

CINCINNATI FINANCIAL CORP
Form 10-Q
April 24, 2019

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

(Mark one)

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

For the quarterly period ended March 31, 2019.

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

For the transition period from _____ to _____.

Commission file number 0-4604

CINCINNATI FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

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

6200 S. Gilmore Road, Fairfield, Ohio 45014-5141

(Address of principal executive offices) (Zip code)

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

N/A

(Former name or former address, if changed since last report.)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class Trading Symbol(s) Name of each exchange on which registered

Common stock CINF Nasdaq Global Select Market

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically 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 such files).

Yes No

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

Large accelerated filer Accelerated filer Nonaccelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Yes No

As of April 19, 2019, there were 163,229,828 shares of common stock outstanding.

CINCINNATI FINANCIAL CORPORATION AND SUBSIDIARIES
FORM 10-Q FOR THE QUARTER ENDED MARCH 31, 2019

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Part I – Financial Information

Item 1. Financial Statements (unaudited)

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Balance Sheets

(Dollars in millions, except per share data)	March 31, 2019	December 31, 2018
Assets		
Investments		
Fixed maturities, at fair value (amortized cost: 2019—\$10,734; 2018—\$10,643)	\$ 11,022	\$ 10,689
Equity securities, at fair value (cost: 2019—\$3,381; 2018—\$3,368)	6,571	5,920
Other invested assets	271	123
Total investments	17,864	16,732
Cash and cash equivalents	802	784
Investment income receivable	128	132
Finance receivable	72	71
Premiums receivable	1,785	1,644
Reinsurance recoverable	527	484
Prepaid reinsurance premiums	50	44
Deferred policy acquisition costs	751	738
Land, building and equipment, net, for company use (accumulated depreciation: 2019—\$265; 2018—\$265)	202	195
Other assets	340	308
Separate accounts	831	803
Total assets	\$ 23,352	\$ 21,935
Liabilities		
Insurance reserves		
Loss and loss expense reserves	\$ 5,944	\$ 5,707
Life policy and investment contract reserves	2,784	2,779
Unearned premiums	2,717	2,516
Other liabilities	752	804
Deferred income tax	817	627
Note payable	32	32
Long-term debt and lease obligations	845	834
Separate accounts	831	803
Total liabilities	14,722	14,102
Commitments and contingent liabilities (Note 12)		
Shareholders' Equity		
Common stock, par value—\$2 per share; (authorized: 2019 and 2018—500 million shares; issued: 2019 and 2018—198.3 million shares)	397	397
Paid-in capital	1,277	1,281
Retained earnings	8,229	7,625
Accumulated other comprehensive income	210	22
Treasury stock at cost (2019—35.1 million shares and 2018—35.5 million shares)	(1,483)	(1,492)
Total shareholders' equity	8,630	7,833

Total liabilities and shareholders' equity	\$23,352	\$ 21,935
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Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Income

(Dollars in millions, except per share data)	Three months ended March 31,	
	2019	2018
Revenues		
Earned premiums	\$1,333	\$1,260
Investment income, net of expenses	157	150
Investment gains and losses, net	663	(191)
Fee revenues	4	4
Other revenues	2	1
Total revenues	2,159	1,224
Benefits and Expenses		
Insurance losses and contract holders' benefits	860	854
Underwriting, acquisition and insurance expenses	411	403
Interest expense	13	13
Other operating expenses	8	4
Total benefits and expenses	1,292	1,274
Income (Loss) Before Income Taxes	867	(50)
Provision (Benefit) for Income Taxes		
Current	28	28
Deferred	144	(47)
Total provision (benefit) for income taxes	172	(19)
Net Income (Loss)	\$695	\$(31)
Per Common Share		
Net income (loss)—basic	\$4.27	\$(0.19)
Net income (loss)—diluted	4.22	(0.19)

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Cincinnati Financial Corporation and Subsidiaries
 Condensed Consolidated Statements of Comprehensive Income

(Dollars in millions)	Three months ended March 31,	
	2019	2018
Net Income (Loss)	\$695	\$(31)
Other Comprehensive Income (Loss)		
Change in unrealized gains on investments, net of tax (benefit) of \$50 and (\$46), respectively	192	(175)
Amortization of pension actuarial loss and prior service cost, net of tax of \$0 and \$0, respectively	—	—
Change in life deferred acquisition costs, life policy reserves and other, net of tax (benefit) of \$(1) and \$1, respectively	(4)	5
Other comprehensive income (loss)	188	(170)
Comprehensive Income (Loss)	\$883	\$(201)

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Shareholders' Equity

(Dollars in millions)	Three months ended March 31,	
	2019	2018
Common Stock		
Beginning of year	\$397	\$397
Share-based awards	—	—
End of period	397	397
Paid-In Capital		
Beginning of year	1,281	1,265
Share-based awards	(14)	(17)
Share-based compensation	9	9
Other	1	1
End of period	1,277	1,258
Retained Earnings		
Beginning of year	7,625	5,180
Cumulative effect of change in accounting for equity securities as of January 1, 2018	—	2,503
Adjusted beginning of year	7,625	7,683
Net income (loss)	695	(31)
Dividends declared (per share of \$0.56 for 2019 and \$0.53 for 2018)	(91)	(87)
End of period	8,229	7,565
Accumulated Other Comprehensive Income (Loss)		
Beginning of year	22	2,788
Cumulative effect of change in accounting for equity securities as of January 1, 2018	—	(2,503)
Adjusted beginning of year	22	285
Other comprehensive income (loss)	188	(170)
End of period	210	115
Treasury Stock		
Beginning of year	(1,492)	(1,387)
Share-based awards	13	14
Shares acquired - share repurchase authorization	—	(15)
Shares acquired - share-based compensation plans	(5)	(2)
Other	1	1
End of period	(1,483)	(1,389)
Total Shareholders' Equity	\$8,630	\$7,946
(In millions)		
Common Stock - Shares Outstanding		
Beginning of year	162.8	163.9
Share-based awards	0.4	0.4
Shares acquired - share repurchase authorization	—	(0.2)
End of period	163.2	164.1

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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Cincinnati Financial Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows

(Dollars in millions)	Three months ended March 31, 2019 2018	
Cash Flows From Operating Activities		
Net income (loss)	\$695	\$(31)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19	18
Investment gains and losses, net	(660)	191
Share-based compensation	9	9
Interest credited to contract holders'	11	11
Deferred income tax expense	144	(47)
Changes in:		
Investment income receivable	4	10
Premiums and reinsurance receivable	(95)	(26)
Deferred policy acquisition costs	(24)	(10)
Other assets	(25)	(8)
Loss and loss expense reserves	(40)	72
Life policy and investment contract reserves	22	21
Unearned premiums	113	55
Other liabilities	(93)	(137)
Current income tax receivable/payable	120	26
Net cash provided by operating activities	200	154
Cash Flows From Investing Activities		
Sale of fixed maturities	1	5
Call or maturity of fixed maturities	269	393
Sale of equity securities	31	104
Purchase of fixed maturities	(289)	(438)
Purchase of equity securities	(26)	(110)
Investment in finance receivables	(8)	(6)
Collection of finance receivables	7	6
Investment in buildings and equipment	(5)	(3)
Change in other invested assets, net	(36)	(5)
Net cash used in investing activities	(56)	(54)
Cash Flows From Financing Activities		
Payment of cash dividends to shareholders	(85)	(80)
Shares acquired - share repurchase authorization	—	(15)
Proceeds from stock options exercised	3	4
Contract holders' funds deposited	19	21
Contract holders' funds withdrawn	(44)	(46)
Other	(19)	(37)
Net cash used in financing activities	(126)	(153)
Net change in cash and cash equivalents	18	(53)
Cash and cash equivalents at beginning of year	784	657
Cash and cash equivalents at end of period	\$802	\$604
Supplemental Disclosures of Cash Flow Information:		
Income taxes received	\$94	\$—

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Noncash Activities

Conversion of securities	\$—	\$3
Equipment acquired under capital lease obligations	3	5
Cashless exercise of stock options	5	2
Other assets and other liabilities	23	30

Accompanying Notes are an integral part of these Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 — Accounting Policies

The condensed consolidated financial statements include the accounts of Cincinnati Financial Corporation and its consolidated subsidiaries, each of which is wholly owned. These statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP). Effective February 28, 2019, the company acquired MSP Underwriting Limited (MSP), a London-based global specialty underwriter. Refer to Note 14, Acquisition, for additional information. The interim condensed consolidated financial statements include MSP's results for the period from February 28, 2019, through March 31, 2019. Foreign exchange rates related to MSP's operations did not have a material impact to our condensed consolidated financial statements. All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Our actual results could differ from those estimates. Certain financial information that is normally included in annual financial statements prepared in accordance with GAAP, but that is not required for interim reporting purposes, has been condensed or omitted.

Our March 31, 2019, condensed consolidated financial statements are unaudited. We believe that we have made all adjustments, consisting only of normal recurring accruals, that are necessary for fair presentation. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements included in our 2018 Annual Report on Form 10-K. The results of operations for interim periods do not necessarily indicate results to be expected for the full year.

Adopted Accounting Updates

ASU 2016-02, Leases (Topic 842)

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, Leases (Topic 842). The main provision of ASU 2016-02 requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The effective date of ASU 2016-02 is for interim and annual reporting periods beginning after December 15, 2018. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842 and ASU 2018-11, Targeted Improvements to Topic 842. ASU 2018-10 makes narrow-scope amendments to certain aspects of the new leasing standard while ASU 2018-11 provides relief from costs of implementing certain aspects of the new leasing standard.

The company adopted this ASU effective January 1, 2019, and it did not have a material impact on our company's consolidated financial position, cash flows or results of operations. The company has elected the practical expedient package for carrying forward historical lease classifications, not re-evaluating for embedded leases and not reassessing initial direct costs. The company also elected additional practical expedients to not recognize short-term leases on the balance sheet and to only combine lease and nonlease components for certain asset classes. We also elected not to restate prior periods. In support of its insurance operations, the company leases real estate properties which qualify as operating leases and also leases equipment and autos which qualify as finance leases. The lease term for real estate properties is typically five years while the term for equipment and autos is three to six years.

ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities

In March 2017, the FASB issued ASU 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. ASU 2017-08 amends guidance on the amortization period of premiums on certain purchased callable debt securities. The amendments shorten the amortization period of premiums on certain purchased callable debt securities to the earliest call date.

The amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment to

beginning retained earnings. The effective date of ASU 2017-08 is for interim and annual reporting periods beginning after December 15, 2018. The company adopted this ASU effective January 1, 2019, and it did not have a material impact on our company's consolidated financial position, cash flows or results of operations.

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ASU 2018-07, Compensation - Stock Compensation (Topic 718) - Improvements to Nonemployee Share-Based Payment Accounting

In June 2018, the FASB issued ASU 2018-07, Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. ASU 2018-07 expands the scope of Topic 718, Compensation - Stock Compensation, which currently only includes share-based payments issued to employees, to include share-based payments issued to nonemployees for the acquisition of goods and services. The effective date of ASU 2018-07 is for interim and annual reporting periods beginning after December 15, 2018. The company adopted this ASU effective January 1, 2019, and it did not have a material impact on our company's consolidated financial position, cash flows or results of operations.

Pending Accounting Updates

ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 amends previous guidance on the impairment of financial instruments by adding an impairment model that allows an entity to recognize expected credit losses as an allowance rather than impairing as they are incurred. The new guidance is intended to reduce complexity of credit impairment models and result in a more timely recognition of expected credit losses. The effective date of ASU 2016-13 is for interim and annual reporting periods beginning after December 15, 2019. The ASU has not yet been adopted. Management is currently evaluating the impact on our company's consolidated financial position, cash flows and results of operations.

ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350) - Simplifying the Test for Goodwill Impairment. ASU 2017-04 simplifies the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Instead, an entity should perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The loss recognized should not exceed the total amount of goodwill allocated to that reporting unit and income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered. The effective date of ASU 2017-04 is for interim and annual goodwill impairment tests performed in any fiscal years beginning after December 15, 2019. The ASU has not yet been adopted; however, it is not expected to have a material impact on our company's consolidated financial position, cash flows or results of operations.

ASU 2018-12, Financial Services - Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts

In August 2018, the FASB issued ASU 2018-12, Financial Services - Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts. ASU 2018-12 is intended to improve the timeliness of recognizing changes in the liability for future policy benefits and modify the rate used to discount future cash flows. The ASU will simplify and improve the accounting for certain market-based options or guarantees associated with deposit or account balance contracts, simplify amortization of deferred acquisition costs while improving and expanding required disclosures. The effective date of ASU 2018-12 is for interim and annual reporting periods beginning after December 15, 2020. The ASU has not yet been adopted. Management is currently evaluating the impact on our company's consolidated financial position, cash flows and results of operations.

ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement. ASU 2018-13 clarifies the fair value

measurement disclosure requirements of ASC 820 by adding, eliminating and modifying disclosures. The effective date of ASU 2018-13 is for interim and annual reporting periods beginning after December 15, 2019. The ASU has not yet been adopted; however, it is not expected to have a material impact on our company's consolidated financial position, cash flows or results of operations.

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ASU 2018-14, Compensation - Retirement Benefits - Defined Benefit Plans - General (Topic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans

In August 2018, the FASB issued ASU 2018-14, Compensation - Retirement Benefits - Defined Benefit Plans - General (Topic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans. ASU 2018-14 clarifies the guidance in ASC 715 to add, remove, and clarify disclosure requirements related to defined benefit pension and other postretirement plans. The effective date of ASU 2018-14 is for annual reporting periods ending after December 15, 2020. The ASU has not yet been adopted; however, it is not expected to have a material impact on our company's consolidated financial position, cash flows or results of operations.

ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract

In August 2018, the FASB issued ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract. ASU 2018-15 amends ASC 350 to include implementation costs of a cloud computing arrangement that is a service contract and clarifies that a customer should apply ASC 350-40 to determine which implementation costs should be capitalized in a cloud computing arrangement that is considered a service contract. The effective date of ASU 2018-15 is for interim and annual reporting periods beginning after December 15, 2019. The ASU has not yet been adopted. Management is currently evaluating the impact on our company's consolidated financial position, cash flows and results of operations.

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NOTE 2 – Investments

The following table provides cost or amortized cost, gross unrealized gains, gross unrealized losses and fair value for our fixed-maturity securities:

(Dollars in millions)	Cost or amortized cost	Gross unrealized gains	losses	Fair value
At March 31, 2019				
Fixed maturity securities:				
Corporate	\$ 5,753	\$ 160	\$ 25	\$5,888
States, municipalities and political subdivisions	4,269	153	3	4,419
Government-sponsored enterprises	305	—	3	302
Commercial mortgage-backed	292	6	1	297
United States government	99	1	—	100
Foreign government	16	—	—	16
Total	\$ 10,734	\$ 320	\$ 32	\$11,022
At December 31, 2018				
Fixed maturity securities:				
Corporate	\$ 5,712	\$ 85	\$ 87	\$5,710
States, municipalities and political subdivisions	4,251	84	31	4,304
Government-sponsored enterprises	316	1	7	310