National Interstate CORP
Form 10-Q
November 04, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2009

OR

o **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 000-51130

National Interstate Corporation
(Exact name of registrant as specified in its charter)

Ohio	**34-1607394**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

3250 Interstate Drive
Richfield, Ohio 44286-9000
(330) 659-8900
(Address and telephone number of principal executive offices)

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. þ Yes o 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 (Section 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). o Yes o 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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check One):

Large Accelerated Filer o	Accelerated Filer þ	Non-Accelerated Filer o (Do not check if a smaller reporting company)	Smaller Reporting Company o

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

The number of shares outstanding of the registrant s sole class of common shares as of November 2, 2009 was 19,393,261.

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PART I FINANCIAL INFORMATION

ITEM 1. *Financial Statements*

National Interstate Corporation and Subsidiaries
Consolidated Balance Sheets
(In thousands, except per share data)

	September 30, 2009 (Unaudited)	December 31, 2008
ASSETS		
Investments:		
Fixed maturities available-for-sale, at fair value (amortized cost $521,089 and $462,562, respectively)	$ 523,742	$ 459,237
Equity securities available-for-sale, at fair value (cost $25,363 and $30,143, respectively)	28,013	27,233
Short-term investments, at cost which approximates fair value	86	85
Total investments	551,841	486,555
Cash and cash equivalents	57,750	77,159
Securities lending collateral (cost $0 and $94,655, respectively)		84,670
Accrued investment income	4,837	5,161
Premiums receivable, net of allowance for doubtful accounts of $769 and $587, respectively	118,274	95,610
Reinsurance recoverables on paid and unpaid losses	151,739	150,791
Prepaid reinsurance premiums	32,730	28,404
Deferred policy acquisition costs	20,124	19,245
Deferred federal income taxes	12,733	18,324
Property and equipment, net	21,693	20,406
Funds held by reinsurer	3,346	3,073
Prepaid expenses and other assets	2,321	1,414
Total assets	$ 977,388	$ 990,812
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Unpaid losses and loss adjustment expenses	$ 417,786	$ 400,001
Unearned premiums and service fees	170,995	156,598
Long-term debt	15,000	15,000
Amounts withheld or retained for account of others	53,013	48,357
Reinsurance balances payable	15,877	10,267
Securities lending obligation		95,828
Accounts payable and other liabilities	31,679	35,813
Commissions payable	9,088	9,274
Assessments and fees payable	4,040	3,600
Total liabilities	717,478	774,738
Shareholders equity:		
Preferred shares no par value		

Authorized 10,000 shares				
Issued 0 shares				
Common shares $0.01 par value				
Authorized 50,000 shares				
Issued 23,350 shares, including 4,049 and 4,055 shares, respectively, in treasury		234		234
Additional paid-in capital		48,942		48,004
Retained earnings		213,017		184,187
Accumulated other comprehensive income (loss)		3,447		(10,613)
Treasury shares		(5,730)		(5,738)
Total shareholders equity		259,910		216,074
Total liabilities and shareholders equity	$	977,388	$	990,812

See notes to consolidated financial statements.

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National Interstate Corporation and Subsidiaries
Consolidated Statements of Operations
(Unaudited)
(In thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	**2008**	**2009**	**2008**
Revenues:				
Premiums earned	$ 70,825	$ 75,058	$ 209,927	$ 214,521
Net investment income	4,501	5,498	14,430	16,793
Net realized gains (losses) on investments (*)	760	(8,457)	1,831	(10,768)
Other	879	605	2,627	2,199
Total revenues	76,965	72,704	228,815	222,745
Expenses:				
Losses and loss adjustment expenses	48,286	51,995	127,052	144,097
Commissions and other underwriting expenses	15,189	18,529	43,565	46,685
Other operating and general expenses	3,085	3,241	9,580	9,786
Expense on amounts withheld	811	1,001	2,578	3,261
Interest expense	71	133	403	704
Total expenses	67,442	74,899	183,178	204,533
Income (loss) before federal income taxes	9,523	(2,195)	45,637	18,212
Provision for federal income taxes	1,367	2,033	12,726	8,499
Net income (loss)	$ 8,156	$ (4,228)	$ 32,911	$ 9,713
Net income (loss) per common share basic	$ 0.42	$ (0.22)	$ 1.71	$ 0.50
Net income (loss) per common share diluted	$ 0.42	$ (0.22)	$ 1.70	$ 0.50
Weighted average of common shares outstanding basic	19,301	19,293	19,301	19,281
Weighted average of common shares outstanding diluted	19,384	19,293	19,360	19,375
Cash dividends per common share	$ 0.07	$ 0.06	$ 0.21	$ 0.18

(*) Consists of the following:

Realized gains (losses) before impairment losses	$	2,035	$	(498)	$	4,339	$	(252)

See notes to consolidated financial statements.

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National Interstate Corporation and Subsidiaries
Consolidated Statements of Shareholders Equity
(Unaudited)
(Dollars in thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
Balance at January 1, 2009	$ 234	$ 48,004	$ 184,187	$ (10,613)	$ (5,738)	$ 216,074
Net income			32,911			32,911
Unrealized appreciation of investment securities, net of tax expense of $7.5 million				14,060		14,060
Comprehensive income						46,971
Dividends on common stock			(4,081)			(4,081)
Issuance of 6,089 treasury shares from restricted stock issued, net of forfeitures		(56)			8	(48)
Stock compensation expense		994				994
Balance at September 30, 2009	$ 234	$ 48,942	$ 213,017	$ 3,447	$ (5,730)	$ 259,910
Balance at January 1, 2008	$ 234	$ 45,566	$ 178,190	$ (5,321)	$ (5,863)	$ 212,806
Net income			9,713			9,713
Unrealized depreciation of investment securities, net of tax benefit of $4.4 million				(16,444)		(16,444)
Comprehensive loss						(6,731)
Dividends on common stock			(3,497)			(3,497)
Issuance of 89,723 treasury shares upon exercise of options and restricted stock issued, net of forfeitures		706			125	831
Tax benefit realized from exercise of stock options		396				396
Stock compensation expense		1,012				1,012
Balance at September 30, 2008	$ 234	$ 47,680	$ 184,406	$ (21,765)	$ (5,738)	$ 204,817

See notes to consolidated financial statements.

National Interstate Corporation and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2009	**2008**
Operating activities		
Net income	$ 32,911	$ 9,713
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of bond premiums and discounts	1,940	1,251
Provision for depreciation and amortization	1,350	1,017
Net realized (gains) losses on investment securities	(1,831)	10,768
Deferred federal income taxes	(1,871)	(2,877)
Stock compensation expense	994	1,012
Increase in deferred policy acquisition costs, net	(879)	(4,488)
Increase in reserves for losses and loss adjustment expenses	17,785	86,627
Increase in premiums receivable	(22,664)	(34,046)
Increase in unearned premiums and service fees	14,397	40,281
Increase in interest receivable and other assets	(856)	(80)
Increase in prepaid reinsurance premiums	(4,326)	(15,260)
(Decrease) increase in accounts payable, commissions and other liabilities and assessments and fees payable	(3,880)	8,283
Increase in amounts withheld or retained for account of others	4,656	9,674
Increase in reinsurance recoverable	(948)	(40,425)
Increase in reinsurance balances payable	5,610	9,845
Other	(45)	(3)
Net cash provided by operating activities	42,343	81,292
Investing activities		
Purchases of fixed maturities	(271,708)	(342,290)
Purchases of equity securities	(4,756)	(3,387)
Proceeds from sale of fixed maturities	39,467	1,148
Proceeds from sale of equity securities	12,135	10,115
Proceeds from maturities and redemptions of investments	216,345	278,896
Capital expenditures	(2,592)	(1,359)
Net cash used in investing activities	(11,109)	(56,877)
Financing activities		
Decrease in securities lending collateral	49,314	54,416
Decrease in securities lending obligation	(95,828)	(54,416)
Additional long-term borrowings		15,000
Reductions of long-term debt		(15,464)
Tax benefit realized from exercise of stock options		396
	(48)	831

Issuance of common shares from treasury upon exercise of stock options or stock award grants				
Cash dividends paid on common shares		(4,081)		(3,497)
Net cash used in financing activities		(50,643)		(2,734)
Net (decrease) increase in cash and cash equivalents		(19,409)		21,681
Cash and cash equivalents at beginning of period		77,159		43,069
Cash and cash equivalents at end of period	$	57,750	$	64,750

See notes to consolidated financial statements.

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NATIONAL INTERSTATE CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements of National Interstate Corporation (the Company) and its subsidiaries have been prepared in accordance with the instructions to Form 10-Q, which differ in some respects from statutory accounting principles permitted by state regulatory agencies.

The consolidated financial statements include the accounts of the Company and its subsidiaries, National Interstate Insurance Company (NIIC), Hudson Indemnity, Ltd. (HIL), National Interstate Insurance Company of Hawaii, Inc. (NIIC-HI), Triumphe Casualty Company (TCC), National Interstate Insurance Agency, Inc. (NIIA), Hudson Management Group, Ltd. (HMG), American Highways Insurance Agency, Inc., Safety, Claims and Litigation Services, Inc., Explorer RV Insurance Agency, Inc. and Safety, Claims and Litigation Services, LLC. Significant intercompany transactions have been eliminated.

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008. The interim financial statements reflect all adjustments which are, in the opinion of management, necessary for the fair presentation of the results for the periods presented. Such adjustments are of a normal recurring nature. Operating results for the three and nine month period ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

The preparation of the financial statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Changes in circumstances could cause actual results to differ materially from those estimates. Certain reclassifications have been made to financial information presented for prior years to conform to the current year s presentation.

2. Securities Lending Program

Prior to June 2009, the Company participated in a securities lending program whereby certain fixed maturity and equity securities from the Company s investment portfolio were loaned to other institutions for short periods of time. The Company required collateral equal to 102% of the market value of the loaned securities plus accrued interest. The collateral was invested by the lending agent generating investment income, net of applicable fees. The Company was not permitted to sell or re-pledge the collateral on the securities lending program. The Company accounted for this program as a secured borrowing and recorded the collateral held and corresponding liability to return the collateral on the Company s Consolidated Balance Sheets at fair value. The securities loaned remained a recorded asset of the Company. Prior to 2008, collateral could be invested in investments with maturities beyond the loan term, including asset backed securities and corporate obligations. However, in light of the market turmoil, beginning in 2008, new cash collateral was only invested in overnight investments.

In June 2009, the Company terminated its securities lending program. During 2009, and prior to the program s termination, approximately $22.1 million of investments within the Company s securities lending collateral matured and were used to pay down a corresponding amount of the Company s securities lending obligation. Upon the program s termination, the Company used cash on hand and securities lending collateral to pay the $73.7 million securities lending obligation. Securities lending collateral that had a fair value of $35.8 million and an unrealized loss of $9.1 million at the termination date were retained by the Company and are included in the Company s fixed maturities portfolio. Other-than-temporary impairments of $1.6 million had previously been taken on these fixed maturities.

During its participation in the program, the Company examined the securities lending collateral held for possible other-than-temporary declines in value. During 2009, and prior to termination of the program, the Company recorded a $0.4 million other-than-temporary impairment on one fixed maturity investment within the Company s securities lending collateral portfolio, compared to $1.1 million recorded during the nine months ended September 30, 2008.

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	September 30, 2009 (Dollars in thousands)	December 31, 2008 (Dollars in thousands)
Collateral obligation	$	$ 95,828
Pretax unrealized loss on fair value of collateral held		(9,985)
Cumulative other-than-temporary impairment charges		(1,173)
Fair value of collateral held		84,670
Fair value of securities lent plus accrued interest		94,265

3. Fair Value Measurements

Under fair value accounting, the Company must determine the appropriate level in the fair value hierarchy for each applicable measurement. The fair value hierarchy prioritizes the inputs, which refer broadly to assumptions market participants would use in pricing an asset or liability, into three levels. It gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The level in the fair value hierarchy within which a fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety. Fair values for the Company s investment portfolio are reviewed by company personnel using data from nationally recognized pricing services as well as non-binding broker quotes.

The pricing services use a variety of observable inputs to estimate the fair value of fixed maturities that do not trade on a daily basis. These inputs include, but are not limited to, recent reported trades, benchmark yields, issuer spreads, bids or offers, reference data and measures of volatility. Included in the pricing of mortgage-backed securities are estimates of the rate of future prepayments and defaults of principal over the remaining life of the underlying collateral. Valuation techniques utilized by pricing services and prices obtained from independent financial institutions are reviewed by company personnel who are familiar with the securities being priced and the markets in which they trade to ensure that the fair value determination is representative of an exit price, as defined by fair value accounting.

Effective April 1, 2009, the Company adopted revised accounting guidance on estimating the fair value of an asset or liability when there is no active market and on identifying transactions that are not orderly. This did not change the objective of fair value measurements. Adoption of this change in the accounting guidance did not have a material impact on the Company s consolidated financial position or results of operations.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical securities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices within Level 1 that are observable for the security, either directly or indirectly. Level 2 inputs include quoted prices for similar securities in active markets, quoted prices for identical or similar securities that are not active and observable inputs other than quoted prices, such as interest rate and yield curves. Level 3 inputs are unobservable inputs for the asset or liability.

Level 1 consists of publicly traded equity securities whose fair value is based on quoted prices that are readily and regularly available in an active market. Level 2 primarily consists of financial instruments whose fair value is based on quoted prices in markets that are not active and include U.S. government and government agency securities, fixed maturity investments, perpetual preferred stock and certain publicly traded common stocks that are not actively traded. Included in Level 2 are $6.0 million of securities, which are valued based upon a non-binding broker quote and validated by management by observable market data. Level 3 consists of financial instruments that are not traded in an active market, whose fair value is estimated by management based on inputs from independent financial institutions, which include non-binding broker quotes, for which the Company believes reflects fair value, but are unable to verify inputs to the valuation methodology. The Company obtained one quote or price per instrument from its brokers and pricing services and did not adjust any quotes or prices that it obtained. Management reviews these broker quotes using information such as the market prices of similar investments.

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The following table presents the Company s investment portfolio, categorized by the level within the fair value hierarchy in which the fair value measurements fall at September 30, 2009:

	September 30, 2009			
	Level 1	Level 2	Level 3	Total
	(Dollars in thousands)			
Fixed maturities:				
U.S. government and government agency obligations	$	$ 177,159	$	$ 177,159
State and local government obligations		162,887	6,373	169,260
Residential mortgage-backed securities		120,217	2,494	122,711
Commercial mortgage-backed securities		3,751		3,751
Corporate obligations		33,756	5,878	39,634
Redeemable preferred stocks	8,231	650	2,346	11,227
Total fixed maturities	8,231	498,420	17,091	523,742
Equity securities:				
Perpetual preferred stock	848	246	396	1,490
Common stock	14,551	11,972		26,523
Total equity securities	15,399	12,218	396	28,013
Short-term investments		86		86
Total investments	23,630	510,724	17,487	551,841
Cash and cash equivalents	57,750			57,750
Total investments and cash and cash equivalents	$ 81,380	$ 510,724	$ 17,487	$ 609,591

The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs for the three months ended September 30, 2009:

	Three Months Ended September 30, 2009				
	Corporate obligations	State and local government obligations	Residential mortgage-backed securities	Redeemable preferred stock	Perpetual preferred stock
	(Dollars in thousands)				
Beginning balance at July 1, 2009	$ 5,825	$ 6,338	$ 2,705	$ 2,299	$ 396
Total gains or (losses):					
Included in earnings	65				
Included in other comprehensive income	65	35	16	47	
Purchases and (settlements) [(1)]	(77)		(227)		
Transfers in and/or (out) of Level 3					
Ending balance at September 30, 2009	$ 5,878	$ 6,373	$ 2,494	$ 2,346	$ 396

The amount of total gains or (losses) for the period included in earnings attributable to the change in unrealized gains or (losses) relating to assets still held at the reporting date	$ 65	$	$	$	$

(1) These amounts are attributable to either purchases of securities or principal pay downs, conversions or maturities during the three months ended September 30, 2009.

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The following table presents a reconciliation of the beginning and ending balances for all investments measured at fair value on a recurring basis using Level 3 inputs for the nine months ended September 30, 2009:

	Nine Months Ended September 30, 2009					
	Corporate obligations	State and local government obligations	Residential mortgage-backed securities	Redeemable preferred stock	Perpetual preferred stock	Securities lending collateral
	(Dollars in thousands)					
Beginning balance at January 1, 2009	$ 4,295	$ 6,118	$	$ 2,406	$ 3,265	$ 5,046
Total gains or (losses):						
Included in earnings	65		(497)		(170)	(421)
Included in other comprehensive income	(45)	255	716	(60)	1,551	546
Purchases and (settlements) [1]	(577)		(269)		(4,250)	(487)
Transfers in and/or (out) of Level 3 [2]	2,140		2,544			(4,684)
Ending balance at September 30, 2009	$ 5,878	$ 6,373	$ 2,494	$ 2,346	$ 396	$
The amount of total gains or (losses) for the period included in earnings attributable to the change in unrealized gains or (losses) relating to assets still held at the reporting date	$ 65	$	$ (497)	$	$ (170)	$ (421)

(1) These amounts are attributable to either purchases of securities or principal pay downs, conversions or maturities during the nine months ended September 30, 2009.

(2) Transfers in and/or (out) of Level 3 relate to the termination of the securities lending program and moving longer-term assets into the investment portfolio during the nine months ended September 30, 2009.

4. Investments

Effective April 1, 2009, the Company adopted revised accounting guidance regarding the recognition and presentation of other-than-temporary impairments. This revision to the guidance is intended to be more operational, amends previously issued other-than-temporary impairment guidance for debt securities and improves the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the consolidated financial statements. This guidance did not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The adoption of this change in the accounting guidance did not have a material impact on the Company s consolidated financial position or results of operations or require a cumulative effect adjustment.

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The cost or amortized cost and fair value of investments in fixed maturities, equity securities and securities lending collateral are as follows:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(Dollars in thousands)		
September 30, 2009 [(1)] :				
Fixed maturities:				
U.S. Government and government agency obligations	$ 174,694	$ 2,486	$ (21)	$ 177,159
State and local government obligations	162,628	8,129	(1,497)	169,260
Residential mortgage-backed securities	126,134	3,010	(6,433)	122,711
Commercial mortgage-backed securities	4,566		(815)	3,751
Corporate obligations	40,641	1,195	(2,202)	39,634
Redeemable preferred stock	12,426	83	(1,282)	11,227
Total fixed maturities	521,089	14,903	(12,250)	523,742
Equity securities:				
Perpetual preferred stocks	1,320	182	(12)	1,490
Common stocks	24,043	2,485	(5)	26,523
Total equity securities	25,363	2,667	(17)	28,013
Short-term investments	86			86
Total investments	$ 546,538	$ 17,570	$ (12,267)	$ 551,841
December 31, 2008:				
Fixed maturities:				
U.S. Government and government agency obligations	$ 199,207	$ 3,120	$ (50)	$ 202,277
State and local government obligations	125,312	2,172	(2,405)	125,079
Residential mortgage-backed securities	77,170	1,425	(27)	78,568
Corporate obligations	46,942	188	(5,116)	42,014
Redeemable preferred stock	13,931	49	(2,681)	11,299
Total fixed maturities	462,562	6,954	(10,279)	459,237
Equity securities:				
Perpetual preferred stocks	8,650	2	(2,912)	5,740
Common stocks	21,493			21,493
Total equity securities	30,143	2	(2,912)	27,233
Short-term investments	85			85
Total investments	$ 492,790	$ 6,956	$ (13,191)	$ 486,555

Securities lending:				
Cash and cash equivalents	$ 42,359	$	$	$ 42,359
Residential mortgage-backed securities	23,108		(8,038)	15,070
Commercial mortgage-backed securities	4,695		(1,164)	3,531
Corporate obligations	24,493	3	(786)	23,710
Total securities lending	$ 94,655	$ 3	$ (9,988)	$ 84,670

(1) As of September 30, 2009, the Company held no securities lending collateral, therefore no breakout is included.

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The amortized cost and fair value of fixed maturities at September 30, 2009, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. The average life of mortgage-backed securities is 3.1 years in the Company s investment portfolio.
Amortized cost and fair value of the fixed maturities in the Company s investment portfolio were as follows:

	Fixed Maturities	
	Amortized Cost	Fair Value
	(Dollars in thousands)	
Due in one year or less	$ 25,886	$ 26,140
Due after one year through five years	155,517	157,368
Due after five years through ten years	157,064	163,149
Due after ten years	51,922	50,623
	390,389	397,280
Mortgage-backed securities	130,700	126,462
Total	$ 521,089	$ 523,742

Gains and losses on the sale of investments, including other-than-temporary impairments charges, were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in thousands)		(Dollars in thousands)	
Fixed maturity gains	$ 266	$ 13	$ 1,828	$ 423
Fixed maturity losses	(1,392)	(3,197)	(2,424)	(3,734)
Equity security gains	1,886		4,766	148
Equity security losses		(4,777)	(1,916)	(6,463)
Securities lending fixed maturity losses		(496)	(423)	(1,142)
Net realized gains (losses) on investments	$ 760	$ (8,457)	$ 1,831	$ (10,768)

Net realized gains were $0.8 million and $1.8 million for the three and nine months ended September 30, 2009, respectively. The net realized gains for both the three and nine month period ended September 30, 2009 were primarily generated from gains on an equity partnership of $1.0 million and $3.6 million, respectively, realized gains from the sales of equity securities of $0.9 million for the three and nine months ended September 30, 2009 and realized gains from the sales or calls of fixed maturity securities of $0.3 and $1.8 million, respectively, for the three and nine months ended September 30, 2009. The gains on equity and fixed maturity securities were primarily due to favorable market conditions that increased the value of the securities over book value and the Company sold these securities to realize these gains.
These gains were offset by other-than-temporary impairment charges of $1.3 million and $2.5 million for the three and nine months ended September 30, 2009, respectively, and equity security losses of $1.3 million primarily related to a conversion of a perpetual preferred stock to common stock on a financial institution holding and losses on an equity partnership of $0.5 million for the nine months ended September 30, 2009. The other-than-temporary impairment charge of $1.3 million during the three months and nine months ended September 30, 2009 relates to one corporate note that experienced credit issues and, due to the potential of selling this security in the near future, the entire impairment charge loss was recognized in earnings. Included in the remaining other-than-temporary impairment

charge for the nine months ended September 30, 2009 are several securities totaling $0.7 million, including one fixed maturity investment previously held within the securities lending collateral portfolio, which experienced credit issues that, in the Company s estimation, made full recovery of the cost of these investments unlikely and credit only impairments of $0.5 million on two mortgage-backed securities which were written down to the present value of the expected cash flows. A non-credit charge of $3.0 million relating to these two mortgage-backed securities is included in other comprehensive income for the nine months ended September 30, 2009.

Net realized losses were $8.5 million and $10.8 million for the three and nine months ended September 30, 2008, respectively. The net realized losses for both the three and nine month period ended September 30, 2008 were primarily caused by an other-than-temporary impairment charge of $8.0 million, which consisted of a $5.8 million charge related to securities issued by Fannie Mae, Freddie Mac and Lehman Brothers Holdings Inc., $1.6 million related to securities in the financial and real estate sector and

$0.6 million, primarily from an asset-backed security. The net realized losses for the nine months ended September 30, 2008 also includes other-than-temporary impairment charges of $2.5 million consisting of $1.6 million on several perpetual preferred stock holdings, $0.6 million on one fixed maturity holding and $0.3 million on two redeemable preferred stock holdings. These charges were due to credit issues that, in the Company s estimation, made full recovery of the cost of these investments unlikely.

The following table summarizes the Company s gross unrealized losses on fixed maturities, equity securities and securities lending collateral and the length of time that individual securities have been in a continuous unrealized loss position:

	Less than Twelve Months				Twelve Months or More			
	Fair Value	Unrealized Losses	Fair Value as % of Cost	Number of Holdings	Fair Value	Unrealized Losses	Fair Value as % of Cost	Number of Holdings
	(Dollars in thousands)							
September 30, 2009 [1]:								
Fixed maturities:								
U.S. Government and government agency obligations	$ 11,241	$ (21)	99.8%	7	$	$		
State and local government obligations	2,430	(15)	99.4%	2	6,734	(1,482)	82.0%	6
Residential mortgage-backed securities	10,106	(35)	99.7%	6	8,520	(6,398)	57.1%	7
Commercial mortgage-backed securities					3,751	(815)	82.2%	2
Corporate obligations	5,780	(272)	95.5%	5	11,816	(1,930)	86.0%	9
Redeemable preferred stocks	1,962	(38)	98.1%	1	7,184	(1,244)	85.2%	21
Total fixed maturities	31,519	(381)	98.8%	21	38,005	(11,869)	76.2%	45
Equity securities:								
Perpetual preferred stocks					220	(12)	94.8%	2
Common stocks	162	(5)	97.0%	2				
Total equity securities	162	(5)	97.0%	2	220	(12)	94.8%	2
Total fixed maturities and equity securities	$ 31,681	$ (386)	98.8%	23	$ 38,225	$ (11,881)	76.3%	47
December 31, 2008:								
Fixed maturities:								
U.S. Government and government agency obligations	$ 4,305	$ (36)	99.2%	5	$ 2,985	$ (14)	99.5%	1

State and local government obligations	24,990	(2,109)	92.2%	28	7,947	(296)	96.4%	7
Residential mortgage-backed securities	2,424	(16)	99.3%	2	680	(11)	98.4%	1
Corporate obligations	14,746	(513)	96.6%	21	16,124	(4,603)	77.8%	20
Redeemable preferred stocks	2,113	(12)	99.4%	2	8,170	(2,669)	75.4%	27
Total fixed maturities	48,578	(2,686)	94.8%	58	35,906	(7,593)	82.5%	56
Equity securities:								
Perpetual preferred stocks	3,368	(2,625)	56.2%	4	1,485	(287)	83.8%	9
Common stocks								
Total equity securities	3,368	(2,625)	56.2%	4	1,485	(287)	83.8%	9
Total fixed maturities and equity securities	$ 51,946	$ (5,311)	90.7%	62	$ 37,391	$ (7,880)	82.6%	65
Securities Lending:								
Residential mortgage-backed securities	$	$			$ 15,070	$ (8,038)	65.2%	7
Commercial mortgage-backed securities					3,531	(1,164)	75.2%	2
Corporate obligations					16,213	(786)	95.4%	5
Total securities lending	$	$			$ 34,814	$ (9,988)	77.7%	14

(1) As of September 30, 2009, the Company held no securities lending collateral, therefore no breakout is included.

The gross unrealized losses on the Company s fixed maturities, equity securities and securities lending portfolios decreased from $23.2 million at December 31, 2008 to $12.3 million at September 30, 2009. The improvement in gross unrealized losses was primarily driven by the partial recovery from December 31, 2008 of the Company s corporate obligations, redeemable preferred stocks and perpetual preferred stock holdings as investment markets recovered during the second and third quarter of 2009. The $12.3 million in gross unrealized losses at September 30, 2009 was primarily on residential mortgage-backed securities and corporate obligations that were transferred into the Company s fixed maturities portfolio from the terminated securities lending portfolio and fixed maturity holdings in state and local governments and redeemable preferred stocks. The gross unrealized losses on common stocks and perpetual preferred stocks are minimal and are considered to be temporary. In the fourth quarter of 2008, the Company began treating its perpetual preferred stocks similar to a debt security for assessing other-than-temporary impairments.

The Company analyzes its perpetual preferred securities by examining credit ratings, contractual payments on these specific issues and other issues of the issuer, company specific data of the issuer and the outlook for industry sectors to ensure that it is appropriate to treat these securities similar to debt securities. Investment grade securities (as determined by nationally recognized rating agencies) represented 77.3% of all fixed maturity securities with unrealized losses and 100% of all perpetual preferred stock securities with unrealized losses.

At September 30, 2009, gross unrealized losses on residential and commercial mortgage-backed securities were $7.2 million and represented 59.2% of the total gross unrealized loss on fixed maturities. There were nine securities with gross unrealized losses of $7.2 million that were in an unrealized loss position for 12 months or more. Three of these securities were rated investment grade and comprised $0.8 million of the gross unrealized losses. The remaining six securities were in an unrealized loss position of $6.4 million, including two securities, which previously had an other-than-temporary impairment credit charge and were in a gross

unrealized loss position of $3.3 million. Based on historical payment data and analysis of expected future cash flows of the underlying collateral, independent credit ratings and other facts and analysis, including management s current intent and ability to hold these securities for a period of time sufficient to allow for anticipated recovery, management believes that the Company will recover its cost basis in all these securities and no additional charges for other-than-temporary impairments will be required.

At September 30, 2009, gross unrealized losses on all other fixed maturity securities primarily consisted of state and local government obligations, corporate obligations and redeemable preferred stock. The state and local government obligations, with gross unrealized losses of $1.5 million, had six holdings that were in an unrealized loss position for more than 12 months. Investment grade securities represented 88.4% of all state and local government obligations with unrealized losses greater than 12 months. The corporate obligations, which are primarily in financial institutions, had gross unrealized losses totaling $2.2 million at September 30, 2009. The gross unrealized losses on corporate obligations consisted of five holdings that were in an unrealized loss position of $0.3 million for less than 12 months and nine holdings with gross unrealized losses of $1.9 million that were in an unrealized loss position for more than 12 months. Investment grade securities represented 78.3% of all corporate obligations with unrealized losses greater than 12 months. The redeemable preferred stocks, which are primarily in financial institutions, had gross unrealized losses totaling $1.3 million, with 21 holdings that were in an unrealized loss position of $1.2 million for more than 12 months. Investment grade securities represented 66.3% of all redeemable preferred stocks with unrealized losses greater than 12 months.

Management concluded that no additional charges for other-than-temporary impairment were required on the fixed maturity holdings based on many factors, including the Company s ability and current intent to hold these investments for a period of time sufficient to allow for anticipated recovery of its amortized cost, the length of time and the extent to which fair value has been below cost, analysis of company-specific financial data and the outlook for industry sectors and credit ratings. The Company believes these unrealized losses are primarily due to temporary market and sector-related factors and does not consider these securities to be other-than-temporarily impaired. If the Company s strategy was to change or these securities were determined to be other-than-temporarily impaired, the Company would recognize a write-down in accordance with its stated policy. The following table is a progression of the amount related to credit losses on fixed maturity securities for which a portion of an other-than-temporary impairment has been recognized in other comprehensive income.

	Three Months Ended September 30, 2009 (Dollars in thousands)	Nine Months Ended September 30, 2009 (Dollars in thousands)
Beginning balance	$ 534	$
Additional credit impairment on:		
Previously impaired securities		
Securities without prior impairments		534
Reductions		
Ending balance	$ 534	$ 534

5. Income Taxes

A reconciliation of the provision for federal income taxes for financial reporting purposes and the provision for federal income taxes calculated at the prevailing federal income tax rate of 35% is as follows:

	Three Months Ended September 30,	Nine Months Ended September 30,

	2009	2008	2009	2008
	(Dollars in thousands)		(Dollars in thousands)	
Expected federal income tax expense (benefit) at statutory rate	$ 3,333	$ (768)	$ 15,973	$ 6,374
Tax effect of tax exempt investment income	(420)	(339)	(1,287)	(1,006)
Change in valuation allowance on net capital losses	(1,792)	3,191	(2,397)	3,191
Other items, net	246	(51)	437	(60)
	$ 1,367	$ 2,033	$ 12,726	$ 8,499

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The tax effects of temporary differences that give rise to significant portions of the net deferred tax assets and liabilities in the Consolidated Balance Sheets were as follows:

	September 30, 2009 (Dollars in thousands)	December 31, 2008 (Dollars in thousands)
Deferred Tax Assets:		
Unearned premiums	$ 9,735	$ 9,035
Unpaid losses and loss adjustment expenses	8,672	8,233
Assignments and assessments	1,099	945
Unrealized losses on investments	360	5,677
Realized losses on investments, primarily impairments	5,966	7,936
Other, net	1,806	873
	27,638	32,699
Valuation allowance	(5,149)	(7,616)
	22,489	25,083
Deferred Tax Liabilities:		
Deferred policy acquisition costs	(7,043)	(6,736)
Other, net	(2,713)	(23)
Total deferred tax liabilities	(9,756)	(6,759)
Net deferred income tax assets	$ 12,733	$ 18,324

Management has reviewed the recoverability of the deferred tax asset and believes that, with the exception of realized losses on investments, the amount will be recoverable against future earnings. The gross deferred tax assets have been reduced by a valuation allowance related to unrealized losses on equity investments for the year ended December 31, 2008 of $0.1 million. There was no such valuation allowance related to unrealized losses on equity investments for the nine months ended September 30, 2009. Additionally, gross deferred tax assets have been reduced by a valuation allowance related to net realized losses on investments of $5.1 million and $7.5 million for the nine months ended September 30, 2009 and year ended December 31, 2008, respectively, both primarily related to impairment charges.

6. Shareholders Equity and Stock-Based Compensation

The Company grants options and other stock awards to officers of the Company under the Long Term Incentive Plan (LTIP). At September 30, 2009, there were 825,567 of the Company s common shares reserved for issuance under the LTIP and options for 647,050 shares were outstanding. Treasury shares are used to fulfill the options exercised and other awards granted. Options and restricted shares vest pursuant to the terms of a written grant agreement. Options must be exercised no later than the tenth anniversary of the date of grant. As set forth in the LTIP, the Compensation Committee of the Board of Directors may accelerate vesting and exercisability of options.

For both the three months ended September 30, 2009 and 2008, the Company recognized stock-based compensation expense of $0.3 million. Related income tax benefits were approximately $0.1 million for both the three months ended September 30, 2009 and 2008. For both the nine months ended September 30, 2009 and 2008, the Company recognized stock-based compensation expense of $1.0 million with related income tax benefits of $0.2 million, respectively.

7. Comprehensive Income

Comprehensive income or loss includes the Company s net income or loss plus the changes in the unrealized gains or losses (net of income taxes) on the Company s available-for-sale securities. There was total comprehensive income for the third quarter of 2009 of $17.4 million and a comprehensive loss of $11.6 million for the third quarter of 2008.

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8. Earnings Per Common Share

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands, except per share data)		(In thousands, except per share data)	
Net income (loss)	$ 8,156	$ (4,228)	$ 32,911	$ 9,713
Weighted average shares outstanding during period	19,301	19,293	19,301	19,281
Additional shares issuable under employee common stock option plans using treasury stock method	83		59	94
Weighted average shares outstanding assuming exercise of stock options [1]	19,384	19,293	19,360	19,375
Net income (loss) per share:				
Basic	$ 0.42	$ (0.22)	$ 1.71	$ 0.50
Diluted	$ 0.42	$ (0.22)	$ 1.70	$ 0.50

(1) Since the Company reported a net loss for the third quarter 2008, the calculated diluted earnings per share was anti-dilutive; therefore, basic earnings (loss) per share was used.

For the three months ended September 30, 2009 and 2008, there were 498,050 and 691,050 respectively, outstanding options and restricted shares excluded from diluted earnings (loss) per share because they were anti-dilutive. For the nine months ended September 30, 2009 and 2008, there were 498,050 and 348,113, respectively, outstanding options and restricted shares excluded from diluted earnings (loss) per share because they were anti-dilutive.

9. Transactions with Related Parties

The Company s principal insurance subsidiary, NIIC, is involved in both the cession and assumption of reinsurance. NIIC is a party to a reinsurance agreement, and NIIA, a wholly-owned subsidiary of the Company, is a party to an underwriting management agreement with Great American Insurance Company (Great American). As of September 30, 2009, Great American owned 52.6% of the outstanding shares of the Company. The reinsurance agreement calls for the assumption by NIIC of all of the risk on Great American s net premiums written for public transportation and recreational vehicle risks underwritten pursuant to the reinsurance agreement. NIIA provides

administrative services to Great American in connection with Great American s underwriting of these risks. The Company also cedes premium through reinsurance agreements with Great American to reduce exposure in certain of its property-casualty insurance programs.

The table below summarizes the reinsurance balance and activity with Great American:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in thousands)		(Dollars in thousands)	
Assumed premiums written	$ 588	$ 821	$ 2,624	$ 4,779
Assumed premiums earned	835	1,617	3,042	4,818
Assumed losses and loss adjustment expense incurred	931	1,347	3,215	3,763
Ceded premiums written	610	576	2,789	3,026
Ceded premiums earned	827	880	2,422	2,707
Ceded losses and loss adjustment expense recoveries	783	452	2,454	849
Payable to Great American as of period end	531	526	531	526

Great American or its parent, American Financial Group, Inc., perform certain services for the Company without charge including, without limitation, actuarial services and on a consultative basis, as needed, internal audit, legal, accounting and other support services. If Great American no longer controlled a majority of the Company s common shares, it is possible that many of these services would cease or, alternatively, be provided at an increased cost to the Company. This could impact the Company s personnel resources, require the Company to hire additional professional staff and generally increase the Company s operating expenses. Management believes, based on discussions with Great American, that these services will continue to be provided by the affiliated entity in future periods and the relative impact on operating results is not material.

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In 2008, Great American filed an Undertaking on Appeal as surety with the Superior Court of the State of California for the County of Los Angeles in the amount of $17.9 million on behalf of NIIC. This surety was purchased from Great American to secure a judgment amount associated with the Company s pending appellate case as noted in Note 11 Commitments and Contingencies and was renewed in January 2009.

10. Reinsurance

Premiums and reinsurance activity consisted of the following:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2009		2008		2009		2008	
	Written	Earned	Written	Earned	Written	Earned	Written	Earned
	(Dollars in thousands)				(Dollars in thousands)			
Direct	$ 67,423	$ 87,158	$ 75,487	$ 93,386	$ 274,044	$ 259,372	$ 304,508	$ 264,561
Assumed	2,145	2,191	1,964	2,748	5,702	6,103	7,739	7,934
Ceded	(10,584)	(18,524)	(15,036)	(21,076)	(59,875)	(55,548)	(72,674)	(57,974)
Net Premium	$ 58,984	$ 70,825	$ 62,415	$ 75,058	$ 219,871	$ 209,927	$ 239,573	$ 214,521

The Company cedes premiums through reinsurance agreements with reinsurers to reduce exposure in certain of its property-casualty insurance programs. Ceded losses and loss adjustment expense recoveries recorded for the three months ended September 30, 2009 and 2008 were $11.3 million and $8.9 million, respectively, and were $37.5 million and $22.3 million for the nine months ended September 30, 2009 and 2008, respectively. The Company remains primarily liable as the direct insurer on all risks reinsured and a contingent liability exists to the extent that the reinsurance companies are unable to meet their obligations for losses assumed. To minimize its exposure to significant losses from reinsurer insolvencies, the Company seeks to do business with only reinsurers rated Excellent or better by A.M. Best Company and regularly evaluates the financial condition of its reinsurers.

11. Commitments and Contingencies

The Company and its subsidiaries are subject at times to various claims, lawsuits and legal proceedings arising in the ordinary course of business. All legal actions relating to claims made under insurance policies are considered in the establishment of the Company s loss and loss adjustment expense reserves. In addition, regulatory bodies, such as state insurance departments, the Securities and Exchange Commission, the Department of Labor and other regulatory bodies may make inquiries and conduct examinations or investigations concerning the Company s compliance with insurance laws, securities laws, labor laws and the Employee Retirement Income Security Act of 1974, as amended. The Company s subsidiaries also have lawsuits pending in which the plaintiff seeks extra-contractual damages from the Company in addition to damages claimed or in excess of the available limits under an insurance policy. These lawsuits, which are in various stages of development, generally mirror similar lawsuits filed against other carriers in the industry. Although the Company is vigorously defending these lawsuits, the outcomes of these cases cannot be determined at this time. The Company has established loss and loss adjustment expense reserves for lawsuits as to which the Company has determined that a loss is both probable and estimable. In addition to these case reserves, the Company also establishes reserves for claims incurred but not reported to cover unknown exposures and adverse development on known exposures. Based on currently available information, the Company believes that reserves for these lawsuits are reasonable and that the amounts reserved did not have a material effect on the Company s financial condition or results of operations. However, if any one or more of these cases results in a judgment against or settlement by the Company for an amount that is significantly greater than the amount so reserved, the resulting liability could have a material effect on the Company s financial condition, cash flows and results of operations.

On August 3, 2007, the Company was informed that the jury in a case pending in the Superior Court of the State of California for the County of Los Angeles (the Court), had issued, on August 2, 2007, a special verdict adverse to the Company s interests in a pending lawsuit against one of the Company s insurance companies. The Court entered a formal judgment on October 25, 2007 and the Company received notice of that formal judgment on November 5, 2007. The current net exposure to the Company for this judgment approximates $7.2 million and, as required by the

Court, the Company secured the judgment amount with a surety bond. However, the Company believes that it has a strong appellate case and strategy and is vigorously pursuing the appellate process. Additionally, during April 2009, the Association of California Insurance Companies, the California affiliate of the Property Casualty Insurers Association of America, filed an amicus curiae brief in support of the Company s legal position. The Company believes the matter will be resolved in a manner that will not have a material adverse effect on the Company s consolidated financial position, results of operations or cash flows. As of September 30, 2009, the Company had not established a case reserve for this claim but has and will continue to closely monitor this case with counsel. The Company has consistently established litigation expense reserves to account for the cost associated with the defense of the Company s position, which it will continue to reserve for throughout the appeal process.

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As a direct writer of insurance, the Company receives assessments by state funds to cover losses to policyholders of insolvent or rehabilitated companies and other authorized fees. These mandatory assessments may be partially recovered through a reduction in future premium taxes in some states over several years. At September 30, 2009 and December 31, 2008, the liability for such assessments was $4.0 million and $3.6 million, respectively, and will be paid over several years as assessed by the various state funds.

12. Segment Information

The Company operates its business as one segment, property and casualty insurance. The Company manages this segment through a product management structure. The following table shows revenues summarized by the broader business component description, which were determined based primarily on similar economic characteristics, products and services:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in thousands)		(Dollars in thousands)	
Revenue:				
Premiums earned:				
Alternative Risk Transfer	$ 36,695	$ 35,814	$ 105,680	$ 99,212
Transportation	14,300	19,162	46,074	56,882
Specialty Personal Lines	14,262	14,046	42,127	40,797
Hawaii and Alaska	3,837	4,467	11,671	13,393
Other	1,731	1,569	4,375	4,237
Total premiums earned	70,825	75,058	209,927	214,521
Net investment income	4,501	5,498	14,430	16,793
Net realized gains (losses) on investments	760	(8,457)	1,831	(10,768)
Other	879	605	2,627	2,199
Total revenues	$ 76,965	$ 72,704	$ 228,815	$ 222,745

13. Subsequent Events

In preparing these financial statements, the Company evaluated subsequent events through the time the financial statements were issued on November 4, 2009. Financial statements are considered issued when they are widely distributed to all shareholders and other financial statement users, or filed with the Securities and Exchange Commission. In conjunction with applicable accounting standards, all material subsequent events have either been recognized in the financial statements or disclosed in the notes to the financial statements.

ITEM 2. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

Forward-Looking Statements

This document, including information incorporated by reference, contains forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995). All statements, trend analyses and other information contained in this Form 10-Q relative to markets for our products and trends in our operations or financial results, as well as other statements including words such as may, target, anticipate, believe, plan, estimate, e intend, project, and other similar expressions, constitute forward-looking statements. We made these statements based on our plans and current analyses of our business and the insurance industry as a whole. We caution that these statements may and often do vary from actual results and the differences between these statements and actual results can be material. Factors that could contribute to these differences include, among other things:

general economic conditions, any weaknesses in the financial markets and other factors, including prevailing interest rate levels and stock and credit market performance, which may affect or continue to affect (among other things) our ability to sell our products and to collect amounts due to us, our ability to access capital

resources and the costs associated with such access to capital and the market value of our investments;

customer response to new products and marketing initiatives;

- tax law changes;
- increasing competition in the sale of our insurance products and services and the retention of existing customers;
- changes in legal environment;
- regulatory changes or actions, including those relating to regulation of the sale, underwriting and pricing of insurance products and services and capital requirements;
- levels of natural catastrophes, terrorist events, incidents of war and other major losses;
- adequacy of insurance reserves; and
- availability of reinsurance and ability of reinsurers to pay their obligations.

The forward-looking statements herein are made only as of the date of this report. We assume no obligation to publicly update any forward-looking statements.

General

We underwrite and sell traditional and alternative risk transfer property and casualty insurance products to the passenger transportation industry and the trucking industry, general commercial insurance to small businesses in Hawaii and Alaska and personal insurance to owners of recreational vehicles and commercial vehicles throughout the United States.

We have four property and casualty insurance subsidiaries: National Interstate Insurance Company (NIIC), National Interstate Insurance Company of Hawaii, Inc. (NIIC-HI), Triumphe Casualty Company (TCC), Hudson Indemnity, Ltd. (HIL) and six other agency and service subsidiaries. We write our insurance policies on a direct basis through NIIC, NIIC-HI and TCC. NIIC is licensed in all 50 states and the District of Columbia. NIIC-HI is licensed in Ohio, Hawaii, Michigan and New Jersey. TCC, a Pennsylvania domiciled company, holds licenses for multiple lines of authority, including auto-related lines, in 26 states and the District of Columbia. HIL is domiciled in the Cayman Islands and provides reinsurance for NIIC, NIIC-HI and TCC primarily for the alternative risk transfer product. Insurance products are marketed through multiple distribution channels, including independent agents and brokers, affiliated agencies and agent internet initiatives. We use our six agency and service subsidiaries to sell and service our insurance business.

As of September 30, 2009, Great American Insurance Company (Great American) owned 52.6% of our outstanding common shares. Great American is a wholly-owned subsidiary of American Financial Group, Inc.

Results of Operations

Overview

Through the operations of our subsidiaries, we are engaged in property and casualty insurance operations. We generate underwriting profits by providing specialized insurance products, services and programs not generally available in the marketplace. We focus on niche insurance markets where we offer insurance products designed to meet the unique needs of targeted insurance buyers that we believe are underserved by the insurance industry.

We derive our revenues primarily from premiums generated by our insurance policies and income from our investment portfolio. Our expenses consist primarily of losses and loss adjustment expenses (LAE), commissions and other underwriting expenses and other operating and general expenses.

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Our September 30, 2009 and 2008 net income from operations, after-tax net realized gains (losses) from investments and net income (loss) were as follows:

	Three Months Ended September 30,			
	2009		2008	
	Amount	Per Share	Amount	Per Share
	(Dollars in thousands, except per share data)			
Net income from operations	$ 5,869	$ 0.30	$ 4,460	$ 0.23
After-tax net realized gains (losses) from investments	2,287	0.12	(8,688)	(0.45)
Net income (loss)	$ 8,156	$ 0.42	$ (4,228)	$ (0.22)

	Nine Months Ended September 30,			
	2009		2008	
	Amount	Per Share	Amount	Per Share
	(Dollars in thousands, except per share data)			
Net income from operations	$ 29,324	$ 1.51	$ 19,903	$ 1.03
After-tax net realized gains (losses) from investments	3,587	0.19	(10,190)	(0.53)
Net income	$ 32,911	$ 1.70	$ 9,713	$ 0.50

Our net income from operations for the three and nine months ended September 30, 2009 was $5.9 million ($0.30 per share diluted) and $29.3 million ($1.51 per share diluted), respectively, compared to $4.5 million ($0.23 per share diluted) and $19.9 million ($1.03 per share diluted) reported in the same periods in 2008. During the first nine months of 2008, we experienced an unusual number of large claims whereas in the first nine months of 2009, we experienced favorable large claims activity levels compared to 2008, thus contributing to the year to date increase in earnings from operations over the same period in 2008. The large claims in the first nine months of 2008 resulted in a 5.9% increase to the loss and LAE ratio, or an approximate $8.2 million decrease to net income from operations. A lower expense ratio of 24.6% for the three months ended September 30, 2009 as compared to 28.2% for the same period in 2008 was the primary factor relating to the $1.4 million increase in net income from operations for the quarter ended September 30, 2009. The decrease in the expense ratio relates to a decrease in net commission expense due to a change in our overall mix of business, as well as a one-time state guaranty fund charge recorded in the third quarter of 2008 which increased the expense ratio during that period by 1.7 percentage points.

We had after-tax net realized gains from investments of $2.3 million ($0.12 per share diluted) and $3.6 million ($0.19 per share diluted) for the third quarter and first nine months of 2009, respectively, compared to after-tax net realized losses from investments of $8.7 million ($0.45 per share diluted) and $10.2 million ($0.53 per share diluted) reported in the same periods in 2008. Included in the 2009 after-tax net realized gains for the third quarter and first nine months of 2009 are other-than-temporary impairment adjustments of $1.3 million and $2.5 million, respectively, compared to other-than-temporary impairment adjustments of $8.0 million and $10.5 million in the same periods in 2008. Despite recording these realized losses in accordance with other-than-temporary impairment accounting guidelines, we intend to maximize future potential recoveries related to these investments. The investment losses incurred in 2008 were a reflection of the unprecedented financial crisis that occurred compared to more typical investment markets being experienced in 2009.

Gross Premiums Written

We operate our business as one segment, property and casualty insurance. We manage this segment through a product management structure. The following table sets forth an analysis of gross premiums written by business component during the periods indicated:

	Three Months Ended September 30,			
	2009		2008	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Alternative Risk Transfer	$ 27,839	40.0%	$ 33,808	43.7%
Transportation	18,837	27.1%	20,972	27.1%
Specialty Personal Lines	14,692	21.1%	14,120	18.2%
Hawaii and Alaska	6,319	9.1%	6,996	9.0%
Other	1,881	2.7%	1,555	2.0%
Gross premiums written	$ 69,568	100.0%	$ 77,451	100.0%

	Nine Months Ended September 30,			
	2009		2008	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Alternative Risk Transfer	$ 161,188	57.6%	$ 172,024	55.1%
Transportation	51,147	18.3%	71,735	23.0%
Specialty Personal Lines	48,210	17.2%	46,800	15.0%
Hawaii and Alaska	14,958	5.4%	17,727	5.7%
Other	4,243	1.5%	3,961	1.2%
Gross premiums written	$ 279,746	100.0%	$ 312,247	100.0%

Gross premiums written include both direct premium and assumed premium. During the third quarter of 2009, our gross premiums written decreased $7.9 million, or 10.2%, compared to the same period in 2008. This decrease is primarily attributable to our alternative risk transfer and transportation components which decreased by $6.0 million, or 17.7%, and $2.1 million, or 10.2%, respectively. The decline in gross premiums written in the alternative risk component was driven by lower renewal premium per policy due to fewer insured vehicles reflecting the current economic conditions, management s decision to reduce lines of coverage written in one of our existing captive programs, as well as other risk selection decisions made during the first half of 2009. This decrease was partially offset by the addition of one new truck captive program during the third quarter of 2009. The decrease in our transportation component is a reflection of the current economic environment, characterized through decreased vehicle count and mileage-based exposures, as well as the continued competitive insurance market. We continue to maintain our disciplined underwriting approach, which is to price our products to achieve an underwriting profit even if we forgo volume in the short term as a result. While our gross premiums written may continue to be impacted by the reduction in these lines of coverage throughout 2009, management believes that such risk selection decisions will provide a benefit to our underwriting results.

For the first nine months of 2009, our gross premiums written decreased $32.5 million, or 10.4%, compared to the same period in 2008. This decrease is primarily attributable to our transportation, alternative risk transfer and Hawaii and Alaska components, which decreased by $20.6 million, $10.8 million and $2.8 million, respectively. The overall decrease in gross premiums written is primarily attributed to several factors including the effect that the current economic environment has had on our commercial customers, particularly through reductions in vehicle counts and

mileage-based exposures, the effects of risk selection and pricing adequacy initiatives specific to a few of our products that we put in place in 2008 and the continued overly aggressive pricing from competition in the insurance marketplace. In spite of the obstacles posed by the current economic environment, we have maintained our disciplined underwriting approach and have continued to generate new business leads and add new programs and accounts to our existing book of business. This was demonstrated in our alternative risk transfer component, where we added five new captive programs during the first nine months of 2009, contributing approximately $16.8 million in gross premiums written. These gains in the alternative risk transfer component were offset by decreased exposures in two of our existing truck captives and one of our existing passenger transportation captives, despite nearly a 100% member retention at the common renewal dates, as well as the reduction in our lines of coverage relative to another existing captive product.

The group captive programs, which focus on specialty or niche businesses, provide various services and coverages tailored to meet specific requirements of defined client groups and their members. These services include risk management consulting, claims administration and handling, loss control and prevention and reinsurance placement, along with providing various types of property and casualty insurance coverage. Insurance coverage is provided primarily to companies with similar risk profiles and to specified classes of business of our agent partners.

As part of our captive programs, we have analyzed, on a quarterly basis, captive members loss performance on a policy year basis to determine if there would be a premium assessment to participants, or if there would be a return of premium to members as a result of better-than-expected losses. We record assessment premium and return of premium as adjustments to written premium (assessments increase written premium; returns of premium reduce written premium). For the third quarter of 2009 and 2008, we recorded a return of premium of $1.7 million and $2.8 million, respectively. For the first nine months of 2009 and 2008, we recorded a return of premium of $3.2 million and $5.3 million, respectively.

Our specialty personal lines component increased $1.4 million, or 3.0%, during the first nine months of 2009 compared to the same period in 2008 primarily due to additional policies in force in our commercial vehicle product from expanded marketing initiatives and product enhancements. The growth in our commercial vehicle product was offset by a decrease in our recreational vehicle product, as the economic downturn has created a decline in the demand for recreational vehicles.

Premiums Earned

Three months ended September 30, 2009 compared to September 30, 2008. The following table shows net premiums earned summarized by the broader business component description, which were determined based primarily on similar economic characteristics, products and services:

	Three Months Ended September 30,		Change	
	2009	2008	Amount	Percent
	(Dollars in thousands)			
Premiums earned:				
Alternative Risk Transfer	$ 36,695	$ 35,814	$ 881	2.5%
Transportation	14,300	19,162	(4,862)	(25.4%)
Specialty Personal Lines	14,262	14,046	216	1.5%
Hawaii and Alaska	3,837	4,467	(630)	(14.1%)
Other	1,731	1,569	162	10.3%
Net premiums earned	$ 70,825	$ 75,058	$ (4,233)	(5.6%)

Our net premiums earned decreased $4.2 million, or 5.6%, to $70.8 million during the three months ended September 30, 2009 compared to $75.0 million for the same period in 2008. This decrease is primarily attributable to the transportation and Hawaii and Alaska components which, compared to 2008, decreased $4.9 million and $0.6 million, respectively. Such decreases are primarily attributed to reductions in gross premiums written in these components during the fourth quarter of 2008 and the first nine months of 2009, which is directly related to the effect that the current economic environment has had on our customers and the effects of risk selection and pricing adequacy initiatives. The decreases in the transportation and Hawaii and Alaska components were partially offset by increases in our alternative risk transfer and specialty personal lines components. The alternative risk transfer component increased $0.9 million, or 2.5%, mainly due to new captive programs introduced in 2008 and throughout 2009, as well as new participants in our existing captive programs. This was partially offset by a decrease attributable to management s decision in 2009 to reduce lines of coverage written in one of our existing captive programs. Our specialty personal lines component increased $0.2 million, or 1.5%, primarily due to an increase in our commercial vehicle product.

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Nine months ended September 30, 2009 compared to September 30, 2008. The following table shows net premiums earned summarized by the broader business component description, which were determined based primarily on similar economic characteristics, products and services:

	Nine Months Ended September 30,		Change	
	2009	2008	Amount	Percent
	(Dollars in thousands)			
Premiums earned:				
Alternative Risk Transfer	$ 105,680	$ 99,212	$ 6,468	6.5%
Transportation	46,074	56,882	(10,808)	(19.0%)
Specialty Personal Lines	42,127	40,797	1,330	3.3%
Hawaii and Alaska	11,671	13,393	(1,722)	(12.9%)
Other	4,375	4,237	138	3.3%
Net premiums earned	$ 209,927	$ 214,521	$ (4,594)	(2.1%)

Our net premiums earned decreased $4.6 million, or 2.1%, to $209.9 million during the nine months ended September 30, 2009 compared to $214.5 million for the same period in 2008. This decrease is primarily attributable to the transportation and Hawaii and Alaska components, which decreased $10.8 million and $1.7 million, respectively, compared to 2008, due to reductions in gross premiums written in these components during the fourth quarter of 2008 and the first nine months of 2009. These reductions related to the effect that the current economic environment has had on our customers and the effects of risk selection and pricing adequacy initiatives undertaken in 2008. Partially offsetting these decreases were increases in our alternative risk transfer and specialty personal lines components. Our alternative risk transfer component increased $6.5 million, or 6.5%, mainly due to new captive programs introduced throughout 2009 and new participants in existing captive programs during 2008 and 2009. Our specialty personal lines component increased $1.3 million, or 3.3%, due to continued gross premiums written growth in our commercial vehicle product.

Underwriting and Loss Ratio Analysis

Underwriting profitability, as opposed to overall profitability or net earnings, is measured by the combined ratio. The combined ratio is the sum of the losses and LAE ratio and the underwriting expense ratio. A combined ratio under 100% is indicative of an underwriting profit. Our underwriting approach is to price our products to achieve an underwriting profit even if we forgo volume as a result. For the three and nine months ended September 30, 2009, we experienced a modest single digit decrease in rate levels on our renewal business due to the continued soft market. The table below presents our net premiums earned and combined ratios for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(Dollars in thousands)		(Dollars in thousands)	
Gross premiums written	$ 69,568	$ 77,451	$ 279,746	$ 312,247
Ceded reinsurance	(10,584)	(15,036)	(59,875)	(72,674)
Net premiums written	58,984	62,415	219,871	239,573
Change in unearned premiums, net of ceded	11,841	12,643	(9,944)	(25,052)
Net premiums earned	$ 70,825	$ 75,058	$ 209,927	$ 214,521

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Six Months Ended September 30, 2012

Consolidated Statements of Income

	Millions of yen	
	Three Months Ended September 30, 2011	**Three Months Ended September 30, 2012**
Operating revenues:		
Wireless services	¥ 943,673	**¥ 921,515**
Equipment sales	122,021	**213,524**
Total operating revenues	1,065,694	**1,135,039**
Operating expenses:		
Cost of services (exclusive of items shown separately below)	218,134	**244,108**
Cost of equipment sold (exclusive of items shown separately below)	168,142	**216,198**
Depreciation and amortization	162,596	**166,744**
Selling, general and administrative	276,036	**299,507**
Total operating expenses	824,908	**926,557**
Operating income	240,786	**208,482**
Other income (expense):		
Interest expense	(774)	**(449)**
Interest income	354	**356**
Other, net	1,250	**(7,617)**
Total other income (expense)	830	**(7,710)**
Income before income taxes and equity in net income (losses) of affiliates	241,616	**200,772**
Income taxes:		
Current	103,507	**86,030**
Deferred	(5,314)	**(3,911)**
Total income taxes	98,193	**82,119**
Income before equity in net income (losses) of affiliates	143,423	**118,653**
Equity in net income (losses) of affiliates, net of applicable taxes	(3,636)	**306**
Net income	139,787	**118,959**
Less: Net (income) loss attributable to noncontrolling interests	484	**2,626**
Net income attributable to NTT DOCOMO, INC.	¥ 140,271	**¥ 121,585**

PER SHARE DATA			
Weighted average common shares outstanding	Basic and Diluted (shares)	41,467,601	**41,467,601**
Basic and Diluted earnings per share attributable to NTT DOCOMO, INC. (yen)		¥ 3,382.66	**¥ 2,932.05**

Consolidated Statements of Comprehensive Income

	Millions of yen	
	Three Months Ended September 30, 2011	**Three Months Ended September 30, 2012**
Net income	¥ 139,787	**¥ 118,959**
Other comprehensive income (loss):		
Unrealized holding gains (losses) on available-for-sale securities, net of applicable taxes	(9,629)	**10,748**
Change in fair value of derivative instruments, net of applicable taxes	(2)	**7**
Foreign currency translation adjustment, net of applicable taxes	(8,879)	**(19,290)**
Pension liability adjustment, net of applicable taxes	86	**107**
Total other comprehensive income (loss)	(18,424)	**(8,428)**
Comprehensive income	121,363	**110,531**
Less: Comprehensive (income) loss attributable to noncontrolling interests	508	**2,665**
Comprehensive income attributable to NTT DOCOMO, INC.	¥ 121,871	**¥ 113,196**

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DOCOMO Earnings Release **Six Months Ended September 30, 2012**

(3) Consolidated Statements of Cash Flows

	Millions of yen	
	Six Months Ended September 30, 2011	**Six Months Ended September 30, 2012**
Cash flows from operating activities:		
Net income	¥ 298,476	**¥ 280,890**
Adjustments to reconcile net income to net cash provided by operating activities-		
Depreciation and amortization	318,384	**324,216**
Deferred taxes	7,127	**17,853**
Loss on sale or disposal of property, plant and equipment	7,173	**11,293**
Impairment loss on marketable securities and other investments	129	**10,175**
Equity in net (income) losses of affiliates	10,565	**1,619**
Changes in assets and liabilities:		
(Increase) / decrease in accounts receivables	57,226	**746,920**
(Increase) / decrease in receivables held for sale		**(562,330)**
(Increase) / decrease in credit card receivables	(10,790)	**(5,281)**
Increase / (decrease) in allowance for doubtful accounts	3,393	**2,346**
(Increase) / decrease in other receivables	15,444	**(276,867)**
(Increase) / decrease in inventories	(28,215)	**(29,672)**
(Increase) / decrease in prepaid expenses and other current assets	(10,468)	**(12,306)**
(Increase) / decrease in non-current installment receivables for handsets	(2,764)	**88,075**
(Increase) / decrease in non-current receivables held for sale		**(124,958)**
Increase / (decrease) in accounts payable, trade	(63,925)	**(69,598)**
Increase / (decrease) in accrued income taxes	19,139	**7,526**
Increase / (decrease) in other current liabilities	17,849	**5,992**
Increase / (decrease) in accrued liabilities for point programs	(15,661)	**(18,072)**
Increase / (decrease) in liability for employees retirement benefits	4,094	**4,246**
Increase / (decrease) in other long-term liabilities	(12,095)	**(21,412)**
Other, net	9,292	**6,344**
Net cash provided by operating activities	624,373	**386,999**
Cash flows from investing activities:		
Purchases of property, plant and equipment	(217,795)	**(285,564)**
Purchases of intangible and other assets	(122,357)	**(125,615)**
Purchases of non-current investments	(11,037)	**(6,793)**
Proceeds from sale of non-current investments	2,138	**1,344**
Acquisitions of subsidiaries, net of cash acquired		**(18,626)**
Purchases of short-term investments	(551,462)	**(492,620)**
Redemption of short-term investments	241,268	**382,279**
Proceeds from redemption of short-term bailment for consumption to a related party		**90,000**
Other, net	(2,543)	**(2,593)**
Net cash used in investing activities	(661,788)	**(458,188)**
Cash flows from financing activities:		
Repayment of long-term debt	(104,037)	**(15,819)**

Proceeds from short-term borrowings	1,439	**7,352**
Repayment of short-term borrowings	(702)	**(5,656)**
Principal payments under capital lease obligations	(2,226)	**(1,631)**
Dividends paid	(107,792)	**(116,088)**
Other, net	1,170	**1,680**
Net cash provided by (used in) financing activities	(212,148)	**(130,162)**
Effect of exchange rate changes on cash and cash equivalents	(60)	**(17)**
Net increase (decrease) in cash and cash equivalents	(249,623)	**(201,368)**
Cash and cash equivalents at beginning of period	765,551	**522,078**
Cash and cash equivalents at end of period	¥ 515,928	**¥ 320,710**
Supplemental disclosures of cash flow information:		
Cash received during the period for:		
Income tax refunds	¥ 228	**¥ 1,012**
Cash paid during the period for:		
Interest, net of amount capitalized	1,724	**967**
Income taxes	176,913	**158,081**

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DOCOMO Earnings Release **Six Months Ended September 30, 2012**

(4) Going Concern Assumption

None

(5) Segment Reporting

	Millions of yen		
Three months ended September 30, 2011	Mobile phone business	All other businesses	Consolidated
Operating revenues	¥ 1,035,034	¥ 30,660	¥ 1,065,694
Operating expenses	792,469	32,439	824,908
Operating income (loss)	¥ 242,565	¥ (1,779)	¥ 240,786

	Millions of yen		
Three months ended September 30, 2012	Mobile phone business	All other businesses	Consolidated
Operating revenues	**¥ 1,092,873**	**¥ 42,166**	**¥ 1,135,039**
Operating expenses	**876,898**	**49,659**	**926,557**
Operating income (loss)	**¥ 215,975**	**¥ (7,493)**	**¥ 208,482**

	Millions of yen		
Six months ended September 30, 2011	Mobile phone business	All other businesses	Consolidated
Operating revenues	¥ 2,050,844	¥ 62,138	¥ 2,112,982
Operating expenses	1,537,997	66,484	1,604,481
Operating income (loss)	¥ 512,847	¥ (4,346)	¥ 508,501

	Millions of yen		
Six months ended September 30, 2012	Mobile phone business	All other businesses	Consolidated
Operating revenues	**¥ 2,128,701**	**¥ 78,619**	**¥ 2,207,320**
Operating expenses	**1,641,921**	**94,290**	**1,736,211**
Operating income (loss)	**¥ 486,780**	**¥ (15,671)**	**¥ 471,109**

There were no transactions between the operating segments. DOCOMO does not disclose geographical information since the amounts of operating revenues generated outside Japan are immaterial.

(6) Significant Changes in NTT DOCOMO, INC. Shareholders Equity

None

(7) Subsequent Event

In October 2012, Philippine Long Distance Telephone Company (PLDT), an investee company of DOCOMO, issued voting preferred stock in response to the final resolution by the Supreme Court of the Philippines regarding the computation of Filipino-alien equity requirement of public utilities companies. Accordingly, DOCOMO s voting interest in PLDT decreased to approximately 9%. As DOCOMO could not exercise significant influence over PLDT, DOCOMO plans to exclude PLDT from the scope of equity method application in and after the financial quarter ending December 31, 2012.

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DOCOMO Earnings Release **Six Months Ended September 30, 2012**

4. Appendices

(1) Operating Data for 2nd Quarter of the Fiscal Year Ending March 31, 2013

Full-year Forecasts: as revised on October 26, 2012

		Fiscal Year Ended Mar. 31, 2012 Six Months (Apr. - Sep. 2011) Results	Second Quarter (Jul.-Sep. 2011) Results	**Fiscal Year Ending Mar. 31, 2013 Six Months (Apr. - Sep. 2012) Results**	**Second Quarter (Jul.-Sep. 2012) Results**	[Ref.] Fiscal Year Ended Mar. 31, 2012 Full-year Results	[Ref.] Fiscal Year Ending Mar. 31, 2013 Full-year Forecasts
Number of Subscriptions and Other Operating Data							
Cellular Subscriptions (1)	thousands	58,993	58,993	**60,787**	**60,787**	60,129	62,140
Xi	thousands	389	389	**6,198**	**6,198**	2,225	11,720
FOMA (2)	thousands	57,862	57,862	**54,588**	**54,588**	57,905	50,420
Communication Module Service (1)	thousands	2,125	2,125	**2,680**	**2,680**	2,330	
Prepaid Subscriptions	thousands	12	12	**133**	**133**	256	
Packet Flat-rate Services Subscriptions	thousands	34,267	34,267	**37,781**	**37,781**	36,295	
Net Increase from Previous Period (1) (3)	thousands	983	578	**657**	**391**	2,120	2,010
Xi	thousands	363	267	**3,973**	**2,881**	2,199	9,490
FOMA (2)	thousands	1,116	538	**(3,316)**	**(2,491)**	1,159	(7,480)
Churn Rate (3)	%	0.50	0.50	**0.77**	**0.79**	0.60	
Number of Handsets Sold (4)	thousands	10,345	5,701	**11,837**	**6,670**	22,089	
i-mode Subscriptions	thousands	46,183	46,183	**37,356**	**37,356**	42,321	32,920
sp-mode Subscriptions	thousands	5,375	5,375	**14,289**	**14,289**	9,586	19,000
i-channel Subscriptions	thousands	15,886	15,886	**15,172**	**15,172**	16,124	
i-concier Subscriptions	thousands	6,007	6,007	**7,480**	**7,480**	5,672	
DCMX Subscriptions (5)	thousands	12,686	12,686	**13,430**	**13,430**	12,949	13,520
ARPU and MOU							
Aggregate ARPU (6) (7)	yen/month/subscription	5,230	5,240	**4,900**	**4,870**	5,140	4,850
Voice ARPU (8)	yen/month/subscription	2,310	2,280	**1,850**	**1,810**	2,200	1,710
Packet ARPU (7)	yen/month/subscription	2,570	2,610	**2,660**	**2,670**	2,590	2,740
Smart ARPU	yen/month/subscription	350	350	**390**	**390**	350	400
MOU (9)	minute/month/subscription	128	129	**119**	**119**	126	

* Please refer to 4. (2) Definition and Calculation Methods of ARPU and MOU for the definition of ARPU and MOU on page 19, and an explanation of the methods used to calculate ARPU and the number of active subscriptions.

(1) Fiscal year ended March 31, 2012 full-year results, six months (April to September 2011) results and second quarter (July to September 2011) results are included mova service which was terminated at the end of March 2012.
(2) Effective March 3, 2008, FOMA subscription became mandatory for subscription to 2in1 services, and those FOMA subscriptions are included in the number of FOMA subscribers.
(3) Data are calculated including communication module services subscriptions.

(4) Sum of new subscriptions, change of subscription from FOMA to Xi, Xi to FOMA, Xi handset upgrade by Xi subscribers, FOMA handset upgrade by FOMA subscribers.
(5) Inclusive of DCMX mini subscriptions
(6) Data are calculated excluding revenues and subscriptions to communication module services, Phone Number Storage and Mail Address Storage.
(7) With the introduction of Smart ARPU in the second quarter of the fiscal year ending March 31, 2013, Aggregate ARPU contains Smart ARPU .
In addition, some elements (revenues from content and cloud services, etc.) included in conventional Packet ARPU of the fiscal year ended March 31, 2012 full-year results, six months (April to September 2012) results and second quarter (July to September 2012) results have been retroactively reclassified into Smart ARPU . The impact of the reclasssification of those periods are ¥80 each.
(8) Inclusive of circuit-switched data communication
(9) Data are calculated excluding subscriptions to communication module services, Phone Number Storage and Mail Address Storage.

DOCOMO Earnings Release **Six Months Ended September 30, 2012**

(2) Definition and Calculation Methods of ARPU and MOU

i. Definition of ARPU and MOU

a. ARPU (Average monthly Revenue Per Unit):
Average monthly revenue per unit, or ARPU, is used to measure average monthly operating revenues attributable to designated services on a per subscription basis. ARPU is calculated by dividing various revenue items included in operating revenues from our wireless services and other services that accompany our wireless services by the number of active subscriptions to our wireless services in the relevant periods. We believe that our ARPU figures provide useful information to analyze the average usage per subscription and the impacts of changes in our billing arrangements. The revenue items included in the numerators of our ARPU figures are based on our U.S. GAAP results of operations.

b. MOU (Minutes of Use): Average monthly communication time per subscription.

ii. ARPU Calculation Methods

Aggregate ARPU = Voice ARPU + Packet ARPU + Packet ARPU + Smart ARPU
- Voice ARPU : Voice ARPU Related Revenues (basic monthly charges, voice communication charges) / No. of active subscriptions
- Packet ARPU : Packet ARPU Related Revenues (basic monthly charges, packet communication charges) / No. of active subscriptions
- Smart ARPU : Revenues from providing services that accompany our wireless services (revenues from content and cloud services, collection of charges, mobile phone insurance service, advertising and others) / No. of active subscriptions

iii. Active Subscriptions Calculation Methods
Sum of No. of active subscriptions for each month ((No. of subscriptions at the end of previous month + No. of subscriptions at the end of current month) / 2) during the relevant period

Note: Subscriptions and revenues for communication module services, Phone Number Storage and Mail Address Storage services are not included in the ARPU and MOU calculations.

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DOCOMO Earnings Release **Six Months Ended September 30, 2012**

(3) Reconciliations of the Disclosed Non-GAAP Financial Measures to the Most Directly Comparable GAAP Financial Measures

The reconciliations for the year ending March 31, 2013 (Revised Forecasts) are provided to the extent available without unreasonable efforts.

i. EBITDA and EBITDA margin

	Billions of yen			
	Year ending March 31, 2013 (Revised Forecasts)	Year ended March 31, 2012	Six months ended September 30, 2011	**Six months ended September 30, 2012**
a. EBITDA	¥ 1,546.0	¥ 1,583.3	¥ 834.1	**¥ 806.6**
Depreciation and amortization	(697.0)	(684.8)	(318.4)	**(324.2)**
Loss on sale or disposal of property, plant and equipment	(29.0)	(24.1)	(7.2)	**(11.3)**
Operating income	820.0	874.5	508.5	**471.1**
Other income (expense)	(6.0)	2.5	3.4	**(5.5)**
Income taxes	(310.0)	(402.5)	(207.6)	**(184.2)**
Equity in net income (losses) of affiliates	(5.0)	(13.5)	(5.8)	**(0.5)**
Less: Net (income) loss attributable to noncontrolling interests	8.0	3.0	0.5	**5.0**
b. Net income attributable to NTT DOCOMO, INC.	507.0	463.9	299.0	**285.9**
c. Operating revenues	4,520.0	4,240.0	2,113.0	**2,207.3**
EBITDA margin (=a/c)	34.2%	37.3%	39.5%	**36.5%**
Net income margin (=b/c)	11.2%	10.9%	14.2%	**13.0%**

Note: EBITDA and EBITDA margin, as we use them, are different from EBITDA as used in Item 10(e) of regulation S-K and may not be comparable to similarly titled measures used by other companies.

ii. ROCE after tax effect

	Billions of yen			
	Year ending March 31, 2013 (Revised Forecasts)	Year ended March 31, 2012	Six months ended September 30, 2011	**Six months ended September 30, 2012**
a. Operating income	¥ 820.0	¥ 874.5	¥ 508.5	**¥ 471.1**
b. Operating income after tax effect {=a*(1-effective tax rate)}	507.6	517.7	301.0	**291.6**
c. Capital employed	5,416.6	5,299.0	5,316.7	**5,408.5**

ROCE before tax effect (=a/c)	15.1%	16.5%	9.6%	**8.7%**
ROCE after tax effect (=b/c)	9.4%	9.8%	5.7%	**5.4%**

Notes: Capital employed (for annual period) = The average of (NTT DOCOMO, INC. shareholders equity + Interest bearing liabilities), each as of March 31, 2012 (or 2011) and 2013 (or 2012)

Capital employed (for six months) = The average of (NTT DOCOMO, INC. shareholders equity + Interest bearing liabilities), each as of March 31, 2012 (or 2011) and September 30, 2012 (or 2011)

Interest bearing liabilities = Current portion of long-term debt + Short-term borrowings + Long-term debt The effective tax rate for the years ended March 31,2012 and the six months ended September 30,2011 was 40.8%.

The effective tax rate for the six months ended September 30,2012 was 38.1%.

The effective tax rate for the year ending March 31,2013 (Forecasts) is 38.1%.

ii. Free cash flows excluding irregular factors and effect by transfer of receivables and changes in investments for cash management purposes

	Billions of yen			
	Year ending March 31, 2013 (Revised Forecasts)	Year ended March 31, 2012	Six months ended September 30, 2011	**Six months ended September 30, 2012**
Free cash flows excluding irregular factors and effect by transfer of receivables and changes in investments for cash management purposes	¥ 240.0	¥ 503.5	¥ 272.8	**¥ 56.2**
Irregular factors (1)	147.0	(147.0)		**147.0**
Effect of transfer of receivables(2)	(246.0)			**(254.0)**
Changes in investments for cash management purposes(3)		(220.5)	(310.2)	**(20.3)**
Free cash flows	141.0	136.0	(37.4)	**(71.2)**
Net cash used in investing activities	(776.0)	(974.6)	(661.8)	**(458.2)**
Net cash provided by operating activities	917.0	1,110.6	624.4	**387.0**

Note: (1) Irregular factors represent the effects of uncollected revenues due to a bank closure at the end of the fiscal period.

(2) Effect of transfer of receivables represents the effect caused by the uncollected amounts of transferred receivables of telephone charges to NTT FINANCE CORPORATION. Since the payment conditions of the consideration of claims transferred to NTT FINANCE CORPORATION are set approximately equivalent to our cash collection cycle history, an impact derived from the transfer of receivables is not significant.

(3) Changes in investments for cash management purposes were derived from purchases, redemption at maturity and disposals of financial instruments held for cash management purposes with original maturities of longer than three months. Net cash used in investing activities includes changes in investments for cash management purposes except for the year ending March 31, 2013. The effect of changes in investments for cash management purposes is not taken into account when we forecasted net cash used in investing activities for the year ending March 31, 2013 due to the difficulties in forecasting such effect.

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DOCOMO Earnings Release **Six Months Ended September 30, 2012**

5. Special Note Regarding Forward-Looking Statements

This earnings release contains forward-looking statements such as forecasts of results of operations, management strategies, objectives and plans, forecasts of operational data such as the expected number of subscription, and the expected dividend payments. All forward-looking statements that are not historical facts are based on management s current plans, expectations, assumptions and estimates based on the information currently available. Some of the projected numbers in this earnings release were derived using certain assumptions that are indispensable for making such projections in addition to historical facts. These forward-looking statements are subject to various known and unknown risks, uncertainties and other factors that could cause our actual results to differ materially from those contained in or suggested by any forward-looking statement. Potential risks and uncertainties include, without limitation, the following:

(1) Changes in the business environment in the telecommunications industry, such as intensifying competition from other service providers, businesses or other technologies caused by Mobile Number Portability, development of appealing new handsets, new market entrants and other factors, or the expansion of the areas of competition could limit our acquisition of new subscriptions and retention of existing subscriptions, or may lead to ARPU diminishing at a greater than expected rate or an increase in our costs and expenses.

(2) Current and new services, usage patterns, and sales schemes introduced by our corporate group may not develop as planned, which could affect our financial condition and limit our growth.

(3) The introduction or change of various laws or regulations inside and outside of Japan, or the application of such laws and regulations to our corporate group could restrict our business operations, which may adversely affect our financial condition and results of operations.

(4) Limitations in the amount of frequency spectrum or facilities made available to us could negatively affect our ability to maintain and improve our service quality and level of customer satisfaction and could increase our costs.

(5) Other mobile service providers in the world may not adopt the technologies and the frequency bands that are compatible with those used by our corporate group s mobile communications system on a continuing basis, which could affect our ability to sufficiently offer international services.

(6) Our domestic and international investments, alliances and collaborations may not produce the returns or provide the opportunities we expect.

(7) Malfunctions, defects or imperfection in our products and services or those of other parties may give rise to problems.

(8) Social problems that could be caused by misuse or misunderstanding of our products and services may adversely affect our credibility or corporate image.

(9)

Inadequate handling of confidential business information including personal information by our corporate group, contractors and others, may adversely affect our credibility or corporate image.

(10) Owners of intellectual property rights that are essential for our business execution may not grant us the right to license or otherwise use such intellectual property rights on acceptable terms or at all, which may limit our ability to offer certain technologies, products and/or services, and we may also be held liable for damage compensation if we infringe the intellectual property rights of others.

(11) Events and incidents caused by natural disasters, social infrastructure paralysis such as power shortages, proliferation of harmful substances, terror or other destructive acts, the malfunctioning of equipment, software bugs, deliberate incidents induced by computer viruses, cyber attacks, equipment misconfiguration, hacking, unauthorized access and other problems could cause failure in our networks, distribution channels and/or other factors necessary for the provision of service, disrupting our ability to offer services to our subscribers, and such incidents may adversely affect our credibility or corporate image, or lead to a reduction of revenues and/or increase of costs.

(12) Concerns about adverse health effects arising from wireless telecommunication may spread and consequently adversely affect our financial condition and results of operations.

(13) Our parent company, NIPPON TELEGRAPH AND TELEPHONE CORPORATION (NTT), could exercise influence that may not be in the interests of our other shareholders.

* Names of companies, products, etc., contained in this release are the trademarks or registered trademarks of their respective organizations.

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