsidiaries. Currently, our insurance subsidiaries are involved in six market conduct examinations.

The insurance laws of the states of domicile of our insurance subsidiaries contain provisions to the effect that the acquisition or change of control of a domestic insurer or of any person that controls a domestic insurer cannot be consummated without the prior approval of the relevant insurance regulator. In general, a presumption of

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control arises from the ownership, control, possession with the power to vote or possession of proxies with respect to a specified percentage (generally 10%) or more of the voting securities of a domestic insurer or of a person that controls a domestic insurer. In addition, certain state insurance laws contain provisions that require pre-acquisition notification to state agencies of a change in control with respect to a non-domestic insurance company licensed to do business in that state. While such pre-acquisition notification statutes do not authorize the state agency to disapprove the change of control, such statutes do authorize certain remedies, including the issuance of a cease and desist order with respect to the non-domestic insurer if certain conditions exist, such as undue market concentration. Such approval requirements may deter, delay or prevent certain transactions affecting the ownership of our common stock.

We are a holding company with no business operations of our own. Consequently, our ability to pay dividends to shareholders and meet our debt payment obligations is largely dependent on dividends or other distributions from our insurance company subsidiaries. State insurance laws restrict the ability of our insurance company subsidiaries to declare shareholder dividends. These subsidiaries may not make an extraordinary dividend until thirty days after the applicable commissioner of insurance has received notice of the intended dividend and has not objected in such time or the commissioner has approved the payment of the extraordinary dividend within the 30-day period. An extraordinary dividend is defined as any dividend or distribution that, together with other distributions made within the preceding twelve months, exceeds the greater of 10% of the insurer's surplus as of the preceding December 31, or the insurer's net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. In addition, an insurer's remaining surplus after payment of a cash dividend to shareholder affiliates must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs.

Generally, the net admitted assets of insurance companies that, subject to other applicable insurance laws and regulations, are available for transfer to the parent company cannot include the net admitted assets required to meet the minimum statutory surplus requirements of the states where the companies are licensed. The maximum amount of dividends payable during 2004 to us by our insurance companies without seeking regulatory approval is approximately \$46 million. In 2003, our insurance companies paid \$39 million of dividends to the holding company.

State insurance law requires our insurance companies to maintain specified levels of statutory capital and surplus. In addition, for competitive reasons, our insurance company subsidiaries need to maintain adequate financial strength ratings from independent rating agencies. Both of these factors may limit the ability of our insurance subsidiaries to declare and pay dividends.

## **Legal Proceedings**

Our subsidiaries are, from time to time, named as defendants in various lawsuits incidental to our insurance operations. Legal actions relating to claims made under insurance policies are considered by us in establishing loss and LAE reserves. There are also several class action lawsuits pending, including one that involves interpretations of state-mandated fee schedules under personal automobile no-fault insurance laws, against us in various stages of development that involve issues not unlike those facing other insurance companies. One suit in a California state court alleges that we improperly cancelled a class of insureds' automobile insurance policies. Another group of related lawsuits challenges our use of certain automated database vendors to assist in evaluating total loss claims. Also pending are lawsuits that seek extra contractual damages in addition to damages claimed under insurance policies. We believe we have recorded adequate reserves for these liabilities and that, based on the status of these lawsuits, there is no individual pending case that is likely to have a material adverse effect on our financial condition, liquidity or results of operations.

## **Properties**

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Our insurance subsidiaries lease approximately 680,000 square feet of office space in numerous cities throughout the United States. Most of these leases expire within 7 years. The most significant leased office spaces are located in suburban Atlanta, Birmingham (our principal office), Cincinnati, Windsor (Connecticut) and Los Angeles.

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**Employees**

We employ approximately 2,200 persons, none of whom are covered by collective bargaining arrangements.



**Table of Contents****MANAGEMENT****Executive Officers, Directors and Nominees**

Our executive officers and directors are as follows:

| <u>Name</u>                | <u>Age(1)</u> | <u>Position</u>  |
|----------------------------|---------------|--|
| James R. Gober             | 52            | Chief Executive Officer, President and Director                |
| John R. Miner              | 43            | Executive Vice President                                       |
| Samuel J. Simon            | 47            | Senior Vice President, General Counsel, Secretary and Director |
| Roger Smith                | 43            | Senior Vice President, Chief Financial Officer and Director    |
| Joseph A. Pietrangelo      | 39            | Senior Vice President  |
| Jorge G. Castro (2)        | 46            | Director   |
| Gregory G. Joseph(2)(3)(4) | 41            | Director   |
| Harold E. Layman(3)(4)     | 57            | Director   |
| Gregory C. Thomas(2)(3)(4) | 56            | Director   |
| Samuel J. Weinhoff         | 53            | Director-Nominee   |

(1) As of March 31, 2004.

(2) Member of the Audit Committee. Mr. Thomas serves as Chairman of the Audit Committee.

(3) Member of Compensation Committee. Mr. Layman serves as Chairman of the Compensation Committee.

(4) Member of the Nominating/Governance Committee. Mr. Joseph serves as Chairman of the Nominating/Governance Committee.

James R. Gober was elected our Chief Executive Officer and President and a director in November 2002 and was elected Chairman in December 2003. Mr. Gober had served in various capacities within each of our insurance company subsidiaries since 1991.

John R. Miner was elected our Executive Vice President in September 2002. Mr. Miner served in various capacities with Great American Insurance Company since 1988, including President of Great American Insurance Company's personal lines division.

Samuel J. Simon has served as our Secretary, Senior Vice President and General Counsel since 2002 and was elected a director in December 2003. Mr. Simon served in various legal and executive capacities with American Financial Group, Inc. since 1986.

Roger Smith was elected our Senior Vice President and Chief Financial Officer in September 2002 and was elected as a director in December 2003. Mr. Smith served in various executive capacities with Great American Insurance Company since 1987.

Joseph A. Pietrangelo was elected as a Senior Vice President in September 2002. Mr. Pietrangelo had served in a executive capacity in our claims division since 1999. He was with Zurich/Farmers Personal Insurance from 1997 to 1999 and served in various capacities with The Progressive Corporation from 1987 to 1997.

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Jorge G. Castro was elected a director in August 2003. Mr. Castro has served as Vice Chairman and Chief Operating Officer of Valenzuela Capital Partners, LLC, a private equity investment firm since 2003. From 1989 to 2003, Mr. Castro was Chief Executive and Chief Investment Officer of CIC/HCM Asset Management. Mr. Castro presently serves on the Board of Trustees of Milton Academy and on the Board of Directors for the New America Alliance.

Gregory G. Joseph was elected a director in February 2003. Mr. Joseph has been Executive Vice President of Joseph Automotive Group since 1990. From 1987 through 1990, Mr. Joseph practiced law with Keating, Muething & Klekamp in Cincinnati, Ohio. He also serves on the advisory board to Xavier University, Cincinnati.

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Harold E. Layman was elected a director in August 2003. Mr. Layman served as President and Chief Executive Officers of Blount International, Inc. until 2002. He currently serves on the Boards of Directors of Blount International, Inc. Graftech International, Ltd., Grant Prideco, Inc., a manufacturer of oilfield drill pipe and other drill stem and related products, and Von Hoffmann Holdings, Inc., a private equity firm.

Gregory C. Thomas was elected a director in February 2003. Mr. Thomas is currently retired after serving, until 1996 in various executive capacities, including Chief Financial Officer of Citicasters Inc. and its predecessor public company.

Samuel J. Weinhoff is an insurance industry consultant in New York City. From 1997 through 2000, he managed Schroder & Co. s U.S. Financial Institutions Group and from 1985 to 1997, he was a Managing Director at Lehman Brothers.

**Board of Directors**

Our directors are divided into two classes and serve for staggered two-year terms. Our Class I directors, whose terms expire in 2004, are James R. Gober, Gregory G. Joseph and Harold E. Layman. Our Class II directors, whose terms expire in 2005, are Jorge G. Castro, Samuel J. Simon, Roger Smith and Gregory C. Thomas.

**Board Committees**

We have an audit committee, a compensation committee and a nominating/governance committee, all of which consist exclusively of members who qualify as independent directors under the applicable requirements of the Nasdaq Stock Market, Inc. The audit committee is responsible for selecting our independent accountants, reviews the results and scope of the independent accountants audit and the services provided by them and reviews and evaluates our audit and control functions. The compensation committee administers our stock plans and makes recommendations concerning salaries and incentive compensation for our employees and establishes the compensation of our executive officers. The nominating/governance committee selects the director nominees to stand for election at annual meetings of shareholders and develops and recommends to the board a set of corporate governance principles for the company.

**Executive Compensation**

The following table sets forth information with respect to compensation earned by our Chief Executive Officer and by our four other executive officers for the fiscal years ended December 31, 2003, 2002 and 2001. Please note that all of the compensation indicated for the years 2002 and 2001 was paid by AFG. Additionally, any compensation paid by AFG for 2003 is indicated in the footnotes following the table.

| Name and Position | Year | Annual Compensation |       |  | Long-Term Compensation               |                                   |                           | All Other Compensation <sup>4</sup> |
|-------------------|------|---------------------|-------|--|--------------------------------------|-----------------------------------|---------------------------|-------------------------------------|
|                   |      | Salary              | Bonus | Other Annual Compensation <sup>1</sup> | Restricted Stock Awards <sup>2</sup> | Securities Underlying Options (#) | LTIP Payouts <sup>3</sup> |                                     |

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|   |                   |                         |                         |                        |              |         |            |           |
|---|-------------------|-------------------------|-------------------------|------------------------|--------------|---------|------------|-----------|
| James R. Gober<br>Chief Executive Officer and<br>President          | 2003              | \$ 550,000              | \$ 389,375              | \$ 1,861               | \$ 1,000,000 | 101,500 | \$ 79,000  | \$ 15,112 |
|   | 2002              | \$ 385,096              | \$ 250,000              | \$ 9,571               | 0            | 0       | \$ 352,850 | \$ 29,000 |
|   | 2001              | \$ 362,020              | \$ 162,500              | \$ 10,182              | 0            | 0       | \$ 208,725 | \$ 28,400 |
| John R. Miner<br>Executive Vice President                           | 2003              | \$ 407,626              | \$ 245,552 <sup>5</sup> | \$ 103,320             | \$ 400,000   | 40,600  | 0          | \$ 14,164 |
|   | 2002              | \$ 389,428              | \$ 91,732               | \$ 3,065               | 0            | 0       | \$ 196,35  | \$ 28,058 |
|   | 2001              | \$ 383,334              | \$ 171,407              | \$ 8,683               | 0            | 0       | 0          | 28,400    |
| Samuel J. Simon<br>Senior Vice President and<br>General Counsel     | 2003 <sup>6</sup> | \$ 368,664 <sup>5</sup> | \$ 257,692              | \$ 37,851              | \$ 350,000   | 36,540  | 0          | \$ 6,800  |
|   | 2002              | \$ 300,000              | \$ 35,000               | \$ 990                 | 0            | 0       | 0          | \$ 20,750 |
|   | 2001              | \$ 300,000              | \$ 20,000               | \$ 1,350               | 0            | 0       | 0          | \$ 19,400 |
| Roger Smith<br>Senior Vice President and<br>Chief Financial Officer | 2003 <sup>7</sup> | \$ 210,000 <sup>5</sup> | \$ 95,838               | \$ 76,872 <sup>8</sup> | \$ 250,000   | 20,300  | 0          | \$ 1,003  |
|   | 2002              | \$ 182,520              | \$ 37,400               | \$ 2,194               | 0            | 0       | 0          | \$ 15,374 |
|   | 2001              | \$ 177,802              | \$ 20,000               | \$ 750                 | 0            | 0       | \$ 9,804   | \$ 13,290 |
| Joseph A. Pietrangelo<br>Senior Vice President                      | 2003              | \$ 212,308              | \$ 72,484 <sup>5</sup>  | \$ 6,060 <sup>9</sup>  | \$ 150,000   | 16,240  | 0          | \$ 2,819  |
|   | 2002              | \$ 205,961              | \$ 50,000               | \$ 400                 | 0            | 0       | 0          | \$ 14,996 |
|   | 2001              | \$ 180,000              | \$ 60,000               | \$ 330                 | 0            | 0       | 0          | \$ 15,400 |

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- <sup>1</sup> Consists of automobile allowance, insurance premiums, relocation expenses, other taxable expenses and interest earned on deferred compensation.
- <sup>2</sup> Value of the restricted stock as of the date of grant. See the table below for the number and vesting schedule of the aggregate restricted stock holdings at the end of 2003.
- <sup>3</sup> Several executives participate in long-term incentive compensation plans ( LTIP ) which reward profitable results for individual business units based on targeted objectives for the unit tied to long-term profitability. The plans generally measure cumulative underwriting profit for the business unit over five years. Payment of earned amounts is generally made over a three-year period following the term of the plan.
- <sup>4</sup> Consists of retirement plan contributions.
- <sup>5</sup> Includes earned deferred compensation of \$47,533 for Mr. Miner, \$30,000 for Mr. Simon, \$10,500 for Mr. Smith and \$20,000 for Mr. Pietrangelo.
- <sup>6</sup> Annual compensation includes \$318,752 paid by AFG in 2003 to Mr. Simon for bonus, salary, relocation expenses and other taxable expenses for 2003.
- <sup>7</sup> Annual compensation includes \$91,800 paid by AFG in 2003 to Mr. Smith for bonuses and the exercise of the nonqualified stock option detailed in Note 8 to this table.
- <sup>8</sup> Includes \$41,728 paid by AFG for the exercise of an option to purchase AFG common stock.
- <sup>9</sup> Includes \$4,687 for the exercise of an option to purchase AFG common stock.

**RESTRICTED STOCK AWARDS IN LAST FISCAL YEAR**

| Name                  | Number of       | Market Value         |
|-----------------------|-----------------|----------------------|
|                       | Shares Awarded* | at December 31, 2003 |
| James R. Gober        | 62,500          | \$ 2,065,625         |
| John R. Miner         | 25,000          | \$ 826,250           |
| Samuel J. Simon       | 21,875          | \$ 722,969           |
| Roger Smith           | 15,625          | \$ 516,406           |
| Joseph A. Pietrangelo | 9,375           | \$ 309,844           |

- \* The restricted stock awards are time-based and vest in one-third increments on February 18, 2004, February 18, 2005 and February 18, 2006. Dividends will be paid on the restricted stock awards quarterly at the same rate as our common stock.

**OPTION GRANTS IN LAST FISCAL YEAR**

| Name                  | Number of Securities Underlying Options Granted | % of Total Options Granted to Employees in Fiscal 2003 | Exercise Price (\$/Per Share) | Expiration Date | Potential Realized Value at Assumed Annual Rates of Price Appreciation for Option Term* |              |
|-----------------------|---|--|-------------------------------|-----------------|---|--------------|
|                       |   |  |                               |                 | 5%  | 10%          |
| James R. Gober        | 101,500   | 24.8%  | \$ 16                         | 2/18/2013       | \$ 1,021,325  | \$ 2,588,238 |
| John R. Miner         | 40,600  | 9.9%   | \$ 16                         | 2/18/2013       | \$ 408,530  | \$ 1,035,295 |
| Samuel J. Simon       | 36,540  | 8.9%   | \$ 16                         | 2/18/2013       | \$ 367,677  | \$ 931,766   |
| Roger Smith           | 20,300  | 5.0%   | \$ 16                         | 2/18/2013       | \$ 204,265  | \$ 517,648   |
| Joseph A. Pietrangelo | 16,240  | 4.0%   | \$ 16                         | 2/18/2013       | \$ 163,412  | \$ 414,118   |

\*

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The assumed 5% and 10% rates of stock appreciation are rates required by the Securities and Exchange Commission for illustrative purposes and are not intended to predict actual stock appreciation. The assumed annual rate of appreciation of 5% and 10% would result with the price of our common stock appreciating to a price of \$26.06 and \$41.50, respectively.

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**FISCAL 2003 OPTION EXERCISES  
AND FISCAL YEAR-END OPTION VALUES**

| Name                  | Shares<br>Acquired<br>On Exercise | Value<br>Realized | Number of Securities      | Value of Unexercised      |
|-----------------------|-----------------------------------|-------------------|---------------------------|---------------------------|
|                       |                                   |                   | Options at FY-End         | In-the-Money              |
|                       |                                   |                   | Exercisable/Unexercisable | Options at FY-End*        |
|                       |                                   |                   | Exercisable/Unexercisable | Exercisable/Unexercisable |
| James R. Gober        | 0                                 |                   | 0/101,500                 | 0/\$1,703,575             |
| John R. Miner         | 0                                 |                   | 0/40,600                  | 0/\$692,230               |
| Samuel J. Simon       | 0                                 |                   | 0/36,540                  | 0/\$623,007               |
| Roger Smith           | 0                                 |                   | 0/20,300                  | 0/\$346,115               |
| Joseph A. Pietrangelo | 0                                 |                   | 0/16,240                  | 0/\$276,892               |

\* Calculation based on closing price of \$33.05 on December 31, 2003.

**CERTAIN ARRANGEMENTS AND RELATIONSHIPS  
BETWEEN OUR COMPANY AND AFG**

In connection with the initial public offering of our common stock, we entered into a number of agreements with AFG. The terms of these agreements, as described below, were negotiated by us and AFG prior to the initial public offering of our common stock. Our board of directors, as constituted at the time, approved the terms of these agreements. The agreements were not reviewed or approved by the independent directors who joined our board upon or after the completion of the initial public offering. We believe that the terms of these agreements are comparable to or more favorable than those that we could have obtained from independent third parties.

**Formation and Separation**

The formation and separation agreement with AFG sets forth the terms of our organization and certain relationships with AFG. Pursuant to the agreement, AFG transferred to us all of the issued and outstanding common stock of the following personal auto insurance subsidiaries and their respective subsidiaries (excluding Leader National Agency of Texas, Inc. and two foreign subsidiaries): Atlanta Casualty Company, Leader Insurance Company, Infinity Insurance Company and Windsor Insurance Company. In exchange, we issued to AFG all of our issued and outstanding common stock and a note payable in the amount of \$55 million. The promissory note was repaid in July 2003 with proceeds from our term loan. In addition, pursuant to a reinsurance agreement described below, effective January 1, 2003, AFG transferred to us substantially all of the personal lines insurance business written by GAI and its subsidiaries through independent agents. Under the agreement, we received investment securities with a market value equal to approximately \$125.3 million (the "Transferred Investments").

The formation and separation agreement also required that we and AFG enter into certain other agreements, including the reinsurance agreement referred to above, a registration rights agreement, an investment advisory agreement, several services agreements, a non-competition agreement, a tax allocation indemnification agreement, a license agreement and other agreements, each as described below. Further, under the agreement, in

the event we incur certain losses which arise from the operation of the NSA Group or the Assumed Agency Business prior to the completion of the initial public offering of our common stock, AFG agreed to indemnify us for 60% of the first \$25 million of losses which are in excess of a \$13.2 million threshold. Losses covered by this indemnification would include, among others, those arising from claims for failure to settle within a policy limit or bad faith claims, and certain other obligations for which reserves have not been established; provided, however, that a loss shall not be subject to indemnification unless such loss equals or exceeds \$200,000. As of the date of this offering memorandum, we have not made any payments that are currently subject to indemnification. We and AFG terminated AFG's obligation to provide such indemnification in exchange for a one-time payment of \$10.5 million to us made by AFG in December 2003.

## Reinsurance

Effective January 1, 2003, we acquired by reinsurance, substantially all of the independent agency produced personal lines insurance written by AFG's principal property and casualty insurance subsidiary, GAI. In addition, we acquired all personal lines insurance assumed by GAI under a pooling agreement among GAI and its affiliated insurance companies. GAI's personal lines insurance consists primarily of personal auto insurance for standard and preferred drivers but also includes other personal lines business such as homeowners, umbrella liability and boat owners.

As the reinsurer, we assumed all obligations, liabilities and rights with respect to the acquired personal lines insurance, including extracontractual and other non-claims obligations related to the acquired personal lines business. GAI has, however, for a two-year period, retained all assigned risk assessments regarding insurance written in New Jersey and all assigned risk assessments regarding insurance written in New York before January 1, 2003. In consideration for our assumption of such obligations and liabilities, on January 1, 2003, GAI transferred to us assets (primarily securities) in an amount equal to \$125.3 million, which represented GAI's net insurance



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liabilities on such personal lines agency business, as reflected in the statement of the assets and liabilities of the acquired personal lines insurance business as of December 31, 2002. Substantially all of the securities transferred to us were investment grade fixed income securities.

Under the agreement, we have the right for three years to cause GAI to continue writing personal lines insurance in compliance with its form and rate filings then in effect. We are obligated to fully reinsure any such personal lines insurance policies issued or renewed by GAI during such time period. In addition, we are obligated to pay to GAI a ceding commission equal to GAI's cost of renewing or issuing such business as well as a fronting fee on such business, which is initially equal to four-tenths of one percent of gross premiums received. In consideration for providing such reinsurance, we receive all net premiums received by GAI or its affiliates on such renewals or new business. We have extended the agreement beyond its initial three-year term as may be necessary to continue to reinsure any independent agency produced personal lines insurance policies that GAI may be required to issue or renew after the scheduled expiration of the agreement.

## **Investment Advisory**

AFG, through its wholly-owned subsidiary, American Money Management Corporation, provides investment advisory services to us for the five year period following completion of the initial public offering of our common stock at a fee of 17/100s of one percent of managed assets. The investment services it furnishes must be in accordance with general investment policies, objectives, directions and guidelines established from time to time by our board of directors or an appropriate committee of the board. For services rendered to our subsidiaries in the years 2003, 2002, 2001 and 2000, American Money Management charged the NSA Group and/or us \$2.0 million, \$1.8 million, \$2.0 million and \$2.0 million, respectively. We amended the agreement with American Money Management to shorten its initial term. As so amended, the initial term will end on December 31, 2006. The agreement will be automatically extended for successive one-year periods unless either party provides written notice of termination at least 90 days prior to the end of the then-current term. We can also terminate the agreement, upon specified notice, for American Money Management's material breach of the agreement or its failure to adhere to our investment guidelines.

## **Tax Allocation**

Before the initial public offering of our common stock, we were parties to a Tax Allocation Agreement with certain AFG affiliates that provided for the filing of consolidated federal income tax returns and the allocation of income tax liability among various AFG subsidiaries as a Consolidated Tax Group. As a result of the completion of the initial public offering, we are no longer a members of the Consolidated Tax Group for federal income tax purposes. In the event any tax issues arise under the Tax Allocation Agreement with respect to periods during which we were a member of the Consolidated Tax Group, we have entered into a tax allocation indemnification agreement pursuant to which we agreed to indemnify the Consolidated Tax Group for liabilities that are allocated to the NSA Group for periods prior to the initial public offering, and that the Consolidated Tax Group agreed to indemnify us for tax liabilities that are allocated to other members of the Consolidated Tax Group for periods prior to the initial public offering. The amount of tax allocated for such periods is generally equal to the federal income tax that would have been payable by us during such periods if the NSA Group had filed separate returns based upon income computed in accordance with generally accepted accounting principles. Under the tax laws, each member of the Consolidated Tax Group is severally liable for the federal income tax liability of each other member of the Consolidated Tax Group. Accordingly, with respect to periods in which we have been included in the Consolidated Tax Group, we could be liable for any federal tax liability incurred, but not discharged, by any other member of the Consolidated Tax Group. As discussed above, the other members of the Consolidated Tax Group will indemnify us for that liability. Taxes allocated to the NSA Group for the years 2002, 2001 and 2000 were \$25.1 million, \$6.1 million, and \$26.4 million, respectively.

## **Other Services**

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We entered into a services agreement for the provision by AFG to us of certain facility sharing, information systems and corporate staff services, including human resources, risk management, legal, financial reporting and other existing shared services. The term for the provision of each service may vary depending on our needs. Some services have been phased out following the completion of the initial public offering of our common stock while others may continue for up to a three-year term. We continue to develop our own internal capabilities in order to reduce and eventually eliminate our reliance on AFG for such services. We pay AFG for these services fees as specified in the services agreement. On each anniversary of the services agreement, the fees for certain services

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may be adjusted based on the consumer price index. For 2002, 2001 and 2000, we estimate that fees allocated to our insurance operations were \$11 million each year. For 2003, fees paid to AFG for these services were \$5.7 million.

## **Non-Competition**

We entered into a non-competition agreement with AFG pursuant to which for the period of five years following completion of the initial public offering of our common stock, AFG shall not, and shall not permit its subsidiaries to,

offer, issue or sell, directly or indirectly within the United States, personal automobile insurance written through independent agents;  
or

employ, offer to employ or solicit with a view to employment any person employed by us whose annual base salary exceeds \$50,000.

The non-competition agreement is not binding upon a subsidiary or a controlling shareholder of AFG after the time such subsidiary or controlling shareholder ceases to be a subsidiary or controlling shareholder of AFG and does not apply to any person which becomes an affiliate of AFG after the closing of the initial public offering of our common stock (other than a subsidiary of AFG), including any person that acquires all or substantially all of the capital stock or assets of AFG. However, the agreement is binding upon any person who has a controlling interest in AFG upon completion of the initial public offering of our common stock until the time such person ceases to have a controlling interest in AFG.

Notwithstanding the foregoing, AFG is not prohibited from

engaging in any line of business in which it is engaged at the completion of the initial public offering of our common stock; or

acquiring an interest in any person engaged in any line of business except for acquisitions of controlling interests, whether in a single transaction or series of transactions, in any subsidiary or entities with, in the aggregate, \$100,000,000 or more in gross annual written premiums or, with respect to one person, 50% or more of its gross revenues, attributable to writing personal automobile insurance, which we refer to as a permitted acquiree. AFG may acquire a controlling interest in a person which is not a permitted acquiree, if AFG promptly divests the personal automobile insurance operations of such subsidiary.

## **Intercompany Securities Transactions**

The NSA Group purchased and sold securities at fair value in transactions with AFG subsidiaries and also transferred securities to its parent in the form of capital distributions and received securities from its parent as capital contributions. For a further description of these securities transactions, see Note 13 to the our consolidated financial statements included with this prospectus.

In December 2003, we received proceeds of approximately \$4.7 million through the sale of one equity security to AFG. The purchase price for the sale was based on the closing price of the security on the date of sale.

**Trademark License**

We entered into a trademark license agreement with GAI. Under this agreement, we acquired rights to use certain trademarks and service marks of GAI in connection with our business. Under the license agreement, we obtained a non-exclusive, royalty-free right to use the Great American name during the term of the Reinsurance Agreement principally in connection with the products and services of the Assumed Agency Business. We also obtained non-exclusive, royalty-free rights in perpetuity to use certain other trademarks and service marks of GAI that relate to our business. These licensed marks will remain the property of GAI and may continue to be used by GAI. Our rights to the marks are subject to certain notice, approval and quality control requirements, as well as other standard commercial terms. Under the license agreement, we agreed to indemnify GAI for any claims and losses that result from our use of the marks outside the scope of the license granted to us. In December 2003, AFG transferred to us certain of the trademarks covered by the trademark license agreement.

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**Miscellaneous**

We provide certain management services to AFG with respect to GAI's direct to consumer personal automobile insurance business at fees that reflect the agreed upon level of service and support to be provided. For 2003, fees incurred by AFG for these services were approximately \$6.5 million. AFG is also required to reimburse us for certain costs. We agreed with AFG that it would satisfy the reimbursement obligation in exchange for a one-time payment of \$3.0 million made by AFG in December 2003.

We lease property located in Cincinnati, Ohio from GAI and also sublease property currently leased by GAI in Cincinnati, Ohio and Windsor, Connecticut. The subleases remain effective through at least the current term of the existing lease. The lease payments made to GAI under any sublease are determined on a cost-sharing basis calculated by the percentage of space, if any, retained by GAI and are secured by the assets of the subtenant. Lease payments allocated for space occupied by the Assumed Agency Business were \$1.4 million, \$1.1 million, \$1.1 million and \$1.2 million, respectively, for the years 2003, 2002, 2001 and 2000.

We are a party to four quota share reinsurance agreements with an AFG subsidiary under which we reinsure the subsidiary's liabilities with respect to certain policies of personal automobile insurance. The agreements allow us to write personal lines insurance in certain states on the subsidiary's form and rate filings then in effect. These agreements terminate on June 30, 2005 unless terminated prior to that time by either party upon 90 days written notice.

**PRINCIPAL SHAREHOLDERS**

The following table sets forth certain information regarding the beneficial ownership of our common stock by:

each person that owns beneficially more than 5% of the outstanding shares of our common stock;

each director, director nominee and executive officer; and

all of our directors, director nominees and executive officers as a group.

Each holder listed below has sole investment and voting power with respect to the shares of common stock beneficially owned by the holder. Except as set forth below, all information is provided as of April 8, 2004.

| <u>Name</u>   | <u>Shares</u> | <u>Percent</u> |
|---|---------------|----------------|
| T. Rowe Price Associates, Inc. (1)<br>100 East Pratt Street Baltimore, Maryland 21202 | 2,044,000     | 9.9%           |
| RS Investment Management Co. LLC (2)  | 1,373,098     | 6.8            |

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388 Market Street, Suite 1700 San Francisco, California 94111

|  |           |      |
|--|-----------|------|
| Trinity Capital of Jacksonville, Inc. (3)                              | 1,050,000 | 5.1  |
| 1819 Goodwin Street Jacksonville, Florida 32204                        |           |      |
| James R. Gober   | 89,050    | *    |
| John R. Miner  | 34,995    | *    |
| Samuel J. Simon  | 32,308    | *    |
| Roger Smith  | 20,935    | *    |
| Joseph A. Pietrangelo  | 12,623    | *    |
| Jorge G. Castro  | 5,000     | *    |
| Gregory G. Joseph  | 7,200     | *    |
| Harold E. Layman   | 5,000     | *    |
| Gregory C. Thomas  | 5,000     | *    |
| Samuel J. Weinhoff   | 0         |      |
| All directors, executive officers and nominees as a group (10 persons) | 212,111   | 1.0% |

\* Less than 1%.

(1) The following is based upon information provided by T. Rowe Price Associates, Inc. ( Price Associates ) as of

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- April 7, 2004. These securities are owned by various individual and institutional investors which Price Associates serves as investment adviser with power to direct investments and/or sole power to vote the securities. For purposes of the reporting requirements of the Securities Exchange Act of 1934, Price Associates is deemed to be a beneficial owner of such securities; however, Price Associates expressly disclaims that it is, in fact, the beneficial owner of such securities. According to Price Associates, it has sole voting power as to 283,900 of these shares and sole dispositive power as to all of these shares.
- (2) The following is based upon information contained on Schedule 13G filed with the Securities and Exchange Commission on February 18, 2004 and information provided by RS Investment Management Co. LLC as of April 8, 2004. These shares are owned by various individual and institutional investors for which RS Investment Management, L.P., RS Investment Management, Inc., and RS Growth Group LLC (all SEC-registered investment advisers controlled by RS Investment Management Co. LLC) serve as investment adviser with power to exercise voting power or investment power, or both. For purposes of the reporting requirements of the Securities Exchange Act of 1934, RS Investment Management Co. LLC, RS Investment Management, L.P., RS Investment Management, Inc., and RS Growth Group LLC (collectively RS Investments ) are deemed to be a beneficial owner of such securities; however, RS Investments expressly disclaims that it is, in fact, the beneficial owner of such securities. According to Schedule 13G, RS Investment Management Co. LLC has shared voting and dispositive power as to all of these shares.
- (3) According to the information contained on Schedule 13G filed with the Securities and Exchange Commission on March 12, 2004, Trinity Capital of Jacksonville, Inc. has shared voting and dispositive power as to all of these shares.

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**DESCRIPTION OF NOTES**

The existing notes were issued, and the exchange notes will be issued, under an indenture dated as of February 17, 2004 between us and American Stock Transfer & Trust Company, as trustee. The following description is only a summary of the material provisions of the notes and the indenture. We urge you to read the indenture, including the form of exchange note, in its entirety because it, and not this description, defines your rights as holders of the notes. All references to us in this section refer solely to Infinity Property and Casualty Corporation and not to our subsidiaries.

**General**

The notes will be issued in an aggregate principal amount of up to \$200,000,000 and will mature on February 18, 2014. The notes will bear interest at the rate of 5.50% per year from February 17, 2004, or from the most recent date to which interest has been paid or provided for, payable semi-annually in arrears on February 18 and August 18, commencing August 18, 2004 to the persons in whose names the notes are registered at the close of business on the next preceding February 3 or August 3, respectively. We may from time to time without notice to, or the consent of, the holders of the notes, create and issue additional notes under the indenture, equal in rank to the notes in all respects (except for the issue price, issue date and the amount of the first payment of interest following the issue date of the exchange notes) so that the exchange notes may be consolidated and form a single series with the notes and have the same terms as to status, redemption and otherwise as the notes issued.

The notes will not be entitled to the benefits of any sinking fund.

**Ranking**

The indenture does not limit our ability or the ability of our subsidiaries to incur additional indebtedness. The notes will be our senior unsecured obligations and will rank equally in right of payment with any of our existing and future unsecured and unsubordinated indebtedness. The notes will be effectively subordinated to any of our future secured indebtedness to the extent of the value of the assets securing that indebtedness. As of the date of this prospectus, our aggregate principal amount of indebtedness (excluding intercompany liabilities) consisted solely of \$200 million of existing notes. We are a holding company and conduct our operations through our subsidiaries. However, the notes will not be guaranteed by any of our subsidiaries and will therefore be structurally subordinated to all indebtedness and other obligations, including trade payables and insurance liabilities, of our subsidiaries. As of December 31, 2003, our subsidiaries had approximately \$1,250 million of total liabilities (including trade payables, capital lease obligations and insurance liabilities but excluding intercompany liabilities).

**Optional Redemption**

We may redeem the notes, at our option, at any time in whole, or from time to time in part, prior to maturity at a redemption price equal to the greater of:



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100% of the principal amount of the notes; and

the sum of the present values of the remaining scheduled payments of principal and interest thereon (exclusive of interest accrued to the date of redemption) discounted to the redemption date on a semiannual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate, plus 20 basis points, plus in each case, accrued interest thereon to the date of redemption.

**Treasury Rate** means, with respect to any redemption date, the rate per year equal to the semiannual equivalent yield to maturity or interpolated (on a day count basis) of the Comparable Treasury Issue, assuming a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such redemption date.

**Comparable Treasury Issue** means the United States Treasury security or securities selected by an Independent Investment Banker as having an actual or interpolated maturity comparable to the remaining term of the notes to be redeemed that would be utilized, at the time of selection and in accordance with customary financial

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practice, in pricing new issues of corporate debt securities of a comparable maturity to the remaining term of such notes.

Independent Investment Banker means one of the Reference Treasury Dealers appointed by the trustee after consultation with us.

Comparable Treasury Price means, with respect to any redemption date:

the average of the Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest such Reference Treasury Dealer Quotations; or

if the trustee obtains fewer than four such Reference Treasury Dealer Quotations, the average of all such quotations.

Reference Treasury Dealer Quotations means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the trustee, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the trustee by such Reference Treasury Dealer at 3:30 p.m. New York City time on the third business day preceding such redemption date.

Reference Treasury Dealer means:

each of UBS Securities LLC and Lehman Brothers Inc. or their respective affiliates; provided, however, that if any of the foregoing shall cease to be a primary U.S. government securities dealer in the United States (a Primary Treasury Dealer), we will substitute therefor another Primary Treasury Dealer; and

two other Primary Treasury Dealers selected by us. Notice of any redemption will be mailed at least 30 days but not more than 60 days before the redemption date to each holder of notes to be redeemed.

Unless we default in payment of the redemption price, on and after the redemption date interest will cease to accrue on the notes or portions thereof called for redemption. We will pay interest to a person other than the holder of record on the record date if we elect to redeem the notes on a date that is after a record date but on or prior to the corresponding interest payment date. In this instance, we will pay accrued interest on the notes being redeemed to, but not including, the redemption date to the same person to whom we will pay the redemption price of those notes.

**Certain Covenants**

The indenture contains, among others, the following covenants:

***Limitation on Liens***

We have agreed that we will not, and will not permit any Subsidiary to, incur, issue, assume or guaranty any indebtedness if such indebtedness is secured by a pledge of, lien on, or security interest in any shares of Voting Stock of any Significant Subsidiary, whether such Voting Stock is now owned or is acquired at a later time, without providing that the notes (together with, if we determine, any other indebtedness or obligations of us or any Subsidiary ranking equally with or senior to the notes and then existing or thereafter created) are secured equally and ratably with such indebtedness. This limitation does not apply to (i) up to \$10 million of indebtedness not contemplated by clause (ii) and (iii), (ii) indebtedness secured by a pledge of, lien on or security interest in, any shares of Voting Stock of any corporation if such pledge, lien or security interest is made or granted prior to or at the time such corporation becomes a Significant Subsidiary, (iii) liens or security interests securing indebtedness of a Significant Subsidiary to us or another Significant Subsidiary or (iv) the extension, renewal or replacement (or successive extensions, renewals or replacements), in whole or in part, of any lien or security interest referred to in the foregoing clauses (ii) and (iii) but only if the principal amount of indebtedness secured by the liens or security interests immediately prior to the extension, renewal or replacement is not increased and the lien or security interest is not extended to other property.

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### ***Limitation on Mergers and Sales of Assets***

We have agreed that we will not enter into a merger or consolidation with another corporation or sell or lease all or substantially all of our assets to another corporation, unless (i) either we are the continuing corporation, or the successor corporation (if other than us) expressly assumes by supplemental indenture our obligations on the notes (in which case, except in the case of such a lease, we will be discharged from our obligations on the notes), and (ii) immediately thereafter, we or the successor corporation (if other than us) would not be in default in the performance of any covenant or condition of the indenture.

Under the laws of the State of New York, which govern the indenture, there is no clear meaning of the phrase "all or substantially all" with regard to a company's assets or property, and the interpretation of such phrase is very fact-intensive. Due to such uncertainty, it may be difficult for holders of the notes to ascertain whether a viable claim exists under the indenture with respect to any given transaction.

### ***Limitations on Disposition of Stock of Significant Subsidiaries***

The indenture provides that we will not, and will not permit any Subsidiary to issue, sell, transfer or otherwise dispose of any shares of capital stock of any Significant Subsidiary (or of any Subsidiary having direct or indirect control of any Significant Subsidiary) except for, subject to the covenant relating to mergers and sales of assets described above,

a sale, transfer or other disposition of any capital stock of any Significant Subsidiary (or of any Subsidiary having direct or indirect control of any Significant Subsidiary) to a wholly owned Subsidiary of us or

a sale, transfer or other disposition of any capital stock of any Significant Subsidiary (or of any Subsidiary having direct or indirect control of any Significant Subsidiary) held by us and our Subsidiaries for at least fair value (as determined by our Board of Directors acting in good faith), and, in either such case, after giving effect to the use of proceeds therefrom, we and our Subsidiaries, considered as a whole, would continue to be principally engaged in the businesses we and they conduct as of February 17, 2004.

We are not required pursuant to the indenture to repurchase the notes, in whole or in part, with the proceeds of any sale, transfer or other disposition of any shares of capital stock of any Subsidiary (or of any Subsidiary having direct or indirect control of any other Subsidiary). Furthermore, the indenture does not provide for any restrictions on our use of any proceeds from that sale, transfer or disposition.

The indenture does not contain any provisions specifically intended to protect holders of the notes in the event of a highly leveraged transaction, reorganization, restructuring, merger or similar transaction involving us.

Although the indenture does contain the provisions described in "Limitation on Liens" above, the indenture does not contain any provisions which will otherwise restrict us from incurring, assuming or becoming liable with respect to any indebtedness or other obligations, whether secured or unsecured, or from paying dividends or making other distributions on our capital stock or purchasing or redeeming our capital stock. The indenture does not contain any financial ratios or specified levels of net worth or liquidity to which we must adhere. In addition, the indenture does not contain any provision which would require us to repurchase or redeem or otherwise modify the terms of any of the notes upon a change in control or other events involving us which may adversely affect the creditworthiness of the notes.

**Certain Definitions**

Significant Subsidiary means a Subsidiary, including its Subsidiaries, that meets any of the conditions set forth under Rule 405 under the Securities Act.

Subsidiary means a corporation, company (including any limited liability company), association, partnership, joint venture, trust or other business entity in which we and/or one or more of our other Subsidiaries owns at least 50% of the Voting Stock.

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Voting Stock means stock of any class or classes or other ownership interest having general voting power under ordinary circumstances to elect a majority of the board of directors, managers, trustees or persons with similar functions of the entity in question, provided that, for the purposes of this definition, stock which carries only the right to vote conditionally on the happening of an event will not be considered Voting Stock whether or not that event has happened.

**Events of Default**

The indenture provides that Events of Default with respect to the notes will be

default for 30 days in payment of interest upon any note;

default in payment of principal or premium, if any, on any note;

default in performance, or breach, of any other covenant or warranty in the indenture for 30 days, after notice;