MGP INGREDIENTS INC
Form 10-Q
August 02, 2018

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2018
or

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________________ to ________________________________

Commission File Number: 0-17196

MGP INGREDIENTS, INC.
(Exact name of registrant as specified in its charter)

KANSAS	45-4082531
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 Commercial Street, Atchison, Kansas	66002
(Address of principal executive offices)	(Zip Code)

(913) 367-1480
(Registrant’s telephone number, including area code)

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. [X] Yes [ ] No

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an "emerging growth company." See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
[ ] Large accelerated filer [X] Accelerated filer
[ ] Non-accelerated filer (Do not check if smaller reporting company [ ] Smaller Reporting Company
[ ] Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). [ ]Yes [X] No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

16,847,737 shares of Common Stock, no par value as of July 26, 2018

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METHOD OF PRESENTATION

Throughout this Report, when we refer to "the Company," "MGP," "we," "us," "our," and words of similar import, we are referring to the combined business of MGP Ingredients, Inc. and its consolidated subsidiaries, except to the extent that the context otherwise indicates. In this document, for any references to Note 1 through Note 10, refer to the Notes to Unaudited Condensed Consolidated Financial Statements in Item 1.

All amounts in this report, except for share, par values, bushels, gallons, pounds, mmbtu, proof gallons, per share, per bushel, per gallon, per proof gallon and percentage amounts, are shown in thousands unless otherwise noted.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

MGP INGREDIENTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Dollars in thousands, except per share amounts)

	Quarter Ended		Year to Date Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net sales	$88,252	$ 85,753	$176,208	$172,922
Cost of sales [(a)]	68,811	66,928	137,816	135,056
Gross profit	19,441	18,825	38,392	37,866
Selling, general and administrative expenses ("SG&A")	8,309	8,311	16,871	15,960
Operating income	11,132	10,514	21,521	21,906
Equity method investment loss (Note 3)	—	(819)	—	(348)
Interest expense, net	(289)	(379)	(496)	(710)
Income before income taxes	10,843	9,316	21,025	20,848
Income tax expense (Note 5)	3,316	2,947	4,571	5,801
Net income	$7,527	$ 6,369	$16,454	$15,047
Income attributable to participating securities	148	183	323	433
Net income attributable to common shareholders and used in earnings per share ("EPS") calculation (Note 6)	$7,379	$ 6,186	$16,131	$14,614
Share information:				
Basic and Diluted weighted average common shares	16,869,481	16,745,679	16,856,423	16,727,305
Basic and diluted earnings per common share	$0.44	$ 0.37	$0.96	$0.87
Dividends and dividend equivalents per common share	$0.08	$ 0.04	$0.16	$0.08

(a) Includes related party purchases of $0 and $9,180 for the quarters ended June 30, 2018 and 2017, respectively. Includes related party purchases of $0 and $18,425 for the year-to-date periods ended June 30, 2018 and 2017, respectively.

See accompanying notes to unaudited condensed consolidated financial statements

MGP INGREDIENTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in thousands, except per share amounts)

	Quarter Ended		Year to Date Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net income	$7,527	$6,369	$16,454	$15,047
Other comprehensive income (loss), net of tax:				
Change in post-employment benefits	41	(38)	28	(77)
Other, net of tax	—	(2)	—	(4)
Other comprehensive income (loss)	41	(40)	28	(81)
Comprehensive income	$7,568	$6,329	$16,482	$14,966

See accompanying notes to unaudited condensed consolidated financial statements

MGP INGREDIENTS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in thousands)

	June 30, 2018	December 31, 2017
Current Assets		
Cash and cash equivalents	$2,280	$ 3,084
Receivables (less allowance for doubtful accounts: June 30, 2018 - $24; December 31, 2017 - $24)	35,758	34,347
Inventory	106,487	93,149
Prepaid expenses	2,802	2,182
Refundable income taxes	1,534	1,980
Total current assets	148,861	134,742
Property and equipment	278,548	267,288
Less accumulated depreciation and amortization	(169,712)	(164,237)
Property and equipment, net	108,836	103,051
Other assets	2,458	2,535
Total assets	$260,155	$ 240,328
Current Liabilities		
Current maturities of long-term debt	$379	$ 372
Accounts payable	23,333	30,037
Accrued expenses	7,937	11,171
Total current liabilities	31,649	41,580
Long-term debt, less current maturities	21,225	21,407
Revolving credit facility	18,857	2,775
Deferred credits	1,789	2,151
Accrued retirement, health and life insurance benefits	2,989	3,133
Other noncurrent liabilities	545	540
Deferred income taxes	741	12
Total liabilities	77,795	71,598
Contingencies (Note 7)		
Stockholders' Equity		
Capital stock		
Preferred, 5% non-cumulative; $10 par value; authorized 1,000 shares; issued and outstanding 437 shares	4	4
Common stock		
No par value; authorized 40,000,000 shares; issued 18,115,965 shares at June 30, 2018 and December 31, 2017, and 16,847,737 and 16,797,420 shares outstanding at June 30, 2018 and December 31, 2017, respectively	6,715	6,715
Additional paid-in capital	14,484	13,912
Retained earnings	180,835	167,129
Accumulated other comprehensive loss	(283)	(311)
Treasury stock, at cost		
Shares of 1,268,228 at June 30, 2018 and 1,318,545 at December 31, 2017	(19,395)	(18,719)

Total stockholders' equity	182,360	168,730
Total liabilities and stockholders' equity	$260,155	$ 240,328

See accompanying notes to unaudited condensed consolidated financial statements

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MGP INGREDIENTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Year to Date Ended	
	June 30, 2018	June 30, 2017
Cash Flows from Operating Activities		
Net income	$16,454	$15,047
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,826	5,554
Distributions received from equity method investee	—	7,131
Deferred income taxes	729	577
Share-based compensation	1,968	1,737
Equity method investment loss	—	348
Changes in operating assets and liabilities:		
Receivables, net	(1,411)	(8,845)
Inventory	(13,338)	(6,693)
Prepaid expenses	(620)	(1,148)
Accounts payable	(5,106)	(671)
Accounts payable to affiliate, net	—	(168)
Accrued expenses	(3,232)	(934)
Income taxes payable/refundable	446	(426)
Deferred credit	(362)	(410)
Accrued retirement health and life insurance benefits	(111)	(256)
Net cash provided by operating activities	1,243	10,843
Cash Flows from Investing Activities		
Additions to plant, property and equipment	(13,065)	(9,933)
Return of equity method investment	—	299
Net cash used in investing activities	(13,065)	(9,634)
Cash Flows from Financing Activities		
Purchase of treasury stock for tax withholding on share-based compensation	(2,073)	(1,131)
Payment of dividends and dividend equivalents	(2,750)	(1,376)
Principal payments on long-term debt	(185)	(177)
Proceeds from credit agreement	16,946	12,467
Payments on credit agreement	(920)	(4,650)
Net cash provided by financing activities	11,018	5,133
Increase (decrease) in cash and cash equivalents	(804)	6,342
Cash and cash equivalents, beginning of period	3,084	1,569
Cash and cash equivalents, end of period	$2,280	$7,911

See accompanying notes to unaudited condensed consolidated financial statements

MGP INGREDIENTS, INC.
CONDENSED CONSOLIDATED STATEMENT OF
CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)
(Dollars in thousands)

	Capital Stock Preferred	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, December 31, 2017	$ 4	$ 6,715	$ 13,912	$ 167,129	$ (311)	$ (18,719)	$ 168,730
Comprehensive income:							
Net income	—	—	—	16,454	—	—	16,454
Other comprehensive income	—	—	—	—	28	—	28
Dividends and dividend equivalents, net of estimated forfeitures	—	—	—	(2,748)	—	—	(2,748)
Share-based compensation	—	—	1,553	—	—	—	1,553
Stock shares awarded, forfeited, or vested	—	—	(981)	—	—	1,397	416
Purchase of treasury stock for tax withholding on share-based compensation	—	—	—	—	—	(2,073)	(2,073)
Balance, June 30, 2018	$ 4	$ 6,715	$ 14,484	$ 180,835	$ (283)	$ (19,395)	$ 182,360

See accompanying notes to unaudited condensed consolidated financial statements

MGP INGREDIENTS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, unless otherwise noted)

Note 1. Accounting Policies and Basis of Presentation

The Company. MGP Ingredients, Inc. ("Company") is a Kansas corporation headquartered in Atchison, Kansas and is a leading producer and supplier of premium distilled spirits and specialty wheat protein and starch food ingredients. Distilled spirits include premium bourbon and rye whiskeys and grain neutral spirits, including vodka and gin. MGP is also a top producer of high quality industrial alcohol for use in both food and non-food applications. The Company's protein and starch food ingredients provide a host of functional, nutritional, and sensory benefits for a wide range of food products to serve the packaged goods industry. The Company's distillery products are derived from corn and other grains (including rye, barley, wheat, barley malt, and milo), and its ingredient products are derived from wheat flour. The majority of the Company's sales are made directly or through distributors to manufacturers and processors of finished packaged goods or to bakeries.

Basis of Presentation and Principles of Consolidation. The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. These unaudited condensed consolidated financial statements as of and for the quarter ended June 30, 2018 should be read in conjunction with the consolidated financial statements and notes thereto in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 filed with the Securities and Exchange Commission ("SEC"). The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments (consisting of normal and recurring adjustments) necessary to fairly present the results for interim periods in accordance with U.S. generally accepted accounting principles ("GAAP"). Pursuant to the rules and regulations of the SEC, certain information and note disclosures normally included in the financial statements prepared in accordance with GAAP have been condensed or omitted.

Use of Estimates. The financial reporting policies of the Company conform to GAAP. The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The application of certain of these policies places demands on management's judgment, with financial reporting results relying on estimation about the effects of matters that are inherently uncertain. For all of these policies, management cautions that future events rarely develop as forecast, and estimates routinely require adjustment and may require material adjustment.

Inventory. Inventory includes finished goods, raw materials in the form of agricultural commodities used in the production process and certain maintenance and repair items. Bourbon and whiskeys are normally aged in barrels for several years, following industry practice; all barreled bourbon and whiskey is classified as a current asset. The Company includes warehousing, insurance, and other carrying charges applicable to barreled whiskey in inventory costs.

Inventories are stated at lower of cost or net realizable value on the first-in, first-out, or FIFO, method. Inventory valuations are impacted by constantly changing prices paid for key materials, primarily corn. Inventory consists of the following:

	June 30, 2018	December 31, 2017
Finished goods	$17,471	$ 13,284
Barreled distillate (bourbon and whiskey)	73,043	65,726
Raw materials	5,272	3,954
Work in process	1,500	1,935
Maintenance materials	7,510	7,256
Other	1,691	994
Total	$106,487	$ 93,149

Revenue Recognition. As a result of the adoption of Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers and related amendments, collectively "Topic 606," ("ASU 2014-09") on January 1, 2018, the Company has changed its accounting policy for revenue recognition (also see Note 2). Revenue is recognized when control of the promised goods or services, through performance obligations by the Company, is transferred to the customer in an amount that reflects the consideration it expects to be entitled to in exchange for the performance obligations. The term between invoicing and when payment is due is not significant and the period between when the entity transfers the promised good or service to the customer and when the customer pays for that good or service is one year or less.

Excise taxes that are both imposed on and concurrent with a specific revenue-producing transaction, that are collected by the Company from a customer are excluded from revenue. Revenue is recognized for the sale of products at the point in time finished products are delivered to the customer in accordance with shipping terms. This is a faithful depiction of the satisfaction of the performance obligation because, at that point control passes to the customer, the customer has legal title and the risk and rewards of ownership have transferred, and the customer has present obligation to pay.

The Company’s distillery products segment routinely enters into bill and hold arrangements, whereby the Company produces and sells unaged distillate to customers, and the product is subsequently barreled at the customer’s request and warehoused at a Company location for an extended period of time in accordance with directions received from the Company’s customers. Even though the unaged distillate remains in the Company's possession, a sale is recognized at the point in time when the customer obtains control of the product. Control is transferred to the customer in bill and hold transactions when: customer acceptance specifications have been met, legal title has transferred, the customer has a present obligation to pay for the product, the risk and rewards of ownership have transferred to the customer, and all the following additional bill and hold criteria have been met: the customer has requested the product be warehoused, the product has been identified as separately belonging to the customer, the product is currently ready for physical transfer to the customer, and the Company does not have the ability to use the product or direct it to another customer.

Warehouse service revenue is recognized over the time that warehouse services are rendered and as they are rendered. This is a faithful depiction of the satisfaction of the performance obligation because control of the aging products has already passed to the customer and there are no additional performance activities required by the Company, except as requested by the customer. The performance of the service activities, as requested, is invoiced as satisfied and revenue is concurrently recognized.

Income Taxes. The Company accounts for income taxes using an asset and liability method which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis.

EPS. Basic and diluted EPS are computed using the two-class method, which is an earnings allocation formula that determines net income per share for each class of Common Stock and participating security according to dividends declared and participation rights in undistributed earnings. Per share amounts are computed by dividing net income attributable to common shareholders by the weighted average shares outstanding during the period.

Fair Value of Financial Instruments. The Company determines the fair values of its financial instruments based on a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy is broken down into three levels based upon the observability of inputs. Fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability. Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if

any, market activity for the asset or liability. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value in its entirety requires judgment and considers factors specific to the asset or liability.

The Company's short term financial instruments include cash and cash equivalents, accounts receivable and accounts payable. The carrying value of the short term financial instruments approximates the fair value due to their short term nature. These financial instruments have no stated maturities or the financial instruments have short term maturities that approximate market.

The fair value of the Company's debt is estimated based on current market interest rates for debt with similar maturities and credit quality. The fair value of the Company's debt was $40,465 and $24,838 at June 30, 2018 and December 31, 2017, respectively. The financial statement carrying value of total debt was $40,461 (including unamortized loan fees) and $24,554 (including unamortized loan fees) at June 30, 2018 and December 31, 2017, respectively. These fair values are considered Level 2 under the fair value hierarchy.

Recently Issued Accounting Pronouncements. In June 2018, the FASB issued ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, which more closely aligns the accounting for employee and nonemployee share-based payments. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2018. For all other entities, the amendments are effective for annual periods in fiscal years beginning after December 15, 2019, and interim periods in fiscal years beginning after December 15, 2020. Early adoption is permitted, but no earlier than an entity's adoption date. The Company is evaluating the effect that ASU 2018-07 will have on its consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income, which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. This ASU is effective for all entities for annual and interim periods in fiscal years beginning after December 15, 2018. Early adoption is permitted, including adoption in any interim period, (1) for public business entities for reporting periods for which financial statements have not yet been issued and (2) for all other entities for reporting periods for which financial statements have not yet been made available for issuance. The Company is evaluating the effect that ASU 2018-02 will have on its consolidated financial statements and related disclosures.

In January 2018, the FASB issued ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842, which clarifies that land easements are in the scope of ASU 2016-02, Leases, and provides transition relief. The effective date and transition requirements of ASU 2018-01 are the same as the effective date and transition requirements of ASU 2016-02 (see below). The Company is evaluating the effect that ASU 2018-01 will have on its consolidated financial statements and related disclosures in conjunction with ASU 2016-02.

In February 2016, the FASB issued ASU 2016-02, Leases, which aims to make leasing activities more transparent and comparable and requires substantially all leases be recognized by lessees on their balance sheet as a liability for lease payments and a right-of-use asset for its right to use the underlying asset during the lease term. This ASU is effective for public business entities for interim and annual reporting periods beginning after December 15, 2018. Although early adoption is permitted, the Company is not planning to early adopt the new standard, which replaces existing lease accounting guidance. The Company can elect to adopt ASC 2016-02 using a modified retrospective transition method requiring application for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Alternatively, the Company can choose to use its effective date as the date of initial application. The Company is evaluating the effect that the new lease guidance will have on its consolidated financial statements and related disclosures.

Recently Adopted Accounting Standard Updates. In March 2017, the FASB issued ASU 2017-07, Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires companies to present the service cost component of net benefit cost in the same line items in which they report compensation cost. Companies will present all other components of net benefit cost outside operating income, if this subtotal is presented. This ASU was effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. The Company adopted ASU 2017-07 on January 1, 2018, with immaterial impact on its financial results and presentation for the quarter and year-to-date periods ended June 30, 2018.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires companies to include cash and cash equivalents that have restrictions on withdrawal or use in total cash and cash equivalents on the statement of cash flows. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. The Company adopted ASU 2016-18 on January 1, 2018, and has determined that there is no impact to the presentation of the condensed consolidated statements of cash flows because the Company had no restricted cash for the quarter and year-to-date periods ended June 30, 2018 and 2017.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which addresses eight classification issues related to the statement of cash flows: Debt prepayment or debt extinguishment costs; Settlement of zero coupon bonds; Contingent consideration payments made after a business combination; Proceeds from the settlement of insurance claims; Proceeds from the settlement of corporate owned life insurance policies, including bank owned life insurance policies; Distributions received from equity method investees; Beneficial interests in securitization transactions; and Separately identifiable cash flows and application of the predominance principle. This ASU was effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. The Company adopted ASU 2016-15 on January 1, 2018, and has determined that there is no impact to the presentation of the condensed consolidated statements of cash flows for the quarter and year-to-date periods ended June 30, 2018 and 2017.

Note 2. Revenue

Adoption of Topic 606, Revenue from Contracts with Customers

On January 1, 2018, the Company adopted ASU 2014-09 using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Financial results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company's historic accounting under Accounting Standards Codification 605, Revenue Recognition ("ASC 605"). The Company has completed its evaluation of the impact of ASU 2014-09 and concluded that there is no impact to the financial statements as a result of its adoption. The Company recorded no adjustment to opening retained earnings as of January 1, 2018 related to the transition from ASC 605 to ASU 2014-09 and there are no differences to disclose to reconcile financial statement activity as reported under ASU 2014-09 to ASC 605 for the quarter and year to date ended June 30, 2018.

Disaggregation of Revenue.

The following table presents the Company's revenues disaggregated by segment and major products and services.

	NET SALES Quarter Ended June 30,		NET SALES Year to Date Ended June 30,	
	2018	2017[(a)]	2018	2017[(a)]
Distillery Products				
Premium beverage alcohol	$42,200	$42,287	$86,271	$87,926
Industrial alcohol	19,295	19,342	38,639	38,465
Food grade alcohol	$61,495	$61,629	$124,910	$126,391
Fuel grade alcohol	1,567	1,767	3,430	3,409
Distillers feed and related co-products	6,663	4,732	12,887	9,654
Warehouse services	2,927	2,571	5,802	5,194
Total distillery products	$72,652	$70,699	$147,029	$144,648
Ingredient Solutions				
Specialty wheat starches	$7,339	$7,411	$14,140	$13,818
Specialty wheat proteins	6,008	5,224	10,744	9,603
Commodity wheat starch	2,090	2,266	4,132	4,354
Commodity wheat protein	163	153	163	499
Total ingredient solutions	$15,600	$15,054	$29,179	$28,274
Total net sales	$88,252	$85,753	$176,208	$172,922

[a] As noted above, prior period amounts were not adjusted upon adoption of Topic 606.

The following table presents the Company's revenues disaggregated by segment and timing of revenue recognition.

	NET SALES Quarter Ended June 30,		NET SALES Year to Date Ended June 30,	
	2018	2017[a]	2018	2017[a]
Distillery Products				
Products transferred at a point in time	$69,725	$68,128	$141,227	$139,454
Services transferred over time	2,927	2,571	5,802	5,194
Total distillery products	$72,652	$70,699	$147,029	$144,648
Ingredient Solutions				
Products transferred at a point in time	$15,600	$15,054	$29,179	$28,274
Total net sales	$88,252	$85,753	$176,208	$172,922

[a] As noted above, prior period amounts were not adjusted upon adoption of Topic 606.

The Company generates revenues from the distillery products segment by the sale of products and by providing warehouse services related to the storage and aging of customer products. The Company generates revenues from the ingredient solutions segment by the sale of products.

Contracts with customers in both segments include a single performance obligation (either the sale of products or the provision of warehouse services). Certain customers may receive volume rebates or discounts, which are accounted for as variable consideration. The Company estimates these amounts based on the expected amount to be provided to customers and reduces revenues recognized. The Company believes there will be no significant changes to the estimates of variable consideration.

Note 3. Equity Method Investments

As of June 30, 2018, the Company had no investments accounted for using the equity method of accounting. Until July 3, 2017, the Company had a 30 percent interest in Illinois Corn Processing ("ICP"), which manufactured alcohol for fuel, industrial and beverage applications. The Company completed the sale of its equity ownership interest in ICP to Pacific Ethanol Central, LLC, on July 3, 2017, consistent with an Agreement and Plan of Merger entered into on June 26, 2017.

Summary Financial Information (unaudited). Condensed financial information related to the Company's non-consolidated equity method investment in ICP for the quarter and year to date ended June 30, 2017 is shown below.

	Quarter Ended June 30, 2017	Year to Date Ended June 30, 2017
ICP's Operating results:		
Net sales [a]	$39,677	$78,062
Cost of sales and expenses [b]	42,410	79,224
Net loss	$(2,733)	$(1,162)

[a]

Includes related party sales to MGPI for the quarter and year to date ended June 30, 2017 of $9,015 and $17,672, respectively.

(b) Includes depreciation and amortization for the quarter and year to date ended June 30, 2017of $862 and $1,720, respectively.

The Company's equity method investment losses for the quarter and year to date ended June 30, 2017, based on unaudited financial statements, were $819 and $348, respectively.

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Note 4. Corporate Borrowings

Indebtedness Outstanding:

Description[a]	June 30, 2018	December 31, 2017
Credit Agreement - Revolver, 3.473% (variable rate) due 2022	$19,324	$ 3,298
Secured Promissory Note, 3.71% (variable rate) due 2022	1,782	1,966
Prudential Note Purchase Agreement, 3.53% (fixed rate) due 2027	20,000	20,000
Unamortized loan fees[b]	(645)	(710)
Total indebtedness outstanding	$40,461	$ 24,554
Less current maturities of long term debt	(379)	(372)
Long-term debt	$40,082	$ 24,182

[a] Interest rates are as of June 30, 2018.
[b] Loan fees are being amortized over the life of the Credit Agreement and Note Purchase Agreement.

Credit Agreements. On August 23, 2017, the Company entered into a credit agreement (the “Credit Agreement”) with Wells Fargo Bank, National Association. The Credit Agreement provides for a $150,000 revolving credit facility. The Company may increase the facility from time to time by an aggregate principal amount of up to $25,000 provided certain conditions are satisfied and at the discretion of the lender. The Credit Agreement matures on August 23, 2022. The Credit Agreement includes certain requirements and covenants, which the Company was in compliance with at June 30, 2018. As of June 30, 2018, the Company's total outstanding borrowings under the Credit Agreement were $19,324 leaving $130,676 available.

On August 23, 2017, the Company also entered into a Note Purchase and Private Shelf Agreement (the “Note Purchase Agreement”) with PGIM, Inc., an affiliate of Prudential Financial, Inc., and certain affiliates of PGIM, Inc. The Note Purchase Agreement provides for the issuance of up to $75,000 of Senior Secured Notes, and the Company issued $20,000 of Senior Secured Notes with a maturity date of August 23, 2027. The Note Purchase Agreement includes certain requirements and covenants, which the Company was in compliance with at June 30, 2018.

Note 5. Income Taxes

On December 22, 2017, the United States enacted tax reform legislation commonly known as the Tax Cuts and Jobs Act (the “Tax Act”), resulting in significant modifications to U.S. tax law. In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118 (“SAB 118”), which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. As of June 30, 2018, we have not made a measurement period adjustment and the accounting for the Tax Act remains incomplete.

Income tax expense for the quarter and year to date ended June 30, 2018 was $3,316 and $4,571, respectively, for an effective tax rate for the quarter of 30.6 percent and for the year to date of 21.7 percent. For the quarter, the effective tax rate differs from the 21 percent federal statutory rate (as lowered by the Tax Act) on pretax income, primarily due to an increased income tax impact related to the 2017 sale of the Company's equity method investment and a net increase in state taxes. Year to date, the effective tax rate differs from the 21 percent federal statutory rate (as lowered by the Tax Act) on pretax income, primarily due to an increased income tax impact related to the 2017 sale of the Company’s equity method investment and a net increase in state taxes, partially offset by the impact of income tax benefits related to share-based compensation as accounted for in ASU 2016-09, Compensation - Stock Compensation (Topic 718) Improvements to Employee Share-Based Payment Accounting (“ASU 2016-09”).

Income tax expense for the quarter and year to date ended June 30, 2017 was $2,947 and $5,801, respectively, for an effective tax rate for the quarter of 31.6 percent and for the year to date of 27.8 percent. The effective tax rate differed from the 35 percent federal statutory rate on pretax income, primarily due to the impact of income tax benefits related to share-based compensation as accounted for in ASU 2016-09, which was adopted by the Company during the quarter ended September 30, 2016, the domestic production activities deduction, and state taxes, including state income tax credits in Indiana and Kansas.

Note 6. EPS

The computations of basic and diluted EPS for the quarters ended June 30, 2018 and 2017 are as follows:

	Quarter Ended		Year to Date Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Operations:				
Net income[(a)]	$7,527	$ 6,369	$16,454	$ 15,047
Income attributable to participating securities[(b)]	148	183	323	433
Net income attributable to common shareholders	$7,379	$ 6,186	$16,131	$ 14,614
Share information:				
Basic and diluted weighted average common shares[(c)]	16,869,481	16,745,679	16,856,421	16,727,305
Basic and diluted EPS	$0.44	$ 0.37	$0.96	$ 0.87

(a) Net income attributable to all shareholders.

(b) At June 30, 2018 and 2017, participating securities included 338,375 and 497,492 unvested restricted stock units ("RSUs"), respectively.

(c) Under the two-class method, weighted average common shares at June 30, 2018 and 2017, exclude unvested, participating securities.

Note 7. Contingencies

There are various legal and regulatory proceedings involving the Company and its subsidiaries. The Company accrues estimated costs for a contingency when management believes that a loss is probable and can be reasonably estimated.

A chemical release occurred at the Company's Atchison facility on October 21, 2016, which resulted in emissions venting into the air. The Company reported the event to the Environmental Protection Agency ("EPA"), the Occupational, Safety, and Health Administration ("OSHA"), and to Kansas and local authorities on that date, and is cooperating fully to investigate and ensure that all appropriate response actions are taken. The Company has also engaged outside experts to assist the investigation and response. The Company believes it is probable that a fine or penalty may be imposed by regulatory authorities, but it is currently unable to reasonably estimate the amount thereof since some investigations are not complete and could take several months up to a few years to complete. Private plaintiffs have initiated, and additional private plaintiffs may initiate, legal proceedings for damages resulting from the emission, but the Company is currently unable to reasonably estimate the amount of any such damages that might result. The Company's insurance is expected to provide coverage of any damages to private plaintiffs, subject to a deductible of $250, but certain regulatory fines or penalties may not be covered and there can be no assurance to the amount or timing of possible insurance recoveries if ultimately claimed by the Company. There was no significant damage to the Company's Atchison plant as a result of this incident. No other MGP facilities, including the distillery in Lawrenceburg, Indiana, were affected by this incident.

OSHA completed its investigation and, on April 19, 2017, issued its penalty to the Company in the amount of $138. Management settled this assessment with OSHA in full for $75, which was paid on May 16, 2017. A portion, or all, of the penalty amount may be covered by insurance.

The EPA informed the Company on August 1, 2017, that it intends to seek civil penalties of approximately $250 in connection with its investigation, while offering the Company the opportunity to settle the matter prior to the EPA

proceeding with a formal enforcement action. The Company is seeking a negotiated settlement with the EPA, but negotiations have paused pending resolution of the EPA's criminal investigation. Since the Company expects a negotiated resolution of the EPA civil case and EPA-proposed civil penalties are not material to the quarter and year to date ended June 30, 2018, the Company has not included an accrual in its results. A portion, or all, of the settled penalty amount may be covered by insurance.

Note 8. Employee and Non-Employee Benefit Plans

Equity-Based Compensation Plans. The Company's equity-based compensation plans provide for the awarding of stock options, stock appreciation rights, shares of restricted stock ("Restricted Stock"), and RSUs for senior executives and salaried employees, as well as non-employee directors. The Company has two active equity-based compensation plans: the Employee Equity Incentive Plan of 2014 (the "2014 Plan") and the Non-Employee Director Equity Incentive Plan (the "Directors' Plan"). The 2014 Plan replaced the inactive Stock Incentive Plan of 2004.

As of June 30, 2018, 322,221 RSUs had been granted of the 1,500,000 shares approved under the 2014 Plan. 68,934 shares had been granted of the 300,000 shares approved under the Directors' Plan. As of June 30, 2018, 341,295 unvested RSUs were outstanding under the Company's long-term incentive plans.

Note 9. Operating Segments

At June 30, 2018 and 2017, the Company had two segments: distillery products and ingredient solutions. The distillery products segment consists of food grade alcohol and distillery co-products, such as distillers feed (commonly called dried distillers grain in the industry) and fuel grade alcohol. The distillery products segment also includes warehouse services, including barrel put away, storage, retrieval, and blending services. Ingredient solutions consists of specialty starches and proteins and commodity starches and proteins.

Operating profit for each segment is based on net sales less identifiable operating expenses. Non-direct SG&A, interest expense, earnings from the Company's equity method investments until sold on July 3, 2017, other special charges, and other general miscellaneous expenses are excluded from segment operations and are classified as Corporate. Receivables, inventories, and equipment have been identified with the segments to which they relate. All other assets are considered as Corporate.

	Quarter Ended		Year to Date Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
Net Sales to Customers				
Distillery products	$72,652	$70,699	$147,029	$144,648
Ingredient solutions	15,600	15,054	29,179	28,274
Total	88,252	85,753	176,208	172,922
Gross Profit				
Distillery products	16,680	15,953	32,550	32,568
Ingredient solutions	2,761	2,872	5,842	5,298
Total	19,441	18,825	38,392	37,866
Depreciation and Amortization				
Distillery products	2,257	2,125	4,498	4,171
Ingredient solutions	379	416	813	824
Corporate	261	275	515	559
Total	2,897	2,816	5,826	5,554
Income (loss) before Income Taxes				
Distillery products	14,777	14,131	28,954	29,649
Ingredient solutions	2,142	2,269	4,566	4,074
Corporate	(6,076)	(7,084)	(12,495)	(12,875)
Total	$10,843	$9,316	$21,025	$20,848

The following table allocates assets to each segment:

	As of June 30, 2018	As of December 31, 2017
Identifiable Assets		
Distillery products	$206,184	$191,321
Ingredient solutions	35,202	28,950
Corporate	18,769	20,057
Total	$260,155	$240,328

Note 10. Subsequent Events

On July 31, 2018, the Board of Directors declared a quarterly dividend payable to stockholders of record as of August 16, 2018, of the Company's Common Stock, and a dividend equivalent payable to holders of certain RSUs as of August 16, 2018, of $.08 per share and per unit, payable on August 31, 2018.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollar amounts in thousands, unless otherwise noted)

CAUTIONARY NOTE CONCERNING FACTORS THAT MAY AFFECT FUTURE RESULTS

This Report on Form 10-Q contains forward looking statements as well as historical information. All statements, other than statements of historical facts, regarding the prospects of our industry and our prospects, plans, financial position, and strategic plan may constitute forward looking statements. In addition, forward looking statements are usually identified by or are associated with such words as "intend," "plan," "believe," "estimate," "expect," "anticipate," "hopeful," "should," "may," "will," "could," "encouraged," "opportunities," "potential," and/or the negatives or variations of these terms or similar terminology. Forward looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from those expressed or implied in the forward looking statements. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward looking statements is included in the section titled "Risk Factors" (Item 1A) of our Annual Report on Form 10-K for the year ended December 31, 2017. Forward looking statements are made as of the date of this report, and we undertake no obligation to update or revise publicly any forward looking statements, whether because of new information, future events or otherwise.

OVERVIEW

MGP is a leading producer and supplier of premium distilled spirits and specialty wheat protein and starch food ingredients. Distilled spirits include premium bourbon and rye whiskeys and grain neutral spirits ("GNS"), including vodka and gin. We are also a top producer of high quality industrial alcohol for use in both food and non-food applications. Our protein and starch food ingredients provide a host of functional, nutritional and sensory benefits for a wide range of food products to serve the packaged goods industry. We have two reportable segments: our distillery products segment and our ingredient solutions segment.

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes included in this Form 10-Q, as well as our audited consolidated financial statements and accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations - General, set forth in our Annual Report on Form 10-K for the year ended December 31, 2017.

RESULTS OF OPERATIONS

Consolidated results

The table below details the consolidated results for quarters ended June 30, 2018 and 2017:

	Quarter Ended June 30,		
	2018	2017	2018 v. 2017
Net sales	$88,252	$85,753	2.9 %
Cost of sales	68,811	66,928	2.8
Gross profit	19,441	18,825	3.3
Gross margin %	22.0 %	22.0 %	— pp[a]
Selling, general, and administrative ("SG&A") expenses	8,309	8,311	—
Operating income	11,132	10,514	5.9
Operating margin %	12.6 %	12.3 %	0.3 pp
Equity method investment loss	—	(819)	(100.0)
Interest expense, net	(289)	(379)	(23.7)
Income before income taxes	10,843	9,316	16.4
Income tax expense	3,316	2,947	12.5
Effective tax expense rate %	30.6 %	31.6 %	(1.0) pp
Net income	$7,527	$6,369	18.2 %
Net income margin %	8.5 %	7.4 %	1.1 pp

[a] Percentage points ("pp").

Net sales - Net sales for quarter ended June 30, 2018 were $88,252, an increase of 2.9 percent compared to the year-ago quarter, which was the result of increased net sales in both segments. Within the distillery segment, net sales were up 2.8 percent, primarily due to increases in the net sales of distillers feed and related co-products and warehouse services. Within the ingredient solutions segment, net sales were up 3.6 percent. Net sales of specialty wheat proteins increased, while net sales of commodity and specialty wheat starches declined and net sales of commodity wheat proteins were flat (see Segment Results below).

Gross profit - Gross profit for quarter ended June 30, 2018 was $19,441, an increase of 3.3 percent compared to the year-ago quarter. The increase was driven by an increase in gross profit in the distillery products segment, partially offset by a decrease in gross profit in the ingredient solutions segment. In the distillery products segment, gross profit increased by $727, or 4.6 percent. In the ingredient solutions segment, gross profit declined by $111, or 3.9 percent (see Segment Results below).

SG&A expenses - SG&A expenses for quarter ended June 30, 2018 were $8,309 and remained flat compared to the year-ago quarter. Increases in personnel costs primarily to support the brands platform and other personnel costs were offset by a savings in professional fees.

Operating income - Operating income for quarter ended June 30, 2018 increased to $11,132 from $10,514 for quarter ended June 30, 2017, primarily due to the increase in gross profit in our distillery products segment, partially offset by a decrease in gross profit in our ingredient solutions segment.

Operating income, quarter versus quarter	Operating Income	Change	
Operating income for the quarter ended June 30, 2017	$ 10,514		
Increase in gross profit - distillery products segment[a]	727	6.9	pp[b]
Decrease in gross profit - ingredient solutions segment[a]	(111)	(1.0)	pp
SG&A expenses	2	—	pp
Operating income for the quarter ended June 30, 2018	$ 11,132	5.9	%

[a] See segment discussion.
[b] Percentage points ("pp").

Equity method investment - We had no equity method investment earnings for quarter ended June 30, 2018, compared to an equity method investment loss of $819 for quarter ended June 30, 2017. The change in equity method investment earnings was due to the sale of our ICP equity method investment on July 3, 2017, to Pacific Ethanol Central, LLC (see Note 3).

Income tax expense - Income tax expense for quarter ended June 30, 2018 was $3,316, for an effective tax rate of 30.6 percent. Income tax expense for the quarter ended June 30, 2017 was $2,947, for an effective tax rate of 31.6 percent. The primary reasons for the 1.0 percentage point decline in our effective tax rate, quarter versus quarter, are the decrease resulting from implementation of the Tax Cuts and Jobs Act (the “Tax Act”), partially offset by a change in income tax impact related to the sale of our ICP equity method investment.

Earnings per share ("EPS") - EPS was $0.44 for quarter ended June 30, 2018 compared to $0.37 for quarter ended June 30, 2017. EPS increased, quarter versus quarter, primarily due to a net increase in operations from our segments, a decline in equity method investment loss from the sale of our ICP equity method investment, and the decline in our effective tax rate described above.

Change in basic and diluted EPS, quarter versus quarter	Basic and Diluted EPS	Change	
Basic and diluted EPS for the quarter ended June 30, 2017	$ 0.37		
Change in operations[a]	0.03	8.1	pp[b]
Change in equity method investment loss[a]	0.03	8.1	pp
Tax: Change in effective tax rate	0.01	2.7	pp
Basic and diluted EPS for the quarter ended June 30, 2018	$ 0.44	18.9	%

[a] Items are net of tax based on the effective tax rate for the base year (2017).
[b] Percentage points ("pp").

Consolidated results

The table below details the consolidated results for year to date ended June 30, 2018 and 2017:

	Year to Date Ended June 30,		
	2018	2017	2018 v. 2017
Net sales	$176,208	$172,922	1.9 %
Cost of sales	137,816	135,056	2.0
Gross profit	38,392	37,866	1.4
Gross margin %	21.8 %	21.9 %	(0.1) pp[(a)]
SG&A expenses	16,871	15,960	5.7
Operating income	21,521	21,906	(1.8)
Operating margin %	12.2 %	12.7 %	(0.5) pp
Equity method investment loss	—	(348)	(100.0)
Interest expense, net	(496)	(710)	(30.1)
Income before income taxes	21,025	20,848	0.8
Income tax expense	4,571	5,801	(21.2)
Effective tax expense rate %	21.7 %	27.8 %	(6.1) pp
Net income	$16,454	$15,047	9.4 %
Net income margin %	9.3 %	8.7 %	0.6 pp

[(a)] Percentage points ("pp").

Net sales - Net sales for year to date June 30, 2018 were $176,208, an increase of 1.9 percent compared to the year-ago period, which was the result of increased net sales in both segments. Within the distillery segment, net sales were up 1.6 percent. Increases in the net sales of distillers feed and related co-products and warehouse services more than offset a decline in the net sales of food grade alcohol, resulting in the increase for the overall segment, period versus period. Net sales of premium beverage alcohol products within food grade alcohol decreased 1.9 percent, while industrial alcohol product net sales increased 0.5 percent, resulting in a food grade alcohol net sales decrease. Within the ingredient solutions segment, net sales were up 3.2 percent. Net sales of specialty wheat proteins and starches increased, while net sales of commodity wheat proteins and starches declined (see Segment Results below).

Gross profit - Gross profit for year to date June 30, 2018 was $38,392, an increase of 1.4 percent compared to the year-ago period. The increase was driven by an increase in gross profit in the ingredient solutions segment, partially offset by a slight decrease in gross profit in the distillery products segment. In the ingredient solutions segment, gross profit increased by $544, or 10.3 percent (see Segment Results below). In the distillery products segment, gross profit declined by $18, or 0.1 percent.

SG&A expenses - SG&A expenses for year to date June 30, 2018 were $16,871, an increase of 5.7 percent compared to the year-ago period. The increase in SG&A was primarily due to investments in our brands platform (personnel costs and advertising and promotion) and other personnel costs, partially offset by a savings in professional fees.

Operating income - Operating income for year to date June 30, 2018 decreased to $21,521 from $21,906 for the period ended June 30, 2017, due to the increase in SG&A expenses described above and a gross profit decline in our distillery products segment, partially offset by an increase in gross profit in our ingredient solutions segment.

Operating income, year to date versus year to date	Operating Income	Change	
Operating income for year to date ended June 30, 2017	$21,906		
Decrease in gross profit - distillery products segment[a]	(18)	(0.1)	pp[b]
Increase in gross profit - ingredient solutions segment[a]	544	2.5	pp
Increase in SG&A expenses	(911)	(4.2)	pp
Operating income for year to date ended June 30, 2018	$21,521	(1.8)%	

[a] See segment discussion.
[b] Percentage points ("pp").

Equity method investment - We had no equity method investment earnings for year to date June 30, 2018, compared to an equity method investment loss of $348 for the period ended June 30, 2017. The change in equity method investment earnings was due to the sale of our ICP equity method investment on July 3, 2017, to Pacific Ethanol Central, LLC (see Note 3).

Income tax expense - Income tax expense for year to date June 30, 2018 was $4,571, for an effective tax rate of 21.7 percent. Income tax expense for year to date June 30, 2017 was $5,801, for an effective tax rate of 27.8 percent. The primary reasons for the 6.1 percentage point decline in our effective tax rate, period versus period, are the decrease resulting from implementation of the Tax Act, partially offset by a change in income tax impact related to the sale of our ICP equity method investment.

Earnings per share ("EPS") - EPS was $0.96 for year to date June 30, 2018 compared to $0.87 for the period ended June 30, 2017. EPS increased, year to date versus year to date, primarily due to the decline in our effective tax rate described above, a decline in equity method investment loss due to the sale of our ICP equity method investment, a decrease in interest expense, net, and the net effect of the tax benefit on vested share-based compensation. Increases to EPS were partially offset by a net decrease in operations.

Change in basic and diluted EPS, year to date versus year to date	Basic and Diluted EPS	Change	
Basic and diluted EPS for year to date ended June 30, 2017	$ 0.87		
Change in operations[a]	(0.02)	(2.3)	pp[b]
Change in equity method investment loss[a]	0.01	1.2	pp
Change in interest expense, net[a]	0.01	1.2	pp
Tax: Net effect of the tax benefit on vested share-based compensation	0.01	1.2	pp
Tax: Change in effective tax rate (excluding tax item above)	0.08	9.1	pp
Basic and diluted EPS for year to date ended June 30, 2018	$ 0.96	10.4 %	

[a] Items are net of tax based on the effective tax rate for the base year (2017), excluding the effect of the tax benefit on vested share-based compensation on the 2017 rate.
[b] Percentage points ("pp").

SEGMENT RESULTS

Distillery Products

The following table shows selected financial information for our distillery products segment for quarters ended June 30, 2018 and 2017.

PRODUCT GROUP NET SALES

	Quarter Ended June 30,		Quarter versus Quarter Net Sales Change Increase / (Decrease)		Quarter versus Quarter Volume Increase / (Decrease)
	2018 Amount	2017 Amount	$ Change	% Change	% Change
Premium beverage alcohol	$42,200	$42,287	$(87)	(0.2)%	
Industrial alcohol	19,295	19,342	(47)	(0.2)	
Food grade alcohol[a]	61,495	61,629	(134)	(0.2)	
Fuel grade alcohol[a]	1,567	1,767	(200)	(11.3)	
Distillers feed and related co-products	6,663	4,732	1,931	40.8	
Warehouse services	2,927	2,571	356	13.8	
Total distillery products	$72,652	$70,699	$1,953	2.8 %	(1.9)% [a]

Other Financial Information

	Quarter Ended June 30,		Quarter versus Quarter Increase / (Decrease)	
	2018	2017	$ Change	% Change
Gross profit	$16,680	$15,953	$727	4.6 %
Gross margin %	23.0 %	22.6 %		0.4 pp[b]

[a] Volume change for alcohol products.
[b] Percentage points ("pp").

Total net sales of distillery products increased $1,953, or 2.8 percent. Increases in the net sales of distillers feed and related co-products and warehouse services of 40.8 percent and 13.8 percent, respectively, over the year-ago quarter more than offset declines in the net sales of fuel grade alcohol and food grade alcohol. Net sales of premium beverage alcohol and industrial alcohol products within food grade alcohol declined slightly, resulting in a modest food grade alcohol net sales decrease. The increase in net sales of distillers feed and related co-products was due to a higher average selling price reflecting improved market conditions during the quarter.

Gross profit increased quarter versus quarter by $727, or 4.6 percent. Gross margin for the quarter ended June 30, 2018 increased to 23.0 percent from 22.6 percent for the prior-year quarter. The increase in gross profit was primarily due to an increase in gross profit for distillers feed and related co-products and premium beverage alcohol, partially offset by a decline in industrial alcohol gross margins and profits.

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Distillery Products

The following table shows selected financial information for our distillery products segment for year to date ended June 30, 2018 and 2017.

	PRODUCT GROUP NET SALES					
	Year to Date Ended June 30,		Year to Date versus Year to Date Net Sales Change Increase / (Decrease)		Year-to-Date versus Year to Date Volume Increase / (Decrease)	
	2018 Amount	2017 Amount	$ Change	% Change	% Change	
Premium beverage alcohol	$86,271	$87,926	$(1,655)	(1.9)%		
Industrial alcohol	38,639	38,465	174	0.5		
Food grade alcohol[a]	124,910	126,391	(1,481)	(1.2)		
Fuel grade alcohol[a]	3,430	3,409	21	0.6		
Distillers feed and related co-products	12,887	9,654	3,233	33.5		
Warehouse services	5,802	5,194	608	11.7		
Total distillery products	$147,029	$144,648	$2,381	1.6 %	0.4 %	[a]

	Other Financial Information				
	Year to Date Ended June 30,		Year to Date versus Year to Date Increase / (Decrease)		
	2018	2017	$ Change	% Change	
Gross profit	$32,550	$32,568	$(18)	(0.1)%	
Gross margin %	22.1 %	22.5 %		(0.4)	pp[b]

[a] Volume change for alcohol products.
[b] Percentage points ("pp").

Total net sales of distillery products increased $2,381, or 1.6 percent. Increases in the net sales of distillers feed and related co-products, warehouse services, and fuel grade alcohol of 33.5 percent, 11.7 percent, and 0.6 percent, respectively, over the prior-year period more than offset a decline in the net sales of food grade alcohol. Net sales of premium beverage alcohol products within food grade alcohol decreased 1.9 percent, while industrial alcohol product net sales increased 0.5 percent, resulting in a food grade alcohol net sales decrease. The increase in net sales of distillers feed and related co-products was due to a higher average selling price reflecting improved market conditions during the period. The decline in net sales of premium beverage alcohol was primarily due to reduced volume related to the timing of customer orders and related shipments during the period.
Gross profit decreased year to date versus year to date by $18, or 0.1 percent. Gross margin for year to date June 30, 2018 decreased to 22.1 percent from 22.5 percent for the prior-year period. The decline in gross profit was primarily due to lower gross margins and profits on industrial alcohol, offset by an increase in distillers feed and related co-products gross profit.

Ingredient Solutions

The following table shows selected financial information for our ingredient solutions segment for quarters ended June 30, 2018 and 2017.

	PRODUCT GROUP NET SALES				
	Quarter Ended June 30,		Quarter versus Quarter Net Sales Change Increase / (Decrease)		Quarter versus Quarter Volume Increase / (Decrease)
	2018 Amount	2017 Amount	$ Change	% Change	% Change
Specialty wheat starches	$7,339	$7,411	$(72)	(1.0)%	
Specialty wheat proteins	6,008	5,224	784	15.0	
Commodity wheat starches	2,090	2,266	(176)	(7.8)	
Commodity wheat proteins	163	153	10	6.5	
Total ingredient solutions	$15,600	$15,054	$546	3.6 %	(6.0)%

	Other Financial Information			
	Quarter Ended June 30,		Quarter versus Quarter Increase / (Decrease)	
	2018	2017	$ Change	% Change
Gross profit	$2,761	$2,872	$(111)	(3.9)%
Gross margin %	17.7 %	19.1 %		(1.4) pp[a]

[a] Percentage points ("pp").

Total ingredient solutions net sales for quarter ended June 30, 2018 increased by $546, or 3.6 percent, compared to the prior-year quarter. This increase was primarily driven by increased net sales of specialty wheat proteins, partially offset by decreased net sales of commodity and specialty wheat starches, quarter versus quarter.

Gross profit decreased quarter versus quarter by $111, or 3.9 percent. Gross margin for the quarter ended June 30, 2018 decreased to 17.7 percent from 19.1 percent for the prior year quarter. The decrease in gross profit was primarily due to an increase in input costs.

Ingredient Solutions

The following table shows selected financial information for our ingredient solutions segment for year to date ended June 30, 2018 and 2017.

PRODUCT GROUP NET SALES

	Year to Date Ended June 30,		Year to Date versus Year to Date Net Sales Change Increase / (Decrease)		Year to Date versus Year to Date Volume Increase / (Decrease)
	2018 Amount	2017 Amount	$ Change	% Change	% Change
Specialty wheat starches	$14,140	$13,818	$322	2.3 %	
Specialty wheat proteins	10,744	9,603	1,141	11.9	
Commodity wheat starches	4,132	4,354	(222)	(5.1)	
Commodity wheat proteins	163	499	(336)	(67.3)	
Total ingredient solutions	$29,179	$28,274	$905	3.2 %	(6.2)%

Other Financial Information

	Year to Date Ended June 30,		Year to Date versus Year to Date Increase / (Decrease)	
	2018	2017	$ Change	% Change
Gross profit	$5,842	$5,298	$544	10.3 %
Gross margin %	20.0 %	18.7 %		1.3 pp[a]

[a] Percentage points ("pp").

Total ingredient solutions net sales for year to date ended June 30, 2018 increased by $905, or 3.2 percent, compared to the prior-year period. This increase was primarily driven by increased net sales of specialty wheat proteins and starches, partially offset by decreased net sales of commodity wheat proteins and starches, period versus period. The year to date net sales decline of commodity wheat proteins and starches reflects our shift to higher margin specialty wheat proteins and starches.

Gross profit increased period versus period by $544, or 10.3 percent. Gross margin for year to date ended June 30, 2018 increased to 20.0 percent from 18.7 percent for the prior-year period. The increase in gross profit was primarily due to the shift to higher margin products and a higher average selling price, partially offset by an increase in input costs.

CASH FLOW, FINANCIAL CONDITION AND LIQUIDITY

We believe our financial condition continues to be of high quality, as evidenced by our ability to generate adequate cash from operations while having ready access to capital at competitive rates.

Operating cash flow and debt through our Credit Agreement and Note Purchase Agreement (Note 4) provide the primary sources of cash to fund operating needs and capital expenditures. These same sources of cash are used to fund shareholder dividends and other discretionary uses. Going forward, we expect to use cash to implement our invest to grow strategy, particularly in the distillery products segment. Our overall liquidity reflects our strong business results and an effective cash management strategy that takes into account liquidity management, economic factors, and tax considerations. We expect our sources of cash, including our Credit Agreement and Note Purchase Agreement, to be adequate to provide for budgeted capital expenditures and anticipated operating requirements for the foreseeable future.

Cash Flow Summary

	Year to Date Ended	
	June 30, 2018	June 30, 2017
Cash provided by operating activities:		
Net income, after giving effect to adjustments to reconcile net income to net cash provided by operating activities	$24,977	$30,394
Receivables, net	(1,411)	(8,845)
Inventory	(13,338)	(6,693)
Accrued expenses	(3,232)	(934)
Income taxes payable/refundable	446	(426)
Accounts payable and accounts payable to affiliate, net	(5,106)	(839)
Other, net	(1,093)	(1,814)
Total	$1,243	$10,843
Cash used in investing activities:		
Additions to property, plant, and equipment	(13,065)	(9,933)
Other	—	299

Total	$(13,065)	$(9,634
Cash provided by financing activities:		
Payment of dividends and dividend equivalents	(2,750)	(1,376
Purchase of treasury stock for tax withholding on share-based compensation	(2,073)	(1,131
Proceeds on debt:		

We have prepared the selected historical consolidated financial data in conformity with U. S. generally accepted accounting principles.

The selected financial data presented below should be read in conjunction with Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and the accompanying notes included in this Form 10-K in order to more fully understand the historical consolidated financial data.

	Years Ended December 31,				
	2014	2013	2012	2011	2010
Direct written premiums	$ 765,685	$ 731,680	$ 696,220	$ 649,262	$ 604,9
Net written premiums	$ 734,914	$ 697,540	$ 663,942	$ 620,316	$ 576,8
Net earned premiums	$ 716,875	$ 681,870	$ 642,469	$ 598,368	$ 551,9
Net investment income	42,303	43,054	40,870	39,060	41,39
Earnings from partnership investments	878	-	-	-	-
Net realized gains on investments	197	1,677	1,975	4,360	863
Finance and other service income	18,544	18,683	18,553	18,370	18,51
Total revenue	778,797	745,284	703,867	660,158	612,7
Loss and loss adjustment expenses	476,366	447,749	422,217	466,640	360,8
Underwriting, operating and	219,023	209,758	200,138	179,157	172,8

related expenses					
Interest expense	90	89	88	88	88
Total expenses	695,479	657,596	622,443	645,885	533,75
Income before income taxes	83,318	87,688	81,424	14,273	78,960
Income tax expense	23,964	26,337	23,354	571	22,618
Net income	$ 59,354	$ 61,351	58,070	13,702	56,342
Earnings per weighted average common share:					
Basic	$ 3.93	$ 4.00	$ 3.80	$ 0.90	$ 3.74
Diluted	$ 3.91	$ 3.98	$ 3.80	$ 0.90	$ 3.74
Cash dividends paid per common share	$ 2.60	$ 2.40	$ 2.20	$ 2.00	$ 1.80
Number of shares used in computing earnings per share:					
Basic	15,107,339	15,354,468	15,288,346	15,165,065	15,065
Diluted	15,197,036	15,399,801	15,295,452	15,176,006	15,084

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	Years Ended December 31,				
	2014	2013	2012	2011	2010
Balance Sheet Data:					
Total cash and investment securities	$ 1,298,716	$ 1,258,453	$ 1,223,736	$ 1,145,783	$ 1,120,969
Total assets	1,675,719	1,625,457	1,574,346	1,472,494	1,439,452
Losses and loss adjustment expense reserves	482,012	455,014	423,842	403,872	404,391
Total liabilities	967,436	930,270	879,987	816,181	785,976
Total shareholders' equity	708,283	695,187	694,359	656,313	653,476
GAAP Ratios:					
Loss ratio (1)	66.5 %	65.7 %	65.7 %	78.0 %	65.4 %
Expense ratio (1)	30.6	30.8	31.2	29.9	31.3
Combined ratio (1)	97.1 %	96.5 %	96.9 %	107.9 %	96.7 %

(1) The loss ratio is the ratio of losses and loss adjustment expenses to net earned premiums. The expense ratio, when calculated on a GAAP basis, is the ratio of underwriting expense to net earned premiums. The combined ratio is the sum of the loss ratio and the expense ratio. Please refer to Insurance Ratios under Item 7—Management's Discussion and Analysis of Financial Condition and Results of Operations for further discussion on our GAAP ratios.

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our accompanying consolidated financial statements and notes thereto, which appear elsewhere in this document. In this discussion, all dollar amounts are presented in thousands, except share and per share data.

The following discussion contains forward-looking statements. We intend statements which are not historical in nature to be, and are hereby identified as "forward-looking statements" to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, the Company's senior management may make forward-looking statements orally to analysts, investors, the media and others. This safe harbor requires that we specify important factors that could cause actual results to differ materially from those contained in forward-looking statements made by or on behalf of us. We cannot promise that our expectations in such forward-looking statements will turn out to be correct. Our actual results could be materially different from and worse than our expectations. See "Forward-Looking Statements" below for specific important factors that could cause actual results to differ materially from those contained in forward-looking statements.

Executive Summary and Overview

In this discussion, "Safety" refers to Safety Insurance Group, Inc. and "our Company," "we," "us" and "our" refer to Safety Insurance Group, Inc. and its consolidated subsidiaries. Our subsidiaries consist of Safety Insurance Company ("Safety Insurance"), Safety Indemnity Insurance Company ("Safety Indemnity"), Safety Property and Casualty Insurance Company ("Safety P&C"), Whiteshirts Asset Management Corporation ("WAMC"), and Whiteshirts Management Corporation, which is WAMC's holding company.

We are a leading provider of private passenger automobile insurance in Massachusetts. In addition to private passenger automobile insurance (which represented 61.7% of our direct written premiums in 2014), we offer a portfolio of other insurance products, including commercial automobile (12.5% of 2014 direct written premiums), homeowners (21.1% of 2014 direct written premiums), dwelling fire, umbrella and business owner policies (totaling 4.7% of 2014 direct written premiums). Operating exclusively in Massachusetts and New Hampshire through our insurance company subsidiaries, Safety Insurance, Safety Indemnity, and Safety P&C (together referred to as the "Insurance Subsidiaries"), we have established strong relationships with independent insurance agents, who numbered 930 in 1,076 locations throughout Massachusetts and New Hampshire during 2014. We have used these relationships and our extensive knowledge of the Massachusetts market to become the third largest private passenger automobile and the second largest commercial automobile insurance carrier in Massachusetts, capturing an approximate 10.7% and 13.5% share, respectively, of the Massachusetts private passenger and commercial automobile markets in 2014, according to statistics compiled by Commonwealth Automobile Reinsurers ("CAR") based on automobile exposures. These statistics total, for each vehicle insured, the number of months during the year insurance for that vehicle is in effect, to arrive at an aggregate number of car-months for each insurer; this aggregate number, divided by 12, equals

the insurer's number of car-years, a measure we refer to in this report as automobile exposures.

The Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire during 2008, personal umbrella business during 2009, and commercial automobile business during 2011. During the years ended December 31, 2014, 2013, and 2012, we wrote $18,755, $13,773, and $9,057 in direct written premiums, respectively, and approximately 20,626, 15,580, and 11,000 policies, respectively, in New Hampshire.

On February 9, 2015, the Insurance Subsidiaries each received a license to begin writing our property and casualty insurance products in the state of Maine. We anticipate that we will begin to write new business in Maine later in 2015.

Recent Trends and Events

· We filed and were approved for a Massachusetts homeowners rate increase of 2.46% which was effective December 1, 2014.

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· We filed and were approved for a New Hampshire automobile rate increase of 3.0%, which was effective November 1, 2014.

· We filed and were approved for a New Hampshire homeowners rate increase of 3.3%, which was effective October 1, 2014.

· We filed and were approved for a Massachusetts commercial automobile insurance rate increase of 3.5% effective February 1, 2015.

· We filed and were approved for a Massachusetts private passenger automobile insurance rate increase of 3.8% effective June 1, 2015.

During 2014, we filed private passenger rate changes that increased the variation of rates within our tiering system which resulted in no change to the overall rate level. Our rates include a 13.0% commission rate for agents.

We define a “catastrophe” as an event that produces pre-tax losses before reinsurance in excess of $1,000 and involves multiple first-party policyholders, or an event that produces a number of claims in excess of a preset, per-event threshold of average claims in a specific area, occurring within a certain amount of time following the event. Catastrophes are caused by various natural events including high winds, winter storms, tornadoes, hailstorms, and hurricanes. The nature and level of catastrophes in any period cannot be reliably predicted.

Catastrophe losses incurred by the type of event are shown in the following table.

	Years Ended December 31,		
Event	2014	2013	2012
Windstorms and hailstorms	$ 1,969	$ -	$ 2,355
Tornado and windstorms	-	-	-
Rainstorms	-	-	-
Floods	-	-	-
Icestorms and snowstorms	6,223	6,161	-
Hurricane and tropical storms	-	-	7,977
Total losses incurred (1)	$ 8,192	$ 6,161	$ 10,332

(1) Total losses incurred includes losses plus defense and cost containment expenses and excludes adjusting and other claims settlement expenses.

We did not have any recoveries from our primary catastrophe reinsurance treaties during the three-year period ended December 31, 2014 because there was no individual catastrophe for which our losses exceeded our retention under the treaties.

Massachusetts Automobile Insurance Market

We have been subject to extensive regulation in the private passenger automobile insurance industry in Massachusetts, which represented 61.7% of our direct written premiums in 2014. In many respects, the private passenger automobile insurance market in Massachusetts prior to 2008 was unique, in comparison to other states. This was due to a number of factors, including unusual regulatory conditions, the market dominance of domestic companies, the relative absence of large national companies, and the heavy reliance on independent insurance agents as the market's principal distribution channel. Perhaps most significantly, prior to 2008, the Massachusetts Commissioner of Insurance

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fixed and established the premium rates and the rating plan to be used by all insurance companies doing business in the private passenger automobile insurance market and the Massachusetts private passenger automobile insurance residual market mechanism featured a reinsurance program run by CAR in which companies were assigned producers.

In 2008, the Commissioner issued a series of decisions to introduce what the Commissioner termed “managed competition” to Massachusetts automobile insurance premium rates and in doing so replaced the fixed and established regime with a prior approval rate review process, governed by regulations that set certain terms and conditions that insurers must comply with in establishing their rates. The Commissioner also replaced the former reinsurance program with an assigned risk plan.

These decisions removed many of the factors that had historically distinguished the Massachusetts private passenger automobile insurance market from the market in other states. However, certain of the historically unique factors have not been eliminated, including compulsory insurance, affinity group marketing, and the prominence of independent agents.

CAR runs a reinsurance pool for ceded commercial automobile policies through a Limited Servicing Carrier Program ("LSC"). CAR has approved Safety and three other servicing carriers to process ceded this commercial automobile insurance. Subject to the Commissioner's review, CAR sets the premium rates for commercial automobile policies reinsured through CAR and this reinsurance pool can generate an underwriting result that is a profit or deficit based upon CAR's rate level. This underwriting result is allocated among every Massachusetts commercial automobile insurance company, including us, based on a company's commercial automobile voluntary market share.

CAR also runs a reinsurance pool for Taxi, Limousine and Car Service risks (the "Taxi/Limo Program"). CAR approved Safety as one of the two servicing carriers for this program beginning January 1, 2011 for a five-year term expiring December 31, 2016.

Statutory Accounting Principles

Our results are reported in accordance with GAAP, which differ from amounts reported in accordance with statutory accounting principles ("SAP") as prescribed by insurance regulatory authorities, which in general reflect a liquidating, rather than going concern concept of accounting. Specifically, under GAAP:

- Policy acquisition costs such as commissions, premium taxes and other variable costs incurred which are directly related to the successful acquisition of a new or renewal insurance contract are capitalized and amortized on a pro rata basis over the period in which the related premiums are earned, rather than expensed as incurred, as required by SAP.

- Certain assets are included in the consolidated balance sheets whereas, under SAP, such assets are designated as "nonadmitted assets," and charged directly against statutory surplus. These assets consist primarily of premium receivables that are outstanding over ninety days, federal deferred tax assets in excess of statutory limitations, furniture, equipment, leasehold improvements and prepaid expenses.

- Amounts related to ceded reinsurance are shown gross of ceded unearned premiums and reinsurance recoverables, rather than netted against unearned premium reserves and loss and loss adjustment expense reserves, respectively, as required by SAP.

- Fixed maturities securities, which are classified as available-for-sale, are reported at current fair values, rather than at amortized cost, or the lower of amortized cost or market, depending on the specific type of security, as required by SAP.

- The differing treatment of income and expense items results in a corresponding difference in federal income tax expense. Changes in deferred income taxes are reflected as an item of income tax benefit or expense, rather than recorded directly to surplus as regards policyholders, as required by SAP. Admittance testing may result in a

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charge to unassigned surplus for non-admitted portions of deferred tax assets. Under GAAP reporting, a valuation allowance may be recorded against the deferred tax asset and reflected as an expense.

Insurance Ratios

The property and casualty insurance industry uses the combined ratio as a measure of underwriting profitability. The combined ratio is the sum of the loss ratio (losses and loss adjustment expenses incurred as a percent of net earned premiums) plus the expense ratio (underwriting and other expenses as a percent of net earned premiums, calculated on a GAAP basis). The combined ratio reflects only underwriting results and does not include income from investments or finance and other service income. Underwriting profitability is subject to significant fluctuations due to competition, catastrophic events, weather, economic and social conditions, and other factors.

Our GAAP insurance ratios are presented in the following table for the periods indicated.

	Year Ended December 31,					
	2014		2013		2012	
GAAP ratios:						
Loss ratio	66.5	%	65.7	%	65.7	%
Expense ratio	30.6		30.8		31.2	
Combined ratio	97.1	%	96.5	%	96.9	%

Share-Based Compensation

On June 25, 2002, the Board of Directors of the Company (the "Board") adopted the 2002 Management Omnibus Incentive Plan (the "Incentive Plan"). The Incentive Plan provides for a variety of awards, including nonqualified stock options ("NQSOs"), stock appreciation rights and restricted stock ("RS") awards.

On March 10, 2006, the Board approved amendments to the Incentive Plan, subject to shareholder approval, to (i) increase the number of shares of common stock available for issuance by 1,250,000 shares, (ii) remove obsolete provisions, and (iii) make other non-material changes. A total of 1,250,000 shares of common stock had previously been authorized for issuance under the Incentive Plan. The Incentive Plan, as amended, was approved by the shareholders at the 2006 Annual Meeting of Shareholders which was held on May 19, 2006. Under the Incentive Plan, as amended, the maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. As of December 31, 2014, there were 453,930 shares available for future grant. The Board and the Compensation Committee intend to issue more awards under the Incentive Plan in the future. Grants outstanding under the Incentive Plan as of December 31, 2014, were comprised of 200,840 restricted shares and 12,700 nonqualified stock options.

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Grants made under the Incentive Plan during the years 2010 through 2014 were as follows.

Type of Equity Awarded	Effective Date	Number of Awards Granted	Fair Value per Share		Vesting Terms
RS	March 9, 2010	77,360	$ 38.78	(1)	3 years, 30%-30%-40%
RS	March 9, 2010	4,000	$ 38.78	(1)	No vesting period (3)
RS	March 23, 2010	25,590	$ 38.09	(1)	5 years, 20% annually (5)
RS	March 9, 2011	68,637	$ 47.35	(1)	3 years, 30%-30%-40%
RS	March 9, 2011	4,000	$ 47.35	(1)	No vesting period (3)
RS	March 23, 2011	22,567	$ 44.94	(1)	5 years, 20% annually (5)
RS	March 8, 2012	77,844	$ 41.75	(1)	3 years, 30%-30%-40%
RS	March 8, 2012	4,000	$ 41.75	(1)	No vesting period (3)
RS	March 21, 2012	20,912	$ 41.96	(1)	5 years, 20% annually (5)
RS	March 11, 2013	28,988	$ 46.96	(1)	3 years, 30%-30%-40%
RS	March 11, 2013	4,000	$ 46.96	(1)	No vesting period (3)
RS	March 11, 2013	35,429	$ 43.90	(2)	3 years, cliff vesting (4)
RS	March 27, 2013	22,485	$ 48.65	(1)	5 years, 20% annually (5)
RS	July 8, 2013	500	$ 51.63	(1)	5 years, 20% annually (5)
RS	August 5, 2013	1,659	$ 54.26	(1)	3 years, 30%-30%-40%
RS	August 5, 2013	2,027	$ 48.27	(1)	3 years, cliff vesting (4)
RS	March 11, 2014	24,426	$ 54.35	(1)	3 years, 30%-30%-40%
RS	March 11, 2014	4,000	$ 54.35	(1)	No vesting period (3)
RS	March 11, 2014	27,928	$ 58.09	(2)	3 years, cliff vesting (4)
RS	March 24, 2014	20,588	$ 53.64	(1)	5 years, 20% annually (5)
RS	July 15, 2014	1,767	$ 50.94	(1)	3 years, 30%-30%-40%
RS	July 15, 2014	1,975	$ 55.70	(2)	3 years, cliff vesting (4)

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(1) The fair value per share of the restricted stock grant is equal to the closing price of our common stock on the grant date.

(2) The fair value per share of the restricted stock grant is equal to the performance-based restricted stock award calculation.

(3) The shares cannot be sold, assigned, pledged, or otherwise transferred, encumbered or disposed of until the recipient is no longer a member of our Board of Directors.

(4) The shares represent performance-based restricted shares award. Vesting of these shares is dependent upon the attainment of pre-established performance objectives, and any difference between shares granted and shares earned at the end of the performance period will be reported at the conclusion of the performance period.

(5) The shares represent awards granted to non-executive employees and vest ratable over a five-year service period.

Reinsurance

We reinsure with other insurance companies a portion of our potential liability under the policies we have underwritten, thereby protecting us against an unexpectedly large loss or a catastrophic occurrence that could produce large losses, primarily in our homeowners line of business. We use various software products to measure our exposure to catastrophe losses and the probable maximum loss to us for catastrophe losses such as hurricanes. The models include estimates for our share of the catastrophe losses generated in the residual market for property insurance by the Massachusetts Property Insurance Underwriting Association ("FAIR Plan"). The reinsurance market has seen from the various software modelers, increases in the estimate of damage from hurricanes in the southern and northeast portions of the United States due to revised estimations of increased hurricane activity and increases in the estimation of demand surge in the periods following a significant event. We continue to manage and model our exposure and adjust our reinsurance programs as a result of the changes to the models. As of January 1, 2015, we have purchased three layers of excess catastrophe reinsurance providing $515,000 of coverage for property losses in excess of $50,000 up to a maximum of $565,000. Our reinsurers co-participation is 65.00% of $100,000 for the 1st layer, 80.0% of $280,000 for

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the 2nd layer and 80.0% of $135,000 for the 3rd layer. As a result of the changes to the models, and our revised reinsurance program, our catastrophe reinsurance in 2015 protects us in the event of a "111-year storm" (that is, a storm of a severity expected to occur once in a 111-year period). Swiss Re, our primary reinsurer, maintains an A.M. Best rating of "A+" (Excellent). Most of our other reinsurers have an A.M. Best rating of "A+" (Excellent) or "A" (Excellent).

We are a participant in CAR, a state-established body that runs the residual market reinsurance programs for commercial automobile insurance in Massachusetts under which premiums, expenses, losses and loss adjustment expenses on ceded business are shared by all insurers writing automobile insurance in Massachusetts. CAR also runs MAIP the private passenger assigned risk in Massachusetts. We also participate in the FAIR Plan in which premiums, expenses, losses and loss adjustment expenses on homeowners business that cannot be placed in the voluntary market are shared by all insurers writing homeowners insurance in Massachusetts. The FAIR Plan has grown dramatically over the past decade as insurance carriers have reduced their exposure to coastal property. The FAIR Plan's exposure to catastrophe losses increased and as a result, the FAIR Plan buys reinsurance to reduce their exposure to catastrophe losses. On July 1, 2014, the FAIR Plan purchased $1,180,000 of catastrophe reinsurance for property losses in excess of $120,000. At December 31, 2014, we had no material amounts recoverable from any reinsurer, excluding $63,681 recoverable from CAR.

Effects of Inflation

We do not believe that inflation has had a material effect on our consolidated results of operations, except insofar as inflation may affect interest rates.

Results of Operations

The following table shows certain of our selected financial results.

	Years Ended December 31,		
	2014	2013	2012
Direct written premiums	$ 765,685	$ 731,680	$ 696,220
Net written premiums	$ 734,914	$ 697,540	$ 663,942
Net earned premiums	$ 716,875	$ 681,870	$ 642,469
Net investment income	42,303	43,054	40,870
Earnings from partnership investments	878	-	-
Net realized gains on investments	197	1,677	1,975

Finance and other service income	18,544	18,683	18,553
Total revenue	778,797	745,284	703,867
Loss and loss adjustment expenses	476,366	447,749	422,217
Underwriting, operating and related expenses	219,023	209,758	200,138
Interest expense	90	89	88
Total expenses	695,479	657,596	622,443
Income before income taxes	83,318	87,688	81,424
Income tax expense	23,964	26,337	23,354
Net income	$ 59,354	$ 61,351	58,070
Earnings per weighted average common share:			
Basic	$ 3.93	$ 4.00	$ 3.80
Diluted	$ 3.91	$ 3.98	$ 3.80
Cash dividends paid per common share	$ 2.60	$ 2.40	$ 2.20

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YEAR ENDED DECEMBER 31, 2014 COMPARED TO YEAR ENDED 2013

Direct Written Premiums. Direct written premiums for the year ended December 31, 2014 increased by $34,005, or 4.6%, to $765,685 from $731,680 for the comparable 2013 period. The 2014 increases occurred primarily in our homeowners, commercial automobile and personal automobile business lines which experienced increases of 3.6%, 5.8%, and 0.5%, respectively, in average written premium per exposure. Written exposures increased by 0.9% in our personal automobile line and increased by 5.7% and 7.5% in our commercial automobile and homeowners lines, respectively. The increase in homeowners exposures is primarily the result of our pricing strategy of offering account discounts to policyholders who insure both an automobile and home with us.

Net Written Premiums. Net written premiums for the year ended December 31, 2014 increased by $37,374, or 5.4%, to $734,914 from $697,540 for 2013. The 2014 increase was primarily due to the factors that increased direct written premiums.

Net Earned Premiums. Net earned premiums for the year ended December 31, 2014 increased by $35,005, or 5.1%, to $716,875 from $681,870 for the comparable 2013 period. The 2014 increase was primarily due to the factors that increased direct written premiums.

The effect of reinsurance on net written and net earned premiums is presented in the following table.

	Years Ended December 31,	
	2014	2013
Written Premiums		
Direct	$ 765,685	$ 731,680
Assumed	25,602	20,593
Ceded	(56,373)	(54,733)
Net written premiums	$ 734,914	$ 697,540
Earned Premiums		
Direct	$ 747,786	$ 715,657
Assumed	23,724	19,251
Ceded	(54,635)	(53,038)

Net earned premiums	$ 716,875	$ 681,870

Net Investment Income. Net investment income for the year ended December 31, 2014 decreased by $751, or 1.7%, to $42,303 from $43,054 for the comparable 2013 period. Net effective annual yield on the investment portfolio was 3.5 % for the year ended December 31, 2014 compared to 3.7 % for the year ended December 31, 2014 Our duration was 3.8 years at December 31, 2014, down from 4.0 years at December 31, 2013.

Earnings from Partnership Investments. Earnings from partnership investments was $878 in 2014. Investment activity in this partnership commenced in 2014.

Realized Gains on Investments. Net realized gains on investments were $197 for the year ended December 31, 2014 compared to $1,677 for the comparable 2013 period.

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The gross unrealized gains and losses on investments in fixed maturity securities, equity securities, including interests in mutual funds, and other invested assets were as follows:

	As of December 31, 2014				
			Gross Unrealized Losses (3)		
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	$ 1,507	$ —	$ (1)	$ —	$ 1,506
Obligations of states and political subdivisions	437,299	23,562	(536)	—	460,325
Residential mortgage-backed securities (1)	201,950	7,015	(1,282)	—	207,683
Commercial mortgage-backed securities	34,216	256	(34)	—	34,438
Other asset-backed securities	10,204	48	(2)	—	10,250
Corporate and other securities	417,341	7,536	(3,628)	—	421,249
Subtotal, fixed maturity securities	1,102,517	38,417	(5,483)	—	1,135,451
Equity securities (2)	97,910	13,332	(2,089)	—	109,153
Other invested assets (5)	11,657	—	—	—	11,657
Totals	$ 1,212,084	$ 51,749	$ (7,572)	$ —	$ 1,256,261

(1) Residential mortgage-backed securities consists of obligations of U.S. Government agencies including collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB).

(2) Equity securities includes interests in mutual funds held to fund the Company's executive deferred compensation plan.

(3) Our investment portfolio included 366 securities in an unrealized loss position at December 31, 2014.

(4) Amounts in this column represent other-than-temporary impairment ("OTTI") recognized in accumulated other comprehensive income.

(5) Other invested assets are accounted for under the equity method which is used as a proxy for fair value.

The composition of our fixed income security portfolio by Moody's rating was as follows:

	As of December 31, 2014	
	Estimated Fair Value	Percent
U.S. Treasury securities and obligations of U.S. Government agencies	$ 210,020	18.5%
Aaa/Aa	463,871	40.9%
A	219,319	19.3%
Baa	108,149	9.5%
Ba	42,784	3.8%
B	64,773	5.7%
Caa	8,121	0.7%
Not rated	18,414	1.6%
Total	$ 1,135,451	100.0%

As of December 31, 2014, our portfolio of fixed maturity investments was principally comprised of investment grade corporate fixed maturity securities, U.S. government and agency securities, and asset-backed securities. The

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portion of our non-investment grade portfolio of fixed maturity investments is primarily comprised of variable rate secured and senior bank loans and high yield bonds. We have no exposure to European sovereign debt.

The following table illustrates the gross unrealized losses included in our investment portfolio and the fair value of those securities, aggregated by investment category. The table also illustrates the length of time that they have been in a continuous unrealized loss position as of December 31, 2014.

	As of December 31, 2014					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	$ —	$ —	$ 1,506	$ 1	$ 1,506	$ 1
Obligations of states and political subdivisions	65,174	489	3,553	47	68,727	536
Residential mortgage-backed securities	18,853	44	47,769	1,238	66,622	1,282
Commercial mortgage-backed securities	10,485	34	—	—	10,485	34
Other asset-backed securities	1,999	2	—	—	1,999	2
Corporate and other securities	119,722	3,079	37,469	549	157,191	3,628
Subtotal, fixed maturity securities	216,233	3,648	90,297	1,835	306,530	5,483
Equity securities	16,119	1,986	1,277	103	17,396	2,089
Total temporarily impaired securities	$ 232,352	$ 5,634	$ 91,574	$ 1,938	$ 323,926	$ 7,572

As of December 31, 2014, we held insured investment securities of approximately $79,149, which represented approximately 6.3% of our total investments. Approximately $52,433 of these securities are pre-refunded, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond.

The following table shows our insured investment securities that are backed by financial guarantors including pre-refunded securities as of December 31, 2014. We do not have any direct investment holdings in a financial guarantee insurance company.

	As of December 31, 2014		
	Total	Pre-refunded Securities	Exposure Net of Pre-refunded Securities
Municipal bonds			
Ambac Assurance Corporation	$ 7,476	$ 7,476	$ -
Financial Guaranty Insurance Company	255	255	-
Assured Guaranty Municipal Corporation	30,678	20,232	10,446
National Public Finance Guaranty Corporation	40,740	24,470	16,270
Total	$ 79,149	$ 52,433	$ 26,716

The Moody's ratings of our insured investments held at December 31, 2014 are essentially the same with or without the investment guarantees.

We reviewed the unrealized losses in our fixed income and equity portfolio as of December 31, 2014 for potential other-than-temporary asset impairments. We held no securities at December 31, 2014 with a material (20.0% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was performed for securities appearing on our “Watch List,” if any. Qualitative analysis considered such factors as the financial condition

and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

Of the $7,572 gross unrealized losses as of December 31, 2014, $537 relates to obligations of U.S. Treasuries, states and political subdivisions. The remaining $7,035 of gross unrealized losses relates primarily to holdings of investment grade asset-backed, corporate, other fixed maturity and equity securities.

The unrealized losses recorded on the investment portfolio at December 31, 2014 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Given our current level of liquidity, the fact that we do not intend to sell these securities, and that it is more likely than not that we will not be required to sell these securities prior to recovery of the cost basis of these securities, these decreases in values are viewed as being temporary.

During the years ended December 31, 2014 and 2013, there was no significant deterioration in the credit quality of any of our holdings and no OTTI charges were recorded related to our portfolio of investment securities.

For information regarding fair value measurements of our investment portfolio, refer to Item 8—Financial Statements and Supplementary Data, Note 14, Fair Value of Financial Instruments, of this Form 10-K.

Finance and Other Service Income. Finance and other service income includes revenues from premium installment charges, which we recognize when earned, and other miscellaneous income and fees. Finance and other service income decreased by $139, or 0.7%, to $18,544 for the year ended December 31, 2014 from $18,683 for the comparable 2013 period.

Losses and Loss Adjustment Expenses. Losses and loss adjustment expenses incurred for the year ended December 31, 2014 increased by $28,617, or 6.4%, to $476,366 from $447,749 for the comparable 2013 period. Our GAAP loss ratio for the year ended December 31, 2014 and 2013 was 66.5% and 65.7%, respectively. Our GAAP loss ratio excluding loss adjustment expenses was 57.8% and 56.5% for the year ended December 31, 2014 and 2013, respectively. Total prior year favorable development included in the pre-tax results for the year ended December 31, 2014 was $37,368, compared to $28,889, for the comparable 2013 period.

Underwriting, Operating and Related Expenses. Underwriting, operating and related expenses for the year ended December 31, 2014 increased by $9,265, or 4.4%, to $219,023 from $209,758 for the comparable 2013 period, primarily due to an increase in commissions expensed to agents. Our GAAP expense ratio for the year ended

December 31, 2014 decreased to 30.6% from 30.8% for the comparable 2013 period.

Interest Expenses. Interest expense was $90 and $89 for the years ended December 31, 2014 and 2013, respectively. The credit facility commitment fee included in interest expense was $75 for each of the years ended December 31, 2014 and 2013.

Income Tax Expense. Our effective tax rates were 28.8% and 30.0% for the years ended December 31, 2014 and 2013, respectively. These effective rates were lower than the statutory rate of 35.0% primarily due to adjustments for tax-exempt investment income.

Net Income. Net income for the year ended December 31, 2014 was $59,354 compared to $61,351 for the comparable 2013 period.

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YEAR ENDED DECEMBER 31, 2013 COMPARED TO YEAR ENDED DECEMBER 31, 2012

Direct Written Premiums. Direct written premiums for the year ended December 31, 2013 increased by $35,460, or 5.1%, to$731,680 from $696,220 for the comparable 2012 period. The 2013 increases occurred primarily in our homeowners, commercial automobile and personal automobile business lines which experienced increases of 4.5%, 0.9%, and 2.5%, respectively, in average written premium per exposure. Written exposures decreased slightly by 0.3% in our personal automobile line and increased by 10.9% and 5.7% in our commercial automobile and homeowners lines, respectively. The increase in homeowners exposures is primarily the result of our pricing strategy of offering account discounts to policyholders who insure both an automobile and home with us.

Net Written Premiums. Net written premiums for the year ended December 31, 2013 increased by $33,598, or 5.1%, to $697,540 from $663,942 for 2012. The 2013 increase was primarily due to the factors that increased direct written premiums.

Net Earned Premiums. Net earned premiums for the year ended December 31, 2013 increased by $39,401, or 6.1%, to $681,870 from $642,469 for the comparable 2012 period. The 2013 increase was primarily due to the factors that increased direct written premiums.

The effect of reinsurance on net written and net earned premiums is presented in the following table.

	Years Ended December 31,	
	2013	2012
Written Premiums		
Direct	$ 731,680	$ 696,220
Assumed	20,593	17,943
Ceded	(54,733)	(50,221)
Net written premiums	$ 697,540	$ 663,942
Earned Premiums		
Direct	$ 715,657	$ 673,596
Assumed	19,251	16,910
Ceded	(53,038)	(48,037)
Net earned premiums	$ 681,870	$ 642,469

Net Investment Income. Net investment income for the year ended December 31, 2013 increased by $2,184, or 5.3%, to $43,054 from $40,870 for the comparable 2012 period. Net effective annual yield on the investment portfolio was 3.7% for both the years ended December 31, 2013 and 2012. Our duration was 4.0 years at December 31, 2013, up from 3.6 years at December 31, 2012.

Net Realized Gains on Investments. Net realized gains on investments were $1,677 for the year ended December 31, 2013 compared to $1,975 for the comparable 2012 period.

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The gross unrealized gains and losses on investments in fixed maturity securities, equity securities, including interests in mutual funds, and other invested assets were as follows:

	As of December 31, 2013				
			Gross Unrealized Losses (3)		
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	$ 1,510	$ -	$ (7)	$ -	$ 1,503
Obligations of states and political subdivisions	461,256	10,248	(4,179)	-	467,325
Residential mortgage-backed securities (1)	205,053	6,879	(3,230)	-	208,702
Commercial mortgage-backed securities	31,885	342	(8)	-	32,219
Other asset-backed securities	13,357	124	(36)	-	13,445
Corporate and other securities	374,171	9,882	(2,290)	-	381,763
Subtotal, fixed maturity securities	1,087,232	27,475	(9,750)	-	1,104,957
Equity securities (2)	83,134	8,821	(84)	-	91,871
Other invested assets (5)	5,748	-	-	-	5,748
Totals	$ 1,176,114	$ 36,296	$ (9,834)	$ -	$ 1,202,576

(1) Residential mortgage-backed securities consists of obligations of U.S. Government agencies including collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB).

(2) Equity securities includes interests in mutual funds held to fund the Company's executive deferred compensation plan.

(3) Our investment portfolio included 220 securities in an unrealized loss position at December 31, 2013.

(4) Amounts in this column represent other-than-temporary impairment ("OTTI") recognized in accumulated other comprehensive income.

(5) Other invested assets are accounted for under the equity method which is used as a proxy for fair value.

The composition of our fixed income security portfolio by Moody's rating was as follows:

	As of December 31, 2013		
	Estimated Fair Value		Percent
U.S. Treasury securities and obligations of U.S. Government agencies	$	212,413	19.2%
Aaa/Aa		468,309	42.4%
A		190,326	17.2%
Baa		92,752	8.4%
Ba		41,718	3.8%
B		65,214	5.9%
Ca		7,005	0.6%
Not rated		27,220	2.5%
Total	$	1,104,957	100.0%

As of December 31, 2013, our portfolio of fixed maturity investments was principally comprised of investment grade corporate fixed maturity securities, U.S. government and agency securities, and asset-backed securities. The portion of our non-investment grade portfolio of fixed maturity investments is primarily comprised of variable rate secured and senior bank loans and high yield bonds. We have no exposure to European sovereign debt.

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The following table illustrates the gross unrealized losses included in our investment portfolio and the fair value of those securities, aggregated by investment category. The table also illustrates the length of time that they have been in a continuous unrealized loss position as of December 31, 2013.

	As of December 31, 2013					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	$ 1,503	$ 7	$ -	$ -	$ 1,503	$ 7
Obligations of states and political subdivisions	131,114	3,898	3,362	281	134,476	4,179
Residential mortgage-backed securities	50,048	1,570	37,166	1,660	87,214	3,230
Commercial mortgage-backed securities	6,008	8	-	-	6,008	8
Other asset-backed securities	3,240	31	4,608	5	7,848	36
Corporate and other securities	86,312	2,223	2,235	67	88,547	2,290
Subtotal, fixed maturity securities	278,225	7,737	47,371	2,013	325,596	9,750
Equity securities	3,933	73	299	11	4,232	84
Total temporarily impaired securities	$ 282,158	$ 7,810	$ 47,670	$ 2,024	$ 329,828	$ 9,834

As of December 31, 2013, we held insured investment securities of approximately $104,998, which represented approximately 8.7% of our total investments. Approximately $59,713 of these securities are pre-refunded, meaning that funds have been set aside in escrow to satisfy the future interest and principal obligations of the bond.

The following table shows our insured investment securities that are backed by financial guarantors including pre-refunded securities as of December 31, 2013. We do not have any direct investment holdings in a financial guarantee insurance company.

	As of December 31, 2013		
Financial Guarantor	Total	Pre-refunded Securities	Exposure Net of Pre-refunded Securities
Municipal bonds			
Ambac Assurance Corporation	$ 17,768	$ 10,439	$ 7,329
Financial Guaranty Insurance Company	263	263	-
Assured Guaranty Municipal Corporation	42,132	31,374	10,758

National Public Finance Guaranty Corporation	44,835	17,637	27,198
Total	$ 104,998	$ 59,713	$ 45,285

The Moody's ratings of our insured investments held at December 31, 2013 are essentially the same with or without the investment guarantees.

We reviewed the unrealized losses in our fixed income and equity portfolio as of December 31, 2013 for potential other-than-temporary asset impairments. We held no securities at December 31, 2013 with a material (20.0% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was performed for securities appearing on our "Watch List," if any. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

Of the $9,834 gross unrealized losses as of December 31, 2013, $4,186 relates to obligations of U.S. Treasuries, states and political subdivisions. The remaining $5,648 of gross unrealized losses relates primarily to holdings of investment grade asset-backed, corporate, other fixed maturity and equity securities.

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The unrealized losses recorded on the investment portfolio at December 31, 2013 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Given our current level of liquidity, the fact that we do not intend to sell these securities, and that it is more likely than not that we will not be required to sell these securities prior to recovery of the cost basis of these securities, these decreases in values are viewed as being temporary.

During the years ended December 31, 2013 and 2012, there was no significant deterioration in the credit quality of any of our holdings and no OTTI charges were recorded related to our portfolio of investment securities.

For information regarding fair value measurements of our investment portfolio, refer to Item 8—Financial Statements and Supplementary Data, Note 14, Fair Value of Financial Instruments, of this Form 10-K.

Finance and Other Service Income. Finance and other service income includes revenues from premium installment charges, which we recognize when earned, and other miscellaneous income and fees. Finance and other service income increased by $130, or 0.7%, to $18,683 for the year ended December 31, 2013 from $18,553 for the comparable 2012 period.

Losses and Loss Adjustment Expenses. Losses and loss adjustment expenses incurred for the year ended December 31, 2013 increased by $25,532, or 6.0%, to $447,749 from $422,217 for the comparable 2012 period. Our GAAP loss ratio for the year ended December 31, 2013 and 2012 remained constant at 65.7%. Our GAAP loss ratio excluding loss adjustment expenses for the year ended December 31, 2013 and 2012 remained constant at 56.5%. Total prior year favorable development included in the pre-tax results for the year ended December 31, 2013 was $28,889, compared to $17,310, for the comparable 2012 period.

Underwriting, Operating and Related Expenses. Underwriting, operating and related expenses for the year ended December 31, 2013 increased by $9,620, or 4.8%, to $209,758 from $200,138 for the comparable 2012 period, primarily due to an increase in commissions paid to agents. Our GAAP expense ratios for the year ended December 31, 2013 decreased to 30.8% from 31.2% for the comparable 2012 period.

Interest Expenses. Interest expense was $89 and $88 for the years ended December 31, 2013 and 2012, respectively. The credit facility commitment fee included in interest expense was $75 for each of the years ended December 31, 2013 and 2012.

Income Tax Expense. Our effective tax rates were 30.0% and 28.7% for the years ended December 31, 2013 and 2012, respectively. These effective rates were lower than the statutory rate of 35.0% primarily due to adjustments for

tax-exempt investment income.

Net Income. Net income for the year ended December 31, 2013 was $61,351 compared to $58,070 for the comparable 2012 period.

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Liquidity and Capital Resources

As a holding company, Safety's assets consist primarily of the stock of our direct and indirect subsidiaries. Our principal source of funds to meet our obligations and pay dividends to shareholders, therefore, is dividends and other permitted payments from our subsidiaries, principally Safety Insurance. Safety is the borrower under our credit facility.

Safety Insurance's sources of funds primarily include premiums received, investment income and proceeds from sales and redemptions of investments. Safety Insurance's principal uses of cash are the payment of claims, operating expenses and taxes, the purchase of investments and payment of dividends to Safety.

Net cash provided by operating activities was $97,569, $110,864, and $104,331 during the years ended December 31, 2014, 2013, and 2012, respectively. Our operations typically generate positive cash flows from operations as most premiums are received in advance of the time when claim and benefit payments are required. These positive operating cash flows are expected to continue to meet our liquidity requirements.

Net cash used for investing activities was $48,522, $51,298 and $74,445 during the years ended December 31, 2014, 2013 and 2012, respectively, as purchases of fixed maturity and equity securities exceeded sales, paydowns, calls and maturities of fixed maturity and equity securities.

Net cash used for financing activities was $62,469, $39,072, and $32,393 during the years ended December 31, 2014, 2013 and 2012, respectively. Net cash used for financing activities is primarily comprised of dividend payments to shareholders and the acquisition of treasury stock.

The Insurance Subsidiaries maintain a high degree of liquidity within their respective investment portfolios in fixed maturity and short-term investments. We do not anticipate the need to sell these securities to meet the Insurance Subsidiaries cash requirements. We expect the Insurance Subsidiaries to generate sufficient operating cash to meet all short-term and long-term cash requirements. However, there can be no assurance that unforeseen business needs or other items will not occur causing us to have to sell securities before their values fully recover; thereby causing us to recognize additional impairment charges in that time period.

Credit Facility

For information regarding our Credit Facility, please refer to Item 8—Financial Statements and Supplementary Data, Note 8, Debt, of this Form 10-K.

Recent Accounting Pronouncements

For information regarding Recent Accounting Pronouncements, please refer to Item 8—Financial Statements and Supplementary Data, Note 2, Summary of Significant Accounting Policies, of this Form 10-K.

Regulatory Matters

Our insurance company's subsidiaries are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid to their parent without prior approval of the Commissioner. The Massachusetts statute limits the dividends an insurer may pay in any twelve-month period, without the prior permission of the Commissioner, to the greater of (i) 10% of the insurer's surplus as of the preceding December 31 or (ii) the insurer's net income for the twelve-month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. Our Insurance Subsidiaries may not declare an "extraordinary dividend" (defined as any dividend or distribution that, together with other distributions made within the preceding twelve months, exceeds the limits established by Massachusetts statute) until thirty days after the Commissioner has received notice of the intended dividend and has not objected. As historically administered by the Commissioner, this provision requires the Commissioner's prior approval of an extraordinary dividend. Under Massachusetts law, an insurer may pay cash

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dividends only from its unassigned funds, also known as earned surplus, and the insurer's remaining surplus must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. At year-end 2014, the statutory surplus of Safety Insurance was $630,041, and its net income for 2014 was $51,211. As a result, a maximum of $63,004 is available in 2014 for such dividends without prior approval of the Commissioner. Under this Massachusetts statute, the Insurance Subsidiaries has restricted net assets in the amount of $567,037 at December 31, 2014. During the twelve months ended December 31, 2014, Safety Insurance recorded dividends to Safety of $59,186

The maximum dividend permitted by law is not indicative of an insurer's actual ability to pay dividends, which may be constrained by business and regulatory considerations, such as the impact of dividends on surplus, which could affect an insurer's ratings or competitive position, the amount of premiums that can be written and the ability to pay future dividends.

Since the initial public offering of its common stock in November 2002, the Company has paid regular quarterly dividends to shareholders of its common stock. Quarterly dividends paid during 2014 and 2013 were as follows:

Declaration Date	Record Date	Payment Date	Dividend per Common Share	Total Dividends Paid and Accrued
February 15, 2013	March 1, 2013	March 15, 2013	$ 0.60	$ 9,200
May 6, 2013	June 3, 2013	June 14, 2013	$ 0.60	$ 9,244
August 7, 2013	September 3, 2013	September 13, 2013	$ 0.60	$ 9,236
November 4, 2013	December 2, 2013	December 13, 2013	$ 0.60	$ 9,239
February 14, 2014	March 3, 2014	March 14, 2014	$ 0.60	$ 9,240
May 6, 2014	June 2, 2014	June 13, 2014	$ 0.60	$ 9,223
August 6, 2014	September 2, 2014	September 15, 2014	$ 0.70	$ 10,506
November 4, 2014	December 2, 2014	December 13, 2014	$ 0.70	$ 10,530

On February 17, 2015, our Board approved and declared a quarterly cash dividend on our common stock of $0.70 per share to be paid on March 13, 2015 to shareholders of record on March 2, 2015. We plan to continue to declare and pay quarterly cash dividends in 2015, depending on our financial position and the regularity of our cash flows.

On August 3, 2007, the Board of Directors approved a share repurchase program of up to $30,000 of the Company's outstanding common shares. As of December 31, 2014, the Board of Directors had cumulatively authorized increases to the existing share repurchase program of up to $150,000 of its outstanding common shares. Under the program, the Company may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does

not require us to repurchase any specific number of shares and may be modified, suspended or terminated at any time without prior notice. As of December 31, 2014 and December 31, 2013, the Company had purchased 2,279,570 and 1,819,547 shares at a cost of $83,835 and $60,368.

Management believes that the current level of cash flow from operations provides us with sufficient liquidity to meet our operating needs over the next 12 months. We expect to be able to continue to meet our operating needs after the next 12 months from internally generated funds. Since our ability to meet our obligations in the long term (beyond such twelve-month period) is dependent upon such factors as market changes, insurance regulatory changes and economic conditions, no assurance can be given that the available net cash flow will be sufficient to meet our operating needs. We expect that we would need to borrow or issue capital stock if we needed additional funds, for example, to pay for an acquisition or a significant expansion of our operations. There can be no assurance that sufficient funds for any of the foregoing purposes would be available to us at such time.

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Off-Balance Sheet Arrangements

We have no material obligations under a guarantee contract meeting the characteristics identified in Accounting Standards Codification ("ASC") 460, Guarantees. We have no material retained or contingent interests in assets transferred to an unconsolidated entity. We have no material obligations, including contingent obligations, under contracts that would be accounted for as derivative instruments. We have no obligations, including contingent obligations, arising out of a variable interest in an unconsolidated entity held by, and material to, us, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with us. We have no direct investments in real estate and no holdings of mortgages secured by commercial real estate. Accordingly, we have no material off-balance sheet arrangements.

Contractual Obligations

We have obligations to make future payments under contracts and credit-related financial instruments and commitments. At December 31, 2014, certain long-term aggregate contractual obligations and credit-related commitments are summarized as follows:

	Payments Due by Period				
	Within One Year	Two to Three Years	Four to Five Years	After Five Years	Total
Loss and LAE reserves	$ 236,186	$ 212,085	$ 28,921	$ 4,820	$ 482,012
Purchase commitments	890	519	-	-	1,409
Operating leases	4,004	7,952	4,038	-	15,994
Total contractual obligations	$ 241,080	$ 220,556	$ 32,959	$ 4,820	$ 499,415

As of December 31, 2014, the Company had loss and LAE reserves of $482,012, unpaid reinsurance recoverables of $61,245 and net loss and LAE reserves of $420,767. Our loss and LAE reserves are estimates as described in more detail under Critical Accounting Policies and Estimates. The specific amounts and timing of obligations related to case reserves, IBNR reserves and related LAE reserves are not set contractually, and the amounts and timing of these obligations are unknown. Nonetheless, based upon our cumulative claims paid over the last ten years, the Company estimates that its loss and LAE reserves will be paid in the period shown above. While management believes that historical performance of loss payment patterns is a reasonable source for projecting future claims payments, there is inherent uncertainty in this estimated projected settlement of loss and LAE reserves, and as a result these estimates will differ, perhaps significantly, from actual future payments. Our operations typically generate substantial positive cash flows from operations as most premiums are received in advance of the time when claim and benefit payments are required. These positive operating cash flows are expected to continue to meet our liquidity requirements, including any unexpected variations in the timing of claim settlements.

As part of the Company's investment activity, we have committed $25,000 to investments in limited partnerships. The Company has contributed $10,576 to these commitments as of December 31, 2014. As of December 31, 2014, the

remaining committed capital due to be called is $14,424.

Critical Accounting Policies and Estimates

Loss and Loss Adjustment Expense Reserves.

Significant periods of time can elapse between the occurrence of an insured loss, the reporting to us of that loss and our final payment of that loss. To recognize liabilities for unpaid losses, we establish reserves as balance sheet liabilities. Our reserves represent estimates of amounts needed to pay reported and unreported losses and the expenses of

investigating and paying those losses, or loss adjustment expenses. Every quarter, we review our previously established reserves and adjust them, if necessary.

When a claim is reported, claims personnel establish a “case reserve” for the estimated amount of the ultimate payment. The amount of the reserve is primarily based upon an evaluation of the type of claim involved, the circumstances surrounding each claim and the policy provisions relating to the loss. The estimate reflects the informed judgment of such personnel based on general insurance reserving practices and on the experience and knowledge of the claims person. During the loss adjustment period, these estimates are revised as deemed necessary by our claims department based on subsequent developments and periodic reviews of the cases. When a claim is closed with or without a payment, the difference between the case reserve and the settlement amount creates a reserve deficiency if the payment exceeds the case reserve or a reserve redundancy if the payment is less than the case reserve.

In accordance with industry practice, we also maintain reserves for estimated losses incurred but not yet reported (“IBNR”). IBNR reserves are determined in accordance with commonly accepted actuarial reserving techniques on the basis of our historical information and experience. We review and make adjustments to incurred but not yet reported reserves quarterly. In addition, IBNR reserves can also be expressed as the total loss reserves required less the case reserves on reported claims.

When reviewing reserves, we analyze historical data and estimate the impact of various loss development factors, such as our historical loss experience and that of the industry, trends in claims frequency and severity, our mix of business, our claims processing procedures, legislative enactments, judicial decisions, legal developments in imposition of damages, and changes and trends in general economic conditions, including the effects of inflation. A change in any of these factors from the assumption implicit in our estimate can cause our actual loss experience to be better or worse than our reserves, and the difference can be material. There is no precise method, however, for evaluating the impact of any specific factor on the adequacy of reserves, because the eventual development of reserves is affected by many factors.

Management determines our loss and LAE reserves estimate based upon the analysis of our actuaries. A reasonable estimate is derived by selecting a point estimate within a range of indications as calculated by our actuaries using generally accepted actuarial techniques. The key assumption in most actuarial analysis is that past patterns of frequency and severity will repeat in the future, unless a significant change in the factors described above takes place. Our key factors and resulting assumptions are the ultimate frequency and severity of claims, based upon the most recent ten years of claims reported to the Company, and the data CAR reports to us to calculate our share of the residual market, as of the date of the applicable balance sheet. For each accident year and each coverage within a line of business our actuaries calculate the ultimate losses incurred. Our total reserves are the difference between the ultimate losses incurred and the cumulative loss and loss adjustment payments made to date. Our IBNR reserves are calculated as the difference between our total reserves and the outstanding case reserves at the end of the accounting period. To determine ultimate losses, our actuaries calculate a range of indications and select a point estimation using such actuarial techniques as:

- Paid Loss Indications: This method projects ultimate loss estimates based upon extrapolations of historic paid loss trends. This method tends to be used on short tail lines such as automobile physical damage.
- Incurred Loss Indications: This method projects ultimate loss estimates based upon extrapolations of historic incurred loss trends. This method tends to be used on long tail lines of business such as automobile liability and homeowner's liability.
- Bornhuetter-Ferguson Indications: This method projects ultimate loss estimates based upon extrapolations of an expected amount of IBNR, which is added to current incurred losses or paid losses. This method tends to be used on small, immature, or volatile lines of business, such as our BOP and umbrella lines of business.
- Bodily Injury Code Indications: This method projects ultimate loss estimates for our private passenger and commercial automobile bodily injury coverage based upon extrapolations of the historic number of accidents and the historic number of bodily injury claims per accident. Projected ultimate bodily injury claims are then segregated into expected claims by type of injury (e.g. soft tissue injury vs. hard tissue

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injury) based on past experience. An ultimate severity, or average paid loss amounts, is estimated based upon extrapolating historic trends. Projected ultimate loss estimates using this method are the aggregate of estimated losses by injury type.

Such techniques assume that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting our ultimate losses, total reserves and resulting IBNR reserves. It is possible that the final outcome may fall above or below these amounts as a result of a number of factors, including immature data, sparse data, or significant growth in a line of business. Using these methodologies our actuaries established a range of reasonably possible estimations for net reserves of approximately $380,067 to $434,553 as of December 31, 2014 compared to a range of $364,146 to $401,265 as of December 31, 2013. In general, the low and high values of the ranges represent reasonable minimum and maximum values of the indications based on the techniques described above. Our selected point estimate of net loss and LAE reserves based upon the analysis of our actuaries was $420,767 as of December 31, 2014 compared to $394,668 as of December 31, 2013.

The following tables present the point estimation of the recorded reserves and the range of estimations by line of business for net loss and LAE reserves as of December 31, 2014 and December 31, 2013.

	As of December 31, 2014		
Line of Business	Low	Recorded	High
Private passenger automobile	$ 216,138	$ 228,559	$ 237,540
Commercial automobile	55,181	64,453	65,705
Homeowners	63,273	69,326	71,275
All other	45,475	58,429	60,033
Total	$ 380,067	$ 420,767	$ 434,553

	As of December 31, 2013		
Line of Business	Low	Recorded	High
Private passenger automobile	$ 216,334	$ 232,362	$ 233,682
Commercial automobile	52,889	55,460	57,765
Homeowners	57,933	62,249	62,545
All other	36,990	44,597	47,273
Total	$ 364,146	$ 394,668	$ 401,265

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The following table presents our total net reserves and the corresponding case reserves and IBNR reserves for each line of business as of December 31, 2014 and December 31, 2013.

	As of December 31, 2014		
Line of Business	Case	IBNR	Total
Private passenger automobile	$ 238,552	$ (10,814)	$ 227,738
CAR assumed private passenger auto	239	582	821
Commercial automobile	39,156	10,436	49,592
CAR assumed commercial automobile	6,793	8,068	14,861
Homeowners	42,552	18,826	61,378
FAIR Plan assumed homeowners	2,966	4,982	7,948
All other	28,864	29,565	58,429
Total net reserves for losses and LAE	$ 359,122	$ 61,645	$ 420,767

	As of December 31, 2013		
Line of Business	Case	IBNR	Total
Private passenger automobile	$ 233,250	$ (1,912)	$ 231,338
CAR assumed private passenger auto	487	538	1,025
Commercial automobile	37,304	5,976	43,280
CAR assumed commercial automobile	6,639	5,540	12,179
Homeowners	38,292	17,426	55,718
FAIR Plan assumed homeowners	2,676	3,855	6,531
All other	22,732	21,865	44,597
Total net reserves for losses and LAE	$ 341,380	$ 53,288	$ 394,668

At December 31, 2014 and 2013, our total IBNR reserves for our private passenger automobile line of business were comprised of $(32,566) and $(25,196) related to estimated ultimate decreases in the case reserves, including anticipated recoveries (i.e. salvage and subrogation), and $21,752 and $23,284 related to our estimation for not yet reported losses, respectively.

Our IBNR reserves consist of our estimate of the total loss reserves required less our case reserves. The IBNR reserves for CAR assumed commercial automobile business are 54.3%, respectively, of our total reserves for CAR assumed commercial automobile business as of December 31, 2014 due to the reporting delays in the information we receive from CAR, as described further in the section on CAR Loss and Loss Adjustment Expense Reserves. Our IBNR reserves for FAIR Plan assumed homeowners are 62.7% of our total reserves for FAIR Plan assumed homeowners at December 31, 2014 due to similar reporting delays in the information we receive from FAIR Plan.

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The following tables present information by line of business for our total net reserves and the corresponding retained (i.e. direct less ceded) reserves and assumed reserves as of December 31, 2014 and 2013.

	As of December 31, 2014		
Line of Business	Retained	Assumed	Net
Private passenger automobile	$ 227,738		
CAR assumed private passenger automobile		$ 821	
Net private passenger automobile			$ 228,559
Commercial automobile	49,592		
CAR assumed commercial automobile		14,861	
Net commercial automobile			64,453
Homeowners	61,378		
FAIR Plan assumed homeowners		7,948	
Net homeowners			69,326
All other	58,429	-	58,429
Total net reserves for losses and LAE	$ 397,137	$ 23,630	$ 420,767

	As of December 31, 2013		
Line of Business	Retained	Assumed	Net
Private passenger automobile	$ 231,338		
CAR assumed private passenger automobile		$ 1,025	
Net private passenger automobile			$ 232,363
Commercial automobile	43,280		
CAR assumed commercial automobile		12,179	
Net commercial automobile			55,459
Homeowners	55,718		
FAIR Plan assumed homeowners		6,531	
Net homeowners			62,249
All other	44,597	-	44,597
Total net reserves for losses and LAE	$ 374,933	$ 19,735	$ 394,668

Residual Market Loss and Loss Adjustment Expense Reserves

We are a participant in CAR, the FAIR Plan and other various residual markets and assume a portion of losses and LAE on business ceded by the industry participants to the residual markets. We estimate reserves for assumed losses and LAE that have not yet been reported to us by the residual markets. Our estimations are based upon the same factors we use for our own reserves, plus additional factors due to the nature of and the information we receive.

Residual market deficits consist of premium ceded to the various residual markets less losses and LAE and is allocated among insurance companies based on a various formulas (the “Participation Ratio”) that takes into consideration a company’s voluntary market share.

Because of the lag in the various residual market estimations, and in order to try to validate to the extent possible the information provided, we must try to estimate the effects of the actions of our competitors in order to establish our Participation Ratio.

Although we rely to a significant extent in setting our reserves on the information the various residual markets provide, we are cautious in our use of that information, both because of the delays in receiving data from the various residual markets. As a result, we are cautious in recording residual market reserves for the calendar years for which we have to estimate our Participation Ratio and these reserves are subject to significant judgments and estimates.

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Sensitivity Analysis

Establishment of appropriate reserves is an inherently uncertain process. There can be no certainty that currently established reserves based on our key assumptions regarding frequency and severity in our lines of business, or our assumptions regarding our share of the CAR loss will prove adequate in light of subsequent actual experience. To the extent that reserves are inadequate and are strengthened, the amount of such increase is treated as a charge to earnings in the period that the deficiency is recognized. To the extent that reserves are redundant and are released, the amount of the release is a credit to earnings in the period the redundancy is recognized. For the twelve months ended December 31, 2014, a 1 percentage-point change in the loss and LAE ratio would result in a change in reserves of $7,166. Each 1 percentage-point change in the loss and loss expense ratio would have had a $4,658 effect on net income, or $0.31 per diluted share.

Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, are an appropriate basis for establishing our reserves. Our individual key assumptions could each have a reasonable possible range of plus or minus 5 percentage-points for each estimation, although there is no guarantee that our assumptions will not have more than a 5 percentage point variation. The following sensitivity tables present information for each of our primary lines of business on the effect each 1 percentage-point change in each of our key assumptions on unpaid frequency and severity could have on our retained (i.e., direct minus ceded) loss and LAE reserves and net income for the twelve months ended December 31, 2014. In evaluating the information in the table, it should be noted that a 1 percentage-point change in a single assumption would change estimated reserves by 1

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percentage-point. A 1 percentage-point change in both our key assumptions would change estimated reserves within a range of plus or minus 2 percentage-points.

	-1 Percent Change in Frequency	No Change in Frequency	+1 Percent Change in Frequency
Private passenger automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	$ (4,555)	$ (2,277)	$ —
Estimated increase in net income	2,961	1,480	—
No Change in Severity			
Estimated (decrease) increase in reserves	(2,277)	—	2,277
Estimated increase (decrease) in net income	1,480	—	(1,480)
+1 Percent Change in Severity			
Estimated increase in reserves	—	2,277	4,555
Estimated decrease in net income	—	(1,480)	(2,961)
Commercial automobile retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(992)	(496)	—
Estimated increase in net income	645	322	—
No Change in Severity			
Estimated (decrease) increase in reserves	(496)	—	496
Estimated increase (decrease) in net income	322	—	(322)
+1 Percent Change in Severity			
Estimated increase in reserves	—	496	992
Estimated decrease in net income	—	(322)	(645)
Homeowners retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(1,228)	(614)	—
Estimated increase in net income	798	399	—
No Change in Severity			
Estimated (decrease) increase in reserves	(614)	—	614
Estimated increase (decrease) in net income	399	—	(399)
+1 Percent Change in Severity			
Estimated increase in reserves	—	614	1,228
Estimated decrease in net income	—	(399)	(798)
All other retained loss and LAE reserves			
-1 Percent Change in Severity			
Estimated decrease in reserves	(1,169)	(584)	—
Estimated increase in net income	760	380	—
No Change in Severity			

Estimated (decrease) increase in reserves	(584)	—	584
Estimated increase (decrease) in net income	380	—	(380)
+1 Percent Change in Severity			
Estimated increase in reserves	—	584	1,169
Estimated decrease in net income	—	(380)	(760)

Our estimated share of CAR loss and LAE reserves is based on assumptions about our Participation Ratio, the size of CAR, and the resulting deficit (similar assumptions apply with respect to the FAIR Plan). Our assumptions consider that past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate

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basis for establishing our CAR reserves. Each of our assumptions could have a reasonably possible range of plus or minus 5 percentage-points for each estimation.

The following sensitivity table presents information of the effect each 1 percentage-point change in our assumptions on our share of reserves for CAR and other residual markets could have on our assumed loss and LAE reserves and net income for the year ended December 31, 2014. In evaluating the information in the table, it should be noted that a 1 percentage-point change in our assumptions would change estimated reserves by 1 percentage-point.

	-1 Percent Change in Estimation	+1 Percent Change in Estimation
CAR assumed private passenger automobile		
Estimated (decrease) increase in reserves	$ (8)	$ 8
Estimated increase (decrease) in net income	5	(5)
CAR assumed commercial automobile		
Estimated (decrease) increase in reserves	(149)	149
Estimated increase (decrease) in net income	97	(97)
FAIR Plan assumed homeowners		
Estimated (decrease) increase in reserves	(79)	79
Estimated increase (decrease) in net income	52	(52)

Reserve Development Summary

The changes we have recorded in our reserves in the past illustrate the uncertainty of estimating reserves. Our prior year reserves decreased by $37,368, $28,889 and $17,310 for the years ended December 31, 2014, 2013, and 2012, respectively.

The following table presents a comparison of prior year development of our net reserves for losses and LAE for the years ended December 31, 2014, 2013 and 2012, respectively. Each accident year represents all claims for an annual accounting period in which loss events occurred, regardless of when the losses are actually reported, booked or paid. Our financial statements reflect the aggregate results of the current and all prior accident years.

	Year Ended December 31,		
Accident Year	2014	2013	2012
2004 & prior	$ (1,796)	$ (1,265)	$ (1,335)
2005	(108)	(728)	(1,909)
2006	(1,132)	(620)	(1,343)
2007	(1,526)	(2,968)	(2,304)
2008	(2,738)	(4,266)	(3,983)
2009	(4,812)	(4,998)	(4,281)
2010	(6,573)	(5,304)	(5,927)
2011	(7,975)	(5,543)	3,772
2012	(8,085)	(3,197)	—
2013	(2,623)	—	—
All prior years	$ (37,368)	$ (28,889)	$ (17,310)

The decreases in prior years reserves during the years ended December 31, 2013 and 2012 resulted from re-estimations of prior year ultimate loss and LAE liabilities. The 2014 decrease is primarily composed of reductions of $23,272, in our retained automobile reserves and $8,804 in our retained homeowners reserves. The 2013 decrease is primarily composed of reductions of $23,938 in our retained automobile reserves and $4,740 in our retained homeowners reserves. The 2012 decrease is primarily composed of reductions of $17,879 in our retained automobile reserves.

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The following table presents information by line of business for prior year development of our net reserves for losses and LAE for the year ended December 31, 2014.

Accident Year	Private Passenger Automobile	Commercial Automobile	Homeowners	All Other	Total
2004 & prior	$ (1,247)	$ (419)	$ (163)	$ 33	$ (1,796)
2005	(350)	(1)	—	243	(108)
2006	(767)	(248)	—	(117)	(1,132)
2007	(1,246)	(5)	(16)	(259)	(1,526)
2008	(1,886)	(216)	(426)	(210)	(2,738)
2009	(2,921)	9	(659)	(1,241)	(4,812)
2010	(4,080)	(20)	(1,187)	(1,286)	(6,573)
2011	(3,185)	(243)	(3,269)	(1,278)	(7,975)
2012	(4,295)	(113)	(2,868)	(809)	(8,085)
2013	(838)	(858)	(577)	(350)	(2,623)
All prior years	$ (20,815)	$ (2,114)	$ (9,165)	$ (5,274)	$ (37,368)

To further clarify the effects of changes in our reserve estimates for CAR and other residual markets, the next two tables break out the information in the table above by source of the business (i.e., non-residual market vs. residual market).

The following table presents information by line of business for prior year development of retained reserves for losses and LAE for the year ended December 31, 2014 that is, all our reserves except for business ceded or assumed from CAR and other residual markets.

Accident Year	Retained Private Passenger Automobile	Retained Commercial Automobile	Retained Homeowners	Retained All Other	Total
2004 & prior	$ (1,184)	$ (406)	$ (164)	$ 33	$ (1,721)
2005	(350)	(1)	—	243	(108)
2006	(767)	(248)	—	(117)	(1,132)
2007	(1,293)	(5)	(8)	(259)	(1,565)
2008	(1,962)	(215)	(417)	(210)	(2,804)
2009	(2,963)	(22)	(656)	(1,241)	(4,882)

2010	(4,091)	(49)	(1,184)	(1,286)	(6,610)
2011	(3,185)	(198)	(3,174)	(1,278)	(7,835)
2012	(4,295)	(77)	(2,713)	(809)	(7,894)
2013	(838)	(1,123)	(488)	(350)	(2,799)
All prior years	$ (20,928)	$ (2,344)	$ (8,804)	$ (5,274)	$ (37,350)

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The following table presents information by line of business for prior year development of reserves assumed from residual markets for losses and LAE for the year ended December 31, 2014.

Accident Year	CAR Assumed Private Passenger Automobile	CAR Assumed Commercial Automobile	FAIR Plan Homeowners	Total
2004 & prior	$ (63)	$ (15)	$ —	$ (78)
2005	—	—	—	—
2006	—	—	—	—
2007	47	—	(8)	39
2008	76	(1)	(9)	66
2009	42	32	(3)	71
2010	11	30	(3)	38
2011	—	(45)	(95)	(140)
2012	—	(35)	(155)	(190)
2013	—	265	(89)	176
All prior years	$ 113	$ 231	$ (362)	$ (18)

Our private passenger automobile line of business prior year reserves decreased by $20,815 for the year ended December 31, 2014. The decrease was primarily due to improved retained private passenger results of $17,789 for the accident years 2007 through 2012. The improved retained private passenger results were primarily due to fewer IBNR claims than previously estimated and better than previously estimated severity on our established bodily injury and property damage case reserves.

Our retained commercial automobile line of business prior year reserves decreased by $2,344 for the year ended December 31, 2014 due primarily to fewer IBNR claims than previously estimated.

Our retained homeowners line of business prior year reserves decreased by $8,804 for the year ended December 31, 2014 due primarily to re-estimation of catastrophe losses for 2010 through 2013.

In estimating all our loss reserves, including CAR, we follow the guidance prescribed by ASC 944, Financial Services-Insurance.

For further information, see “Results of Operations: Losses and Loss Adjustment Expenses.”

Other-Than-Temporary Impairments.

We use a systematic methodology to evaluate declines in fair values below cost or amortized cost of our investments. This methodology ensures that we evaluate available evidence concerning any declines in a disciplined manner.

In our determination of whether a decline in fair value below amortized cost is an other-than-temporary impairment (“OTTI”), we consider and evaluate several factors and circumstances including the issuer’s overall financial condition, the issuer’s credit and financial strength ratings, a weakening of the general market conditions in the industry or geographic region in which the issuer operates, a prolonged period (typically six months or longer) in which the fair value of an issuer’s securities remains below our amortized cost, and any other factors that may raise doubt about the issuer’s ability to continue as a going concern.

ASC 320, Investments — Debt and Equity Securities requires entities to separate an OTTI of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Under ASC 320, the amount of the OTTI related to a credit loss is

recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that the Company will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt securities, the Company accounts for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income.

For further information, see "Results of Operations: Net Realized Gains (Losses) on Investments."

Forward-Looking Statements

Forward-looking statements might include one or more of the following, among others:

- Projections of revenues, income, earnings per share, capital expenditures, dividends, capital structure or other financial items;
- Descriptions of plans or objectives of management for future operations, products or services;
- Forecasts of future economic performance, liquidity, need for funding and income;
- Descriptions of assumptions underlying or relating to any of the foregoing; and
- Future performance of credit markets.

Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts. They often include words such as "believe," "expect," "anticipate," "intend," "plan," "estimate," "aim," "projects," or w similar meaning and expressions that indicate future events and trends, or future or conditional verbs such as "will," "would," "should," "could," or "may." All statements that address expectations or projections about the future, including statements about the Company's strategy for growth, product development, market position, expenditures and financial results, are forward-looking statements.

Forward-looking statements are not guarantees of future performance. By their nature, forward-looking statements are subject to risks and uncertainties. There are a number of factors, many of which are beyond our control, that could cause actual future conditions, events, results or trends to differ significantly and/or materially from historical results or those projected in the forward-looking statements. These factors include but are not limited to the competitive nature of our industry and the possible adverse effects of such competition. Although a number of national insurers that are much larger than we are do not currently compete in a material way in the Massachusetts private passenger automobile market, if one or more of these companies decided to aggressively enter the market it could have a material adverse effect on us. Other significant factors include conditions for business operations and restrictive

regulations in Massachusetts, the possibility of losses due to claims resulting from severe weather, the possibility that the Commissioner may approve future Rule changes that change the operation of the residual market, the possibility that existing insurance-related laws and regulations will become further restrictive in the future, our possible need for and availability of additional financing, and our dependence on strategic relationships, among others, and other risks and factors identified from time to time in our reports filed with the SEC. Refer to Part I, Item 1A — Risk Factors.

Some other factors, such as market, operational, liquidity, interest rate, equity and other risks, are described elsewhere in this Annual Report on Form 10-K. Factors relating to the regulation and supervision of our Company are also described or incorporated in this report. There are other factors besides those described or incorporated in this report that could cause actual conditions, events or results to differ from those in the forward-looking statements.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We do not undertake any obligation to update publicly or revise any forward-looking statements to reflect circumstances or events that occur after the date the forward-looking statements are made.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk. Market risk is the risk that we will incur losses due to adverse changes in market rates and prices. We have exposure to market risk through our investment activities and our financing activities. Our primary market risk exposure is to changes in interest rates. We use both fixed and variable rate debt as sources of financing. We have not entered, and do not plan to enter, into any derivative financial instruments for trading or speculative purposes.

Interest Rate Risk. Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. Our exposure to interest rate changes primarily results from our significant holdings of fixed rate investments and from our financing activities. Our fixed maturity investments include U.S. and foreign government bonds, securities issued by government agencies, obligations of state and local governments and governmental authorities, corporate bonds and asset-backed securities, most of which are exposed to changes in prevailing interest rates.

We manage our exposure to risks associated with interest rate fluctuations through active review of our investment portfolio by our management and Board and consultation with third-party financial advisors. As a general matter, we do not attempt to match the durations of our assets with the durations of our liabilities, and the majority of our liabilities are “short tail.” Our goal is to maximize the total after-tax return on all of our investments. An important strategy that we employ to achieve this goal is to try to hold enough in cash and short-term investments in order to avoid liquidating longer-term investments to pay claims.

Based upon the results of interest rate sensitivity analysis, the following table shows the interest rate risk of our investments in fixed maturities, measured in terms of fair value (which is equal to the carrying value for all our fixed maturity securities).

	-100 Basis Point Change	No Change	+100 Basis Point Change
As of December 31, 2014			
Estimated fair value	$ 1,171,808	$ 1,135,451	$ 1,095,575
Estimated increase (decrease) in fair value	$ 36,357	$ —	$ (39,876)
As of December 31, 2013			
Estimated fair value	$ 1,146,871	$ 1,104,957	$ 1,060,888
Estimated increase (decrease) in fair value	$ 41,914	$ —	$ (44,069)

With respect to floating rate debt, we are exposed to the effects of changes in prevailing interest rates. At December 31, 2014, we had no debt outstanding under our credit facility. Assuming the full utilization of our current available credit facility, a 2.0% increase in the prevailing interest rate on our variable rate debt would result in interest expense increasing approximately $600 for 2014, assuming that all of such debt is outstanding for the entire year.

In addition, in the current market environment, our investments can also contain liquidity risks.

Equity Risk. Equity risk is the risk that we will incur economic losses due to adverse changes in equity prices. Our exposure to changes in equity prices results from our holdings of common stock and mutual funds held to fund the executive deferred compensation plan. We continuously evaluate market conditions and we expect in the future to purchase additional equity securities. We principally manage equity price risk through industry and issuer diversification and asset allocation techniques.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

SAFETY INSURANCE GROUP, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Safety Insurance Group, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Safety Insurance Group, Inc. and its subsidiaries at December 31, 2014 and December 31, 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014 based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, appearing on Management's Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts

March 2, 2015

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Balance Sheets

(Dollars in thousands, except share data)

	December 31, 2014	December 31, 2013
Assets		
Investments:		
Securities available for sale:		
Fixed maturities, at fair value (amortized cost: $1,102,517 and $1,087,232)	$ 1,135,451	$ 1,104,957
Equity securities, at fair value (cost: $97,910 and $83,134)	109,153	91,871
Other invested assets	11,657	5,748
Total investments	1,256,261	1,202,576
Cash and cash equivalents	42,455	55,877
Accounts receivable, net of allowance for doubtful accounts	175,532	169,304
Receivable for securities sold	—	1,320
Accrued investment income	10,295	10,329
Taxes recoverable	—	709
Receivable from reinsurers related to paid loss and loss adjustment expenses	6,267	4,588
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	61,245	60,346
Ceded unearned premiums	19,638	17,900
Deferred policy acquisition costs	67,329	63,388
Deferred income taxes	-	3,984
Equity and deposits in pools	23,159	18,733
Other assets	13,538	16,403
Total assets	$ 1,675,719	$ 1,625,457
Liabilities		
Loss and loss adjustment expense reserves	$ 482,012	$ 455,014
Unearned premium reserves	390,361	370,583
Accounts payable and accrued liabilities	65,863	66,508
Payable for securities purchased	4,591	13,327
Payable to reinsurers	7,653	7,094
Deferred income taxes	1,614	—
Taxes payable	265	—
Other liabilities	15,077	17,744
Total liabilities	967,436	930,270
Commitments and contingencies (Note 7)		
Shareholders’ equity		
Common stock: $0.01 par value; 30,000,000 shares authorized; 17,288,728 and 17,207,929 shares issued	173	172

Additional paid-in capital	175,583	170,391
Accumulated other comprehensive income, net of taxes	28,715	17,200
Retained earnings	587,647	567,792
Treasury stock, at cost: 2,279,570 and 1,819,547 shares	(83,835)	(60,368)
Total shareholders’ equity	708,283	695,187
Total liabilities and shareholders’ equity	$ 1,675,719	$ 1,625,457

The accompanying notes are an integral part of these financial statements.

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Operations

(Dollars in thousands, except per share data)

	Year Ended December 31,		
	2014	2013	2012
Net earned premiums	$ 716,875	$ 681,870	$ 642,469
Net investment income	42,303	43,054	40,870
Earnings from partnership investments	878	—	—
Net realized gains on investments	197	1,677	1,975
Finance and other service income	18,544	18,683	18,553
Total revenue	778,797	745,284	703,867
Losses and loss adjustment expenses	476,366	447,749	422,217
Underwriting, operating and related expenses	219,023	209,758	200,138
Interest expense	90	89	88
Total expenses	695,479	657,596	622,443
Income before income taxes	83,318	87,688	81,424
Income tax expense	23,964	26,337	23,354
Net income	$ 59,354	$ 61,351	$ 58,070
Earnings per weighted average common share:			
Basic	$ 3.93	$ 4.00	$ 3.80
Diluted	$ 3.91	$ 3.98	$ 3.80
Cash dividends paid per common share	$ 2.60	$ 2.40	$ 2.20
Number of shares used in computing earnings per share:			
Basic	15,107,339	15,354,468	15,288,346
Diluted	15,197,036	15,399,801	15,295,452

The accompanying notes are an integral part of these financial statements.

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(Dollars in thousands)

	Year Ended December 31,		
	2014	2013	2012
Net income	$ 59,354	$ 61,351	$ 58,070
Other comprehensive income, net of tax:			
Unrealized holding gains (losses) during the period, net of tax expense (benefit) of $6,269, ($13,497), and $4,856.	11,643	(25,066)	9,019
Reclassification adjustment for gains included in net income, net of tax expense of ($69), ($587), and ($691).	(128)	(1,090)	(1,284)
Unrealized gains (losses) on securities available for sale	11,515	(26,156)	7,735
Comprehensive income	$ 70,869	$ 35,195	$ 65,805

The accompanying notes are an integral part of these financial statements.

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income, Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2011	$ 169	$ 157,167	$ 35,621	$ 518,925	$ (55,569)	$ 656,313
Net income				58,070		58,070
Other comprehensive income, net of deferred federal income taxes			7,735			7,735
Restricted share awards issued	1	166				167
Recognition of employee share-based compensation, net of deferred federal income taxes		4,484				4,484
Exercise of options, net of federal income taxes		1,224				1,224
Dividends paid and accrued				(33,634)		(33,634)
Acquisition of treasury stock						-
Balance at December 31, 2012	170	163,041	43,356	543,361	(55,569)	694,359
Net income				61,351		61,351
Other comprehensive loss, net of deferred federal income taxes			(26,156)			(26,156)
Restricted share awards issued	1	187				188
Recognition of employee share-based compensation, net of deferred federal		4,618				4,618

income taxes						
Exercise of options, net of federal income taxes	1	2,545				2,546
Dividends paid and accrued				(36,920)		(36,920)
Acquisition of treasury stock					(4,799)	(4,799)
Balance at December 31, 2013	172	170,391	17,200	567,792	(60,368)	695,187
Net income				59,354		59,354
Other comprehensive income, net of deferred federal income taxes			11,515			11,515
Restricted share awards issued	1	216				217
Recognition of employee share-based compensation, net of deferred federal income taxes		4,677				4,677
Exercise of options, net of federal income taxes		299				299
Dividends paid and accrued				(39,499)		(39,499)
Acquisition of treasury stock					(23,467)	(23,467)
Balance at December 31, 2014	$ 173	$ 175,583	$ 28,715	$ 587,647	$ (83,835)	$ 708,283

The accompanying notes are an integral part of these financial statements.

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Dollars in thousands)

	Year Ended December 31,		
	2014	2013	2012
Cash flows from operating activities:			
Net income	$ 59,354	$ 61,351	$ 58,070
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization, net	13,123	12,326	14,322
Provision for deferred income taxes	(602)	1,899	1,023
Net realized gains on investments	(197)	(1,677)	(1,975)
Earnings from partnership investments	(878)		
Changes in assets and liabilities:			
Accounts receivable	(6,228)	(3,554)	(11,607)
Accrued investment income	34	258	(418)
Receivable from reinsurers	(2,578)	(6,139)	(3,495)
Ceded unearned premiums	(1,738)	(1,694)	(2,184)
Deferred policy acquisition costs	(3,941)	(2,723)	(3,949)
Other assets	(2,871)	3,084	(1,444)
Loss and loss adjustment expense reserves	26,998	31,172	19,970
Unearned premium reserves	19,778	17,364	23,657
Accounts payable and accrued liabilities	(577)	1,050	13,426
Payable to reinsurers	559	38	1,718
Other liabilities	(2,667)	(1,891)	(2,783)
Net cash provided by operating activities	97,569	110,864	104,331
Cash flows from investing activities:			
Fixed maturities purchased	(234,172)	(193,814)	(333,603)
Equity securities purchased	(27,665)	(75,891)	(9,397)
Other invested assets purchase	(4,976)	(5,600)	—
Proceeds from sales and paydowns of fixed maturities	153,701	179,729	165,878
Proceeds from maturities, redemptions, and calls of fixed maturities	52,253	34,264	98,045
Proceed from sales of equity securities	14,097	14,934	8,837
Fixed assets purchased	(1,760)	(4,920)	(4,205)
Net cash used for investing activities	(48,522)	(51,298)	(74,445)
Cash flows from financing activities:			
Proceeds from stock options exercised	297	2,592	1,241
Excess tax benefit from stock options exercised	3	—	—
Dividends paid to shareholders	(39,302)	(36,865)	(33,634)
Acquisition of treasury stock	(23,467)	(4,799)	—
Net cash used for financing activities	(62,469)	(39,072)	(32,393)

Net (decrease) increase in cash and cash equivalents	(13,422)	20,494	(2,507)
Cash and cash equivalents at beginning of year	55,877	35,383	37,890
Cash and cash equivalents at end of period	$ 42,455	$ 55,877	$ 35,383
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Federal and state income taxes	$ 23,720	$ 18,890	$ 19,730
Interest	$ 75	$ 75	$ 75

The accompanying notes are an integral part of these financial statements.

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1.Basis of Presentation

The consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the United States of America ("GAAP"). The consolidated financial statements include Safety Insurance Group, Inc. and its subsidiaries (the "Company"). The subsidiaries consist of Safety Insurance Company, Safety Indemnity Insurance Company, Safety Property and Casualty Insurance Company, Whiteshirts Asset Management Corporation ("WAMC"), and Whiteshirts Management Corporation, which is WAMC's holding company. All intercompany transactions have been eliminated.

The Company was incorporated on June 25, 2001 in the State of Delaware. On October 16, 2001, the Company acquired all of the issued and outstanding common stock of Thomas Black Corporation ("TBC") and its property and casualty subsidiaries. TBC subsequently merged with and into Safety Insurance Group, Inc. with Safety Insurance Group, Inc. being the corporation surviving the merger.

The Company is a leading provider of personal lines property and casualty insurance focused primarily on the Massachusetts market. The Company's principal product line is private passenger automobile insurance, which accounted for 61.7% of its direct written premiums in 2014. The Company operates through its insurance company subsidiaries, Safety Insurance Company, Safety Indemnity Insurance Company, and Safety Property and Casualty Insurance Company (together referred to as the "Insurance Subsidiaries").

The Insurance Subsidiaries began writing private passenger automobile and homeowners insurance in New Hampshire during 2008, personal umbrella insurance in New Hampshire during 2009, and commercial automobile insurance in New Hampshire during 2011.

2.Summary of Significant Accounting Policies

Investments

Investments in fixed maturities available for sale, which include taxable and non taxable bonds and redeemable preferred stocks, are reported at fair value. Investments in equity securities available for sale, which include interests in common stocks, mutual funds and a real estate investment trust ("REIT"), are reported at fair value. Fair values for fixed maturity securities are based on estimates obtained from independent pricing services. Fair values for equity securities are derived from external market quotations, with the exception of the REIT whose fair value was determined using the trust's net asset value obtained from its audited financial statements. Short term investments, which consist of U.S. Treasury bills, are reported at amortized cost, which approximates fair value. Other long term investments consist of investments in limited partnerships. The partnership interest is accounted for using the equity method of accounting and recorded in earnings from partnership investments. The carrying value of this investment is written down, or impaired, to fair value when a decline in value is considered to be other than temporary. In applying the equity method (including assessment for other than temporary impairment), the Company uses financial information provided by the investee, generally on a one to three month lag. Unrealized gains or losses on fixed maturity and equity securities reported at fair value are excluded from earnings and reported in a separate component of shareholders' equity, known as "Accumulated other comprehensive income (loss), net of taxes," until realized. Realized gains or losses on the sale or maturity of investments are determined based on the specific cost identification method. Fixed maturities and equity securities that experience declines in value that are other than temporary are written down to fair value with a corresponding charge to net realized losses on investments.

Investment income is recognized on an accrual basis of accounting. Bonds not backed by other loans are amortized using the interest method. Loan backed bonds and structured securities are amortized using the interest method and significant changes in estimated cash flows from the original purchase assumptions are accounted for using the retrospective method.

Cash and Cash Equivalents

Cash and cash equivalents includes money market accounts and United States (“U.S.”) Treasury bills with original maturities of three months or less from the date of purchase. U.S. Treasury bills are stated at amortized cost, which approximates fair value.

Accounts Receivable

Amounts included in accounts receivable represent premiums as well as finance charges, the majority of which are both billed on a monthly installment basis. Accounts receivable are stated net of allowances for doubtful accounts. At December 31, 2014 and 2013, these allowances were $462 and $456, respectively. Uncollected premium balances over ninety days past due are written off.

Deferred Policy Acquisition Costs

Amounts that vary with and are primarily related to the successful acquisition of a new or renewal insurance contract, principally commissions and premium taxes, are deferred and amortized ratably over the effective period of the policies. All other acquisition expenses are expensed as incurred. Deferred policy acquisition costs are reviewed to determine if they are recoverable from future income, and if not, are charged to expense. Future investment income attributable to related premiums is not taken into account in measuring the recoverability of the carrying value of this asset. Amortization of acquisition costs in the amount of $132,526, $126,201, and $118,850 was charged to underwriting, operating and other expenses for the years ended 2014, 2013 and 2012, respectively.

Equity and Deposits in Pools

Equity and deposits in pools represents the net receivable amounts from the residual market mechanisms, Commonwealth Automobile Reinsurers (“CAR”) for automobile and Massachusetts Property Insurance Underwriting Association (“FAIR Plan”) for homeowner insurance in Massachusetts. See Note 8 for a discussion of the Company’s accounting for amounts assumed from residual markets.

Equipment and Leasehold Improvements

Property, equipment, leasehold improvements, and software which are included in other assets are carried at cost less accumulated depreciation. Depreciation is provided using the straight line or accelerated method over the estimated useful lives of the related assets, which range from 3 to 10 years. Amortization of leasehold improvements is provided using the straight line method over the term of the lease. The costs of computer software developed or obtained for internal use are capitalized and amortized over the estimated life of the business system, beginning when the software is ready for its intended use. Maintenance and repairs are charged to expense as incurred.

Losses and Loss Adjustment Expenses

Liabilities for losses and loss adjustment expenses (“LAE”) include case basis estimates for open claims reported prior to year end and estimates of unreported claims and claim adjustment expenses, net of salvage and subrogation. The estimates are continually reviewed and modified to reflect current conditions, and any resulting adjustments are reflected in current operating results. Adjustments for anticipated salvage and subrogation are recorded on incurred and reported and incurred but not reported losses.

Premiums and Unearned Premiums

Premiums are earned over the terms of the respective policies, which are generally one year. Unearned premiums represent the portion of premiums written applicable to the unexpired terms of the policies.

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Ceded premiums are charged to income over the terms of the respective policies and the applicable term of the reinsurance contracts with third party reinsurers. Ceded unearned premiums represent the unexpired portion of premiums ceded to CAR and other reinsurers.

Premiums received in advance of the policy effective date are recorded as a liability and not recognized as income until earned. Such amounts are included in accounts payable and accrued liabilities and totaled $14,617 and $15,453 at December 31, 2014 and 2013, respectively.

Reinsurance

Liabilities for unearned premiums and unpaid losses are stated before deductions for ceded reinsurance. The ceded amounts are carried as receivables. Earned premiums are stated net of deductions for ceded reinsurance.

The Company, as primary insurer, will be required to pay losses in their entirety in the event that the reinsurers are unable to discharge their obligations under the reinsurance agreements.

Advertising Costs

Advertising costs are charged to expense when they are incurred. Total advertising costs were $2,108, $2,145 and $2,099 for the years ended December 31, 2014, 2013, and 2012, respectively.

Finance and Other Service Income

Finance and other service income primarily includes revenues from premium installment charges, which are recognized when earned.

Income Taxes

The Company and its subsidiaries file a consolidated U.S. federal income tax return. The method of allocation among members of the consolidated group is subject to a written agreement approved by the Board of Directors (the “Board”). The consolidated tax liability is allocated on the basis of the members’ proportionate contribution to consolidated taxable income.

Deferred income taxes are generally recognized when assets and liabilities have different values for financial statement and tax reporting purposes, and for other temporary taxable and deductible differences as defined by Accounting Standards Codification (“ASC”) 740, Income Taxes. A valuation allowance is established where management has assessed that it is more likely than not that the Company will not be able to utilize the full deferred tax asset.

Earnings per Weighted Average Common Share

Basic earnings per weighted average common share (“EPS”) is calculated by dividing net income by the weighted average number of basic common shares outstanding during the period including unvested restricted shares which are considered participating securities. Diluted earnings per share amounts are based on the weighted average number of common shares including non-vested performance stock grants and the net effect of potentially dilutive common stock options.

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The following table sets forth the computation of basic and diluted EPS for the periods indicated.

	Year Ended December 31,		
	2014	2013	2012
Net income available to common shareholders for basic and diluted earnings per share	$ 59,354	$ 61,351	$ 58,070
Weighted average common and common equivalent shares outstanding used to calculate basic earnings per share	15,107,339	15,354,468	15,288,346
Common equivalent shares- stock options	2,391	5,558	7,106
Common equivalent shares- non-vested performance stock grants	87,306	39,775	—
Weighted average common and common equivalent shares outstanding used to calculate diluted earnings per share	15,197,036	15,399,801	15,295,452
Basic earnings per share	$ 3.93	$ 4.00	$ 3.80
Diluted earnings per share	$ 3.91	$ 3.98	$ 3.80
Undistributed earnings attributable to Safety's common shareholders - basic and diluted:			
Net income from continuing operations attributable to Safety's common shareholders -Basic	$ 3.93	$ 4.00	$ 3.80
Dividends declared	(2.60)	(2.40)	(2.20)
Undistributed earnings	$ 1.33	$ 1.60	$ 1.60
Net income from continuing operations attributable to Safety's common shareholders -Diluted	$ 3.91	$ 3.98	$ 3.80
Dividends declared	(2.60)	(2.40)	(2.20)
Undistributed earnings	$ 1.31	$ 1.58	$ 1.60

Diluted EPS excludes stock options with exercise prices and exercise tax benefits greater than the average market price of the Company’s common stock during the period because their inclusion would be anti dilutive. There were no anti dilutive stock options for the years ended December 31, 2014, 2013 and 2012.

Share Based Compensation

Accounting Standards Codification (“ASC”) 718, Compensation —Stock Compensation requires the Company to measure and recognize the cost of employee services received in exchange for an award of equity instruments. Under the provisions of ASC 718, share-based compensation cost is measured at the grant date, based on the fair value of the award, and is recognized as an expense over the requisite service period (generally the vesting period of the equity grant).

See Note 6 for further information regarding share based compensation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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Recent Accounting Pronouncements

In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosures of Uncertainties about an Entity’s Ability as a Going Concern” (“ASU 2014-15”). ASU 2014-15 provides guidance on determining when and how to disclose going concern uncertainties in the financial statements, and requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016 and interim periods thereafter. Early adoption is permitted. The Company does not expect the adoption of ASU 2014-15 to have a material impact on the Company’s consolidated financial position and results of operations.

In June 2014, the FASB issued ASU No. 2014-12, "Compensation—Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period" ("ASU 2014-12”), which revises the accounting treatment for stock compensation tied to performance targets. ASU 2014-12 is effective for calendar years beginning after December 15, 2015. The impact of adoption to the Company’s consolidated financial condition and results of operations is currently being evaluated.

On May 28, 2014, the FASB issued as final, ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)” which supersedes virtually all existing revenue recognition guidance under GAAP. The update's core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The update is effective for interim and annual reporting periods in fiscal years beginning after December 15, 2016 and prohibits early adoption. The update allows for the use of either the retrospective or modified retrospective approach of adoption. The impact of adoption to the Company’s consolidated financial condition and results of operations is currently being evaluated.

In February 2013, the Financial Accounting Standards Board issued ASU 2013-02, “Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income” (“ASU 2013-02”). ASU 2013-02 requires entities to present in either a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source and the income statement line items affected by the reclassification. Items not required to be reclassified to net income in their entirety are cross referenced to a related footnote for additional information. ASU 2013-02 was effective for interim and annual periods beginning after December 15, 2012. The impact of adoption was not material to the Company’s consolidated financial condition and results of operations.

Segments

The Company comprises one business segment: property and casualty insurance operations. Management organizes the business around private passenger automobile insurance in Massachusetts sold exclusively through independent agents and offers other personal and commercial insurance as complementary products. In accordance with ASC 280, Segment Reporting, the financial information of the segment is presented consistent with the way results are regularly

evaluated by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

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3.Investments

The gross unrealized gains and losses on investments in fixed maturity securities, including redeemable preferred stocks that have characteristics of fixed maturities, and equity securities, including interests in mutual funds, were as follows for the periods indicated.

	As of December 31, 2014				
			Gross Unrealized Losses (3)		
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	$ 1,507	$ —	$ (1)	$ —	$ 1,506
Obligations of states and political subdivisions	437,299	23,562	(536)	—	460,325
Residential mortgage-backed securities (1)	201,950	7,015	(1,282)	—	207,683
Commercial mortgage-backed securities	34,216	256	(34)	—	34,438
Other asset-backed securities	10,204	48	(2)	—	10,250
Corporate and other securities	417,341	7,536	(3,628)	—	421,249
Subtotal, fixed maturity securities	1,102,517	38,417	(5,483)	—	1,135,451
Equity securities (2)	97,910	13,332	(2,089)	—	109,153
Other invested assets (5)	11,657	—	—	—	11,657
Totals	$ 1,212,084	$ 51,749	$ (7,572)	$ —	$ 1,256,261

	As of December 31, 2013				
			Gross Unrealized Losses (3)		
	Cost or Amortized Cost	Gross Unrealized Gains	Non-OTTI Unrealized Losses	OTTI Unrealized Losses (4)	Estimated Fair Value
U.S. Treasury securities	$ 1,510	$ —	$ (7)	$ —	$ 1,503
Obligations of states and political subdivisions	461,256	10,248	(4,179)	—	467,325
Residential mortgage-backed securities (1)	205,053	6,879	(3,230)	—	208,702
Commercial mortgage-backed securities	31,885	342	(8)	—	32,219
Other asset-backed securities	13,357	124	(36)	—	13,445

Corporate and other securities	374,171	9,882	(2,290)	—	381,763
Subtotal, fixed maturity securities	1,087,232	27,475	(9,750)	—	1,104,957
Equity securities (2)	83,134	8,821	(84)	—	91,871
Other invested assets (5)	5,748	—	—	—	5,748
Totals	$ 1,176,114	$ 36,296	$ (9,834)	$ —	$ 1,202,576

(1) Residential mortgage backed securities consists primarily of obligations of U.S. Government agencies including collateralized mortgage obligations issued, guaranteed and/or insured by the following issuers: Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA) and the Federal Home Loan Bank (FHLB).

(2) Equity securities includes interests in mutual funds held to fund the Company’s executive deferred compensation plan.

(3) The Company’s investment portfolio included 366 and 220 securities in an unrealized loss position at December 31, 2014 and December 31, 2013, respectively.

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(4) Amounts in this column represent other than temporary impairment ("OTTI") recognized in accumulated other comprehensive income.
(5) Other invested assets are accounted for under the equity method which approximates fair value.

The amortized cost and the estimated fair value of fixed maturity securities, by maturity, are shown below for the period indicated. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	As of December 31, 2014	
	Amortized Cost	Estimated Fair Value
Due in one year or less	$ 57,252	$ 57,740
Due after one year through five years	297,731	301,918
Due after five years through ten years	214,437	217,540
Due after ten years	286,727	305,882
Asset-backed securities	246,370	252,371
Totals	$ 1,102,517	$ 1,135,451

The gross realized gains and losses on sales of investments were as follows for the periods indicated.

	Year Ended December 31,		
	2014	2013	2012
Gross realized gains			
Fixed maturity securities	$ 644	$ 854	$ 1,845
Equity securities	1,534	1,011	270
Gross realized losses			

Fixed maturity securities	(1,651)	(141)	(115)
Equity securities	(330)	(47)	(25)
Net realized gains on investments	$ 197	$ 1,677	$ 1,975

In the normal course of business, the Company enters into transactions involving various types of financial instruments, including investments in fixed maturities and equity securities. Investment transactions have credit exposure to the extent that a counter party may default on an obligation to the Company. Credit risk is a consequence of carrying, trading and investing in securities. To manage credit risk, the Company focuses on higher quality fixed income securities, reviews the credit strength of all companies in which it invests, limits its exposure in any one investment and monitors the portfolio quality, taking into account credit ratings assigned by recognized statistical rating organizations.

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The following tables as of December 31, 2014 and 2013 present the gross unrealized losses included in the Company's investment portfolio and the fair value of those securities aggregated by investment category. The tables also present the length of time that they have been in a continuous unrealized loss position.

	As of December 31, 2014					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	$ —	$ —	$ 1,506	$ 1	$ 1,506	$ 1
Obligations of states and political subdivisions	65,174	489	3,553	47	68,727	536
Residential mortgage-backed securities	18,853	44	47,769	1,238	66,622	1,282
Commercial mortgage-backed securities	10,485	34	—	—	10,485	34
Other asset-backed securities	1,999	2	—	—	1,999	2
Corporate and other securities	119,722	3,079	37,469	549	157,191	3,628
Subtotal, fixed maturity securities	216,233	3,648	90,297	1,835	306,530	5,483
Equity securities	16,119	1,986	1,277	103	17,396	2,089
Total temporarily impaired securities	$ 232,352	$ 5,634	$ 91,574	$ 1,938	$ 323,926	$ 7,572

	As of December 31, 2013					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
U.S. Treasury securities	$ 1,503	$ 7	$ -	$ -	$ 1,503	$ 7
Obligations of states and political subdivisions	131,114	3,898	3,362	281	134,476	4,179
Residential mortgage-backed securities	50,048	1,570	37,166	1,660	87,214	3,230
Commercial mortgage-backed securities	6,008	8	-	-	6,008	8

Other asset-backed securities	3,240	31	4,608	5	7,848	36
Corporate and other securities	86,312	2,223	2,235	67	88,547	2,290
Subtotal, fixed maturity securities	278,225	7,737	47,371	2,013	325,596	9,750
Equity securities	3,933	73	299	11	4,232	84
Total temporarily impaired securities	$ 282,158	$ 7,810	$ 47,670	$ 2,024	$ 329,828	$ 9,834

Other Than Temporary Impairments

ASC 320, Investments—Debt and Equity Securities requires entities to separate an OTTI of a debt security into two components when there are credit related losses associated with the impaired debt security for which the Company asserts that it does not have the intent to sell the security, and it is more likely than not that it will not be required to sell the security before recovery of its cost basis. Under ASC 320, the amount of the OTTI related to a credit loss is recognized in earnings, and the amount of the OTTI related to other factors is recorded as a component of other comprehensive income (loss). In instances where no credit loss exists but it is more likely than not that the Company will have to sell the debt security prior to the anticipated recovery, the decline in market value below amortized cost is recognized as an OTTI in earnings. In periods after the recognition of an OTTI on debt securities, the Company accounts for such securities as if they had been purchased on the measurement date of the OTTI at an amortized cost basis equal to the previous amortized cost basis less the OTTI recognized in earnings. For debt securities for which OTTI was

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recognized in earnings, the difference between the new amortized cost basis and the cash flows expected to be collected will be accreted or amortized into net investment income.

The Company holds no subprime mortgage debt securities. All of the Company's holdings in mortgage backed securities are either U.S. Government or Agency guaranteed or are rated investment grade by either Moody's or Standard & Poor's.

The unrealized losses in the Company's fixed income and equity portfolio as of December 31, 2014 were reviewed for potential other than temporary asset impairments. The Company held no securities at December 31, 2014 with a material (20% or greater) unrealized loss for four or more consecutive quarters. Specific qualitative analysis was also performed for any additional securities appearing on the Company's "Watch List," if any. Qualitative analysis considered such factors as the financial condition and the near term prospects of the issuer, whether the debtor is current on its contractually obligated interest and principal payments, changes to the rating of the security by a rating agency and the historical volatility of the fair value of the security.

The qualitative analysis performed by the Company concluded that the unrealized losses recorded on the investment portfolio at December 31, 2014 resulted from fluctuations in market interest rates and other temporary market conditions as opposed to fundamental changes in the credit quality of the issuers of such securities. Therefore, decreases in fair values of the Company's securities are viewed as being temporary.

During the years ended December 31, 2014 and 2013, there was no significant deterioration in the credit quality of any of the Company's holdings and no OTTI charges were recorded related to the Company's portfolio of investment securities. At December 31, 2014 and December 31, 2013, there were no amounts included in accumulated other comprehensive income related to securities which were considered by the Company to be other than temporarily impaired.

Based upon the qualitative analysis performed, the Company's decision to hold these securities, the Company's current level of liquidity and its positive operating cash flows, management believes it is more likely than not that it will not be required to sell any of its securities before the anticipated recovery in the fair value to its amortized cost basis.

Net Investment Income

The components of net investment income were as follow for the periods indicated.

	Year Ended December 31,		
	2014	2013	2012
Interest on fixed maturity securities	$ 40,717	$ 43,328	$ 42,235
Dividends on equity securities	3,428	1,829	559
Equity in earnings of other invested assets	685	148	—
Interest on other assets	79	139	39
Interest on cash and cash equivalents	10	18	18
Total investment income	44,919	45,462	42,851
Investment expenses	2,616	2,408	1,981
Net investment income	$ 42,303	$ 43,054	$ 40,870

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4.Equipment and Leasehold Improvements

The carrying value of equipment and leasehold improvements by classification was as follows for the periods indicated.

	As of December 31,	
	2014	2013
Software	$ 21,748	$ 20,608
Computer equipment	6,807	6,365
Leasehold improvements	2,524	2,524
Other equipment	2,400	2,400
Furniture and fixtures	1,316	1,186
Total cost	34,795	33,083
Less accumulated depreciation and amortization	26,510	22,419
Equipment and leasehold improvements, net	$ 8,285	$ 10,664

Depreciation and amortization expense for the years ended December 31, 2014, 2013, and 2012 was $4,133, $3,974, and $4,450, respectively.

5.Employee Benefit Plan

The Company sponsors the Safety Insurance Company 401(k) qualified defined contribution retirement plan (the “Retirement Plan”). The Retirement Plan is available to all eligible employees of the Company. An employee must be 21 years of age to be eligible to participate in the Retirement Plan and is allowed to contribute on a pre tax basis up to the maximum allowed under federal law. The Retirement Plan is administered by the Company and is subject to the provisions of the Employee Retirement Income Security Act of 1974. At the close of each Retirement Plan year, the Company makes a matching contribution equal to 100% of the amount each participant contributed during the plan year from their total pay, up to a maximum amount of 8% of the participant’s base salary, to those participants who have contributed to the Retirement Plan and were employed on the last day of the Retirement Plan year. Compensation expense related to the Retirement Plan was $2,775, $2,649, and $2,490 for the years ended December 31, 2014, 2013, and 2012, respectively.

6.Share Based Compensation

Management Omnibus Incentive Plan

Long-term incentive compensation is provided under the Company's 2002 Management Omnibus Incentive Plan ("the Incentive Plan") which provides for a variety of share-based compensation awards, including nonqualified stock options, incentive stock options, stock appreciation rights and restricted stock ("RS") awards. The maximum number of shares of common stock with respect to which awards may be granted is 2,500,000. The Incentive Plan was amended in March of 2013 to remove "share recycling" plan provisions. Hence, shares of stock covered by an award under the Incentive Plan that are forfeited are no longer available for issuance in connection with 2013 and future grants of awards. At December 31, 2014, there were 453,930 shares available for future grant. The Board of Directors and the Compensation Committee intend to issue more awards under the Incentive Plan in the future.

For the years ended December 31, 2014, 2013, and 2012, the Company recorded compensation expense related to awards under the Incentive Plan of $2,981, $2,954, and $2,877, net of income tax benefit of $1,605, $1,591, and $1,549, respectively.

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Stock Options

The following table summarizes stock option activity under the Incentive Plan.

	Years Ended December 31,					
	2014		2013		2012	
	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price	Shares Under Option	Weighted Average Exercise Price
Outstanding at beginning of year	20,200	$ 41.64	87,500	$ 39.24	125,700	$ 37.63
Exercised	(7,500)	39.60	(67,300)	38.52	(36,900)	33.63
Forfeited	—	—	—	—	(1,300)	42.85
Outstanding at end of period	12,700	42.85	20,200	41.64	87,500	39.24
Exercisable at end of period	12,700	$ 42.85	20,200	$ 41.64	87,500	$ 39.24

At December 31, 2014, 2013, and 2012, the aggregate intrinsic value of outstanding shares under option was $269, $296, and $606 with a weighted average remaining contractual term of 1.2, 2.1, and 2.9 years, respectively. Aggregate intrinsic value represents the total pretax intrinsic value, which is the difference between the fair value based upon the Company's closing year end stock price at December 31, 2014, 2013, and 2012 and the exercise price which would have been received by the option holders had all option holders exercised their options as of those dates. The exercise price on stock options outstanding under the Incentive Plan was $42.85 at December 31, 2014. The range of exercise prices on stock options outstanding under the Incentive Plan was $18.50 to $42.85 at December 31, 2013 and $13.30 to $42.85 at December 31, 2012. The total intrinsic value of options exercised during the years ended December 31, 2014, 2013, and 2012 was $183, $1,197, and $463, respectively.

Restricted Stock

Service-based restricted stock awarded in the form of unvested shares is recorded at the market value of the Company's common stock on the grant date and amortized ratably as compensation expense over the requisite service period. Service-based restricted stock awards generally vest over a three-year period and vest 30% on the first and second anniversaries of the grant date and 40% on the third anniversary of the grant date, except for non-executive employees' restricted stock awards which vest ratably over a five-year service period and independent directors' stock awards which vest immediately. Independent directors' stock awards cannot be sold, assigned, pledged, or otherwise transferred, encumbered or disposed of until the recipient is no longer a member of the Board of Directors.

In addition to service-based awards, the Company grants performance-based restricted shares to certain employees. These performance shares cliff vest after a three-year performance period provided certain performance measures are attained. A portion of these awards, which contain a market condition, vest according to the level of total shareholder return achieved by the Company compared to its property-casualty insurance peers over a three-year period. The remainder, which contain a performance condition, vest according to the level of Company's combined ratio results

compared to a target based on its property-casualty insurance peers.

Actual payouts can range from 0% to 200% of target shares awarded depending upon the level of achievement of the respective market and performance conditions during a three fiscal-year performance period. Compensation expense for share awards with a performance condition is based on the probable number of awards expected to vest using the performance level most likely to be achieved at the end of the performance period.

Performance-based awards with market conditions are accounted for and measured differently from awards that have a performance or service condition. The effect of a market condition is reflected in the award's fair value on the grant date. That fair value is recognized as compensation cost over the requisite service period regardless of whether the market-based performance objective has been satisfied.

All of the Company's restricted stock awards are issued as incentive compensation and are equity classified.

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The following table summarizes restricted stock activity under the Incentive Plan assuming a target payout for the performance-based shares.

	Years Ended December 31,					
	2014		2013		2012	
	Shares Under Restriction	Weighted Average Fair Value	Shares Under Restriction	Weighted Average Fair Value	Shares Under Restriction	Weighted Average Fair Value
Outstanding at beginning of year	211,234	$ 43.51	263,883	$ 41.47	282,117	$ 39.24
Granted	50,781	53.94	57,632	47.87	102,756	41.79
Vested and unrestricted	(81,149)	43.80	(103,788)	40.75	(117,936)	36.50
Forfeited	(4,750)	44.46	(6,493)	43.48	(3,054)	38.13
Outstanding at end of period	176,116	$ 46.38	211,234	$ 43.51	263,883	$ 41.47

	Years Ended December 31,					
	2014		2013		2012	
	Performance-based Shares Under Restriction	Weighted Average Fair Value	Performance-based Shares Under Restriction	Weighted Average Fair Value	Performance-based Shares Under Restriction	Weighted Average Fair Value
Outstanding at beginning of year	37,456	$ 44.13	—	$ —	—	$ —
Granted	29,903	57.94	37,456	44.13	—	—
Vested and unrestricted	—	—	—	—	—	—
Forfeited	(2,635)	46.96	—	-	—	—
Outstanding at end of period	64,724	$ 50.40	37,456	$ 44.13	—	$ —

As of December 31, 2014, there was $6,479 of unrecognized compensation expense related to non vested restricted stock awards that is expected to be recognized over a weighted average period of 1.8 years. The total fair value of the shares that were vested and unrestricted during the years ended December 31, 2014, 2013, and 2012 was $3,554, $4,230, and $4,304, respectively.

7.Commitments and Contingencies

Lease Commitments

The Company has various non cancelable long term operating leases. The approximate minimum annual rental payments due under these lease agreements as of December 31, 2014 are presented in the following table.

2015	$ 4,004
2016	4,006
2017	3,946
2018	3,915
2019	123
Total minimum lease payments	$ 15,994

Certain lease agreements contain renewal options and, in addition to the minimum annual rentals, generally provide for payment of a share of the real estate taxes and operating expenses in excess of a base amount. Rental expense

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was $4,236, $4,150, and $4,114 for the years ended December 31, 2014, 2013, and 2012, respectively. All leases expire prior to 2020. The Company expects that in the normal course of business, leases that expire will be renewed.

An eighth amendment to a lease agreement for the lease of office space was executed on April 5, 2007. Under the provisions of this amendment, additional space was occupied and the lease term was extended an additional ten years commencing on January 1, 2009, with an option to renew for one additional five year term.

At December 31, 2014, the Company has software purchase commitments of $1,409.

As part of the Company's investment activity, we have committed $25,000 to investments in limited partnerships. The Company has contributed $10,576 to these commitments as of December 31, 2014. As of December 31, 2014, the remaining committed capital due to be called is $14,424.

Contingencies

Various claims, generally incidental to the conduct of normal business, are pending or alleged against the Company from time to time. In the opinion of management, based in part on the advice of legal counsel, the ultimate resolution of such claims will not have a material adverse effect on the Company's consolidated financial statements. However, if estimates of the ultimate resolutions of those proceedings are revised, liabilities related to those proceedings could be adjusted in the near term.

Massachusetts law requires that insurers licensed to do business in Massachusetts participate in the Massachusetts Insurers Insolvency Fund ("Insolvency Fund"). Members of the Insolvency Fund are assessed a proportionate share of the obligations and expenses of the Insolvency Fund in connection with an insolvent insurer. It is anticipated that there will be additional assessments from time to time relating to various insolvencies. Although the timing and amounts of any future assessments are not known, based upon existing knowledge, management's opinion is that such future assessments will not have a material effect upon the financial position of the Company.

8.Debt

The Company has a Revolving Credit Agreement (the "Credit Agreement") with RBS Citizens, NA ("RBS Citizens"). The Credit Agreement provides a $30,000 revolving credit facility with an accordion feature allowing for future expansion of the committed amount up to $50,000. Loans under the credit facility bear interest at the Company's option at either (i) the LIBOR rate plus 1.25% per annum or (ii) the higher of RBS Citizens prime rate or 0.5% above the federal funds rate plus 1.25% per annum. Interest only is payable prior to maturity. The Credit Agreement has a maturity date of August 14, 2018.

The Company's obligations under the credit facility are secured by pledges of its assets and the capital stock of its operating subsidiaries. The credit facility is guaranteed by the Company's non insurance company subsidiaries. The credit facility contains covenants including requirements to maintain minimum risk based capital ratios and statutory surplus of Safety Insurance Company as well as limitations or restrictions on indebtedness, liens, and other matters. As of December 31, 2014, the Company was in compliance with all covenants. In addition, the credit facility includes customary events of default, including a cross default provision permitting the lenders to accelerate the facility if the

Company (i) defaults in any payment obligation under debt having a principal amount in excess of $10,000 or (ii) fails to perform any other covenant permitting acceleration of all such debt.

The Company had no amounts outstanding on its credit facility at December 31, 2014 or 2013. The credit facility commitment fee included in interest expenses was computed at a rate of 0.25% per annum on the $30,000 commitment at December 31, 2014 and 2013.

The Company became a member of the FHLB-Boston during the quarter ended September 30, 2014. Membership in the FHLB-Boston allows the Company to borrow money at competitive interest rates provided the loan is collateralized by specific U.S Government residential mortgage backed securities. The Company has no amounts outstanding from the FHLB-Boston at December 31, 2014.

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9.Reinsurance

The Company cedes insurance to CAR and to other reinsurers. The Company has a property catastrophe excess of loss agreement and a casualty excess of loss agreement that qualify as reinsurance treaties and are designed to protect against large or unusual loss and LAE activity. Reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to the Company. The Company evaluates the financial condition of its reinsurers and monitors economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer insolvencies.

The Company is subject to concentration of credit risk with respect to reinsurance ceded to CAR. At December 31, 2014, reinsurance receivables on paid and unpaid loss and LAE with a carrying value of $52,667 and ceded unearned premiums of $17,909 were associated with CAR. At December 31, 2013, reinsurance receivables on paid and unpaid loss and LAE with a carrying value of $48,507 and ceded unearned premiums of $15,657 were associated with CAR. The Company assumes a proportionate share of the obligations from CAR. The Company makes an estimate of its share of assumed activity from the most recent quarter reported by CAR and records adjustments to the reported activity to reflect its anticipated final assumed obligations. The Company's participation in CAR resulted in assumed net losses of $1,278, $1,487 and $424 for the years ended December 31, 2014, 2013 and 2012, respectively.

CAR has been, with few exceptions, required by law to issue a policy to any applicant who seeks it. As a servicing carrier of CAR, this requirement has applied to the Company.

The effect of assumed and ceded premiums on net written and earned premiums and losses and LAE incurred is as follows.

	Years Ended December 31,		
	2014	2013	2012
Written Premiums			
Direct	$ 765,685	$ 731,680	$ 696,220
Assumed	25,602	20,593	17,943
Ceded	(56,373)	(54,733)	(50,221)
Net written premiums	$ 734,914	$ 697,540	$ 663,942
Earned Premiums			
Direct	$ 747,786	$ 715,657	$ 673,596
Assumed	23,724	19,251	16,910
Ceded	(54,635)	(53,038)	(48,037)
Net earned premiums	$ 716,875	$ 681,870	$ 642,469
Loss and LAE			
Direct	$ 486,649	$ 465,162	$ 431,526
Assumed	18,144	15,247	13,102
Ceded	(28,427)	(32,660)	(22,411)

Net loss and LAE	$ 476,366	$ 447,749	$ 422,217

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10.Loss and Loss Adjustment Expense Reserves

The following table sets forth a reconciliation of beginning and ending reserves for losses and loss adjustment expenses (“LAE”), as shown in the Company’s consolidated financial statements for the periods indicated.

	Year Ended December 31,		
	2014	2013	2012
Reserves for losses and LAE at beginning of year	$ 455,014	$ 423,842	$ 403,872
Less receivable from reinsurers related to unpaid losses and LAE	(60,346)	(52,185)	(51,774)
Net reserves for losses and LAE at beginning of year	394,668	371,657	352,098
Incurred losses and LAE, related to:			
Current year	513,734	476,638	439,527
Prior years	(37,368)	(28,889)	(17,310)
Total incurred losses and LAE	476,366	447,749	422,217
Paid losses and LAE related to:			
Current year	316,979	299,882	272,454
Prior years	133,288	124,856	130,204
Total paid losses and LAE	450,267	424,738	402,658
Net reserves for losses and LAE at end of period	420,767	394,668	371,657
Plus receivable from reinsurers related to unpaid losses and LAE	61,245	60,346	52,185
Reserves for losses and LAE at end of period	$ 482,012	$ 455,014	$ 423,842

At the end of each period, the reserves were re estimated for all prior accident years. The Company’s prior year reserves decreased by $37,368, $28,889, and $17,310 for the years ended 2014, 2013, and 2012, respectively, and resulted from re estimations of prior years ultimate loss and LAE liabilities. The decrease in prior year reserves during 2014 was primarily composed of a reduction $23,272 in the Company’s retained automobile and $8,804 in the Companies retained homeowners reserves. The decrease in prior year reserves during 2013 was primarily composed of a reduction in the Company’s retained automobile reserves, partially offset by an increase in reserves of homeowners and all other lines of business. The decrease in prior year reserves during 2012 was primarily composed of reductions in the Company’s retained automobile reserves.

The Company’s private passenger automobile line of business prior year reserves decreased during the years ended December 31, 2014, 2013 and 2012 primarily due to improved retained private passenger results. The improved retained private passenger results were primarily due to fewer incurred but not yet reported claims than previously estimated and better than previously estimated severity on the Company’s established bodily injury and property damage case reserves.

Due to the nature of the risks that the Company underwrites and has historically underwritten, management does not believe that it has an exposure to asbestos or environmental pollution liabilities.

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11.Income Taxes

A summary of the income tax expense in the Consolidated Statements of Income is shown below.

	Years Ended December 31,		
	2014	2013	2012
Current Income Taxes:			
Federal	$ 24,389	$ 24,417	$ 22,328
State	177	21	3
	24,566	24,438	22,331
Deferred Income Taxes:			
Federal	(602)	1,899	1,023
State	—	—	—
	(602)	1,899	1,023
Total income tax expense	$ 23,964	$ 26,337	$ 23,354

The income tax expense attributable to the consolidated results of operations is different from the amounts determined by multiplying income before federal income taxes by the statutory federal income tax rate. The sources of the difference and the tax effects of each were as follows for the periods indicated.

	Years Ended December 31,		
	2014	2013	2012
Federal income tax expense, at statutory rate	$ 29,162	$ 30,691	$ 28,498
Tax exempt investment income, net	(5,429)	(4,711)	(5,142)
State taxes, net	115	14	2
Nondeductible expenses	222	210	202
Other, net	(106)	133	(206)
Total income tax expense	$ 23,964	$ 26,337	$ 23,354

The deferred income tax asset (liability) represents the tax effects of temporary differences attributable to the Company's consolidated federal tax return group. Its components were as shown in the following table for the periods indicated.

	Years Ended December 31,	
	2014	2013
Deferred tax assets:		
Discounting of loss reserves	$ 6,505	$ 7,057
Discounting of unearned premium reserve	26,993	25,770
Bad debt allowance	516	384
Employee benefits	8,112	7,248
Rent incentive	503	635
Total deferred tax assets	42,629	41,094
Deferred tax liabilities:		
Deferred acquisition costs	(23,565)	(22,186)
Investments	(2,161)	(1,881)
Net unrealized gains on investments	(15,462)	(9,261)
Depreciation	(35)	(295)
Software development costs	(2,090)	(2,505)
Premium acquisition expenses	(862)	(890)
Other	(68)	(92)
Total deferred tax liabilities	(44,243)	(37,110)
Net deferred tax (liability) asset	$ (1,614)	$ 3,984

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The Company believes, based upon consideration of objective and verifiable evidence, including its recent earnings history and its future expectations, that the Company's taxable income in future years will be sufficient to realize all federal deferred tax assets.

The Company adopted the provisions of ASC 740, Income Taxes on January 1, 2007. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 requires that the Company determine whether the benefits of its tax positions have a more likely than not chance of being sustained upon audit based upon the technical merits of the tax position. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company believes that the positions taken on its income tax returns for open tax years will be sustained upon examination by the IRS. Therefore, the Company has not recorded a liability under ASC 740.

As of December 31, 2014, 2013 and 2012, the Company had no unrecognized tax benefits, and none which if recognized would affect the effective tax rate. The Company does not currently anticipate significant changes in the amount of unrecognized income tax benefits during the next twelve months.

The Company records interest and penalties associated with audits as a component of income before income taxes. Penalties are recorded in underwriting, operating and other expenses, and interest expense is recorded in interest expenses in the Consolidated Statement of Operations. The Company had no interest and penalties related to income taxes accrued as of December 31, 2014 and 2013.

The Company's U.S. federal tax return for the year ended December 31, 2012 was examined by the IRS. The examination was completed during the quarter ending June 30, 2014 with no findings. In the Company's opinion, adequate tax liabilities have been established for all open years. However, the amount of these tax liabilities could be revised in the near term if estimates of the Company's ultimate liability are revised. Tax years prior to 2011 are closed.

12.Share Repurchase Program

On August 3, 2007, the Board of Directors approved a share repurchase program of up to $30,000 of the Company's outstanding common shares. As of December 31, 2014, the Board of Directors had cumulatively authorized increases to the existing share repurchase program of up to $150,000 of its outstanding common shares. Under the program, the Company may repurchase shares of its common stock for cash in public or private transactions, in the open market or otherwise. The timing of such repurchases and actual number of shares repurchased will depend on a variety of factors including price, market conditions and applicable regulatory and corporate requirements. The program does not require the Company to repurchase any specific number of shares and it may be modified, suspended or terminated at any time without prior notice. During the year ended December 31, 2014, the Company purchased 460,023 of its common shares on the open market under the program at a cost of $23,467. During the year ended December 31, 2013, the Company purchased 90,902 of its common shares on the open market under the program at a cost of $4,799. As of December 31, 2014, the Company had purchased 2,279,570 shares at a cost of $83,835. As of December 31, 2013, the Company had purchased 1,819,547 shares on the open market at a cost of $60,368.

13.Statutory Net Income and Surplus

Statutory Accounting Practices

The Company’s insurance company subsidiaries, domiciled in the Commonwealth of Massachusetts, prepare statutory financial statements in accordance with the accounting practices prescribed or permitted by the Division. Prescribed statutory accounting practices are those practices that are incorporated directly or by reference in state laws, regulations, and general administrative rules applicable to all insurance enterprises domiciled in a particular state. Permitted statutory accounting practices include practices not prescribed by the Division, but allowed by the Division. Statutory net income of the Company’s insurance company subsidiaries was $55,330, $57,518, and $56,895 for the years ended December 31, 2014, 2013, and 2012, respectively. Statutory capital and surplus of the Company’s insurance subsidiaries was $630,041 and $627,993 at December 31, 2014 and 2013, respectively.

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Dividends

The Insurance Subsidiaries are subject to various regulatory restrictions that limit the maximum amount of dividends available to be paid to their parent without prior approval of the Commonwealth of Massachusetts Commissioner of Insurance (the "Commissioner"). Massachusetts statute limits the dividends an insurer may pay in any twelve month period, without the prior permission of the Commissioner, to the greater of (i) 10% of the insurer's surplus as of the preceding December 31 or (ii) the insurer's net income for the twelve month period ending the preceding December 31, in each case determined in accordance with statutory accounting practices. Our insurance company subsidiaries may not declare an "extraordinary dividend" (defined as any dividend or distribution that, together with other distributions made within the preceding twelve months, exceeds the limits established by Massachusetts statute) until thirty days after the Commissioner has received notice of the intended dividend and has not objected. As historically administered by the Commissioner, this provision requires the Commissioner's prior approval of an extraordinary dividend. Under Massachusetts law, an insurer may pay cash dividends only from its unassigned funds, also known as earned surplus, and the insurer's remaining surplus must be both reasonable in relation to its outstanding liabilities and adequate to its financial needs. At year end 2014, the statutory surplus of Safety Insurance was $630,041 and its net income for 2014 was $51,211. As a result, a maximum of $63,004 is available in 2014 for such dividends without prior approval of the Commissioner. During the year ended December 31, 2014, Safety Insurance recorded dividends to Safety of $59,186. As result of this Massachusetts statute, the Insurance Subsidiaries had restricted net assets in the amount of $567,037 at December 31, 2014.

Risk Based Capital Requirements

The NAIC has adopted a formula and model law to implement risk based capital requirements for most property and casualty insurance companies, which are designed to determine minimum capital requirements and to raise the level of protection that statutory surplus provides for policyholder obligations. Under Massachusetts law, insurers having less total adjusted capital than that required by the risk based capital calculation will be subject to varying degrees of regulatory action, depending on the level of capital inadequacy. The risk based capital law provides for four levels of regulatory action. The extent of regulatory intervention and action increases as the level of total adjusted capital to risk based capital falls. As of December 31, 2014, the Insurance Subsidiaries had total adjusted capital of $630,041, which is in excess of amounts requiring company or regulatory action at any prescribed risk based capital action level. Minimum statutory capital and surplus, or company action level risk based capital, was $96,662 at December 31, 2014.

14.Fair Value of Financial Instruments

ASC 820, Fair Value Measurements and Disclosure provides a revised definition of fair value, establishes a framework for measuring fair value and expands financial statement disclosure requirements for fair value information. Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants (an exit price). ASC 820 establishes a fair value hierarchy that distinguishes between inputs based on market data from independent sources ("observable inputs") and a reporting entity's internal assumptions based upon the best information available when external market data is limited or unavailable ("unobservable inputs"). The fair value hierarchy in ASC 820 prioritizes fair value measurements into three levels based on the nature of the inputs as follows:

Level 1 — Valuations based on quoted prices in active markets for identical assets and liabilities;

Level 2 — Valuations based on observable inputs that do not meet the criteria for Level 1, including quoted prices in inactive markets and quoted prices in active markets for similar, but not identical instruments; and

Level 3 — Valuations based on unobservable inputs.

Fair values for the Company's fixed maturity securities are based on prices provided by its custodian bank and its investment managers. Both the Company's custodian bank and investment managers use a variety of independent, nationally recognized pricing services to determine market valuations. If the pricing service cannot provide fair value determinations, the Company obtains non-binding price quotes from broker-dealers. A minimum of two quoted prices is

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obtained for the majority of the Company's available-for-sale fixed maturity securities in its investment portfolio. The Company's custodian bank is its primary provider of quoted prices from third-party pricing services and broker-dealers. To provide reasonable assurance of the validity of each price or quote, a secondary third-party pricing service or broker-dealer quote is obtained from the Company's investment managers. An examination of the pricing data is then performed for each security. If the variance between the primary and secondary price quotes for a security is within an accepted tolerance level, the quoted price obtained from the Company's custodian bank is used in the financial statements for the security. If the variance between the primary and secondary price quotes exceeds an accepted tolerance level, the Company obtains a quote from an alternative source, if possible, and documents and resolves any differences between the pricing sources. In addition, the Company may request that its investment managers and its traders provide input as to which vendor is providing prices that its traders believe are reflective of fair value for the security. Following this process, the Company may decide to value the security in its financial statements using the secondary or alternative source if it believes that pricing is more reflective of the security's value than the primary pricing provided by its custodian bank. The Company analyzes market valuations received to verify reasonableness, to understand the key assumptions used and their sources, and to determine an appropriate ASC 820 fair value hierarchy level based upon trading activity and the observability of market inputs. Based on this evaluation and investment class analysis, each price is classified into Level 1, 2 or 3.

Fair values of instruments are based on (i) quoted prices in active markets for identical assets (Level 1), (ii) quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active and model-derived valuations in which all significant inputs are observable in active markets (Level 2) or (iii) valuations derived from valuation techniques in which one or more significant inputs are unobservable in the marketplace (Level 3).

The Company's Level 1 securities consist of equity securities whose values are based on quoted prices in active markets for identical assets. The Company's Level 2 securities are comprised of available-for-sale fixed maturity securities whose fair value was determined using observable market inputs. The Company's Level 3 security is a real estate investment trust equity investment whose fair value was determined using the trust's net asset value obtained from its audited financial statements; however, the Company is required to submit a request 45 days before a quarter end to dispose of the security. Fair values for securities for which quoted market prices were unavailable were estimated based upon reference to observable inputs such as benchmark interest rates, market comparables, and other relevant inputs. Investments valued using these inputs include U.S. Treasury securities, obligations of states and political subdivisions, corporate securities, commercial and residential mortgage-backed securities, and other asset-backed securities. Inputs into the fair value application that are utilized by asset class include but are not limited to:

- States and political subdivisions: overall credit quality, including assessments of market sectors and the level and variability of sources of payment such as general obligation, revenue or lease; credit support such as insurance, state or local economic and political base, prefunded and escrowed to maturity covenants.
- Corporate fixed maturities: overall credit quality, the establishment of a risk adjusted credit spread over the applicable risk-free yield curve for discounted cash flow valuations; assessments of the level of industry economic sensitivity, company financial policies, indenture restrictive covenants, and/or security and collateral.
- Residential mortgage-backed securities, U.S. agency pass-throughs, collateralized mortgage obligations ("CMOs"), non U.S. agency CMOs: estimates of prepayment speeds based upon historical prepayment rate trends, underlying collateral interest rates, original weighted average maturity, vintage year, borrower credit quality characteristics, interest rate and yield curve forecasts, U.S. government support programs, tax policies, and delinquency/default

trends.

- Commercial mortgage-backed securities: overall credit quality, including assessments of the level and variability of credit support and collateral type such as office, retail, or lodging, predictability of cash flows for the deal structure, prevailing economic market conditions.
- Other asset-backed securities: overall credit quality, estimates of prepayment speeds based upon historical trends and characteristics of underlying loans, including assessments of the level and variability of

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collateral, revenue generating agreements, area licenses agreements, product sourcing agreements and equipment and property leases.

- Real estate investment trust ("REIT"): net asset value per share derived from member ownership in capital venture to which a proportionate share of independently appraised net assets is attributed.
- Federal Home Loan Bank of Boston ("FHLB-Boston"): value is equal to the cost of the member stock purchased.

All unadjusted estimates of fair value for our fixed maturities priced by the pricing services as described above are included in the amounts disclosed in Level 2.

In order to ensure the fair value determination is representative of an exit price (consistent with ASC 820), the Company's procedures for validating quotes or prices obtained from third parties include, but are not limited to, obtaining a minimum of two price quotes for each fixed maturity security if possible, as discussed above, the periodic testing of sales activity to determine if there are any significant differences between the market price used to value the security as of the balance sheet date and the sales price of the security for sales that occurred around the balance sheet date, and the periodic review of reports provided by its investment manager regarding those securities with ratings changes and securities placed on its "Watch List." In addition, valuation techniques utilized by pricing services and prices obtained from external sources are reviewed by the Company's external investment manager, whose investment professionals are familiar with the securities being priced and the markets in which they trade, to ensure the fair value determination is representative of an exit price (consistent with ASC 820).

With the exception of the REIT and FHLB-Boston securities, which are categorized as Level 3 securities, the Company's entire available-for-sale portfolio was priced based upon quoted market prices or other observable inputs as of December 31, 2014. There were no significant changes to the valuation process during the year ended December 31, 2014. As of December 31, 2014 and December 31, 2013, no quotes or prices obtained were adjusted by management. All broker quotes obtained were non-binding.

At December 31, 2014 and December 31, 2013, investments in fixed maturities and equity securities classified as available-for-sale had a fair value which equaled carrying value of $1,244,604 and $1,196,828, respectively. At December 31, 2014 and December 31, 2013, we held no short-term investments. The carrying values of cash and cash equivalents and investment income accrued approximated fair value.

The following tables summarize the Company's total fair value measurements for available for sale investments for the periods indicated.

As of December 31, 2014

	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	$ 1,506	$ —	$ 1,506	$ —
Obligations of states and political subdivisions	460,325	—	460,325	—
Residential mortgage-backed securities	207,683	—	207,683	—
Commercial mortgage-backed securities	34,438	—	34,438	—
Other asset-backed securities	10,250	—	10,250	—
Corporate and other securities	421,249	—	421,249	—
Equity securities	109,153	91,523	—	17,630
Total investment securities	$ 1,244,604	$ 91,523	$ 1,135,451	$ 17,630

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	As of December 31, 2013			
	Total	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
U.S. Treasury securities	$ 1,503	$ —	$ 1,503	$ —
Obligations of states and political subdivisions	467,325	—	467,325	—
Residential mortgage-backed securities	208,702	—	208,702	—
Commercial mortgage-backed securities	32,219	—	32,219	—
Other asset-backed securities	13,445	—	13,445	—
Corporate and other securities	381,763	—	381,763	—
Equity securities	91,871	75,951	—	15,920
Total investment securities	$ 1,196,828	$ 75,951	$ 1,104,957	$ 15,920

There were no transfers between Level 1 and Level 2 during the years ended December 31, 2014 or 2013.

The following tables summarize the changes in the Company's Level 3 fair value securities for the periods indicated.

	Year Ended December 31,		
	2014	2013	2012
Balance at beginning of period	$ 15,920	$ 5,346	$ —
Net gains and losses included in earnings	—	—	—
Net gains included in other comprehensive income	1,205	574	—
Purchases	505	10,000	—
Transfers into Level 3	—	—	5,346
Transfers out of Level 3	—	—	—
Balance at end of period	$ 17,630	$ 15,920	$ 5,346
Amount of total losses included in earnings attributable to the change in unrealized losses related to assets still held at end of period	$ —	$ —	$ —

Transfers in and out of Level 3 are attributable to changes in the ability to observe significant inputs in determining fair value exit pricing. As noted in the table above, no transfers were made in or out of Level 3 during 2014 and 2013. A transfer of the Company's investment in a real estate investment trust equity investment was made during 2012 into the Level 3 classification. The Company held two Level 3 securities at December 31, 2014.

15.Quarterly Results of Operations (Unaudited)

An unaudited summary of the Company's 2014 and 2013 quarterly performance, and audited annual performance, is as follows.

	Year ended December 31, 2014				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
Total revenue	$ 191,087	$ 192,946	$ 196,119	$ 198,645	$ 778,797
Net income	12,125	21,423	15,436	10,370	59,354
Earnings per weighted average common share:					
Basic	0.79	1.40	1.03	0.69	3.93
Diluted	0.79	1.40	1.03	0.69	3.91
Cash dividends paid per common share	0.60	0.60	0.70	0.70	2.60

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	Year ended December 31, 2013				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total Year
Total revenue	$ 181,796	$ 184,001	$ 187,694	$ 191,793	$ 745,284
Net income	13,984	18,059	17,656	11,652	61,351
Earnings per weighted average common share:					
Basic	0.91	1.17	1.15	0.76	4.00
Diluted	0.91	1.17	1.14	0.76	3.98
Cash dividends paid per common share	0.60	0.60	0.60	0.60	2.40

16.Related Party Transactions

Mr. A. Richard Caputo, Jr., a member of the Company's Board of Directors and the Chairman of its Investment Committee, is a principal of The Jordan Company, LP ("Jordan"). In 2012, the Company participated as a lender in two loans made by syndicates of lenders to a portfolio company in which funds managed by Jordan are controlling or a significant investor. The first loan, made to Vantage Specialties, Inc., currently bears interest at a rate of 5.00% per annum and matures on February 10, 2018. The Company's participation in the loan is $1,451 at December 31, 2014. The second loan, made to ARCAS Automotive (formerly known as Sequa Auto), was disposed of in 2014. The remaining loan amortizes in equal quarterly installments of 0.25% of the principal amount per quarter. The Company made the loans on the same terms as the other lenders participating in the syndicate. The loans were subject to the approval of the Company's full Investment Committee.

17.Subsequent Events

The Company has evaluated subsequent events for recognition or disclosure in the consolidated financial statements on Form 10 K filed herewith and no events have occurred that require recognition or disclosure.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended [the "Exchange Act"]) as of the end of the period covered by this report. Based on that evaluation, our CEO and CFO have concluded that our disclosure controls and procedures are adequate and effective and ensure that all information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and that information required to be disclosed in such reports is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control—Integrated Framework (2013), our management concluded that our internal control over financial reporting was effective as of December 31, 2014.

PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, has audited the effectiveness of Safety Insurance Group, Inc.'s internal control over financial reporting as of December 31, 2014, as stated in their report which is included herein.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting identified in connection with the evaluation required by Exchange Act Rules 13a-15 and 15d-15 that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect our internal control over financial reporting.

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ITEM 9B. OTHER INFORMATION

The following disclosures relate to actions taken by the Board of Directors of the Company (the "Board"), the Compensation Committee of the Board and the Board of Directors of Safety Insurance Company and would otherwise have been filed during the first fiscal quarter of 2015 on a Form 8-K.

· On February 24, 2015, the Compensation Committee of the Board approved the 2014 annual executive cash bonus pool in the total amount of $2,266 pursuant to the Annual Performance Incentive Plan. Of the total pool, the following amounts were allocated to the Company's CEO and Named Executive Officers: David F. Brussard, $828; William J. Begley, Jr., $300; Edward N. Patrick, Jr., $269; George M. Murphy, $263; James D. Berry, $198.

· On February 24, 2015, the Compensation Committee of the Board approved executive long-term incentive awards to certain members of senior management pursuant to our 2002 Management Omnibus Incentive Plan, as Amended. The long-term incentive awards were granted in a total amount of $3,300 in the form of restricted stock, to be effective on and given a fair value of the closing price of our common stock on February 24, 2015. Of the total award, 45% vests in three annual installments of 30% on February 24, 2016, 30% on February 24, 2017, and 40% on February 24, 2018 and were allocated to the Company's CEO and Named Executive Officers as follows; David F. Brussard, $551 worth of restricted stock; William J. Begley, Jr., $203 worth of restricted stock; George M. Murphy $225 worth of restricted stock; and James D. Berry, $180 worth of restricted stock. The form of restricted stock agreement with service vesting that will be entered into is attached hereto as Exhibit 10.19. Of the total award, 55% vests over a three-year performance period commencing on January 1, 2015 and ending on December 31, 2017. Vesting of these shares is dependent upon the attainment of pre-established performance objectives and were allocated to the Company's CEO and Named Executive Officers as follows; David F. Brussard, $674 worth of restricted stock; William J. Begley, Jr., $248 worth of restricted stock; George M. Murphy $275 worth of restricted stock; and James D. Berry, $220 worth of restricted stock. The form of restricted stock agreement with performance-based vesting that will be entered into is attached hereto as Exhibit 10.65.

· Upon recommendation from the Compensation Committee, on February 24, 2015, the Board approved executive deferred compensation awards pursuant to the Executive Incentive Compensation Plan in the total amount of $1,020. Of the total award, the following amounts were allocated to the Company's CEO and Named Executive Officers: David F. Brussard, $376; William J. Begley, Jr., $140 James D. Berry, $105; Edward N. Patrick, Jr., $116, and George M. Murphy, $129.

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PART III

ITEMS 10-14.

Within 120 days after the close of its fiscal year, the Company intends to file with the Securities and Exchange Commission a definitive proxy statement pursuant to Regulation 14A of the Securities Exchange Act of 1934 as amended, which will include the matters required by these items.

PART IV.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

(a) The following documents are filed as a part of this report:

1. Financial Statements: The Consolidated Financial Statements for the year ended December 31, 2014 are contained herein as listed in the Index to Consolidated Financial Statements.

2. Financial Statement Schedules: The Financial Statement Schedules are contained herein as listed in the Index to Financial Statement Schedules.

3. Exhibits: The exhibits are contained herein as listed in the Index to Exhibits.

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SAFETY INSURANCE GROUP, INC.

INDEX TO FINANCIAL STATEMENT SCHEDULES

Schedules		Page
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V	Valuation and Qualifying Accounts	102
VI	Supplemental Information Concerning Property and Casualty Operations	103

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Safety Insurance Group, Inc.

Summary of Investments—Other than Investments in Related Parties

Schedule I

At December 31, 2014

(Dollars in thousands)

	Cost or Amortized Cost	Estimated Fair Value	Amount at which shown in the Balance Sheet
Fixed maturities:			
U.S. government and government agencies and authorities	$ 203,457	$ 209,189	$ 209,189
Obligations of states and political subdivisions	437,299	460,325	460,325
Corporate and other securities	461,761	465,937	465,937
Total fixed maturities	1,102,517	1,135,451	1,135,451
Equity securities:			
Common stocks:			
Industrial, miscellaneous and all other	97,910	109,153	109,153
Total equity securities	97,910	109,153	109,153
Other invested assets	11,657	11,657	11,657
Total investments	$ 1,212,084	$ 1,256,261	$ 1,256,261

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Safety Insurance Group, Inc.

Condensed Financial Information of the Registrant

Condensed Balance Sheets

Schedule II

(Dollars in thousands)

	December 31,	
	2014	2013
Assets		
Investments in consolidated affiliates	$ 709,523	$ 696,195
Other	54	69
Total assets	$ 709,577	$ 696,264
Liabilities		
Accounts payable and other liabilities	$ 1,294	$ 1,077
Total liabilities	1,294	1,077
Shareholders’ equity	708,283	695,187
Total liabilities and shareholders’ equity	$ 709,577	$ 696,264

Safety Insurance Group, Inc.

Condensed Financial Information of the Registrant

Condensed Statements of Income and Comprehensive Income

Schedule II

(Dollars in thousands)

	Years Ended December 31,		
	2014	2013	2012
Revenues	$ —	$ —	$ —
Expenses	1,264	1,201	1,194

Net loss	(1,264)	(1,201)	(1,194)
Earnings from consolidated subsidiaries	60,618	62,552	59,264
Net income	59,354	61,351	58,070
Other net comprehensive income, net of taxes	11,515	(26,156)	7,735
Comprehensive net income	$ 70,869	$ 35,195	$ 65,805

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Safety Insurance Group, Inc.

Condensed Financial Information of the Registrant

Condensed Statements of Cash Flows

Schedule II

(Dollars in thousands)

	Years Ended December 31,		
	2014	2013	2012
Net income	$ 59,354	$ 61,351	$ 58,070
Adjustments to reconcile net income to net cash provided by operating activities:			
Earnings from consolidated subsidiaries	(60,618)	(62,552)	(59,264)
Dividends received from consolidated subsidiaries(1)	59,186	36,114	29,137
Amortization of restricted stock expense	4,315	4,153	4,430
Changes in assets and liabilities:			
Other assets	15	(61)	12
Accounts payable and accrued liabilities	217	67	8
Net cash provided by operating activities	62,469	39,072	32,393
Proceeds from exercise of stock options	297	2,592	1,241
Excess tax benefit from stock options exercised	3		
Dividends paid	(39,302)	(36,865)	(33,634)
Acquisition of treasury stock	(23,467)	(4,799)	—
Net cash used for financing activities	(62,469)	(39,072)	(32,393)
Net increase in cash and cash equivalents	—	—	—
Cash and cash equivalents, beginning of year	—	—	—
Cash and cash equivalents, end of year	$ —	$ —	$ —

(1) In 2013 and 2012, the Company incorrectly presented dividends received from operating subsidiaries that represent returns on these investments as investing activities rather than as operating activities in the statements of cash flows. The Company has revised the presentation of all prior cash flows to correct this classification. No portion of the dividends received from operating subsidiaries during 2014, 2013 or 2012 represent returns of capital and therefore no portion is presented as an investing activity.

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Safety Insurance Group, Inc.

Supplementary Insurance Information

Schedule III

(Dollars in thousands)

Segment	As of December 31, Deferred Policy Acquisition Costs	Future Policy Benefits, Losses, Claims and Loss Expenses	Unearned Premiums
Property and Casualty Insurance			
2014	$ 67,329	$ 482,012	$ 390,361
2013	63,388	455,014	370,583
2012	60,665	423,842	353,219

Segment	Years Ended December 31, Premium Revenue	Net Investment Income	Benefits, Claims, Losses, and Settlement Expenses	Other Operating Expenses	Premiums Written	Amortization of Deferred Policy Acquisition Costs
Property and Casualty Insurance						
2014	$ 716,875	$ 42,303	$ 476,366	$ 86,497	$ 734,914	$ 132,526
2013	681,870	43,054	447,749	83,557	697,540	126,201
2012	642,469	40,870	422,217	81,288	663,942	118,850

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Safety Insurance Group, Inc.

Reinsurance

Schedule IV

(Dollars in thousands)

Property and Casualty Insurance Earned Premiums	Gross Amount	Ceded to Other Companies	Assumed from Other Companies	Net Amount	Percent of Amount Assumed to Net
Years ended December 31,					
2014	$ 747,786	$ 54,635	$ 23,724	$ 716,875	3.3%
2013	715,657	53,038	19,251	681,870	2.8%
2012	673,596	48,037	16,910	642,469	2.6%

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Safety Insurance Group, Inc.

Valuation and Qualifying Accounts

Schedule V

(Dollars in thousands)

	Balance at Beginning of Period	Additions Charged to Costs and Expenses	Charged to Other Accounts	Deductions(1)	Balance at End of Period
Allowance for doubtful accounts Years Ended December 31,					
2014	$ 456	$ 1,131	$ —	$ 1,125	$ 462
2013	635	836	—	1,015	456
2012	362	1,253	—	980	635

(1) Deductions represent write offs of accounts determined to be uncollectible.

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Safety Insurance Group, Inc.

Supplemental Information Concerning Property and Casualty Insurance Operations

Schedule VI

(Dollars in thousands)

	As of December 31,			Years Ended December 31,	
Affiliation With Registrant	Deferred Policy Acquisition Costs	Reserves for Unpaid Claims and Claims Adjustment Expenses	Unearned Premiums	Earned Premiums	Net Investment Income
Consolidated Property & Casualty Subsidiaries					
2014	$ 67,329	$ 482,012	$ 390,361	$ 716,875	$ 42,303
2013	63,388	455,014	370,583	681,870	43,054
2012	60,665	423,842	353,219	642,469	40,870

	Years Ended December 31, Claims and Claims Adjustment Expenses Incurred Related to				
Affiliation With Registrant	Current Year	Prior Year	Amortization of Deferred Policy Acquisition Costs	Paid Claims and Claims Adjustment Expenses	Premiums Written
Consolidated Property & Casualty Subsidiaries					
2014	$ 513,734	$ (37,368)	$ 132,526	$ 450,267	$ 734,914
2013	476,638	(28,889)	126,201	424,738	697,540
2012	439,527	(17,310)	118,850	402,658	663,942

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 2, 2015

Safety Insurance Group, Inc.
By: /s/ David F. Brussard
David F. Brussard,
President, Chief Executive Officer and Chairman of the Board

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints David F. Brussard and William J. Begley, Jr., and each of them individually, his true and lawful attorney-in-fact and agent with full power of substitution and resubstitution for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto each such attorney-in-fact and agent, or his substitutes, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, to all intents and purposes and as fully as he might or could do in person, hereby ratifying and confirming all that each such attorney-in-fact and agent, or his substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report has been signed by the following persons in the capacities and on the date indicated:

Signature	Title	Date
/s/ David F. Brussard	President, Chief Executive Officer and Chairman of the Board	March 2, 2015

David F. Brussard

/s/ William J. Begley, Jr. William J. Begley, Jr.	Vice President, Chief Financial Officer, Secretary, and Principal Accounting Officer	March 2, 2015
/s/ A. Richard Caputo, Jr. A. Richard Caputo, Jr.	Director	March 2, 2015
/s/ Frederic H. Lindeberg Frederic H. Lindeberg	Director	March 2, 2015
/s/ Peter J. Manning Peter J. Manning	Director	March 2, 2015
/s/ David K. McKown David K. McKown	Director	March 2, 2015

SAFETY INSURANCE GROUP, INC.

INDEX TO EXHIBITS

Exhibit Number	Description
3.1	Form of Amended and Restated Certificate of Incorporation of Safety Insurance Group, Inc.(1)
3.2	Form of Amended and Restated Bylaws of Safety Insurance Group, Inc.(1)
4	Form of Stock Certificate for the Common Stock (1)
10.1	Lease Agreement between Thomas Black Corporation and Aman, Inc. for the lease of office space located on the 1st through 6th, 11th and 12th floors of 20 Custom House Street, Boston, Massachusetts, dated June 11, 1987, and as amended on October 11, 1988, September 14, 1989, September 19, 1990, February 23, 1994, December 20, 1996, June 24, 2002, July 26, 2004 and April 5, 2007 (2)
10.2	Tax Indemnity Agreement by and among Safety Holdings, Inc. and the Management Team, dated October 16, 2001(1)
10.3	2001 Restricted Stock Plan (1)(4)
10.4	Executive Incentive Compensation Plan (1)(4)
10.5	2002 Management Omnibus Incentive Plan, as Amended (7)
10.6	Reinsurance Terms Sheet between Safety Insurance Company and Swiss Re America Corporation, effective January 1, 2002(1)
10.7	Excess Catastrophe Reinsurance Program Terms Sheet between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Blanch Inc., effective January 1, 2002(1)
10.8	Property Risk Excess of Loss Reinsurance Program Terms Sheet between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Blanch Inc., effective January 1, 2002(1)
10.9	Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and the Hartford Steam Boiler Inspection and Insurance Company, effective July 1, 2003(1)
10.10	Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and David F. Brussard, as of December 31, 2008(3)(4)(11)
10.11	Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and William J. Begley, Jr., as of December 31, 2008(3)(4)(11)
10.12	Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and Edward N. Patrick, Jr., as of December 31, 2008(3)(4)(11)
10.13	Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and Daniel D. Loranger, as of December 31, 2008(3)(4)(11)
10.14	Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and Robert J. Kerton, as of December 31, 2008(3)(4)(13)
10.15	Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and David E. Krupa, as of December 31, 2008(3)(4)(11)
10.16	Safety Insurance Company Executive Incentive Compensation Plan—Basic Document(4)(5)(12)
10.17	Safety Insurance Company Executive Incentive Compensation Plan—Adoption Agreement(4)(5)(12)
10.18	Safety Insurance Company Executive Incentive Compensation Plan—Rabbi Trust Agreement(4)(5)(12)
10.19	Form of Restricted Stock Notice and Agreement (with vesting) under the 2002 Management Omnibus Incentive Plan(4)(5)

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10.20 Form of Restricted Stock Notice and Agreement (without vesting) under the 2002 Management Omnibus Incentive Plan(4)(5)
10.21 Form of Nonqualified Stock Option Notice and Agreement under the 2002 Management Omnibus Incentive Plan(4)(5)
10.22 Form of Incentive Stock Option Notice and Agreement under the 2002 Management Omnibus Incentive Plan(4)(5)
10.23 Form of Stock Appreciation Right Notice and Agreement under the 2002 Management Omnibus Incentive Plan(4)(5)
10.24 Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and James D. Berry, as of December 31, 2008(4)(6)(13)
10.25 Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and George M. Murphy, as of December 31, 2008(4)(6)(13)
10.26 Excess Catastrophe Reinsurance Contract between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Blanch Inc., effective January 1, 2006(7)
10.27 Property Excess of Loss Reinsurance Contract between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Blanch Inc., effective January 1, 2006(7)
10.28 Casualty Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Re America Corporation, effective January 1, 2006(7)
10.29 Addendum No. 1 to Casualty Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Re America Corporation, effective January 1, 2006(7)
10.30 Property Catastrophe Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Re America Corporation, effective January 1, 2006(7)
10.31 Umbrella Liability Quota Share Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Re America Corporation, effective January 1, 2006(7)
10.32 Addendum No. 1 to Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and the Hartford Steam Boiler Inspection and Insurance Company, effective April 1, 2006(7)
10.33 Annual Performance Incentive Plan(4)(7)
10.34 Excess Catastrophe Reinsurance Contract between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Inc., effective January 1, 2007(8)
10.35 Addendum No.1 to Excess Catastrophe Reinsurance Contract between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Inc., adding Safety Property and Casualty Insurance Company as a named reinsured company, effective January 1, 2007(8)
10.36 Property Excess of Loss Reinsurance Contract between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Inc., effective January 1, 2007(8)
10.37 Addendum No. 1 to Property Excess of Loss Reinsurance Contract between Safety Insurance Company, Safety Indemnity Insurance Company and Benfield Inc., adding Safety Property and Casualty Insurance Company as a named reinsured company, effective January 1, 2007(8)
10.38 Property Catastrophe Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Reinsurance America Corporation, effective January 1, 2007(8)
10.39 Addendum No. 2 to Casualty Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Reinsurance America Corporation, effective January 1, 2007(8)

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10.40 Addendum No. 2 to Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and The Hartford Steam Boiler Inspection and Insurance Company, effective January 1, 2007(8)
10.41 Addendum No. 1 to Umbrella Liability Quota Share Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Re America Corporation, adding Safety Property and Casualty Insurance Company as a named reinsured company, effective September 1, 2007(9)
10.42 Addendum No. 3 to Casualty Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Swiss Re America Corporation, adding Safety Property and Casualty Insurance Company as a named reinsured company, effective September 1, 2007(9)
10.43 Amendment to Annual Performance Incentive Plan(4)(11)
10.44 Amendment to Management Omnibus Incentive Plan dated December 31, 2008(4)(11)
10.45 Service Line for Homeowners Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company, and Safety Property and Casualty Insurance Company and The Hartford Steam Boiler Inspection and Insurance Company, effective August 1, 2010 (14)
10.46 Equipment Breakdown for Homeowners Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company, and Safety Property and Casualty Insurance Company and the Hartford Steam Boiler Inspection and Insurance Company, effective August 1, 2010(14)
10.47 Amendment to Management Omnibus Incentive Plan dated August 4, 2010 (4)(15)
10.48 Umbrella Liability Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Safety Property and Casualty Insurance Company and Swiss Reinsurance America Corporation Effective January 1, 2011(16)
10.49 Property Catastrophe Excess of Loss Reinsurance Agreement between Safety Insurance Company, Safety Indemnity Insurance Company and Safety Property and Casualty Insurance Company and Swiss Reinsurance America Corporation Effective January 1, 2011(16)
10.50 Excess Catastrophe Reinsurance Contract between Safety Insurance Company, Safety Indemnity Insurance Company and Safety Property and Casualty Insurance Company and AON Benfield Effective January 1, 2011(16)
10.51 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and David F. Brussard, as of December 17, 2012(4)(17)
10.52 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and William J. Begley, Jr., as of December 17, 2012(4) (17)
10.53 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and Daniel D. Loranger, as of December 17, 2012(4) (17)
10.54 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and Edward N. Patrick, Jr., as of December 17, 2012(4) (17)
10.55 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and David E. Krupa, as of December 17, 2012(4) (17)
10.56 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and Robert J. Kerton, as of December 17, 2012(4) (17)
10.57 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and James D. Berry, as of December 17, 2012(4) (17)
10.58 Amendment No. 1 to the Amended and Restated Employment Agreement by and between Safety Insurance Group, Inc. and George M. Murphy, as of December 17, 2012(4) (17)
10.59 Amendment to Management Omnibus Incentive Plan, as Amended dated March 11, 2013(4)(18)

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10.60	Form of Restricted Stock Notice and Agreement (with performance-based vesting) under the 2002 Management Omnibus Plan, as Amended(4)(18)
10.61	Amended and Restated Revolving Credit Agreement with RBS Citizens(19)
10.62	Form of Restricted Stock Notice and Agreement (with performance-based vesting) under the 2002 Management Omnibus Plan, As Amended(4) (20)
10.63	Employment Agreement by and between Safety Insurance Group, Inc. and Paul J. Narciso, as of August 5, 2013(4) (20)
10.64	Employment Agreement by and between Safety Insurance Group, Inc. and Stephen A. Varga, as of August 6, 2014(4) (21)
10.65	Form of Restricted Stock Notice and Agreement (with performance-based vesting) under the 2002 Management Omnibus Plan, As Amended(4) (22)
10.66	Form of Restricted Stock Notice and Agreement under the 2002 Management Omnibus Plan, As Amended(4) (22)
21	Subsidiaries of Safety Insurance Group, Inc.(9)
23	Consent of PricewaterhouseCoopers LLP (22)
24	Power of Attorney(1)
31.1	CEO Certification Pursuant to Rule 13a 14(a)/15d 14(a), as Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002(22)
31.2	CFO Certification Pursuant to Rule 13a 14(a)/15d 14(a), as Adopted Pursuant to Section 302 of the Sarbanes Oxley Act of 2002(22)
32.1	CEO Certification Pursuant to U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002(22)
32.2	CFO Certification Pursuant to U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002(22)
101.INS	XBRL Instance Document (22)
101.SCH	XBRL Taxonomy Extension Schema (22)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase (22)
101.DEF	XBRL Taxonomy Extension Definition Linkbase (22)
101.LAB	XBRL Taxonomy Extension Label Linkbase (22)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase (22)

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(1)Incorporated herein by reference to the Registrant’s Registration Statement on Form S-1 (File No. 333-87056) filed April 26, 2002, and as amended on Form S-8 (Reg. No. 333-110676) filed on November 21, 2003 and as amended on Form S-8 (Reg. No. 333-140423) filed on February 2, 2007.

(2)Incorporated herein by reference to the Registrant’s Registration Statement on Form S-1 (File No. 333-87056) filed April 26, 2002, and as amended on Form S-8 (Reg. No. 333-110676) filed on November 21, 2003 and as amended on Form S-8 (Reg. No. 333-140423) filed on February 2, 2007, and as incorporated herein by reference on Form 10-Q for the quarterly period ended June 30, 2007, as filed on August 9, 2007.

(3)Incorporated herein by reference to the Registrant's Form 10-Q for the quarterly period ended September 30, 2004 filed on November 9, 2004.

(4)Denotes management contract or compensation plan or arrangement.

(5)Incorporated herein by reference to the Registrant’s Form 10-K for the year ended December 31, 2004 filed on March 16, 2005.

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(6)Incorporated herein by reference to the Registrant's Form 10-K for the year ended December 31, 2005 filed on March 16, 2006.

(7)Incorporated herein by reference to the Registrant's Form 10-K for the year ended December 31, 2006 filed on March 1, 2007.

(8)Incorporated herein by reference to the Registrant's Form 10-Q for the quarter ended September 30, 2007 filed on November 9, 2007.

(9)Incorporated herein by reference to the Registrant's Form 10-K for the year ended December 31, 2007 filed on March 14, 2008.

(11)Incorporated herein by reference to the Registrant's Form 8-K filed on December 31, 2008.

(12)Incorporated herein by reference to the Registrant's Form 10-Q for the quarter ended September 30, 2008, as filed on November 7, 2008.

(13)Incorporated herein by reference to the Registrant's Form 10-K for the year ended December 31, 2008 filed on March 13, 2009.

(14)Incorporated herein by reference to the Registrant's Form 10-Q for the quarter ended June 30, 2010, as filed on August 6, 2010.

(15)Incorporated herein by reference to the Registrant's Form 10-K for the year ended December 31, 2010 filed on March 14, 2011.

(16)Incorporated herein by reference to the Registrant's Form 10-Q for the quarter ended September 30, 2011, as filed on November 8, 2011.

(17)Incorporated herein by reference to the Registrant's Form 8-K filed on December 20, 2012.

(18)Incorporated herein by reference to the Registrant's Form 10-K for the year ended December 31, 2012 filed on March 18, 2013

(19)Incorporated herein by reference to the Registrant's Form 8-K filed on August 26, 2013.

(20)Incorporated herein by reference to the Registrant's Form 10-Q for the quarter ended September 30, 2013, as filed on November 8, 2013.

(21)Incorporated herein by reference to the Registrant's Form 10-Q for the quarter ended September 30, 2014, as filed on November 7, 2014.

(22)Included herein.