

INFINITY PROPERTY & CASUALTY CORP

Form 10-Q

November 03, 2011

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from _____ to _____

Commission File No. 0-50167

INFINITY PROPERTY AND CASUALTY CORPORATION

(Exact name of registrant as specified in its charter)

Incorporated under

the Laws of Ohio

03-0483872

(State or other jurisdiction of

incorporation or organization)

(I.R.S. Employer

Identification No.)

3700 Colonnade Parkway, Suite 600, Birmingham, Alabama 35243

(Address of principal executive offices and zip code)

(205) 870-4000

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by rule 12b-2 of the Exchange Act). Yes No

As of October 31, 2011 there were 11,834,589 shares of the registrant's common stock outstanding.

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

PART I
FINANCIAL INFORMATIONITEM 1
Financial StatementsINFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS(in thousands, except per share data)
(unaudited)

	Three months ended September 30,			Nine months ended September 30,		
	2011	2010	% Change	2011	2010	% Change
Revenues:						
Earned premium	\$255,138	\$232,503	9.7 %	\$745,703	\$670,159	11.3 %
Net investment income	10,166	11,090	(8.3)%	31,117	33,968	(8.4)%
Net realized gains on investments*	722	7,991	(91.0)%	5,604	7,580	(26.1)%
Other income	101	85	19.6 %	201	206	(2.2)%
Total revenues	266,127	251,669	5.7 %	782,625	711,913	9.9 %
Costs and Expenses:						
Losses and loss adjustment expenses	195,275	152,304	28.2 %	566,685	452,227	25.3 %
Commissions and other underwriting expenses	58,124	53,339	9.0 %	170,689	155,356	9.9 %
Interest expense	2,702	2,701	0.0 %	8,105	8,101	0.0 %
Corporate general and administrative expenses	1,729	2,057	(16.0)%	5,654	6,155	(8.1)%
Other expenses	1,026	(373)	(374.9)%	1,425	2,174	(34.4)%
Total costs and expenses	258,856	210,028	23.2 %	752,558	624,014	20.6 %
Earnings before income taxes	7,271	41,641	(82.5)%	30,067	87,899	(65.8)%
Provision for income taxes	1,139	10,810	(89.5)%	5,343	25,169	(78.8)%
Net Earnings	\$6,132	\$30,831	(80.1)%	\$24,724	\$62,730	(60.6)%
Earnings per Common Share:						
Basic	\$0.51	\$2.45	(79.2)%	\$2.02	\$4.83	(58.2)%
Diluted	0.50	2.39	(79.1)%	1.97	4.72	(58.3)%
Average Number of Common Shares:						
Basic	12,070	12,576	(4.0)%	12,230	12,980	(5.8)%
Diluted	12,344	12,913	(4.4)%	12,524	13,292	(5.8)%
Cash Dividends per Common Share	\$0.18	\$0.14	28.6 %	\$0.54	\$0.42	28.6 %
* Net realized gains before impairment losses	\$1,146	\$8,141	(85.9)%	\$6,873	\$9,530	(27.9)%
Total other-than-temporary impairment (OTTI) losses	(442)	(49)	799.9 %	(2,121)	(191)	NM
Non-credit portion in other comprehensive income	19	0	0.0 %	1,036	0	0.0 %
	(1)	(101)	(98.9)%	(185)	(1,760)	(89.5)%

OTTI losses reclassified from other
comprehensive income

Net impairment losses recognized in earnings	(424)	(150)	181.8	%	(1,270)	(1,951)	(34.9)%
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Total net realized gains on investments	\$722		\$7,991		(91.0)%	\$5,604		\$7,580		(26.1)%
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NM = Not meaningful

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	September 30, 2011 (unaudited)	December 31, 2010
Assets		
Investments:		
Fixed maturities – at fair value (amortized cost \$1,136,287 and \$1,153,802)	\$1,177,290	\$1,177,718
Equity securities – at fair value (cost \$26,344 and \$29,333)	33,104	42,301
Total investments	\$1,210,395	\$1,220,019
Cash and cash equivalents	52,157	63,605
Accrued investment income	11,224	12,033
Agents' balances and premium receivable, net of allowances for doubtful accounts of \$12,781 and \$12,323	389,700	336,676
Property and equipment, net of accumulated depreciation of \$43,155 and \$43,731	38,975	25,132
Prepaid reinsurance premium	2,262	1,890
Recoverables from reinsurers (includes \$87 and \$289 on paid losses and LAE)	14,841	16,809
Deferred policy acquisition costs	92,034	79,398
Current and deferred income taxes	15,851	14,867
Receivable for securities sold	5,541	0
Other assets	5,445	6,653
Goodwill	75,275	75,275
Total assets	\$1,913,699	\$1,852,357
Liabilities and Shareholders' Equity		
Liabilities:		
Unpaid losses and loss adjustment expenses	\$493,531	\$477,833
Unearned premium	480,741	417,371
Payable to reinsurers	0	42
Long-term debt (fair value \$207,388 and \$199,132)	194,790	194,729
Commissions payable	22,030	18,960
Payable for securities purchased	12,772	419
Other liabilities	58,510	81,819
Total liabilities	\$1,262,373	\$1,191,173
Commitments and contingencies (See Note 10)		
Shareholders' equity:		
Common stock, no par value (50,000,000 shares authorized; 21,329,834 and 21,167,947 shares issued)	\$21,319	\$21,228
Additional paid-in capital	354,034	349,742
Retained earnings	643,598	625,492
Accumulated other comprehensive income, net of tax	31,528	24,488
Treasury stock, at cost (9,450,658 and 8,698,962 shares)	(399,153) (359,766
Total shareholders' equity	\$651,326	\$661,184
Total liabilities and shareholders' equity	\$1,913,699	\$1,852,357
See Condensed Notes to Consolidated Financial Statements.		

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(in thousands)

(unaudited)

	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), Net of Tax	Treasury Stock	Total
Balance at December 31, 2009	\$21,064	\$344,031	\$541,167	\$19,500	\$(307,602)	\$618,160
Net earnings	—	—	62,730	—	—	62,730
Net change in postretirement benefit liability	—	—	—	(52)	—	(52)
Change in unrealized gain on investments	—	—	—	14,002	—	14,002
Change in non-credit component of impairment losses on fixed maturities	—	—	—	3,620	—	3,620
Comprehensive income	—	—	—	—	—	\$80,300
Dividends paid to common shareholders	—	—	(5,449)	—	—	(5,449)
Shares issued and share-based compensation expense, including tax benefit	132	4,395	—	—	—	4,527
Acquisition of treasury stock	—	—	—	—	(45,815)	(45,815)
Balance at September 30, 2010	\$21,195	\$348,426	\$598,449	\$37,069	\$(353,417)	\$651,723
Net earnings	\$—	\$—	\$28,792	\$—	\$—	\$28,792
Net change in postretirement benefit liability	—	—	—	(68)	—	(68)
Change in unrealized gain on investments	—	—	—	(13,130)	—	(13,130)
Change in non-credit component of impairment losses on fixed maturities	—	—	—	617	—	617
Comprehensive income	—	—	—	—	—	\$16,212
Dividends paid to common shareholders	—	—	(1,749)	—	—	(1,749)
Shares issued and share-based compensation expense, including tax benefit	32	1,316	—	—	—	1,348
Acquisition of treasury stock	—	—	—	—	(6,350)	(6,350)
Balance at December 31, 2010	\$21,228	\$349,742	\$625,492	\$24,488	\$(359,766)	\$661,184
Net earnings	\$—	\$—	\$24,724	\$—	\$—	\$24,724
Net change in postretirement benefit liability	—	—	—	(31)	—	(31)
Change in unrealized gain on investments	—	—	—	6,102	—	6,102
Change in non-credit component of impairment losses on fixed maturities	—	—	—	969	—	969
Comprehensive income	—	—	—	—	—	\$31,764
Dividends paid to common shareholders	—	—	(6,618)	—	—	(6,618)
Shares issued and share-based compensation expense, including tax benefit	91	4,291	—	—	—	4,383

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Acquisition of treasury stock	—	—	—	—	(39,387)	(39,387)
Balance at September 30, 2011	\$21,319	\$354,034	\$643,598	\$31,528	\$(399,153)	\$651,326

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Three months ended September 30,	
	2011	2010
Operating Activities:		
Net earnings	\$6,132	\$30,831
Adjustments:		
Depreciation	1,850	2,590
Amortization	2,038	1,704
Net realized gains on investments	(722)	(7,991)
Loss on disposal of property and equipment	160	4
Share-based compensation expense	967	1,139
Excess tax benefits from share-based payment arrangements	(169)	0
Non-cash activity related to rabbi trust	(65)	0
Increase in accrued investment income	(5)	(8)
Increase in agents' balances and premium receivable	(14,928)	(13,224)
Decrease in reinsurance receivables	186	1,253
Increase in deferred policy acquisition costs	(1,519)	(3,689)
Decrease in other assets	5,579	4,253
Increase (decrease) in unpaid losses and loss adjustment expenses	10,422	(4,813)
Increase in unearned premium	14,409	10,039
Decrease in other liabilities	(5,848)	(2,419)
Net cash provided by operating activities	18,488	19,668
Investing Activities:		
Purchases of and additional investments in:		
Fixed maturities	(46,844)	(178,622)
Equity securities	(2,000)	0
Property and equipment	(2,705)	(1,205)
Maturities and redemptions of fixed maturities	22,416	34,692
Sales of:		
Fixed maturities	49,360	145,219
Equity securities	0	0
Net cash provided by investing activities	20,228	84
Financing Activities:		
Proceeds from stock options exercised and employee stock purchases, including tax benefit	271	652
Excess tax benefits from share-based payment arrangements	169	0
Acquisition of treasury stock	(21,284)	(16,436)
Dividends paid to shareholders	(2,170)	(1,762)
Net cash used in financing activities	(23,014)	(17,547)
Net increase in cash and cash equivalents	15,702	2,205
Cash and cash equivalents at beginning of period	36,455	63,147
Cash and cash equivalents at end of period	\$52,157	\$65,352
See Condensed Notes to Consolidated Financial Statements.		

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INFINITY PROPERTY AND CASUALTY CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine months ended September 30,	
	2011	2010
Operating Activities:		
Net earnings	\$24,724	\$62,730
Adjustments:		
Depreciation	6,676	7,864
Amortization	5,869	4,710
Net realized gains on investments	(5,604)	(7,580)
Loss on disposal of property and equipment	362	7
Share-based compensation expense	2,383	3,182
Excess tax benefits from share-based payment arrangements	(169)	0
Non-cash activity related to rabbi trust	(47)	0
Decrease (increase) in accrued investment income	809	(625)
Increase in agents' balances and premium receivable	(53,024)	(52,979)
Decrease in reinsurance receivables	1,596	214
Increase in deferred policy acquisition costs	(12,635)	(12,994)
Increase in other assets	(3,582)	(7,641)
Increase (decrease) in unpaid losses and loss adjustment expenses	15,698	(11,660)
Increase in unearned premium	63,370	61,993
Decrease in payable to reinsurers	(42)	(58)
(Decrease) increase in other liabilities	(20,328)	15,712
Net cash provided by operating activities	26,057	62,876
Investing Activities:		
Purchases of and additional investments in:		
Fixed maturities	(242,707)	(371,671)
Equity securities	(2,000)	0
Property and equipment	(20,881)	(6,906)
Maturities and redemptions of fixed maturities	113,081	105,828
Sales of:		
Fixed maturities	150,231	225,403
Equity securities	7,871	0
Net cash provided by (used in) investing activities	5,596	(47,346)
Financing Activities:		
Proceeds from stock options exercised and employee stock purchases, including tax benefit	1,999	1,344
Excess tax benefits from share-based payment arrangements	169	0
Acquisition of treasury stock	(38,650)	(45,775)
Dividends paid to shareholders	(6,618)	(5,449)
Net cash used in financing activities	(43,100)	(49,879)
Net decrease in cash and cash equivalents	(11,447)	(34,349)
Cash and cash equivalents at beginning of period	63,605	99,700
Cash and cash equivalents at end of period	\$52,157	\$65,352

See Condensed Notes to Consolidated Financial Statements.

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011

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| 1. Reporting and Accounting Policies | 7. Income Taxes |
| 2. Share-Based Compensation | 8. Additional Information |
| 3. Computation of Earnings Per Share | 9. Insurance Reserves |
| 4. Fair Value | 10. Commitments and Contingencies |
| 5. Investments | 11. Subsequent Events |
| 6. Long-Term Debt | |

Note 1 Reporting and Accounting Policies

Nature of Operations

We are a holding company that, through subsidiaries, provides personal automobile insurance with a concentration on nonstandard auto insurance. Although licensed to write insurance in all 50 states and the District of Columbia, we focus on select states that we believe offer the greatest opportunity for premium growth and profitability.

Basis of Consolidation and Reporting

The accompanying consolidated financial statements are unaudited and should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2010. This Quarterly Report on Form 10-Q, including the Condensed Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations, focuses on our financial performance since the beginning of the year.

These financial statements reflect certain adjustments necessary for a fair presentation of our results of operations and financial position. Such adjustments consist of normal, recurring accruals recorded to match expenses with their related revenue streams and the elimination of all significant inter-company transactions and balances.

We have evaluated events that occurred after September 30, 2011 for recognition or disclosure in our financial statements and the notes to the financial statements.

Estimates

We based certain accounts and balances within these financial statements upon our estimates and assumptions. The amount of reserves for claims not yet paid, for example, is an item that we can only record by estimation. Unrealized capital gains and losses on investments are subject to market fluctuations, and we use judgment in the determination of whether unrealized losses on certain securities are temporary or other-than-temporary. Should actual results differ significantly from these estimates, the effect on our results of operations could be material. The results of operations for the periods presented may not be indicative of our results for the entire year.

Pending Accounting Standards

In October 2010, the FASB issued guidance that modifies the accounting for the deferral of costs associated with the successful acquisition or renewal of insurance contracts. The new guidance is effective for reporting periods beginning after December 15, 2011 and should be applied prospectively, with retrospective application permitted. We are in the process of evaluating the impact of adoption on our results of operations and financial position.

Reclassifications

We have reclassified certain amounts in the prior period consolidated financial statements to conform to the current period presentation. These reclassifications had no effect on total shareholders' equity, net cash flow or net earnings as previously reported.

Schedules may not foot due to rounding.

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INFINITY PROPERTY AND CASUALTY CORPORATION 10-Q

Condensed Notes to Consolidated Financial Statements

Note 2 Share-Based Compensation

Restricted Stock Plan

We established the Restricted Stock Plan in 2002 and amended it on July 31, 2007. There are 500,000 shares of our common stock reserved for issuance under the Restricted Stock Plan, of which we have issued 278,843 shares as of September 30, 2011. We expense the fair value of shares issued under the Restricted Stock Plan over the vesting periods of the awards based on the market value of our stock on the date of grant.

On July 31, 2007, our Compensation Committee (“Committee”) approved the grant of 72,234 shares of restricted stock to certain officers under the Restricted Stock Plan. These shares of restricted stock vested in full on July 31, 2011. On August 2, 2011, the Committee approved the grant of an additional 72,234 shares of restricted stock to certain officers under the Restricted Stock Plan. These shares will vest in full on August 2, 2014. During the vesting period, the shares of restricted stock will not have voting rights and will accrue dividends, which we will not pay until the shares have vested. We treat the restricted shares as issued and outstanding for calculation of diluted earnings per share only. Until fully vested, we will not consider the shares issued and outstanding for purposes of the basic earnings per share calculation.

Non-employee Directors’ Stock Ownership Plan

In May 2005, our shareholders approved the Non-employee Directors’ Stock Ownership Plan (“Directors’ Plan”). The purpose of the Directors’ Plan is to include our common stock as part of the compensation provided to our non-employee directors and to provide for stock ownership requirements for our non-employee directors. There are 200,000 shares of our common stock reserved for issuance under the Directors’ Plan, of which we have issued 43,959 shares as of September 30, 2011. Under the terms of the Directors’ Plan, we grant shares on or about June 1 of each year and we restrict these shares from sale or transfer by any recipient for six months from the date of grant. In June 2011, we issued 6,657 shares of our common stock, valued pursuant to the Directors’ Plan at \$350,000, to our non-employee directors. In June 2010, we issued 7,672 shares of our common stock, valued pursuant to the Directors’ Plan at \$350,000, to our non-employee directors. We treat participants’ shares as issued and outstanding for basic and diluted earnings per share calculations.

Employee Stock Purchase Plan

We established our Employee Stock Purchase Plan (“ESPP”) in 2004, amended and restated it on August 3, 2010. Under the ESPP, all eligible full-time employees may purchase shares of our common stock at a 15% discount to the current market price. Employees may allocate up to 25% of their base salary with a maximum annual participation amount of \$25,000. If a participant sells any shares purchased under the ESPP within one year, we preclude that employee from participating in the ESPP for one year from the date of sale. The source of shares issued to participants is treasury shares or authorized but previously unissued shares. The maximum number of shares that we may issue under the ESPP may not exceed 1,000,000, of which we have issued 46,238 as of September 30, 2011. Our ESPP is qualified under Section 423 of the Internal Revenue Code of 1986, as amended. We treat participants’ shares as issued and outstanding for basic and diluted earnings per share calculations.

Performance Share Plan

Our shareholders approved the Performance Share Plan (“PSP”) on May 20, 2008 and an amended and restated PSP on May 26, 2010. The purpose of the PSP is to align further the interest of management with our long-term shareholders by including performance-based compensation, payable in shares of common stock, as a component of an executive’s annual compensation. The Committee administers the PSP and will (i) establish the performance goals, which may include but are not limited to, combined ratio, premium growth, growth within certain specific geographic areas and earnings per share or return on equity over the course of the upcoming three year period, (ii) determine the PSP

participants, (iii) set the performance share units to be awarded to such participants, and (iv) set the rate at which performance share units will convert to shares of common stock based upon attainment of the performance goals. The number of shares of common stock that we may issue under the PSP is limited to 500,000 shares. In April 2011, we issued 32,957 shares under the PSP.

Stock Option Plan

We amended our Stock Option Plan (“SOP”) to prohibit any future grant of stock options from the plan after May 20, 2008. We amended the plan again on August 2, 2011. We have granted no options since 2004. We generally granted options with an exercise price equal to the closing price of our stock at the date of grant and these options have a 10-year contractual life. All of

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Condensed Notes to Consolidated Financial Statements

the options under the SOP have fully vested. Subject to specific limitations contained in the SOP, our Board of Directors has the ability to amend, suspend or terminate the plan at any time without shareholder approval. The SOP will continue in effect until the exercise or expiration of all options granted under the plan.

As permitted by the Stock Compensation topic of the FASB Accounting Standards Codification, we used the modified Black-Scholes model with the assumptions noted below to estimate the value of employee stock options on the date of grant. Expected volatilities are based on historical volatilities of our stock. We selected the expected option life to be 7.5 years, which represents the midpoint between the last vesting date and the end of the contractual term. The risk-free interest rate for periods within the contractual life of the options is based on the yield on 10-year Treasury notes in effect at the time of grant. The dividend yield was based on expected dividends at the time of grant.

We estimated the weighted-average grant date fair values of options granted during 2004 and 2003 using the modified Black-Scholes valuation model and the following weighted-average assumptions:

	2004 Grants		2003 Grants	
Weighted-average grant date fair value	\$13.87		\$5.97	
Dividend yield	0.7	%	1.4	%
Expected volatility	33.0	%	33.0	%
Risk-free interest rate	4.3	%	4.0	%
Expected life	7.5	years	7.5	years
Weighted-average grant exercise price	\$33.56		\$16.11	
Outstanding as of September 30, 2011	79,050		113,405	

The following table describes activity for our Stock Option Plan:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Term (in years)	Aggregate Intrinsic Value (a) (in millions)
Outstanding at December 31, 2010	238,758	\$ 22.52		
Granted	0	0		