HANOVER INSURANCE GROUP, INC.
Form 10-Q
May 08, 2009
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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 March 31, 2009

¨ **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 1-13754

THE HANOVER INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**04-3263626**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

440 Lincoln Street, Worcester, Massachusetts 01653

(Address of principal executive offices) (Zip Code)

(508) 855-1000

(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. Yes x No ¨

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

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

The number of shares outstanding of the registrant s common stock was 51,130,527 as of May 1, 2009.

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PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME

(In millions, except per share data)	**(Unaudited) Three Months Ended March 31, 2009**	**2008**
REVENUES		
Premiums	**$ 632.0**	$ 617.7
Net investment income	**64.9**	64.6
Net realized investment losses	**(6.1)**	(0.3)
Fees and other income	**8.1**	13.3
Total revenues	**698.9**	695.3
LOSSES AND EXPENSES		
Losses and loss adjustment expenses	**428.3**	380.1
Policy acquisition expenses	**143.1**	137.4
Other operating expenses	**94.2**	91.7
Total losses and expenses	**665.6**	609.2
Income before federal income taxes	**33.3**	86.1
Federal income tax expense:		
Current	**12.6**	12.9
Deferred	**0.5**	16.2
Total federal income tax expense	**13.1**	29.1
Income from continuing operations	**20.2**	57.0
Discontinued operations (See Note 3):		
Gain (loss) from discontinued FAFLIC business (net of income tax benefit of $2.1 in 2008)	**5.0**	(3.5)
Loss from operations of discontinued accident and health business (net of income tax benefit of $0.1 in 2009)	**(3.3)**	
Gain on disposal of variable life and annuity business (net of income tax expense of $0.1 in 2008)	**3.9**	6.2
Other discontinued operations		(1.2)
Net income	**$ 25.8**	$ 58.5
PER SHARE DATA		
Basic		
Income from continuing operations	**$ 0.40**	$ 1.10
Discontinued operations:		
Gain (loss) from discontinued FAFLIC business (net of income tax benefit of $0.04 in 2008)	**0.10**	(0.07)
Loss from operations of discontinued accident and health business	**(0.07)**	
Gain on disposal of variable life and annuity business	**0.08**	0.12
Other discontinued operations		(0.02)

Net income per share	**$ 0.51**	$ 1.13
Weighted average shares outstanding	**51.1**	51.7
<u>Diluted</u>		
Income from continuing operations	**$ 0.39**	$ 1.09
Discontinued operations:		
Gain (loss) from discontinued FAFLIC business (net of income tax benefit of $0.04 in 2008)	**0.10**	(0.07)
Loss from operations of discontinued accident and health business	**(0.06)**	
Gain on disposal of variable life and annuity business	**0.07**	0.12
Other discontinued operations		(0.02)
Net income per share	**$ 0.50**	$ 1.12
Weighted average shares outstanding	**51.4**	52.3

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED BALANCE SHEETS

(In millions, except per share data)	(Unaudited) March 31, 2009	December 31, 2008
ASSETS		
Investments:		
Fixed maturities, at fair value (amortized cost of $4,517.1 and $4,382.0)	**$ 4,317.8**	$ 4,140.9
Equity securities, at fair value (cost of $97.6 and $97.6)	**77.2**	76.2
Mortgage loans	**30.7**	31.1
Other long-term investments	**18.1**	18.4
Total investments	**4,443.8**	4,266.6
Cash and cash equivalents	**345.8**	397.7
Accrued investment income	**53.8**	52.3
Premiums, accounts and notes receivable, net	**584.9**	578.5
Reinsurance receivable on paid and unpaid losses and unearned premiums	**1,114.8**	1,129.6
Deferred policy acquisition costs	**264.2**	264.8
Deferred federal income taxes	**269.3**	285.6
Goodwill	**169.6**	169.9
Other assets	**320.6**	315.7
Assets of discontinued operations	**131.3**	1,769.5
Total assets	**$ 7,698.1**	$ 9,230.2
LIABILITIES		
Policy liabilities and accruals:		
Losses and loss adjustment expenses	**$ 3,156.5**	$ 3,201.3
Unearned premiums	**1,237.5**	1,246.3
Other policy liabilities	**1.8**	1.8
Total policy liabilities and accruals	**4,395.8**	4,449.4
Expenses and taxes payable	**614.9**	622.3
Reinsurance premiums payable	**54.2**	61.3
Long-term debt	**530.5**	531.4
Liabilities of discontinued operations	**135.1**	1,678.6
Total liabilities	**5,730.5**	7,343.0
Commitments and contingencies (Note 11)		
SHAREHOLDERS EQUITY		
Preferred stock, $0.01 par value, 20.0 million shares authorized, none issued		
Common stock, $0.01 par value, 300.0 million shares authorized, 60.5 million shares issued	**0.6**	0.6
Additional paid-in capital	**1,802.8**	1,803.8
Accumulated other comprehensive loss	**(333.1)**	(384.8)
Retained earnings	**976.3**	949.8
Treasury stock at cost (9.6 million shares)	**(479.0)**	(482.2)

Total shareholders equity		**1,967.6**		1,887.2
Total liabilities and shareholders equity	**$**	**7,698.1**	$	9,230.2

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(In millions)	(Unaudited) Three Months Ended March 31, 2009	2008
Preferred Stock		
Balance at beginning and end of period	**$**	$
Common Stock		
Balance at beginning and end of period	**0.6**	0.6
Additional Paid-In Capital		
Balance at beginning of period	**1,803.8**	1,822.6
Tax (provision) benefit from stock options	**(0.1)**	0.2
Employee and director stock-based awards	**(0.9)**	(24.4)
Balance at end of period	**1,802.8**	1,798.4
Accumulated Other Comprehensive Loss		
Net Unrealized (Depreciation) Appreciation on Investments and Derivative Instruments:		
Balance at beginning of period	**(276.1)**	5.5
Net appreciation (depreciation) during the period:		
Net appreciation (depreciation) on available-for-sale securities and derivative instruments	**48.6**	(3.6)
Benefit for deferred federal income taxes	**0.2**	1.2
	48.8	(2.4)
Balance at end of period	**(227.3)**	3.1
Defined Benefit Pension and Postretirement Plans:		
Balance at beginning of period	**(108.7)**	(25.9)
Amounts arising in the period	**(0.6)**	(0.1)
Amortization during the period:		
Amount recognized as net periodic benefit cost	**5.0**	(1.2)
(Provision) benefit for deferred federal income taxes	**(1.5)**	0.4
	2.9	(0.9)
Balance at end of period	**(105.8)**	(26.8)
Total accumulated other comprehensive loss	**(333.1)**	(23.7)
Retained Earnings		
Balance at beginning of period	**949.8**	946.9
Net income	**25.8**	58.5
Treasury stock issued for less than cost	**(1.4)**	(5.6)
Recognition of share-based compensation	**2.1**	12.8

Balance at end of period	**976.3**	1,012.6
Treasury Stock		
Balance at beginning of period	**(482.2)**	(450.7)
Shares purchased at cost		(32.9)
Net shares reissued at cost under employee stock-based compensation plans	**3.2**	16.4
Balance at end of period	**(479.0)**	(467.2)
Total shareholders equity	**$ 1,967.6**	$ 2,320.7

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In millions)	**(Unaudited) Three Months Ended March 31, 2009**	**2008**
Net income	**$ 25.8**	$ 58.5
Other comprehensive income (loss):		
Available-for-sale securities:		
Net appreciation (depreciation) during the period	**48.6**	(3.3)
Benefit for deferred federal income taxes	**0.2**	1.1
Total available-for-sale securities	**48.8**	(2.2)
Derivative instruments:		
Net depreciation during the period		(0.3)
Benefit for deferred federal income taxes		0.1
Total derivative instruments		(0.2)
	48.8	(2.4)
Pension and postretirement benefits:		
Amounts arising in the period	**(0.6)**	(0.1)
Amortization recognized as net periodic benefit costs:		
Net actuarial loss	**6.8**	0.3
Prior service cost	**(1.4)**	(1.1)
Transition asset	**(0.4)**	(0.4)
Total amortization recognized as net periodic benefit costs	**5.0**	(1.2)
(Provision) benefit for deferred federal income taxes	**(1.5)**	0.4
Total pension and postretirement benefits	**2.9**	(0.9)
Other comprehensive income (loss)	**51.7**	(3.3)
Comprehensive income	**$ 77.5**	$ 55.2

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

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THE HANOVER INSURANCE GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In millions)	**(Unaudited) Three Months Ended March 31, 2009**	**2008**
Cash flows from operating activities		
Net income	**$ 25.8**	$ 58.5
Adjustments to reconcile net income to net cash used in operating activities:		
Gain on disposal of variable life and annuity business	**(3.9)**	(6.2)
Gain from sale of FAFLIC	**(5.0)**	
Loss from other discontinued operations		1.2
Net realized investment losses	**9.3**	5.0
Net amortization and depreciation	**2.3**	4.1
Stock-based compensation expense	**2.7**	3.4
Amortization of deferred benefit plan costs	**5.0**	(1.1)
Deferred federal income taxes	**0.5**	16.2
Change in deferred acquisition costs	**0.6**	(3.0)
Change in premiums and notes receivable, net of reinsurance premiums payable	**(12.6)**	(60.4)
Change in accrued investment income	**(1.6)**	(2.6)
Change in policy liabilities and accruals, net	**(43.4)**	(67.6)
Change in reinsurance receivable	**14.0**	31.2
Change in expenses and taxes payable	**(58.6)**	(56.8)
Other, net	**3.4**	(3.2)
Net cash used in operating activities	**(61.5)**	(81.3)
Cash flows from investing activities		
Proceeds from disposals and maturities of available-for-sale fixed maturities	**511.6**	276.6
Proceeds from disposals of equity securities and other investments		4.8
Proceeds from mortgages sold, matured or collected	**0.4**	2.9
Proceeds from collections of installment finance and notes receivable		118.7
Proceeds from the sale of FAFLIC	**105.8**	
Cash transferred with sale of FAFLIC	**(108.1)**	
Net cash used to acquire Verlan Holdings, Inc		(2.2)
Purchase of available-for-sale fixed maturities	**(624.2)**	(214.8)
Purchase of equity securities and other investments	**(7.7)**	(8.1)
Capital expenditures	**(0.1)**	(3.9)
Disbursements to fund installment finance and notes receivable		(106.9)
Net cash (used in) provided by investing activities	**(122.3)**	67.1
Cash flows from financing activities		
Exercise of options	**0.3**	2.5
Proceeds from excess tax benefits related to share-based payments		0.1
Change in short term debt		37.2
Change in collateral related to securities lending program	**0.8**	(16.5)
Treasury stock purchased at cost		(32.9)
Net cash provided by (used in) financing activities	**1.1**	(9.6)

Net change in cash and cash equivalents	**(182.7)**	(23.8)
Net change in cash related to discontinued operations	**130.8**	57.0
Cash and cash equivalents, beginning of period	**397.7**	210.6
Cash and cash equivalents, end of period	**$ 345.8**	$ 243.8

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

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THE HANOVER INSURANCE GROUP, INC.

NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Principles of Consolidation

The accompanying unaudited consolidated financial statements of The Hanover Insurance Group, Inc. (THG or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the requirements of Form 10-Q.

The interim consolidated financial statements of THG include the accounts of The Hanover Insurance Company (Hanover Insurance), and Citizens Insurance Company of America (Citizens), THG s principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. These legal entities conduct their operations through several business segments discussed in Note 8. All significant intercompany accounts and transactions have been eliminated. The Company s results of operations also included the results of First Allmerica Financial Life Insurance Company (FAFLIC) through December 31, 2008. On January 2, 2009, the Company sold FAFLIC to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity) a subsidiary of the Goldman Sachs Group, Inc. (Goldman Sachs). Accordingly, the FAFLIC business was classified as a discontinued operation in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* (Statement No. 144) and prior periods in the consolidated Statements of Income have been reclassified to conform to this presentation. Additionally, as of December 31, 2008, a portion of FAFLIC s accounts were classified as assets and liabilities of discontinued operations in the consolidated Balance Sheets (See Note 3 Discontinued Operations of FAFLIC Business).

The accompanying interim consolidated financial statements reflect, in the opinion of the Company's management, all adjustments necessary for a fair presentation of the financial position and results of operations. The results of operations for the three months ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the Company s 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The preparation of financial statements in conformity with generally accepted accounting principles requires the Company 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 the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to current year presentation.

2. New Accounting Pronouncements

Recently Adopted Standards

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 163, *Accounting for Financial Guarantee Insurance Contracts an interpretation of FASB Statement No. 60* (Statement No. 163). Statement No. 163 provides for changes to both the recognition and measurement of premium revenues and claim liabilities for financial guarantee insurance contracts that are within the scope of Statement of Financial Accounting Standards No. 60, *Accounting and Reporting by Insurance Enterprises* and that do not qualify as a derivative instrument in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement also expands the disclosure requirements related to financial guarantee insurance contracts to include such items as the Company s method of tracking insured financial obligations with credit deterioration, financial information about the insured financial obligations, and management s policies for placing and monitoring the insured financial obligations. Statement No. 163 is effective for fiscal years beginning after December 15, 2008, except for certain disclosures related to the insured financial obligations, which were effective for the third quarter of 2008. The Company adopted Statement No. 163 on January 1, 2009. The Company does not have financial guarantee insurance products, and, accordingly the adoption of Statement No. 163 did not have an effect on the Company s results of operations or financial position.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (Statement No. 141(R)). This Statement requires the acquiring entity in a business combination to recognize all assets acquired and liabilities assumed in a transaction at the acquisition-date fair value, with certain exceptions. Additionally, the statement requires changes to the accounting treatment of acquisition related items, including, among other items, transaction costs, contingent consideration, restructuring costs, indemnification assets and tax benefits. Statement No. 141(R) also provides for a substantial number of new disclosure requirements. In April 2009, the FASB issued FSP FAS 141(R)-1, *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (FSP FAS 141(R)-1). This FSP amends and clarifies Statement No. 141(R) to address application issues regarding initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. Statement No. 141(R) and FSP FAS 141(R)-1 are effective for business combinations initiated on or after the first annual reporting period beginning after December 15, 2008. The Company adopted Statement No. 141(R) and FSP FAS 141(R)-1 effective January 1, 2009. The adoption of Statement No. 141(R) and FSP FAS 141(R)-1 did not have an effect on the Company s financial position or results of operations; however they will likely have an impact on the Company s accounting for future business combinations, but the effect is dependent upon acquisitions, if any, that are made in the future.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51* (Statement No. 160), which establishes new standards governing the accounting for and reporting of noncontrolling interests (previously referred to as minority interests). This statement establishes reporting requirements which include, among other things, that noncontrolling interests be reflected as a separate component of equity, not as a liability. It also requires that the interests of the parent and the noncontrolling interest be clearly identifiable. Additionally, increases and decreases in a parent s ownership interest that leave control intact shall be reflected as equity transactions, rather than step acquisitions or dilution gains or losses. This statement also requires changes to the presentation of information in the financial statements and provides for additional disclosure requirements. Statement No. 160 is effective for fiscal years beginning on or after December 15, 2008. The Company adopted Statement No. 160 as of January 1, 2009. The effect of adopting Statement No. 160 was not material to the Company s financial position or results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (Statement No. 159). Statement No. 159 permits a company to choose, at specified election dates, to measure at fair value certain eligible financial assets and liabilities that are not currently required to be measured at fair value. The specified election dates include, but are not limited to, the date when an entity first recognizes the item, when an entity enters into a firm commitment or when changes in the financial instrument causes it to no longer qualify for fair value accounting under a different accounting standard. An entity may elect the fair value option for eligible items that exist at the effective date. At that date, the difference between the carrying amounts and the fair values of eligible items for which the fair value option is elected should be recognized as a cumulative effect adjustment to the opening balance of retained earnings. The fair value option may be elected for each entire financial instrument, but need not be applied to all similar instruments. Once the fair value option has been elected, it is irrevocable. Unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. Statement No. 159 was effective as of the beginning of fiscal years that begin after November 15, 2007. The Company did not elect to implement the fair value option for eligible financial assets and liabilities as of January 1, 2008.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Statement No. 157). This statement creates a common definition of fair value to be used throughout generally accepted accounting principles. Statement No. 157 will apply whenever another standard requires or permits assets or liabilities to be measured at fair value, with certain exceptions. The standard establishes a hierarchy for determining fair value which emphasizes the use of observable market data whenever available. The statement also requires expanded disclosures which include the extent to which assets and liabilities are measured at fair value, the methods and assumptions used to measure fair value and the effect of fair value measures on earnings. In October 2008, the FASB issued FSP FAS No. 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP FAS No. 157-3). This FSP clarifies how Statement No. 157 should be applied when valuing securities in markets that are not active. This Statement provides guidance on how companies may use judgment, in addition to market information, in certain circumstances to value assets which have inactive markets. This FSP is effective upon issuance, including prior periods that financial statements have not yet been issued. Statement No. 157 was effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The difference between the carrying amounts and fair values of those financial instruments held at the date this statement is initially applied should be recognized as a cumulative effect adjustment to the opening balance of retained earnings for the fiscal year in which this statement is initially applied. Additionally, in February 2008, the FASB issued Staff Position FAS 157-2, *Effective Date of FASB Statement No. 157*, which delayed the effective date of Statement No. 157 for all non-recurring fair value measurements of nonfinancial assets and nonfinancial liabilities until the fiscal year beginning after November 15, 2008. As a result, the Company partially applied the provisions of Statement No. 157 upon adoption at January 1, 2008 and adopted the remaining provisions relating to certain nonfinancial assets and liabilities on January 1, 2009. The effect of adopting Statement No. 157 and related FSP FAS No. 157-2 and FAS No. 157-3 for both financial and non-financial assets and liabilities, was not material to the Company s financial position or results of operations. In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value when the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS No. 157-4). This FSP provides additional guidance for estimating fair value in accordance with Statement No. 157, when the volume and level of activity for the asset or liability have significantly decreased. The emphasis of the FSP is that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing market participants, under current market conditions. This FSP also further clarifies the guidance to be considered when determining whether or not a transaction is orderly. The FSP is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. The Company does not expect the effect of adopting FSP FAS No. 157-4 will be material to its results of operations or financial position. See further disclosure in Note 7 Fair Value.

Recently Issued Standards

In April 2009, the FASB issued FSP FAS No. 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS No. 115-2 and FAS 124-2). This FSP replaces current other-than-temporary impairment guidance for debt securities specific to a company s intent and ability to hold impaired securities. In its consideration of the recognition of an other-than-temporary impairment on a debt security, a company must assess not only its intent to sell the security, but also the likelihood that it will be required to sell the security before the recovery of its cost basis. A company shall also determine the amount of an other-than-temporary impairment that is related to credit losses. Such amounts shall be recognized in the income statement. Other-than-temporary losses related to factors other than credit losses shall be recognized in accumulated other comprehensive income. The FSP is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. For debt securities that were previously impaired, a company shall recognize the cumulative effect of initially applying this FSP as an adjustment to retained earnings. The Company is currently assessing the effect of adopting FSP FAS No. 115-2 and FAS 124-2.

3. Discontinued Operations of FAFLIC Business

On January 2, 2009, THG sold its remaining life insurance subsidiary, FAFLIC, to Commonwealth Annuity, a subsidiary of Goldman Sachs. Approval was obtained from the Massachusetts Division of Insurance for a pre-close dividend from FAFLIC consisting of designated assets with a statutory book value of approximately $130 million. Total proceeds from the sale, including the dividend, were approximately $230 million, net of transaction costs. Additionally, coincident with the sale transaction, Hanover Insurance and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC s discontinued accident and health insurance business. THG has also indemnified Commonwealth Annuity for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business transferred.

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The Company accounted for the disposal of its FAFLIC business as a discontinued operation in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-lived Assets* (Statement No. 144). For the year ended December 31, 2008, the Company recognized a $77.3 million loss associated with the sale transaction.

The following table summarizes the results for this discontinued business for the periods indicated:

	(Unaudited) Three Months Ended March 31,	
(In millions)	**2009**	**2008**
Gain (Loss) from discontinued FAFLIC business	**$ 5.0**	$ (3.5)

For the three months ended March 31, 2009, the Company recognized income from discontinued operations of $5.0 million, primarily resulting from a change in the Company s estimate of indemnification liabilities related to the sale. Net losses of $3.5 million in the first quarter of 2008 reflect realized investment losses of $4.7 million and segment losses primarily from unfavorable mortality in the traditional line of business. These unfavorable items were partially offset by a $2.1 million tax benefit. Total revenues associated with the FAFLIC business in the first quarter of 2008 were $22.1 million. This business also generated a loss before taxes of $5.6 million during that period.

In connection with the sales transaction, the Company agreed to indemnify Commonwealth Annuity for certain legal, regulatory and other matters that existed as of the sale. Accordingly, the Company established a gross liability in accordance with FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45) of $9.9 million. As of March 31, 2009, the Company s total gross FIN 45 liability was $2.6 million. The Company regularly reviews and updates its FIN 45 liability for legal and regulatory matter indemnities. Although the Company believes its current estimate for its FIN 45 liability is appropriate, there can be no assurance that these estimates will not materially increase in the future. Adjustments to this reserve are recorded in the results of the Company in the period in which they are determined.

Included in Assets of discontinued operations as of December 31, 2008 were $1,710.4 million of assets that were included in the sale of FAFLIC. Included in Liabilities of discontinued operations as of December 31, 2008 were $1,627.6 million of liabilities that were included in the sale of FAFLIC. In accordance with Statement No. 144, the following table details the major assets and liabilities reflected in these captions.

December 31, 2008	
(In millions)	
Assets:	
Cash and investments	$ 1,182.2
Reinsurance recoverable	241.5
Separate account assets	263.4
Other assets	49.3
Valuation allowance	(26.0)
Total assets	$ 1,710.4
Liabilities:	
Policy liabilities	$ 1,305.6
Separate account liabilities	263.4
Trust instruments supported by funding obligations	15.0
Other liabilities	43.6
Total liabilities	$ 1,627.6

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4. Other Significant Transactions

On November 28, 2008, the Company acquired AIX Holdings, Inc. (AIX) for approximately $100 million, subject to various terms and conditions. AIX is a specialty property and casualty insurer that underwrites and manages program business, utilizing alternative risk transfer techniques.

On June 2, 2008, the Company completed the sale of its premium financing subsidiary, AMGRO Inc., to Premium Financing Specialists, Inc. The Company recorded a gain of $11.1 million related to this sale, which was reflected in the Consolidated Statement of Income as part of Discontinued Operations in the second quarter of 2008.

On March 14, 2008, the Company acquired all of the outstanding shares of Verlan for $29.0 million. Verlan, now referred to as Hanover Specialty Property, is a specialty company providing property insurance to small and medium-sized manufacturing and distribution companies that are highly protected fire risks.

On October 16, 2007, the Company s Board of Directors authorized a share repurchase program of up to $100 million. Under this repurchase authorization, the Company may repurchase its common stock from time to time, in varying amounts and prices and at such times deemed appropriate, subject to market conditions and other considerations. The Company is not required to purchase any specific number of shares or to make purchases by any certain date under this program. In light of current economic conditions, the Company has not repurchased shares since June 2008.

On December 30, 2005, the Company sold its variable life insurance and annuity business to Goldman Sachs, including the reinsurance of 100% of the variable business of FAFLIC. THG agreed to indemnify Goldman Sachs for certain litigation, regulatory matters and other liabilities related to the pre-closing activities of the business that was sold. The Company accounted for the disposal as a discontinued operation in accordance with Statement No. 144. In the first quarter of 2008, the Company recognized a benefit of $6.2 million, including $5.8 million resulting from the release of liabilities associated with the estimated liabilities for certain contractual indemnities to Goldman Sachs recorded in accordance with FIN 45. The $3.9 million gain in the first quarter of 2009 related to a further change in the Company s estimate of indemnification liabilities.

5. Federal Income Taxes

Federal income tax expense for the three months ended March 31, 2009 and 2008 has been computed using estimated effective tax rates. These rates are revised, if necessary, at the end of each successive interim period to reflect the current estimates of the annual effective tax rates.

In the first quarter of 2009, the Company decreased its valuation allowance related to its deferred tax asset by $14.1 million, from $348.2 million to $334.1 million. The decrease in this valuation allowance resulted primarily from unrealized appreciation of the Company s investment portfolio offset by realized capital losses. Accordingly, the Company recorded a decrease in valuation allowance of $17.3 million as an adjustment to Accumulated Other Comprehensive Income, partially offset by increases in its valuation allowance of $2.1 million as an adjustment to Federal Income Tax Expense and $1.1 million as an adjustment to Discontinued Operations in its Consolidated Statements of Income.

The Company or its subsidiaries files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company and its subsidiaries are no longer subject to U.S. federal income tax examinations by tax authorities for years before 2005. The IRS audits of the years 2005 and 2006 commenced in December 2007. The Company and its subsidiaries are still subject to U.S. state income tax examinations by tax authorities for years after 1998.

6. Pension and Other Postretirement Benefit Plans

The Company s defined benefit pension plans, which provided retirement benefits based on a cash balance formula, were frozen as of January 1, 2005; therefore, no further cash balance allocations have been credited for plan years beginning on or after January 1, 2005. In addition, certain transition group employees were eligible for a grandfathered benefit based upon service and compensation; such benefits were also frozen at January 1, 2005 levels with an annual transition pension adjustment. The Company has additional unfunded pension plans and postretirement plans to provide benefits to certain full-time employees, former agents, retirees and their dependents.

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The components of net periodic benefit cost for pension and other postretirement benefit plans are as follows:

(In millions)	(Unaudited) Three Months Ended March 31, 2009	2008	2009	2008
	Pension Benefits		Postretirement Benefits	
Service cost benefits earned during the period	**$**	$	**$**	$ 0.2
Interest cost	**8.5**	8.2	**0.7**	0.9
Expected return on plan assets	**(6.1)**	(8.5)		
Recognized net actuarial loss	**6.7**	0.3	**0.1**	0.1
Amortization of transition asset	**(0.4)**	(0.4)		
Amortization of prior service cost			**(1.4)**	(1.1)
Net periodic cost (benefit)	**$ 8.7**	$ (0.4)	**$ (0.6)**	$ 0.1

In April 2009 the Company contributed $30 million to its qualified plan related to the 2008 plan year. Approximately $18 million of this contribution is discretionary.

7. Fair Value

Effective January 1, 2008, the Company adopted Statement No. 157 as it relates to its financial assets and liabilities. Statement No. 157 provides for a standard definition of fair value to be used in new and existing pronouncements. Statement No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability, i.e., exit price, in an orderly transaction between market participants and also establishes a hierarchy for determining fair value, which emphasizes the use of observable market data whenever available. The three broad levels defined by the hierarchy are as follows, with the highest priority given to Level 1 as these are the most reliable, and the lowest priority given to Level 3:

Level 1 Quoted prices in active markets for identical assets.

Level 2 Quoted prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, or other inputs that are observable or can be corroborated by observable market data, including model-derived valuations.

Level 3 Unobservable inputs that are supported by little or no market activity.

When more than one level of input is used to determine fair value, the financial instrument is classified as Level 1, 2 or 3 according to the lowest priority level that has a significant impact on the fair value measurement.

The Company performs a review of the fair value hierarchy classifications on a quarterly basis. Changes in the observability of valuation inputs may result in the reclassification of certain financial assets or liabilities within the fair value hierarchy. Reclassifications related to Level 3 of the fair value hierarchy are reported as transfers in or out of Level 3 as of the beginning of the quarter in which the reclassification occurs. During the quarter ended March 31, 2009, the Company transferred certain assets that were previously classified as Level 3 into Level 2, primarily as a result of changes in the significance of unobservable inputs on the fair value measurement.

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The Company currently holds fixed maturity securities and equity securities, and prior to January 2, 2009, the Company also held separate account assets, for which fair value is determined on a recurring basis. The following tables present for each hierarchy level, the Company s assets that were measured at fair value at March 31, 2009 and December 31, 2008.

	Fair Value at March 31, 2009 (Unaudited)			
(in millions)	**Total**	**Level 1**	**Level 2**	**Level 3**
Fixed Maturities:				
U.S. Treasury securities and U.S. Government and agency securities	**$ 293.3**	**$ 93.4**	**$ 199.9**	**$**
States and political subdivisions	**750.0**		**730.8**	**19.2**
Foreign governments	**2.8**		**2.8**	
Corporate fixed maturities	**2,085.8**	**1.0**	**2,042.7**	**42.1**
Mortgage-backed securities	**1,229.2**	**5.0**	**1,214.9**	**9.3**
Total fixed maturities (1)	**4,361.1**	**99.4**	**4,191.1**	**70.6**
Equity securities (2)	**65.7**	**52.6**	**11.9**	**1.2**
Total investment assets at fair value, including assets of discontinued operations	**4,426.8**	**152.0**	**4,203.0**	**71.8**
Investment assets of discontinued operations at fair value	**(92.0)**	**(0.1)**	**(91.9)**	
Total investment assets of continuing operations at fair value	**$ 4,334.8**	**$ 151.9**	**$ 4,111.1**	**$ 71.8**

(1) Excludes $48.7 million of trust preferred capital securities of a THG affiliated entity that are designated as held-to-maturity that are carried at amortized cost.

(2) Excludes certain investments in equities of unconsolidated affiliates totaling $11.5 million that are carried at cost.

	Fair Value at December 31, 2008			
(in millions)	**Total**	**Level 1**	**Level 2**	**Level 3**
Fixed Maturities:				
U.S. Treasury securities and U.S. Government and agency securities	$ 355.6	$ 101.4	$ 254.2	$
States and political subdivisions	726.9		718.3	8.6
Foreign governments	4.8	1.8	3.0	
Corporate fixed maturities	2,468.4		2,414.3	54.1
Mortgage-backed securities	1,529.8		1,503.4	26.4
Total fixed maturities (1)	5,085.5	103.2	4,893.2	89.1
Equity securities (2)	64.9	52.9	10.8	1.2
Separate account assets	263.4	263.4		
Total investment assets at fair value, including assets of discontinued operations	5,413.8	419.5	4,904.0	90.3
Investment assets of discontinued operations	(1,250.3)	(304.4)	(940.1)	(5.8)
Total investment assets of continuing operations at fair value	$ 4,163.5	$ 115.1	$ 3,963.9	$ 84.5

(1) Excludes $42.2 million of trust preferred capital securities of a THG affiliated entity that are designated as held-to-maturity that are carried at amortized cost.

(2) Excludes certain investments in equities of unconsolidated affiliates totaling $11.4 million that are carried at cost.

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The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2009 and 2008.

	(Unaudited) Three Months Ended March 31, 2009			(Unaudited) Three Months Ended March 31, 2008				
	Level 3 Assets			Level 3 Assets				Level 3 Liabilities
(in millions)	Fixed Maturities	Equity Securities	Total Assets	Fixed Maturities	Equity Securities	Derivatives	Total Assets	Derivatives
Balance January 1	**$ 89.1**	**$ 1.2**	**$ 90.3**	$ 30.5	$ 1.3	$ 5.8	$ 37.6	$ (1.1)
Total gains (losses):								
Included in earnings	**0.3**		**0.3**			2.3	2.3	(2.2)
Included in other comprehensive income	**(0.5)**		**(0.5)**	(0.1)		(0.3)	(0.4)	
Net (redemptions) purchases	**(4.8)**		**(4.8)**	7.8			7.8	
Transfers out of Level 3	**(7.7)**		**(7.7)**					
Balance March 31, including assets and liabilities of discontinued operations	**76.4**	**1.2**	**77.6**	38.2	1.3	7.8	47.3	(3.3)
Assets and liabilities of discontinued operations	**(5.8)**		**(5.8)**	(3.3)		(7.8)	(11.1)	3.3
Balance March 31, including assets of continuing operations	**$ 70.6**	**$ 1.2**	**$ 71.8**	$ 34.9	$ 1.3	$	$ 36.2	$

The table below summarizes losses and gains due to changes in fair value, including both realized and unrealized gains and losses, recorded in net income for Level 3 assets and liabilities for the three months ended March 31, 2009 and 2008.

	(Unaudited) Three Months Ended March 31, 2009			(Unaudited) Three Months Ended March 31, 2008				
	Level 3 Assets			Level 3 Assets				Level 3 Liabilities
(in millions)	Fixed Maturities	Equity Securities	Total Assets	Fixed Maturities	Equity Securities	Derivatives	Total Assets	Derivatives
Classification of net realized investment gains (losses) and net change in unrealized depreciation:								
Gain (loss) from discontinued FAFLIC business	**$**	**$**	**$**	$	$	$ 2.3	$ 2.3	$ (2.2)
Net realized investment losses	**0.3**		**0.3**					
Total	**$ 0.3**	**$**	**$ 0.3**	$	$	$ 2.3	$ 2.3	$ (2.2)

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8. Other Comprehensive Income

The following table provides a reconciliation of gross unrealized investment gains (losses) to the net balance shown in the Consolidated Statements of Comprehensive Income:

	(Unaudited) Three Months Ended March 31,	
(In millions)	**2009**	**2008**
Unrealized appreciation (depreciation) on available-for-sale securities:		
Unrealized holding gains (losses) arising during period, net of income tax benefit of $0.2 in 2009 and $2.9 in 2008	**$ 39.5**	**$ (5.4)**
Less: reclassification adjustment for losses included in net income, net of income tax benefit of $1.8 in 2008	**(9.3)**	**(3.2)**
Total available-for-sale securities	**48.8**	**(2.2)**
Unrealized depreciation on derivative instruments:		
Unrealized holding losses arising during period, net of income tax benefit of $0.1 in 2008		**(0.2)**
Other comprehensive income (loss)	**$ 48.8**	**$ (2.4)**

9. Segment Information

The Company s primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines, and Other Property and Casualty. Personal Lines includes personal automobile, homeowners and other personal coverages, while Commercial Lines includes commercial multiple peril, commercial automobile, workers compensation, and other commercial coverages, such as bonds and inland marine business. In addition, the Other Property and Casualty segment consists of: Opus Investment Management, Inc. (Opus), which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets; as well as voluntary pools in which the Company has not actively participated since 1995. Prior to its sale on June 2, 2008, AMGRO Inc., the Company s premium financing business, was also included in the Other Property and Casualty segment. Additionally, prior to the sale of FAFLIC on January 2, 2009, the operations of the former Life Companies segment was reflected as a separate segment. This business is now reflected as discontinued operations. Certain ongoing expenses were also reclassified from the Life Companies segment to the Property and Casualty business. In accordance with Statement of Financial Accounting Standards No. 131, *Disclosures About Segments of an Enterprise and Related Information* (Statement No. 131 *),* the separate financial information of each 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. A summary of the Company s reportable segments is included below.

The Company reports interest expense related to its corporate debt separately from the earnings of its operating segments. Corporate debt consists of the Company s junior subordinated debentures and its senior debentures.

Management evaluates the results of the aforementioned segments on a pre-tax basis. Segment income excludes certain items which are included in net income, such as federal income taxes and net realized investment gains and losses, including certain gains or losses on derivative instruments, because fluctuations in these gains and losses are determined by interest rates, financial markets and the timing of sales. Also, segment income excludes net gains and losses on disposals of businesses, discontinued operations, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. While these items may be significant components in understanding and assessing the Company s financial performance, management believes that the presentation of segment income enhances understanding of the Company s results of operations by highlighting net income attributable to the core operations of the business. However, segment income should not be construed as a substitute for net income determined in accordance with generally accepted accounting principles.

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Summarized below is financial information with respect to business segments:

(In millions)	(Unaudited) Three Months Ended March 31, 2009	2008
Segment revenues:		
Property and Casualty:		
Personal Lines	**$ 394.8**	$ 403.2
Commercial Lines	**304.3**	283.6
Other Property and Casualty	**6.9**	10.9
Total Property and Casualty	**706.0**	697.7
Intersegment revenues	**(1.0)**	(2.1)
Total segment revenues	**705.0**	695.6
Adjustments to segment revenues:		
Net realized investment losses	**(6.1)**	(0.3)
Total revenues	**$ 698.9**	$ 695.3
Segment income before federal income taxes and discontinued operations:		
Property and Casualty:		
Personal Lines:		
GAAP underwriting loss	**$ (26.5)**	$ (5.2)
Net investment income	**27.6**	29.7
Other income	**2.0**	2.6
Personal Lines segment income	**3.1**	27.1
Commercial Lines:		
GAAP underwriting income	**15.3**	36.1
Net investment income	**31.6**	30.9
Other income	**0.3**	1.0
Commercial Lines segment income	**47.2**	68.0
Other Property and Casualty:		
GAAP underwriting loss		(1.0)
Net investment income	**5.5**	3.8
Other net expenses	**(6.3)**	(1.5)
Other Property and Casualty segment (loss) income	**(0.8)**	1.3
Total Property and Casualty	**49.5**	96.4
Interest on corporate debt	**(10.0)**	(10.0)
Segment income before federal income taxes	**39.5**	86.4
Adjustments to segment income:		
Net realized investment losses	**(6.1)**	(0.3)
Other items	**(0.1)**	
Income from continuing operations before federal income taxes	**$ 33.3**	$ 86.1

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Summarized below is financial information with respect to business segments:

(In millions)	Identifiable Assets (Unaudited) March 31, 2009	Identifiable Assets December 31, 2008
Property and Casualty (1)(3)	**$ 7,580.6**	$ 7,586.6
Assets of discontinued operations (2)	**131.3**	1,769.5
Intersegment eliminations (3)	**(13.8)**	(125.9)
Total	**$ 7,698.1**	$ 9,230.2

(1) The Company reviews assets based on the total Property and Casualty Group and does not allocate between the Personal Lines, Commercial Lines and Other Property and Casualty segments. Included in the Property and Casualty group s assets as of December 31, 2008 are those assets which were being retained by the Company subsequent to the sale of FAFLIC.

(2) March 31, 2009 includes assets related to the Company s discontinued accident and health insurance business. December 31, 2008 includes both the assets which were sold to Commonwealth Annuity as part of the FAFLIC sale on January 2, 2009 and those related to the Company s discontinued accident and health insurance business.

(3) The 2008 balance includes a $120.6 million dividend receivable from FAFLIC to the holding company, which was paid in January 2009.

Discontinued Operations FAFLIC Business

On January 2, 2009, FAFLIC was sold to Commonwealth Annuity. In accordance with Statement No. 144 the Company determined that this business qualified as a discontinued operation (see Note 3 for further discussion of the FAFLIC sale transaction). Accordingly, as of December 31, 2008, assets related to the disposition of FAFLIC of $1,710.4 million, net of the related valuation allowance, were aggregated and classified as assets of discontinued operations on the Consolidated Balance Sheets and related liabilities of $1,627.6 million were aggregated and classified as liabilities of discontinued operations on the Consolidated Balance Sheets.

Discontinued Operations Accident and Health Insurance Business

During 1999, the Company exited its accident and health insurance business, consisting of its Employee Benefit Services (EBS) business, its Affinity Group Underwriters business and its accident and health assumed reinsurance pool business. Prior to 1999, these businesses comprised substantially all of the former Corporate Risk Management Services segment. Accordingly, the operating results of the discontinued segment have been reported in accordance with Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions* (APB Opinion No. 30). On January 2, 2009, Hanover Insurance directly assumed a portion of the accident and health business; and therefore continues to apply APB Opinion No. 30 to this business. In addition, the remainder of the FAFLIC accident and health business was reinsured also by Hanover Insurance and has been reported in accordance with Statement No. 144.

At March 31, 2009 and December 31, 2008, the portion of the discontinued accident and health business that was directly assumed had assets of $63.0 million and $59.1 million, respectively, consisting primarily of invested assets and reinsurance recoverables, and liabilities of approximately $44.0 million and $51.0 million, respectively, consisting primarily of policy liabilities. At March 31, 2009 and December 31, 2008, the assets and liabilities of this business, as well as those of the reinsured portion of the accident and health business are classified as assets and liabilities of discontinued operations in the Consolidated Balance Sheets.

10. Stock-based Compensation

Compensation cost recorded pursuant to Statement No. 123(R) and the related tax benefits were as follows:

(In millions)	(Unaudited) Quarter Ended March 31, 2009	2008
Stock-based compensation expense	**$ 2.7**	$ 3.4
Tax benefit	**(0.9)**	(1.2)
Stock-based compensation expense, net of taxes	**$ 1.8**	$ 2.2

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Stock Options

Information on the Company s stock option plan activity is summarized below.

	(Unaudited) Three Months Ended March 31, 2009		(Unaudited) Three Months Ended March 31, 2008	
(In whole shares and dollars)	**Shares**	**Weighted Average Exercise Price**	**Shares**	**Weighted Average Exercise Price**
Outstanding, beginning of period	**2,998,821**	**$ 41.02**	3,268,912	$ 41.15
Granted	**520,000**	**34.19**	92,909	44.79
Exercised	**10,500**	**29.64**	69,350	35.98
Forfeited or cancelled	**26,250**	**51.18**	8,250	53.72
Expired	**184,100**	**52.07**	115,400	52.63
Outstanding, end of period	**3,297,971**	**$ 39.28**	3,168,821	$ 40.91

Restricted Stock and Restricted Stock Units

The following tables summarize activity information about employee restricted stock and restricted stock units:

	(Unaudited) Three Months Ended March 31, 2009		(Unaudited) Three Months Ended March 31, 2008	
(In whole shares and dollars)	**Shares**	**Weighted Average Grant Date Fair Value**	**Shares**	**Weighted Average Grant Date Fair Value**
Restricted stock and restricted stock units:				
Outstanding, beginning of period	**470,905**	**$ 45.41**	179,416	$ 46.79
Granted	**273,160**	**34.22**	284,202	45.09
Vested and exercised	**4,162**	**44.58**	6,000	35.87
Forfeited	**2,518**	**45.66**	2,561	45.16
Outstanding, end of period	**737,385**	**$ 41.31**	455,057	$ 45.87
Performance-based restricted stock units:				
Outstanding, beginning of period (1)	**164,442**	**$ 46.10**	402,929	$ 44.16
Granted (1)	**47,375**	**34.19**	127,624	42.40
Vested and exercised	**40,507**	**46.28**	342,757	44.27
Forfeited			882	50.60
Outstanding, end of period (1)	**171,310**	**$ 42.15**	186,914	$ 45.64

(1) Performance based restricted stock units are based upon the achievement of the performance metric at 100%. These units have the potential to range from 0% to 175% of the shares disclosed, which varies based on grant year and individual participation level. Increases or decreases to the 100% target level are reflected as granted in the period in which performance-based stock unit goals are achieved. In

2008, 26,004 and 43,640 performance-based stock units were included as granted due to completion levels in excess of 100% for units originally granted in 2006 and 2005, respectively. The weighted average grant date fair value for these awards was $46.28 and $36.34 for 2006 and 2005 grants, respectively. There were 57,980 shares awarded as new grants made in 2008 which have a weighted average grant date fair value of $45.21.

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11. Earnings Per Share

The following table provides share information used in the calculation of the Company s basic and diluted earnings per share:

(In millions, except per share data)	**(Unaudited) Three Months Ended March 31, 2009**	**2008**
Basic shares used in the calculation of earnings per share	**51.1**	51.7
Dilutive effect of securities:		
Employee stock options	**0.1**	0.3
Non-vested stock grants	**0.2**	0.3
Diluted shares used in the calculation of earnings per share	**51.4**	52.3
Per share effect of dilutive securities on income from continuing operations and net income	**$ (0.01)**	$ (0.01)

Diluted earnings per share for the three months ended March 31, 2009 and 2008 excludes 3.1 million and 2.0 million, respectively, of common shares issuable under the Company s stock compensation plans, because their effect would be antidilutive.

12. Commitments and Contingencies

LITIGATION

Durand Litigation

On March 12, 2007, a putative class action suit captioned Jennifer A. Durand v. The Hanover Insurance Group, Inc., The Allmerica Financial Cash Balance Pension Plan was filed in the United States District Court for the Western District of Kentucky. The named plaintiff, a former employee who received a lump sum distribution from the Company s Cash Balance Plan at or about the time of her termination, claims that she and others similarly situated did not receive the appropriate lump sum distribution because in computing the lump sum, the Company understated the accrued benefit in the calculation. The Company filed a motion to dismiss on the basis that the plaintiff failed to exhaust administrative remedies, which motion was granted without prejudice in a decision dated November 7, 2007. This decision was reversed by an order dated March 24, 2009 issued by the United States Court of Appeals for the Sixth Circuit, and the case was remanded to the district court. In the Company s judgment, the outcome is not expected to be material to its financial position, although it could have a material effect on the results of operations for a particular quarter or annual period.

Hurricane Katrina Litigation

The Company has been named as a defendant in various litigations, including putative class actions, relating to disputes arising from damages which occurred as a result of Hurricane Katrina in 2005. As of March 31, 2009, there were approximately 94 such cases. These cases have been filed in both Louisiana state courts and federal district courts. These cases generally involve, among other claims, disputes as to the amount of reimbursable claims in particular cases (e.g. how much of the damage to an insured property is attributable to flood and therefore not covered, and how much is attributable to wind, which may be covered), as well as the scope of insurance coverage under homeowners and commercial property policies due to flooding, civil authority actions, loss of landscaping, business interruption and other matters. Certain of these cases claim a breach of duty of good faith or violations of Louisiana insurance claims handling laws or regulations and involve claims for punitive or exemplary damages.

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On August 23, 2007, the State of Louisiana (individually and on behalf of the State of Louisiana, Division of Administration, Office of Community Development) filed a putative class action in the Civil District Court for the Parish of Orleans, State of Louisiana, entitled State of Louisiana, individually and on behalf of State of Louisiana, Division of Administration, Office of Community Development ex rel The Honorable Charles C. Foti, Jr., The Attorney General For the State of Louisiana, individually and as a class action on behalf of all recipients of funds as well as all eligible and/or future recipients of funds through The Road Home Program v. AAA Insurance, et al., No. 07-8970. The complaint named as defendants over 200 foreign and domestic insurance carriers, including THG. Plaintiff seeks to represent a class of current and former Louisiana citizens who have applied for and received or will receive funds through Louisiana s Road Home program. On August 29, 2007, Plaintiff filed an Amended Petition in this case, asserting myriad claims, including claims for breach of: contract, the implied covenant of good faith and fair dealing, fiduciary duty and Louisiana s bad faith statutes. Plaintiff seeks relief in the form of, among other things, declarations that (a) the efficient proximate cause of losses suffered by putative class members was windstorm, a covered peril under their policies; (b) the second efficient proximate cause of their losses was storm surge, which Plaintiff contends is not excluded under class members policies; (c) the damage caused by water entering affected parishes of Louisiana does not fall within the definition of flood ; (d) the damages caused by water entering Orleans Parish and the surrounding area was a result of man-made occurrence and are properly covered under class members policies; (e) many class members suffered total losses to their residences; and (f) many class members are entitled to recover the full value for their residences stated on their policies pursuant to the Louisiana Valued Policy Law. In accordance with these requested declarations, Plaintiff seeks to recover amounts that it alleges should have been paid to policyholders under their insurance agreements, as well as penalties, attorneys fees, and costs. The case has been removed to the Federal District Court for the Eastern District of Louisiana.

On March 5, 2009, the court issued an Order granting in part and denying in part a Motion to Dismiss filed by defendants. The court dismissed all claims for bad faith and breach of fiduciary duty and all claims for flood damages under policies with flood exclusions or asserted under the Valued Policy Law, but rejected the insurers arguments that the purported assignments from individual claimants to the state were barred by anti-assignment provisions in the insurers policies. On April 16, 2009, the court denied a Motion for Reconsideration of its ruling regarding the anti-assignment provisions, but certified the issue as ripe for immediate appeal. On April 30, 2009, defendants filed a Petition for Permission to Appeal to the United States Court of Appeals for the Fifth Circuit.

The Company established its loss and LAE reserves on the assumption that it will not have any liability under the Road Home or similar litigation, and that the Company will otherwise prevail in litigation as to the causes of certain large losses and not incur extra contractual or punitive damages.

Other Matters

The Company has been named a defendant in various other legal proceedings arising in the normal course of business, including two suits with respect to which the Company is obligated to indemnify Commonwealth Annuity and Goldman Sachs in connection with the sale in 2005 of its variable life insurance and annuity business, which challenge the Company s former Life Companies imposition of certain restrictions on trading funds invested in separate accounts.

REGULATORY AND INDUSTRY DEVELOPMENTS

Unfavorable economic conditions may contribute to an increase in the number of insurance companies that are under regulatory supervision. This may result in an increase in mandatory assessments by state guaranty funds, or voluntary payments by solvent insurance companies to cover losses to policyholders of insolvent or rehabilitated companies. Mandatory assessments, which are subject to statutory limits, can be partially recovered through a reduction in future premium taxes in some states. The Company is not able to reasonably estimate the potential impact of any such future assessments or voluntary payments.

Over the past three years, state-sponsored insurers, reinsurers or involuntary pools have increased significantly, particularly those states which have Atlantic or Gulf Coast exposures. As a result, the potential assessment exposure of insurers doing business in such states and the attendant collection risks have increased, particularly, in the Company s case, in the states of Massachusetts, Louisiana and Florida. Such actions and related regulatory restrictions on rate increases, underwriting and the ability to non-renew business may limit the Company s ability to reduce its potential exposure to hurricane related losses. At this time, the Company is unable to predict the likelihood or impact of any such potential assessments or other actions.

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In February 2009, the Governor of Michigan called upon every automobile insurer operating in the state to freeze personal automobile insurance rates for 12 months to allow time for the legislature to enact comprehensive automobile insurance reform. In addition, she endorsed a number of proposals by her appointed Automobile and Home Insurance Consumer Advocate which would, among other things, change the current rate approval process from the current file and use system to prior approval , mandate affordable rates, reduce the threshold for law suits to be filed in at fault incidents, and prohibit the use of certain underwriting criteria such as credit-based insurance scores. The Office of Financial and Insurance Regulation (OFIR) had previously issued regulations prohibiting the use of credit scores to rate personal lines insurance policies, which regulations are the subject of litigation which is expected to be reviewed by the Michigan Supreme Court. Pending a determination by the Michigan Supreme Court, OFIR is enjoined from disapproving rates on the basis that they are based in part on credit-based insurance scores. At this time, the Company is unable to predict the likelihood of adoption or impact on the business of any such proposals or regulations, but any such restrictions could have an adverse effect on the Company s results of operations.

From time to time, proposals have been made to establish a federal based insurance regulatory system and to allow insurers to elect either federal or state-based regulation (optional federal chartering). In light of the current economic crisis and the focus on increased regulatory controls, particularly with regard to financial institutions, the Company expects renewed interest in such proposals. In fact, several proposals have been introduced to create a system of optional federal chartering and to create federal oversight mechanisms for insurance or insurance holding companies which are systemically important to the United States financial system. The Company cannot predict the impact that any such change will have on its operations or business or on that of the Company s competitors.

In addition, the Company is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies. The potential outcome of any such action or regulatory proceedings in which the Company has been named a defendant, and the Company s ultimate liability, if any, from such action or regulatory proceedings, is difficult to predict at this time. In the Company s opinion, based on the advice of legal counsel, the ultimate resolutions of such proceedings will not have a material effect on the Company s financial position, although they could have a material effect on the results of operations for a particular quarter or annual period.

RESIDUAL MARKETS

The Company is required to participate in residual markets in various states, which generally pertains to high risk insureds, disrupted markets or lines of business or geographic areas where rates are regarded as excessive. The results of the residual markets are not subject to the predictability associated with the Company s own managed business, and are significant to the workers compensation line of business, the homeowners line of business and both the personal and commercial automobile lines of business.

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PART I

ITEM 2

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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Introduction

The following Management s Discussion and Analysis of Financial Condition and Results of Operations is intended to assist readers in understanding the interim consolidated results of operations and financial condition of The Hanover Insurance Group, Inc. and subsidiaries (THG) and should be read in conjunction with the interim Consolidated Financial Statements and related footnotes included elsewhere in this Quarterly Report on Form 10-Q and the Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our 2008 Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Our results of operations include the accounts of The Hanover Insurance Company (Hanover Insurance) and Citizens Insurance Company of America (Citizens), our principal property and casualty companies; and certain other insurance and non-insurance subsidiaries. Our results of operations also included the results of First Allmerica Financial Life Insurance Company (FAFLIC), our former run-off life insurance and annuity subsidiary through December 31, 2008. On January 2, 2009, we sold FAFLIC to Commonwealth Annuity and Life Insurance Company (Commonwealth Annuity), a subsidiary of The Goldman Sachs Group, Inc. (Goldman Sachs). As of December 31, 2008 and for all prior periods presented, operations from FAFLIC have been reclassified as discontinued operations. Additionally, as of December 31, 2008, a portion of FAFLIC s accounts were classified as assets and liabilities of discontinued operations in the Consolidated Balance Sheets.

Executive Overview

Our property and casualty business includes our Personal Lines segment, our Commercial Lines segment and our Other Property and Casualty segment. As noted above, on January 2, 2009, we sold FAFLIC to Commonwealth Annuity. Total net proceeds from the sale after transaction expenses were approximately $230 million. Coincident with the sale transaction, Hanover Insurance and FAFLIC entered into a reinsurance contract whereby Hanover Insurance assumed FAFLIC s discontinued accident and health insurance business.

Developments during the first quarter of 2009 continue to illustrate that the U.S. and global financial markets and economies are in an unprecedented period of uncertainty and volatility. Although credit spreads began to tighten modestly related to our investment grade industrial and utility corporate bonds, residential mortgage-backed securities and below investment grade securities, they continued to widen in the financial sector of our corporate bond portfolio. Concerns about troubled assets held by financial institutions, as well as the general economic crisis, have resulted in continued uncertainty in the financial services industry and have slowed the industry s recovery. The ongoing uncertainty in the financial markets and uncertainty around possible implications of governmental funding have also continued to impact credit market liquidity.

Our investment holdings, which totaled $4.8 billion at March 31, 2009, and consist primarily of fixed maturities, and cash and cash equivalents, included securities with net unrealized loss positions of approximately $227 million. Our unrealized loss position declined slightly from December 31, 2008, in part due to the recognition of impairment charges of $16.5 million during the first quarter of 2009. These impairment charges primarily related to credit-related losses on higher yielding below investment grade fixed maturities in the industrial sector and perpetual preferred securities in the financial sector. Additionally, our unrealized loss position improved due to the aforementioned tightening of certain credit spreads.

Approximately 95% of our fixed maturity holdings are investment grade securities. We expect that the capital markets will continue to be volatile in the near-term. There is uncertainty regarding what effect government programs will have on the financial markets and the time that is required for companies to successfully execute meaningful actions that will provide relief to the markets. We believe, however, that recent and ongoing government actions to support the banking and financial sectors, the quality of the assets we hold, and our relatively strong capital position will allow us, over time, to realize the anticipated long-term economic value related to securities we hold that are in an unrealized loss position. Additionally, we have a substantially liquid portfolio with a laddered duration structure which provides for periodic maturities and thus expect to have the ability to hold such securities for the period of time anticipated to allow for a recovery in fair value.

In the first quarter of 2009, we recorded $37.4 million of pre-tax catastrophe losses primarily due to an unusually severe winter. This represents an increase of approximately $18 million compared to the first quarter of 2008. The increased level of claim activity predominantly came from Michigan, our largest market, other Midwestern states, and New England.

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During early May 2009, A.M. Best Company upgraded the financial strength ratings of our property and casualty companies, Hanover Insurance and Citizens to an A rating from their prior rating of A- . A.M. Best also upgraded the rating related to our Senior Debt to BBB from a prior rating of BBB- . We believe that these upgrades, which occurred at a time of such uncertainty in the financial services industry, reflect the strength of our balance sheet, our solid capital position, and our investments in the business over the past several years. These upgrades are expected to provide access to certain business groups and markets, particularly in Commercial Lines, that have previously not been significant in our mix of business. However, there can be no assurance that the ratings upgrade will produce the results expected.

Personal Lines

In our Personal Lines business, we are focused on making investments that are intended to help us maintain profitability, build a distinctive position in the market and provide us with profitable growth opportunities. Actions we have taken related to catastrophe management in coastal states, including Florida and Louisiana have reduced our growth in premium in our homeowners line; however, we believe these actions have improved our risk profile. Current market conditions continue to be challenging as pricing pressures and economic conditions remain difficult, especially in Michigan, impacting our ability to grow and retain business in this, our largest state, and elsewhere. We are working closely with our partner agents in Michigan to remain a significant writer with strong margins. Also, in 2009 we continued our mix management initiatives relating to our ***Connections® Auto*** product to improve the overall profitability of the business. We are focused on reducing our growth in less profitable automobile segments and increasing our multi-car and account business consistent with our strategy. We believe that market conditions will remain challenging and competitive in Personal Lines. Despite these challenges and transitions, we experienced relatively flat growth levels in Personal Lines and expect that trend to continue in 2009 as the industry continues to respond to the difficult economic environment.

Our ***Connections Auto*** product is available in eighteen states. We believe that this product will help us to profitably grow our market share over time. The ***Connections Auto*** product is designed to be competitive for a wide spectrum of drivers through its multivariate rating application, which calculates rates based upon the magnitude and correlation of multiple risk factors. At the same time, a core strategy is to broaden our portfolio offerings and write total accounts , which are accounts that include multiple personal line coverages for the same customer. Our homeowners product, ***Connections® Home***, is available in sixteen states. It is intended to improve our competitiveness for total account business by significantly improving ease of doing business for our agents and by providing better packaging of coverages for policyholders. Having implemented a broader portfolio of products, we continue to refine these products and to work closely with high potential agents to increase the percentage of business they place with us and to ensure that it is consistent with our preferred mix of business. Additionally, we remain focused on diversifying our state mix beyond our four core states of Michigan, Massachusetts, New York and New Jersey. We expect these efforts to contribute to profitable growth and improved retention in our Personal Lines segment over time.

Commercial Lines

In the Commercial Lines business, the market remains competitive. Price competition requires us to continue to be highly disciplined in our underwriting process to ensure that we grow the business only at acceptable margins. We continue to target, through mid-sized agents, small and first-tier middle markets, which encompass clients whose premiums are generally below $200,000. We also continue to develop our specialty businesses, which on average are expected to offer higher margins over time and enable us to deliver a more complete product portfolio to our agents and policyholders. Our specialty lines now account for approximately one third of our Commercial Lines business. Additional growth in our specialty lines continues to be a significant part of our strategy. Our ongoing focus on expanding our product offerings in specialty businesses was evidenced by our acquisitions of Verlan Holdings, Inc. (Verlan), which we market as Hanover Specialty Property, a specialty company providing property insurance to small and medium-sized manufacturing and distribution companies that are highly protected fire risks, AIX Holdings, Inc. (AIX), a specialty property and casualty insurance carrier that focuses on underwriting and managing program business that utilizes alternative risk transfer techniques and Professionals Direct, Inc. (PDI), which we market as Hanover Professionals, providing professional liability coverage for small to medium-sized legal practices over the past two years. Additionally, we have developed our niche insurance programs, such as for schools, religious institutions and moving and storage companies. We believe these acquisitions and the development of our niche businesses provide us with better breadth and diversification of products and improve our competitive position with our agents.

In January 2009, we introduced another specialty niche for human services organizations such as non-profit youth and community service organizations. As a complimentary initiative, we have established a business focused on management liability, specifically non-profit directors and officers liability, employment practices liability and eventually private company directors and officers liability. In addition, we have made a number of enhancements to our core products and technology platforms that are intended to drive more total account placements in our Small Commercial business, which we believe will enhance margins. Our focus continues to be on improving and expanding our partnerships with agents. We believe our specialty capabilities and small commercial platform, coupled with distinctiveness in the middle market, enables us to deliver significant value to our agents and policyholders in our target markets.

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Description of Operating Segments

Our primary business operations include insurance products and services in three property and casualty operating segments. These segments are Personal Lines, Commercial Lines and Other Property and Casualty. Personal Lines includes personal automobile, homeowners and other personal coverages, while Commercial Lines includes commercial multiple peril, commercial automobile, workers compensation and other commercial coverages, such as bonds and inland marine business. In addition, the Other Property and Casualty segment consists of: Opus Investment Management, Inc. (Opus), which markets investment management services to institutions, pension funds and other organizations; earnings on holding company assets, as well as voluntary pools business in which we have not actively participated since 1995. Prior to its sale on June 2, 2008, Amgro, Inc. (AMGRO), our premium financing business was also included in the Other Property and Casualty segment. Additionally, prior to the sale of FAFLIC on January 2, 2009, our operations also included the results of this life insurance and annuity business as a separate segment. We present the separate financial information of each segment consistent with the manner in which our chief operating decision maker evaluates results in deciding how to allocate resources and in assessing performance.

We report interest expense related to our corporate debt separately from the earnings of our operating segments. Corporate debt consists of our junior subordinated debentures and our senior debentures.

Results of Operations

Our consolidated net income includes the results of our three operating segments (segment income), which we evaluate on a pre-tax basis, and our interest expense on corporate debt. In addition, segment income excludes certain items which we believe are not indicative of our core operations. The income of our segments excludes items such as federal income taxes and net realized investment gains and losses, including net gains or losses on certain derivative instruments, because fluctuations in these gains and losses are determined by interest rates, financial markets and the timing of sales. Also, segment income excludes net gains and losses on disposals of businesses, discontinued operations, restructuring costs, extraordinary items, the cumulative effect of accounting changes and certain other items. Although the items excluded from segment income may be significant components in understanding and assessing our financial performance, we believe segment income enhances an investor s understanding of our results of operations by highlighting net income attributable to the core operations of the business. However, segment income should not be construed as a substitute for net income determined in accordance with generally accepted accounting principles (GAAP).

Catastrophe losses are a significant component in understanding and assessing the financial performance of our business. However, catastrophic events, such as Hurricanes Katrina, Ike and Gustav make it difficult to assess the underlying trends in this business. Management believes that providing certain financial metrics and trends excluding the effects of catastrophes helps investors to understand the variability in periodic earnings and to evaluate the underlying performance of our operations.

Our consolidated net income for the first quarter of 2009 was $25.8 million, compared to $58.5 million for the same period in 2008. The $32.7 million decrease in earnings was primarily due to $46.9 million in lower segment income driven by an increase in catastrophe losses, as well as a decrease in prior year favorable development, In addition, net realized investment losses increased $5.8 million. These decreases in the earnings were partially offset by $16.0 million of lower tax expense related to income from continuing operations.

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The following table reflects segment income as determined in accordance with Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*, and a reconciliation of total segment income to consolidated net income.

(In millions)	Three Months Ended March 31, 2009	2008
Segment income before federal income taxes:		
Property and Casualty		
Personal Lines	**$ 3.1**	$ 27.1
Commercial Lines	**47.2**	68.0
Other Property and Casualty	**(0.8)**	1.3
Total Property and Casualty	**49.5**	96.4
Interest expense on corporate debt	**(10.0)**	(10.0)
Total segment income before federal income taxes	**39.5**	86.4
Federal income tax expense on segment income	**(13.1)**	(29.1)
Net realized investment losses	**(6.1)**	(0.3)
Other non-operating items	**(0.1)**	
Income from continuing operations, net of taxes	**20.2**	57.0
Discontinued operations:		
Gain (loss) from discontinued FAFLIC business, net of taxes	**5.0**	(3.5)
Loss from discontinued accident and health business, net of taxes	**(3.3)**	
Gain on disposal of variable life and annuity business, net of taxes	**3.9**	6.2
Other discontinued operations		(1.2)
Net income	**$ 25.8**	$ 58.5

Segment Results

The following is our discussion and analysis of the results of operations by business segment. The segment results are presented before taxes and other items which management believes are not indicative of our core operations, including realized gains and losses.

Property and Casualty

The following table summarizes the results of operations for the Property and Casualty group for the periods indicated:

(In millions)	Three Months Ended March 31, 2009	2008
Net premiums written	**$ 629.9**	$ 628.5
Net premiums earned	**$ 632.0**	$ 617.7
Net investment income	**64.7**	64.4
Other income	**9.3**	15.6
Total segment revenues	**706.0**	697.7

Losses and LAE	**428.3**	380.1
Policy acquisition expenses	**143.1**	137.4
Other operating expenses	**85.1**	83.8
Total losses and operating expenses	**656.5**	601.3
Segment income	**$ 49.5**	$ 96.4

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Three Months Ended March 31, 2009 Compared to Three Months Ended March 31, 2008

The Property and Casualty group s segment income decreased $46.9 million, or 48.7%, to $49.5 million, in the first quarter of 2009, compared to $96.4 million in the first quarter of 2008. This decrease was primarily due to an increase of approximately $37 million in incremental weather-related losses, $18.1 million of which are categorized as catastrophe-related and approximately $19 million of which are categorized as non-catastrophe-related. These weather-related losses were primarily caused by the severe winter storms experienced in the Midwest and Northeast. Favorable development on prior years loss and loss adjustment expense (LAE) reserves decreased $14.4 million, to $41.2 million in the first quarter of 2009, from $55.6 million in the same period of 2008, of which approximately $12 million was primarily due to, and reflected in the aforementioned weather-related activity for storms occurring in December 2008. In addition to the effects of weather-related activity, earnings decreased by $9.5 million. This decrease is primarily due to $7.0 million of higher operating expenses primarily due to increased costs in our specialty business, including our recently acquired subsidiaries, increased employee benefit costs and costs related to the increase in earned premium.

Production and Underwriting Results

The following table summarizes GAAP net premiums written and GAAP loss, LAE, expense and combined ratios for the Personal Lines and Commercial Lines segments. These items are not meaningful for our Other Property and Casualty segment.

	Three Months Ended March 31,					
	2009			2008		
(In millions, except ratios)	**GAAP Net Premiums Written**	**GAAP Loss Ratios (1)(2)**	**Cata-strophe loss ratios (3)**	**GAAP Net Premiums Written**	**GAAP Loss Ratios (1)(2)**	**Cata-strophe loss ratios (3)**
Personal Lines:						
Personal automobile	**$ 249.2**	**61.7**	**0.4**	$ 259.3	59.8	0.2
Homeowners	**89.7**	**81.6**	**22.9**	83.3	65.7	9.1
Other personal	**8.3**	**32.3**	**2.0**	9.1	32.6	7.1
Total Personal Lines	**347.2**	**66.8**	**7.1**	351.7	60.8	3.0
Commercial Lines:						
Workers compensation	**33.5**	**44.0**		38.2	38.9	
Commercial automobile	**48.0**	**47.8**	**0.4**	53.5	41.9	
Commercial multiple peril	**93.1**	**64.2**	**11.2**	94.6	36.9	7.6
Other commercial	**108.1**	**30.9**	**1.1**	90.5	29.6	2.1
Total Commercial Lines	**282.7**	**46.5**	**4.2**	276.8	35.9	3.3
Total	**$ 629.9**	**58.2**	**5.9**	$ 628.5	51.0	3.1

	2009			2008		
	GAAP LAE Ratio	**GAAP Expense Ratio**	**GAAP Combined Ratio (4)**	**GAAP LAE Ratio**	**GAAP Expense Ratio**	**GAAP Combined Ratio (4)**
Personal Lines	**11.5**	**28.1**	**106.4**	11.2	28.5	100.5
Commercial Lines	**6.9**	**40.7**	**94.1**	9.6	39.7	85.2
Total	**9.6**	**33.4**	**101.2**	10.6	32.9	94.5

(1) GAAP loss ratio is a common industry measurement of the results of property and casualty insurance underwriting. This ratio reflects incurred claims compared to premiums earned. Our GAAP loss ratios include catastrophe losses.

(2) Includes policyholders dividends.

(3) Catastrophe loss ratio reflects incurred catastrophe claims compared to premiums earned.

(4) GAAP combined ratio is a common industry measurement of the results of property and casualty insurance underwriting. This ratio is the sum of incurred claims, claim expenses and underwriting expenses incurred to premiums earned. Our GAAP combined ratios also include the impact of catastrophes. Federal income taxes, net investment income and other non-underwriting expenses are not reflected in the GAAP combined ratio.

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The following table summarizes GAAP underwriting results for the Personal Lines, Commercial Lines and Other Property and Casualty segments and reconciles it to GAAP segment income.

	Three Months Ended							
	March 31, 2009				March 31, 2008			
	Personal Lines	Commercial Lines	Other Property and Casualty	Total	Personal Lines	Commercial Lines	Other Property and Casualty	Total
GAAP underwriting loss, excluding prior year reserve development and catastrophes	**$ (8.6)**	**$ (6.4)**	**$**	**$ (15.0)**	$ (6.2)	$ (0.2)	$	$ (6.4)
Prior year reserve development favorable (unfavorable)	**8.1**	**33.1**		**41.2**	12.0	44.6	(1.0)	55.6
Pretax catastrophe effect	**(26.0)**	**(11.4)**		**(37.4)**	(11.0)	(8.3)		(19.3)
GAAP underwriting (loss) profit	**(26.5)**	**15.3**		**(11.2)**	(5.2)	36.1	(1.0)	29.9
Net investment income	**27.6**	**31.6**	**5.5**	**64.7**	29.7	30.9	3.8	64.4
Fees and other income	**3.5**	**4.4**	**1.4**	**9.3**	4.2	4.3	7.1	15.6
Other operating expenses	**(1.5)**	**(4.1)**	**(7.7)**	**(13.3)**	(1.6)	(3.3)	(8.6)	(13.5)
Segment income (loss)	**$ 3.1**	**$ 47.2**	**$ (0.8)**	**$ 49.5**	$ 27.1	$ 68.0	$ 1.3	$ 96.4

Personal Lines

Personal Lines net premiums written decreased $4.5 million, or 1.3%, to $347.2 million for the first quarter of 2009. The most significant factor contributing to this decrease was a decline in net premiums written in Massachusetts, which resulted from a decrease in premium from the Massachusetts Commonwealth Automobile Reinsurers (CAR) facility and a rate decrease of 9.7% effective April 1, 2008 following the implementation of managed competition in the state, as well as from declines in net premiums written in New Jersey and Michigan. These decreases were partially offset by growth in personal automobile renewal premium and an increase in new homeowners premium in our targeted growth states.

Policies in force in the personal automobile line of business decreased 1.0% at the end of the first quarter of 2009 compared to the first quarter of 2008 driven by a decrease in Michigan, which we attribute to the difficult economic conditions in the state, partially offset by net growth in policies in force in Massachusetts. Since December 31, 2008, policies in force in the personal automobile line have remained essentially flat.

Policies in force in the homeowners line of business increased 1.6% at the end of the first quarter of 2009, compared to the first quarter of 2008, primarily driven by increases in newer, growth-targeted states, partially offset by a decrease in policies in force in Florida, where throughout 2008 we non-renewed all homeowners polices. On a sequential basis, policies in force in the homeowners line of business grew 1.2% since December 31, 2008.

Personal Lines underwriting loss increased $21.3 million, to $26.5 million, in the first quarter of 2009, compared to $5.2 million in the first quarter of 2008. This increased loss was primarily due to an increase of approximately $20 million in incremental weather-related losses, $14.7 million of which are categorized as catastrophe-related and approximately $5 million of which are categorized as non-catastrophe-related. These weather-related losses were primarily caused by the severe winter storms experienced in the Midwest and Northeast. Favorable development on prior years loss and LAE reserves decreased $3.9 million, to $8.1 million in the first quarter of 2009, from $12.0 million in the same period of 2008, of which approximately $6 million was primarily due to, and reflected in the aforementioned weather-related activity for storms occurring in December 2008. In addition to the effects of weather-related activity, earnings decreased by $1.1 million, primarily due to lower net investment income.

Our ability to maintain and increase Personal Lines net written premium and to maintain and improve underwriting results is expected to be affected by increasing price competition, regulatory actions and the difficult economic conditions, particularly in Michigan, which is our largest state.

New business generally experiences higher loss ratios than our other business, and is more difficult to predict. We have experienced loss ratios with our ***Connections Auto*** business, which are higher than expected, particularly in states in which we have less experience and data. Our ability to maintain or increase earnings and continue to grow could be adversely affected should the loss ratios for new business prove to be higher than our pricing and profitability expectations, or if required adjustments to enhance risk segmentation and related agency management actions result in making our products less price competitive.

It is difficult to predict the impact that the current recessionary environment will have on our Personal Lines business. Our ability to increase pricing may be impacted as agents and consumers may become more price sensitive, customers may shop for policies

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more frequently or aggressively, utilize comparative rating models or turn to direct sales channels rather than independent agents. Additionally, new business premiums, retention levels and renewal premiums may decrease as policyholders reduce coverages or change deductibles to reduce premiums, home values decline, foreclosures increase and policyholders retain older or less expensive automobiles and purchase or insure fewer ancillary items such as boats, trailers and motor homes for which we provide coverages. Additionally, claims frequency could increase as policyholders submit and pursue claims more aggressively than in the past, fraud incidences may increase, or we may experience higher incidents of abandoned properties or poorer maintenance which may also result in more claims activity. Our Personal Lines segment could also be affected by an ensuing consolidation of independent insurance agencies.

In addition, as discussed under Contingencies and Regulatory Matters Other Regulatory Matters , certain states have taken, and others may take, actions which significantly affect the property and casualty insurance market, including ordering rate reductions for personal automobile and homeowners insurance products and subjecting insurance companies that do business in that state to onerous underwriting or other restrictions and potentially significant assessments. Such state actions or our responses thereto could have a significant impact on our underwriting margins and growth prospects, as well as our ability to manage exposures to hurricane or other high risk losses.

Notwithstanding these concerns, we believe that our agency distribution strategy, the strength of our market share in key states, our account rounding strategy, the relatively inelastic demand for insurance products and our capital position, place us in a good position to manage these issues and concerns relative to many of our peer competitors.

Commercial Lines

Commercial Lines net premiums written increased $5.9 million, or 2.1%, to $282.7 million for the first quarter of 2009. This increase was primarily due to increased written premium from our recently acquired subsidiaries, AIX and Hanover Specialty Property of $22.2 million, partially offset by the non-recurring increase in net written premium of $9.4 million in the first quarter 2008 resulting from the termination of our umbrella excess of loss reinsurance treaty. The remaining premium decrease was due to declines in new business in our core lines and lower renewal premium.

Commercial Lines underwriting income decreased $20.8 million, to $15.3 million, in the first quarter of 2009, compared to $36.1 million in the first quarter of 2008. This decrease is primarily due to an increase of approximately $16 million in incremental weather-related losses, $3.1 million of which are categorized as catastrophe-related and approximately $13 million of which are categorized as non-catastrophe-related. These weather-related losses were primarily caused by the severe winter storms experienced in the Midwest and Northeast. Favorable development on prior years loss and LAE reserves decreased $11.5 million, to $33.1 million in the first quarter of 2009, from $44.6 million in the same period of 2008, of which approximately $6 million is reflected in the aforementioned weather-related activity for storms occurring in December 2008. In addition to the effect of weather-related activity, earnings decreased by $4.5 million. This decrease is primarily due to $5.9 million of higher operating expenses principally attributable to $11.0 million in increased costs in our specialty business, including our recently acquired subsidiaries, $3.0 million in less favorable prior year non-weather-related development and $1.5 million in increased employee benefit costs. This decrease was partially offset by a change in our actuarial methodology for estimating loss adjustment expense reserves, reducing LAE expenses by approximately $10 million in the current quarter. Favorable development of prior year LAE reserves was $2.9 million in the first quarter of 2008.

We continue to experience significant price competition in all lines of business in our Commercial Lines segment. Premium has decreased modestly on renewal policies, most notably in our middle market and commercial automobile business. We have also experienced relatively flat pricing in our small commercial business. The industry is also generally experiencing overall rate decreases. Our ability to increase Commercial Lines net premiums written while maintaining or improving underwriting results is expected to be affected by price competition and the difficult economic conditions, particularly in Michigan.

It is difficult to predict the impact of the current economic environment on our Commercial Lines segment, but businesses may become more price sensitive. We may also experience decreased new business levels, retention and renewal rates and renewal premiums. The overall decline in the economy is likely to result in reductions in demand for insurance products and services as more companies cease to do business and there are fewer business start-ups, particularly as small businesses are affected by a decline in overall consumer and business spending.

In addition, businesses may seek to reduce or eliminate coverages to reduce costs and there will likely be a reduction in payroll levels, which would reduce workers compensation premiums and may result in an increase in workers compensation claims. Our Commercial Lines segment could also be affected by an ensuing consolidation of independent insurance agencies.

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Notwithstanding these concerns, we believe that our agency distribution strategy, our broad product offerings, the strength of our growing specialty businesses, disruptions in the marketplace which may result in improved pricing, the relatively inelastic demand for insurance products and our capital position, place us in a good position to manage these issues and concerns relative to many of our peer competitors.

Other Property and Casualty

Segment income of the Other Property and Casualty segment decreased $2.1 million, to a loss of $0.8 million for the quarter ended March 31, 2009, from profit of $1.3 million in the same period of 2008. The decrease is primarily due to higher employee benefit costs.

Investment Results

Net investment income before taxes increased $0.3 million, or 0.5%, to $64.7 million for the quarter ended March 31, 2009, primarily due to an increase in average pre-tax yields on fixed maturities and an increase in investment earnings from our recently acquired subsidiaries. Average pre-tax yields on fixed maturities were 5.8% for the quarter ended March 31, 2009 and 5.7% for the quarter ended March 31, 2008.

Reserve for Losses and Loss Adjustment Expenses

Overview of Loss Reserve Estimation Process

We maintain reserves for our property and casualty products to provide for our ultimate liability for losses and loss adjustment expenses with respect to reported and unreported claims incurred as of the end of each accounting period. These reserves are estimates, taking into account actuarial projections at a given point in time, of what we expect the ultimate settlement and administration of claims will cost based on facts and circumstances then known, estimates of future trends in claim severity and frequency, judicial theories of liability and policy coverage, and other factors.

We determine the amount of loss and loss adjustment expense reserves (the loss reserves) based on an estimation process that is very complex and uses information obtained from both company specific and industry data, as well as general economic information. The estimation process is judgmental, and requires us to continuously monitor and evaluate the life cycle of claims on type-of-business and nature-of-claim bases. Using data obtained from this monitoring and assumptions about emerging trends, our actuaries develop information about the size of ultimate claims based on historical experience and other available market information. The most significant assumptions used in the actuarial estimation process, which vary by line of business, include determining the expected consistency in the frequency and severity of claims incurred but not yet reported to prior years claims, the trend in loss costs, changes in the timing of the reporting of losses from the loss date to the notification date and expected costs to settle unpaid claims. This process assumes that past experience, adjusted for the estimated effects of current developments and anticipated trends, is an appropriate basis for predicting future events. On a quarterly basis, our actuaries provide to management a point estimate for each significant line of our direct business to summarize their analysis.

In establishing the appropriate loss reserve balances for any period, management carefully considers these actuarial point estimates, which are the principal bases for establishing our reserve balances, along with a qualitative evaluation of business trends, environmental changes, and numerous other factors. In general, such additional factors may include, but are not limited to, improvement or deterioration of the actuarial indications in the period, the maturity of the accident year, trends observed over the recent past such as changes in the mix of business or the impact of regulatory or litigation developments, the anticipated impact of new product introductions or expansion into new geographic areas, the level of volatility within a particular line of business, and the magnitude of the difference between the actuarial indication and the recorded reserves. Regarding our indirect business from voluntary and involuntary pools, we are provided loss estimates by managers of each pool. We adopt reserve estimates for the pools that consider this information and other facts.

Management s Review of Judgments and Key Assumptions

There is greater inherent uncertainty in estimating insurance reserves for certain types of property and casualty insurance lines, particularly workers compensation and other liability lines, where a longer period of time may elapse before a definitive determination of ultimate liability and losses may be made. In addition, the technological, judicial, regulatory and political climates involving these types of claims change regularly. There is also greater uncertainty in establishing reserves with respect to new business, particularly new business which is generated with respect to newly introduced product lines, by newly appointed agents or in geographies in which we have less experience in conducting business, such as the program business written by our recently acquired AIX subsidiary. In such cases, there is less historical experience or knowledge and less data upon which the actuaries can rely. Historically, we have limited the issuance of long-tailed other liability policies, including directors and officers (D&O) liability, errors and omissions (E&O) liability and medical malpractice liability. With the acquisition of Hanover Professionals in 2007, which writes lawyers professional errors and omissions coverage, and the introduction of new specialty coverages, we are modestly increasing and expect to continue to increase our exposure to longer-tailed liability lines, including D&O coverages.

We regularly update our reserve estimates as new information becomes available and further events occur which may impact the resolution of unsettled claims. Reserve adjustments are reflected in the results of operations as adjustments to losses and LAE. Often, these adjustments are recognized in periods subsequent to the period in which the underlying policy was written and the loss event occurred. These types of subsequent adjustments are described separately as prior year reserve development . Such development can be either favorable or unfavorable to our financial results and may vary by line of business.

Inflation generally increases the cost of losses covered by insurance contracts. The effect of inflation varies by product. Our property and casualty insurance premiums are established before the amount of losses and LAE and the extent to which inflation may affect such expenses are known. Consequently, we attempt, in establishing rates and reserves, to anticipate the potential impact of inflation and increasing medical costs in the projection of ultimate costs. We have experienced increasing medical and attendant care costs, including those associated with personal automobile personal injury protection claims, particularly in Michigan, as well as in our workers compensation line in most states. This increase is reflected in our reserve estimates, but continued increases could contribute to increased losses and LAE in the future.

We regularly review our reserving techniques, our overall reserving position and our reinsurance. Based on (i) our review of historical data, legislative enactments, judicial decisions, legal developments in impositions of damages and policy coverage, political attitudes and trends in general economic conditions, (ii) our review of per claim information, (iii) our historical loss experience and that of the industry, (iv) the relatively short-term nature of most policies written by us, and (v) our internal estimates of required reserves, we believe that adequate provision has been made for loss reserves. However, establishment of appropriate reserves is an inherently uncertain process and there can be no certainty that current established reserves will prove adequate in light of subsequent actual experience. A significant change to the estimated reserves could have a material impact on our results of operations and financial position. An increase or decrease in reserve estimates would result in a corresponding decrease or increase in financial results. For example, each one percentage point change in the aggregate loss and LAE ratio resulting from a change in reserve estimation is currently projected to have an approximate $25 million impact on property and casualty segment income, based on 2008 full year premiums.

As discussed below, estimated loss and LAE reserves for claims occurring in prior years developed favorably by $41.2 million and $55.6 million for the quarters ended March 31, 2009 and 2008, respectively, which represents 1.9% and 2.5% of net loss reserves held, respectively.

The major causes of material uncertainty relating to ultimate losses and loss adjustment expenses (risk factors) generally vary for each line of business, as well as for each separately analyzed component of the line of business. In some cases, such risk factors are explicit assumptions of the estimation method and in others, they are implicit. For example, a method may explicitly assume that a certain percentage of claims will close each year, but will implicitly assume that the legal interpretation of existing contract language will remain unchanged. Actual results will likely vary from expectations for each of these assumptions, resulting in an ultimate claim liability that is different from that being estimated currently.

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Some risk factors will affect more than one line of business. Examples include changes in claim department practices, changes in settlement patterns, regulatory and legislative actions, court actions, timeliness of claim reporting, state mix of claimants, and degree of claimant fraud. Additionally, there is also a higher degree of uncertainty due to growth in our newly acquired companies, for which we have limited historical claims experience. The extent of the impact of a risk factor will also vary by components within a line of business. Individual risk factors are also subject to interactions with other risk factors within line of business components. Thus, risk factors can have offsetting or compounding effects on required reserves.

We are also defendants in various litigation, including putative class actions, which claim punitive damages or claim a broader scope of policy coverage than our interpretation, particularly in connection with losses incurred from Hurricane Katrina. The reserves established with respect to Hurricane Katrina assume that we will prevail with respect to these matters (See also Contingencies and Regulatory Matters). Although we believe our current Hurricane Katrina reserves are adequate, there can be no assurance that our ultimate costs associated with this event will not substantially exceed these estimates. We have fully utilized all of our available reinsurance with respect to losses and LAE related to Hurricane Katrina.

Loss and LAE Reserves by Line of Business

We perform actuarial reviews on certain detailed line of business coverages. These individual estimates are summarized into nine broader lines of business including personal automobile, homeowners, workers compensation, commercial automobile, commercial multiple peril, and other personal and other commercial lines. Asbestos and environmental reserves and pools business are separately analyzed.

The process of estimating reserves involves considerable judgment by management and is inherently uncertain. Actuarial point estimates by lines of business are the primary bases for determining ultimate expected losses and LAE and the level of net reserves required; however, other factors are considered as well. In general, such additional factors may include, but are not limited to, improvement or deterioration of the actuarial indications in the period, the maturity of the accident year, trends observed over the recent past such as changes in the mix of business or the impact of regulatory or litigation developments, the amount of data or experience we have with respect to a particular product or geographic area, the level of volatility within a particular line of business, and the magnitude of the difference between the actuarial indication and the recorded reserves.

The table below shows our recorded reserves, net of reinsurance, and the related actuarial reserve point estimates by line of business at March 31, 2009 and December 31, 2008.

	March 31, 2009		**December 31, 2008**	
(In millions)	**Recorded Net Reserves**	**Actuarial Point Estimate**	**Recorded Net Reserves**	**Actuarial Point Estimate**
Personal Automobile	**$ 647.6**	**$ 611.1**	$ 668.4	$ 638.0
Homeowners	**104.7**	**100.5**	98.5	96.4
Other Personal Lines	**22.0**	**17.6**	21.0	18.1
Workers Compensation	**353.5**	**330.2**	361.7	347.4
Commercial Automobile	**155.8**	**147.7**	159.2	153.1
Commercial Multiple Peril	**438.4**	**403.4**	443.4	409.0
Other Commercial Lines	**265.3**	**252.9**	269.2	257.0
Asbestos and Environmental	**18.4**	**18.4**	18.3	18.3
Pools and Other	**168.8**	**168.8**	173.4	173.4
Total	**$ 2,174.5**	**$ 2,050.6**	$ 2,213.1	$ 2,110.7

The principal factors considered by management in addition to the actuarial point estimates in determining the reserves at March 31, 2009 and December 31, 2008 vary by line of business. In our Commercial Lines segment, management considered the growth and product mix changes and recent adverse property related frequency trends in certain coverages. In addition, management also considered the significant growth in our inland marine and bond businesses for which we have limited actuarial data to estimate losses and the product mix change in our bond business towards a greater proportion of contract surety bonds where losses tend to emerge over a longer period of time and are cyclical related to general economic conditions. Moreover, in our Commercial Lines segment, management considered the potential for adverse development in the workers compensation line where losses tend to emerge over long periods of time and rising medical costs, while moderating, have continued to be a concern. With the acquisitions of Hanover Professionals and AIX, we are modestly increasing our exposure to longer-tailed liability lines and there is less historical experience and less actuarial data available that may result in less certainty when estimating ultimate reserves. Also, higher retentions on our reinsurance program beginning January 1, 2008 compared to prior years may impact the emergence of trends in underlying data that could add to the uncertainty and variability of our actuarial estimates going forward. In our Personal Lines segment, management considered the adverse personal automobile personal injury development and related potential for adverse trends due to costs shifting from health insurers to property and casualty insurers resulting from economic concerns and health insurance coverage trends, developments in personal automobile property costs in the 2007 and 2008 accident years and an increase in physical damage frequency, all of which have added additional uncertainty to future development in our personal automobile line. Additionally, management considered the significant growth in our new business with our ***Connections Auto*** product and related growth in a number of states where there is additional uncertainty in the ultimate profitability and development of reserves due to the unseasoned nature of our new business and new agency relationships in these markets, as well as emerging loss trends which are higher than expected. Although our experience and data in these areas is growing with the passage of time, a sufficient number of years of actuarial data is not yet available to base loss estimates solely on this data in new geographical areas and agency relationships and with new products which results in less certainty when estimating ultimate reserves and requires more judgment by management. Also in Personal Lines, management considered the significant improvement in frequency trends the industry experienced during 2001 through 2006 in these lines of business which were unanticipated and remain to some extent unexplained. Management also considered the likelihood of future adverse development related to significant catastrophe losses experienced in 2005 and 2008. Regarding our indirect business from voluntary and involuntary pools, we are provided loss estimates by managers of each pool. We adopt reserve estimates for the pools that consider this information and other factors. At March 31, 2009 and December 31, 2008, total recorded net reserves were 6.0% and 4.9% greater than actuarially indicated reserves, respectively. During the current quarter, the increase in the difference between recorded and actuarially indicated reserves is due to a change in our actuarial reserve methodology for estimating loss adjustment expenses. The change involves our changing our reliance from a traditional paid-to-paid methodology to reliance on a method based on claim counts and cost per claim, taking into account the settlement status of the claim, which we believe more appropriately reflects the ultimate cost of settlement.

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The table below provides a reconciliation of the gross beginning and ending reserve for unpaid losses and LAE as follows:

	Three Months Ended March 31,	
(In millions)	2009	2008
Reserve for losses and LAE, beginning of period	**$ 3,201.3**	$ 3,165.8
Incurred losses and LAE, net of reinsurance recoverable:		
Provision for insured events of current year	**469.3**	435.9
Decrease in provision for insured events of prior years; favorable development	**(41.2)**	(55.6)
Total incurred losses and LAE	**428.1**	380.3
Payments, net of reinsurance recoverable:		
Losses and LAE attributable to insured events of current year	**148.3**	131.7
Losses and LAE attributable to insured events of prior years	**313.3**	266.3
Hurricane Katrina	**5.1**	9.7
Total payments	**466.7**	407.7
Change in reinsurance recoverable on unpaid losses	**(6.2)**	(18.6)
Purchase of Verlan Fire Insurance Company		4.2
Reserve for losses and LAE, end of period	**$ 3,156.5**	$ 3,124.0

The table below summarizes the gross reserve for losses and LAE by line of business.

(In millions)	March 31, 2009	December 31, 2008
Personal Automobile	**$ 1,267.5**	$ 1,292.5
Homeowners and Other	**158.5**	152.1
Total Personal	**1,426.0**	1,444.6
Workers Compensation	**541.0**	547.0
Commercial Automobile	**220.6**	226.4
Commercial Multiple Peril	**494.5**	499.5
Other Commercial	**474.4**	483.8
Total Commercial	**1,730.5**	1,756.7
Total reserve for losses and LAE	**$ 3,156.5**	$ 3,201.3

The total reserve for losses and LAE as disclosed in the above table decreased by $44.8 million for the quarter ended March 31, 2009.

Prior Year Development by Line of Business

When trends emerge that we believe affect the future settlement of claims, we adjust our reserves accordingly. Reserve adjustments are reflected in the Consolidated Statements of Income as adjustments to losses and LAE. Often, we recognize these adjustments in periods subsequent to the period in which the underlying loss event occurred. These types of subsequent adjustments are disclosed and discussed separately as prior year reserve development . Such development can be either favorable or unfavorable to our financial results.

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The following table summarizes the change in provision for insured events of prior years, excluding those related to Hurricane Katrina (see Management s Review of Judgments and Key Assumptions for a further discussion of Hurricane Katrina) by line of business.

	Three Months Ended March 31,		
(In millions)	**2009**		**2008**
(Decrease) increase in loss provision for insured events of prior years:			
Personal Automobile	**$ (14.0)**		$ (16.2)
Homeowners and Other	**5.6**		3.6
Total Personal	**(8.4)**		(12.6)
Workers Compensation	**(6.9)**		(9.6)
Commercial Automobile	**(2.9)**		(5.9)
Commercial Multiple Peril	**(2.5)**		(16.7)
Other Commercial	**(10.9)**		(9.5)
Total Commercial	**(23.2)**		(41.7)
Voluntary Pools			1.0
Decrease in loss provision for insured events of prior years	**(31.6)**		(53.3)
Decrease in LAE provision for insured events of prior years	**(9.6)**	&er-left:1pt none #D9D9D9 ;border-bottom:1pt none #D9D9D9 ;border-right:1pt none #D9D9D9 ;height:12.00pt;font-family:Times New Roman;font-size:10pt;text-align:right;" nowrap="nowrap">3,251	5,100

Note H – Earnings per Share

Net income (loss) was used as the numerator in computing both basic and diluted income per Common share for the

three-months ended March 31, 2016 and 2015. The following table reconciles the weighted-average shares outstanding used for these computations.

	Three Months Ended March 31,	
(Weighted-average shares)	2016	2015

Basic method	172,114,012	177,734,159
Dilutive stock options and restricted stock units*	–	507,457
Diluted method	172,114,012	178,241,616

*Due to a net loss, recognized by the Company for the 2016 period, no unvested stock awards were included in the computation of diluted earnings per share because the effect would have been anti-dilutive.

	Three Months Ended March 31,	
	2016	2015
Antidilutive stock options excluded from diluted shares	5,714,823	3,314,751
Weighted average price of these options	$ 51.07	$ 57.19

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Contd.)

Note I – Income Taxes

The Company's effective income tax rate is calculated as the amount of income tax expense divided by income before income tax expense. For the three-month periods in 2016 and 2015, the Company's effective income tax rates were as follows:

	2016	2015
Three months ended March 31	24.7%	103.0%

The effective tax rates for most periods where earnings are generated, generally exceed the U.S. statutory tax rate of 35% due to several factors, including: the effects of income generated in foreign tax jurisdictions, certain of which have income tax rates that are higher than the U.S. Federal rate; U.S. state tax expense; and certain expenses, including exploration and other expenses in certain foreign jurisdictions, for which no income tax benefits are available or are not presently being recorded due to a lack of reasonable certainty of adequate future revenue against which to utilize these expenses as deductions. Conversely, the effective tax rates for most periods where losses are incurred generally are lower than U.S. statutory tax rate of 35% due to similar reasons. The effective tax rate for the three-month period ended March 31, 2016 was below the U.S. statutory tax rate primarily due to effects of losses incurred in its Canadian operations and exploration and other expenses in certain foreign jurisdictions that have little or no realized tax benefits. The effective tax rate for the three-month period ended March 31, 2015 was above the U.S. statutory tax rate primarily due to a deferred tax benefit associated with the sale of Malaysian assets.

The Company's tax returns in multiple jurisdictions are subject to audit by taxing authorities. These audits often take years to complete and settle. Although the Company believes that recorded liabilities for unsettled issues are adequate, additional gains or losses could occur in future years from resolution of outstanding unsettled matters. As of March 31, 2016, the earliest years remaining open for audit and/or settlement in our major taxing jurisdictions are as follows: United States – 2011; Canada – 2008; Malaysia – 2009; and United Kingdom – 2014.

Note J – Financial Instruments and Risk Management

Murphy often uses derivative instruments to manage certain risks related to commodity prices, foreign currency exchange rates and interest rates. The use of derivative instruments for risk management is covered by operating policies and is closely monitored by the Company's senior management. The Company does not hold any derivatives for speculative purposes and it does not use derivatives with leveraged or complex features. Derivative instruments are traded primarily with creditworthy major financial institutions or over national exchanges, such as the New York Mercantile Exchange (NYMEX). The Company has a risk management control system to monitor commodity price risks and any derivatives obtained to manage a portion of such risks. For accounting purposes, the Company has not designated commodity and foreign currency derivative contracts as hedges, and therefore, it recognizes all gains and losses on these derivative contracts in its Consolidated Statements of Operations. Certain interest rate derivative contracts were accounted for as hedges and the net payment upon settlement recording the fair value of these contracts was deferred in Accumulated Other Comprehensive Loss. This deferred cost is being reclassified to Interest Expense in the Consolidated Statements of Operations over the period until the associated notes mature in 2022.

Commodity Purchase Price Risks

The Company is subject to commodity price risk related to crude oil, natural gas liquids and natural gas it produces and sells. The Company had open derivative contracts at March 31, 2016. The impact from marking to market these commodity derivative contracts decreased the loss before income taxes by $56.8 million for the three-month period ended March 31, 2016. There were no open derivative contracts at March 31, 2015.

Open West Texas Intermediate (WTI) contracts were as follows:

At March 31, 2016	Volumes (barrels per day)	Swap Prices
April – December 2016	20,000	$52.01 per barrel

Subsequent to March 31, 2016, the Company entered into an additional 5,000 barrels per day in WTI futures contracts for the second half of 2016 at an average price of $45.30 per barrel.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Contd.)

Note J – Financial Instruments and Risk Management (Contd.)

Foreign Currency Exchange Risks

The Company is subject to foreign currency exchange risk associated with operations in countries outside the U.S. At March 31, 2016 and 2015 short-term derivative instrument were outstanding in Canada for approximately $11.3 million and $15.5 million, respectively, to manage the currency risks of certain U.S. dollar accounts receivable associated with sale of Canadian crude oil. The worksheet impact from marking to market these foreign currency derivative contracts improved loss before income taxes by $0.3 million and $38 thousand for the three-month periods ended March 31, 2016 and 2015, respectively.

At March 31, 2016 and December 31, 2015, the fair value of derivative instruments not designated as hedging instruments are presented in the following table.

	March 31, 2016		December 31, 2015	
(Thousands of dollars)	Asset (Liability) Derivatives		Asset (Liability) Derivatives	
Type of Derivative Contract	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Commodity	Accounts receivable	$ 65,518	Accounts receivable	$ 89,358
Foreign exchange	Accounts receivable	276	Accounts payable	29

For the three-month period ended March 31, 2016 and 2015, the gains and losses recognized in the Consolidated Statements of Operations for derivative instruments not designated as hedging instruments are presented in the following table.

	Gain (Loss) Three Months Ended

(Thousands of dollars)		March 31,	
Type of Derivative Contract	Statement of Operations Location	2016	2015
Commodity	Sales and other operating revenues	$ 13,189	–
Foreign exchange	Interest and other income	305	63
		$ 13,494	63

Interest Rate Risks

In 2011 the Company entered into a series of derivative contracts known as forward starting interest rate swaps to manage interest rate risk associated with $350 million of 10-year notes that were sold in May 2012. These interest rate swaps matured in May 2012. Under hedge accounting rules, the Company deferred the net cost associated with these contracts to match the payment of interest on these notes through 2022. During each of the three-month periods ended March 31, 2016 and 2015, $0.7 million of the deferred loss on the interest rate swaps was charged to Interest expense in the Consolidated Statement of Operations. The remaining loss deferred on these matured contracts at March 31, 2016 was $18.1 million, which is recorded, net of income taxes of $6.3 million, in Accumulated Other Comprehensive Loss in the Consolidated Balance Sheet. The Company expects to charge approximately $2.1 million of this deferred loss to Interest expense in the Consolidated Statement of Operations during the remaining nine months of 2016.

Fair Values – Recurring

The Company carries certain assets and liabilities at fair value in its Consolidated Balance Sheets. The fair value hierarchy is based on the quality of inputs used to measure fair value, with Level 1 being the highest quality and Level 3 being the lowest quality. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are observable inputs other than quoted prices included within Level 1. Level 3 inputs are unobservable inputs which reflect assumptions about pricing by market participants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Contd.)

Note J – Financial Instruments and Risk Management (Contd.)

The carrying value of assets and liabilities recorded at fair value on a recurring basis at March 31, 2016 and December 31, 2015 are presented in the following table.

	March 31, 2016				December 31, 2015			
(Thousands of dollars)	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Foreign currency exchange derivative contracts	$ –	276	–	276	–	–	–	–
Commodity derivative contracts	–	65,518	–	65,518	–	89,358	–	89,358
	$ –	65,794	–	65,794	–	89,358	–	89,358
Liabilities:								
Nonqualified employee savings plans	$ 12,628	–	–	12,628	12,971	–	–	12,971
Foreign currency exchange derivative contracts	–	–	–	–	–	29	–	29
	$ 12,628	–	–	12,628	12,971	29	–	13,000

The fair value of WTI crude oil derivative contracts was determined based on active market quotes for WTI crude oil at the balance sheet date. The fair value of foreign exchange derivative contracts in each year was based on market quotes for similar contracts at the balance sheet dates. The income effect of changes in the fair value of crude oil derivative contracts is recorded in Sales and Other Operating Revenues in the Consolidated Statements of Operations while the effects of changes in fair value of foreign exchange derivative contracts is recorded in Interest and Other Income. The nonqualified employee savings plan is an unfunded savings plan through which participants seek a return via phantom investments in equity securities and/or mutual funds. The fair value of this liability was based on quoted prices for these equity securities and mutual funds. The income effect of changes in the fair value of the nonqualified employee savings plan is recorded in Selling and General Expenses in the Consolidated Statements of Operations. The Company offsets certain assets and liabilities related to derivative contracts when the legal right of offset exists. There were no offsetting positions recorded at March 31, 2016 and December 31, 2015.

Fair Values – Nonrecurring

As a result of significantly lower commodity prices during the first quarter of 2016, the Company recognized approximately $95.1 million in pretax noncash impairment charges related to producing properties. The fair value information associated with these impaired properties is presented in the following table.

	March 31, 2016				
	Fair Value Level 1	Level 2	Level 3	Net Book Value Prior to Impairment	Total Pretax (Noncash) Impairment Loss
(Thousands of dollars)					
Assets:					
Impaired proved properties					
Canada	$ –	–	71,967	167,055	95,088

The fair values were determined by internal discounted cash flow models using estimates of future production, prices from futures exchanges, costs and a discount rate believed to be consistent with those used by principal market participants in the applicable region.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Contd.)

Note K – Accumulated Other Comprehensive Loss

The components of Accumulated Other Comprehensive Loss on the Consolidated Balance Sheets at December 31, 2015 and March 31, 2016 and the changes during the three-month period ended March 31, 2016 are presented net of taxes in the following table.

(Thousands of dollars)	Foreign Currency Translation Gains (Losses)[1]	Retirement and Postretirement Benefit Plan Adjustments[1]	Deferred Loss on Interest Rate Derivative Hedges[1]	Total[1]
Balance at December 31, 2015	$ (513,004)	(179,260)	(12,278)	(704,542)
Components of other comprehensive income:				
Before reclassifications to income	148,669	3	–	148,672
Reclassifications to income	–	2,513[2]	482[3]	2,995
Net other comprehensive income	148,669	2,516	482	151,667
Balance at March 31, 2016	$ (364,335)	(176,744)	(11,796)	(552,875)

1All amounts are presented net of income taxes.

2Reclassifications before taxes of $3,867 for the three-month period ended March 31, 2016 are included in the computation of net periodic benefit expense. See Note G for additional information. Related income taxes of $1,354 for the three-month period ended March 31, 2016 are included in Income tax expense.

3Reclassifications before taxes of $741 for the three-month period ended March 31, 2016 are included in Interest expense. Related income taxes of $259 for the three month period ended March 31, 2016 are included in Income tax expense.

Note L – Environmental and Other Contingencies

The Company’s operations and earnings have been and may be affected by various forms of governmental action both in the United States and throughout the world. Examples of such governmental action include, but are by no means limited to: tax increases and retroactive tax claims; royalty and revenue sharing increases; import and export controls; price controls; currency controls; allocation of supplies of crude oil and petroleum products and other goods; expropriation of property; restrictions and preferences affecting the issuance of oil and gas or mineral leases;

restrictions on drilling and/or production; laws and regulations intended for the promotion of safety and the protection and/or remediation of the environment; governmental support for other forms of energy; and laws and regulations affecting the Company's relationships with employees, suppliers, customers, stockholders and others. Because governmental actions are often motivated by political considerations and may be taken without full consideration of their consequences, and may be taken in response to actions of other governments, it is not practical to attempt to predict the likelihood of such actions, the form the actions may take or the effect such actions may have on the Company.

Murphy and other companies in the oil and gas industry are subject to numerous federal, state, local and foreign laws and regulations dealing with the environment. Violation of federal or state environmental laws, regulations and permits can result in the imposition of significant civil and criminal penalties, injunctions and construction bans or delays. A discharge of hazardous substances into the environment could, to the extent such event is not insured, subject the Company to substantial expense, including both the cost to comply with applicable regulations and claims by neighboring landowners and other third parties for any personal injury and property damage that might result.

The Company currently owns or leases, and has in the past owned or leased, properties at which hazardous substances have been or are being handled. Although the Company has used operating and disposal practices that were standard in the industry at the time, hazardous substances may have been disposed of or released on or under the properties owned or leased by the Company or on or under other locations where these wastes have been taken for disposal. In addition, many of these properties have been operated by third parties whose treatment and disposal or release of hydrocarbons or other wastes were

Note L – Environmental and Other Contingencies (Contd.)

not under Murphy's control. Under existing laws the Company could be required to remove or remediate previously disposed wastes (including wastes disposed of or released by prior owners or operators), to clean up contaminated property (including contaminated groundwater) or to perform remedial plugging operations to prevent future contamination. Certain of these historical properties are in various stages of negotiation, investigation, and/or cleanup and the Company is investigating the extent of any such liability and the availability of applicable defenses. The Company has retained certain liabilities related to environmental matters at formerly owned U.S. refineries that were sold in 2011. The Company also obtained insurance covering certain levels of environmental exposures related to past operations of these refineries. The Company believes costs related to these sites will not have a material adverse affect on Murphy's net income, financial condition or liquidity in a future period.

During 2015, the Company's subsidiary in Canada identified a leak or leaks at an infield condensate transfer pipeline at the Seal field in a remote area of Alberta. The pipeline was immediately shut down and the Company's emergency response plan was activated. In cooperation with local governmental regulators, and with the assistance of qualified consultants, an investigation and remediation plan is progressing as planned and the Company's insurers have been notified. The Company has not yet established a complete estimate of the costs to remediate the site. Based on the assessments done to date, the Company recorded $43.9 million in other expense during 2015 associated with the estimated costs of remediating the site. The Company has spent $31.7 million to date associated with this event. Further refinements in the estimated total cost to remediate the site are anticipated in future periods, including possible fines from regulators and insurance recoveries. It is possible that the ultimate net remediation costs to the Company associated with the condensate leak or leaks will exceed the amount of expense recorded through March 31, 2016.

There is the possibility that environmental expenditures could be required at currently unidentified sites, and new or revised regulations could require additional expenditures at known sites. However, based on information currently available to the Company, the amount of future remediation costs incurred at known or currently unidentified sites is not expected to have a material adverse effect on the Company's future net income, cash flows or liquidity.

Murphy and its subsidiaries are engaged in a number of other legal proceedings, all of which Murphy considers routine and incidental to its business. Based on information currently available to the Company, the ultimate resolution of these matters is not expected to have a material adverse effect on the Company's net income, financial condition or liquidity in a future period.

Note M – Commitments

The Company has entered into forward sales contracts to mitigate the price risk for a portion of its 2016 natural gas sales volumes in Western Canada. The natural gas sales contracts call for deliveries in 2016 of approximately 59 million cubic feet per day at Cdn $3.19 per MCF. These natural gas contracts have been accounted for as normal sales for accounting purposes.

Note N – Business Segments

(Millions of dollars)	Total Assets at March 31, 2016	Three Months Ended March 31, 2016 External Revenues	Three Months Ended March 31, 2016 Income (Loss)	Three Months Ended March 31, 2015 External Revenues	Three Months Ended March 31, 2015 Income (Loss)
Exploration and production*					
United States	$ 5,587.1	174.7	(65.6)	280.1	(93.9)
Canada	2,537.1	106.1	(87.3)	152.3	(38.5)
Malaysia	2,436.0	148.2	22.3	445.7	223.1
Other	143.6	0.1	(26.2)	–	(72.0)
Total exploration and production	10,703.8	429.1	(156.8)	878.1	18.7
Corporate	719.7	1.2	(42.7)	43.6	(15.2)
Assets/revenue/income (loss) from continuing operations	11,423.5	430.3	(199.5)	921.7	3.5
Discontinued operations, net of tax	37.2	–	0.7	–	(17.9)
Total	$ 11,460.7	430.3	(198.8)	921.7	(14.4)

*Additional details about results of oil and gas operations are presented in the table on page 24.

Note O – New Accounting Principles and Recent Accounting Pronouncements

Leases

In February 2016, The Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) to increase transparency and comparability among companies by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous generally accepted accounting principles (GAAP) and this ASU is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The new standard is effective for financial statements issued for annual periods beginning after December 15, 2018 and interim periods within those annual periods. Early adoption is permitted for all entities. The Company anticipates adopting this guidance in 2019 and is currently evaluating the standard and its impact on its consolidated financial statements and footnote disclosures.

Compensation-Stock Compensation

In March 2016, the FASB issued an ASU intended to simplify the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification within the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim period or annual period. The Company will adopt this guidance in 2017 and is currently evaluating the impact on its consolidated financial statements and footnote disclosures.

Note P – Subsequent Events

In April 2016, a Canadian subsidiary of the Company signed a purchase and sale agreement for the sale of its interest in Syncrude Canada Ltd. (“Syncrude”) asset to Suncor Energy Inc. (“Suncor”), for approximately C$937 million, subject to closing adjustments. The company will divest its five percent, non-operated working interest in Syncrude subject to regulatory approval and normal closing conditions, and the sale is anticipated to close in mid-year 2016.

In April 2016, a Canadian subsidiary of the Company completed its transaction to divest natural gas processing and sales pipeline assets that support Murphy’s Montney natural gas fields in the Tupper area of northeastern British Columbia. Total cash consideration received by Murphy upon closing of the transaction was C$538 million. The net book value of assets being divested totaling approximately $226.7 million has been classified as current assets held for sale as of March 31, 2016. The resulting gain on sale will be deferred and recognized over the next 20 years as a reduction of lease operating expense in Canadian “conventional” operating segment consistent with the expected continuing involvement of the subsidiary.

In a separate transaction, the same Canadian subsidiary signed a definitive agreement to acquire a 70 percent operated working interest (WI) of Athabasca Oil Corporation’s (Athabasca) production, acreage, infrastructure and facilities in the Kaybob Duvernay lands, and a 30 percent non-operated WI of Athabasca’s production, acreage, infrastructure and facilities in

the liquids rich Montney lands in Alberta. Under the terms of the joint venture the total consideration amounts to C$475 million, of which Murphy will pay approximately C$250 million in cash at closing, subject to normal closing adjustments, and

the remaining C$225 million in the form of a carried interest for a period of up to five years. The transaction is expected to close in the second quarter of 2016.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overall Review

During the first quarter 2016, worldwide benchmark oil and natural gas prices continued to be significantly below average comparable benchmark prices during the first quarter 2015. These lower oil and natural gas prices have led the Company to incur losses from operations in 2016. Although the Company continues to aggressively attack its overall cost structure, a continuation of very low commodity prices would continue to lead to adverse effects on the Company's income and cash flow.

Results of Operations

Murphy's income by type of business is presented below.

		Income (Loss) Three Months Ended March 31,	
(Millions of dollars)		2016	2015
Exploration and production	$	(156.8)	18.7
Corporate and other		(42.7)	(15.2)
Income (loss) from continuing operations		(199.5)	3.5
Discontinued operations		0.7	(17.9)
Net loss	$	(198.8)	(14.4)

Murphy's net loss in the first quarter of 2016 was $198.8 million ($1.16 per diluted share) compared to net loss of $14.4 million ($0.08 per diluted share) in the first quarter of 2015. Income (loss) from continuing operations decreased from a profit of $3.5 million ($0.02 per diluted share) in the 2015 quarter to a loss of $199.5 million ($1.16 per diluted share) in 2016. In the 2016 first quarter, the Company's exploration and production continuing operations incurred a loss of $156.8 million compared to earnings of $18.7 million in the 2015 quarter. The net loss in the 2016 quarter was unfavorably impacted by lower revenues due to significantly lower realized oil and natural gas sales prices and lower volume sold, and impairment charges, offset in part by lower lease operating expenses, lower depreciation expense and lower exploration costs. The corporate function had after-tax costs of $42.7 million in the 2016 first quarter compared to after-tax costs of $15.2 million in the 2015 period with the unfavorable variance in the current period mostly due to lower benefits from foreign exchange effects offset in part by lower administrative costs. The 2016 first quarter included income from discontinued operations of $0.7 million ($0.00 per diluted share) compared to a loss of $17.9 million ($0.10 per diluted share) in the 2015 period. Discontinued operations in the prior period primarily consisted of costs relating to winding down of refining and marketing operations in the U.K., the final components of which were sold at the end of the second quarter 2015.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Results of Operations (Contd.)

Exploration and Production

Results of exploration and production continuing operations are presented by geographic segment below.

	Income (Loss) Three Months Ended March 31,	
(Millions of dollars)	2016	2015
Exploration and production		
United States	$ (65.6)	(93.9)
Canada	(87.3)	(38.5)
Malaysia	22.3	223.1
Other International	(26.2)	(72.0)
Total	$ (156.8)	18.7

First quarter 2016 vs. 2015

United States exploration and production operations reported a loss of $65.6 million in the first quarter of 2016 compared to a loss of $93.9 million in the 2015 quarter. Results improved $28.3 million in the 2016 quarter compared to the 2015 period as lower supply costs and lower exploration expenses more than offset declines in revenues. Revenue in the U.S. fell $105.4 million in the period due to both lower oil and natural gas realized sales prices and lower volumes sold. Lease operating expenses decreased by $46.3 million due to lower costs in Eagle Ford Shale and offshore Gulf of Mexico compared to same quarter in 2015 with most of the reduction due to the Company aggressively attacking its cost structure. Severance and ad valorem taxes in the 2016 quarter were $7.9 million lower than the 2015 period primarily due to weaker average commodity prices and lower volume sold. Depreciation expense decreased $36.0 million in 2016 compared to 2015 due to both lower unit rates in the 2016 period and lower volume sold. Exploration expenses were down $56.3 million in the first quarter of 2016 primarily related to lower dry hole costs of $46.4 million compared to the 2015 quarter.

Operations in Canada had a loss of $87.3 million in the first quarter 2016 compared to a loss of $38.5 million in the 2015 quarter. Canadian results of operations worsened by $48.8 million in the 2016 quarter and included losses for both conventional oil and natural gas operations and synthetic oil operations. Results for conventional operations were $48.8 million lower in 2016 due to impairment expense, lower average realized sales prices for crude oil and natural gas and lower oil volume sold. These were partially offset by higher natural gas volumes produced, lower supply costs and no repeat of prior year charges for an environmental provision at the Seal heavy oil area. Natural gas sales volumes increased in 2016 due to higher production in the Tupper area of Western Canada as a result of no repeat of 2015 pipeline restriction by a third party and lower royalty. Lease operating expenses associated with conventional operations were $8.0 million lower in the 2016 quarter due to both lower costs and a weaker Canadian dollar exchange rate. Impairment expense was $95.1 million in 2016 due to a write down of heavy oil properties at Seal in Western Canada and the Terra Nova field offshore East Coast Canada. Both impairments were the result of weakening in oil sales prices at March 31, 2016 compared to the end of 2015. Synthetic operations results for 2016 were virtually the same as in the first quarter of 2015. Lower oil sales prices were offset by higher volume sold due to improved uptime at the processing facility and lower lease operating expense. Lease operating expenses associated with synthetic operations were $5.8 million lower in the 2016 quarter due to lower maintenance costs, lower fuel costs and a weaker Canadian dollar exchange rate.

Malaysia operations reported earnings of $22.3 million in the 2016 quarter compared to earnings of $223.1 million during the same period in 2015. Results were down $200.8 million in 2016 in Malaysia due to a $199.5 million after-tax gain on sale of a 10% interest in Malaysian assets in the 2015 period. Lower commodity prices received and lower volumes sold in the 2016 period were virtually offset by lower lease operating expenses and lower depreciation expense. Crude oil and natural gas sales volumes in Malaysia were lower in the 2016 quarter, primarily due to natural field decline. Lease operating expenses decreased in the 2016 period by $13.2 million due to lower costs and lower volume sold compared to 2015. Depreciation expense was $144.5 million lower in 2016 compared to the 2015 quarter primarily due to lower unit rates following 2015 impairment charges at certain producing properties and lower oil and natural gas volumes sold.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Results of Operations (Contd.)

Exploration and Production (Contd.)

First quarter 2016 vs. 2015 (Contd.)

Other international operations reported a loss of $26.2 million in the first quarter of 2016 compared to a loss of $72.0 million in the 2015 quarter. The $45.8 million improvement in the 2016 period was primarily related to lower exploration expenses. Dry hole costs decreased by $31.9 million in the current period and geological and geophysical costs were $10.8 million less than the 2015 period.

Total hydrocarbon production averaged 196,568 barrels of oil equivalent per day in the 2016 first quarter, which represented a 11.3% decrease from the 221,554 barrels of oil equivalents per day produced in the 2015 quarter. Average crude oil and condensate production was 123,475 barrels per day in the first quarter of 2016 compared to 140,400 barrels per day in the first quarter of 2015. Crude oil production decreased approximately 7,500 barrels in the Eagle Ford Shale area of South Texas in 2016 due to well decline associated with significantly less drilling in the last half of 2015 and early 2016 in response to lower prices. Crude oil production in the Gulf of Mexico was higher in the 2016 quarter due to added production from the Medusa field’s subsea expansion project completed in June 2015. Heavy oil production from the Seal area in Western Canada was lower in 2016 primarily due to volumes shut-in associated with uneconomic wells and natural decline. Oil production offshore Eastern Canada was lower during 2016 primarily due to lower uptime at the Terra Nova field. Lower oil production in 2016 in Malaysia was primarily attributable to less net oil volumes produced due to the sale of 10% of the Company’s total interest in early 2015 coupled with natural decline. On a worldwide basis, the Company's crude oil and condensate prices averaged $34.19 per barrel in the first quarter 2016 compared to $47.12 per barrel in the 2015 period, a decline of 27% quarter to quarter. Total production of natural gas liquids (NGL) was 9,235 barrels per day in the 2016 first quarter compared to 10,412 barrels per day in the same 2015 period. The decrease in NGL production was primarily associated with lower natural gas volumes sold in the U.S. The average sales price for U.S. NGL was $8.36 per barrel in the 2016 quarter compared to $12.89 per barrel in 2015. Natural gas sales volumes averaged 383 million cubic feet per day in the first quarter 2016 compared to 424 million cubic feet per day in 2015. Natural gas sales volumes decreased in North America for 2016 due primarily to lower volumes produced offshore Gulf of Mexico but was partially offset by higher volumes in the Tupper area of Western Canada. Natural gas production volumes in Malaysia decreased in the 2016 period due the sale of 10% of the Company’s total interests in early 2015 and natural decline. North American natural gas sales prices averaged $1.57 per thousand cubic feet (MCF) in the 2016 quarter, 36% below the $2.46 per MCF average in the same quarter of 2015. The average realized price for natural gas produced in the 2016 quarter at fields offshore Sarawak was $3.67 per MCF, compared to a price of $4.50 per MCF in the 2015 quarter.

Additional details about results of oil and gas operations are presented in the tables on page 24.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Results of Operations (Contd.)

Exploration and Production (Contd.)

Selected operating statistics for the three-month periods ended March 31, 2016 and 2015 follow.

	Three Months Ended March 31,	
	2016	2015
Net crude oil and condensate produced – barrels per day	123,475	140,400
United States – Eagle Ford Shale	42,538	50,035
– Gulf of Mexico and other	14,098	12,779
Canada – light	131	130
– heavy	3,319	6,208
– offshore	8,821	9,379
– synthetic	15,559	13,684
Malaysia1 – Sarawak	13,035	17,754
– Block K	25,974	30,431
Net crude oil and condensate sold – barrels per day	119,195	149,428
United States – Eagle Ford Shale	42,537	50,035
– Gulf of Mexico and other	14,098	12,779
Canada – light	131	130
– heavy	3,319	6,208
– offshore	9,382	9,236
– synthetic	15,559	13,684
Malaysia1 – Sarawak	13,759	21,209
– Block K	20,410	36,147
Net natural gas liquids produced – barrels per day	9,235	10,412
United States – Eagle Ford Shale	7,225	7,454
– Gulf of Mexico and other	1,227	2,158
Canada	12	22
Malaysia1 – Sarawak	771	778
Net natural gas liquids sold – barrels per day	9,762	9,979

United States – Eagle Ford Shale	7,225	7,454
– Gulf of Mexico	1,227	2,158
Canada	12	22
Malaysia1 – Sarawak	1,298	345
Net natural gas sold – thousands of cubic feet per day	383,150	424,453
United States – Eagle Ford Shale	38,294	40,284
– Gulf of Mexico and other	23,409	57,050
Canada	209,823	191,083
Malaysia1 – Sarawak	98,255	112,053
– Block K	13,369	23,983
Total net hydrocarbons produced – equivalent barrels per day2	196,568	221,554
Total net hydrocarbons sold – equivalent barrels per day2	192,815	230,149

1 The Company sold a 10% interest in Malaysia properties on January 29, 2015. Production in this table includes production for these sold interests through the date of disposition.

2 Natural gas converted on an energy equivalent basis of 6:1.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Results of Operations (Contd.)

Exploration and Production (Contd.)

	Three Months Ended March 31, 2016	2015
Weighted average sales prices		
Crude oil and condensate – dollars per barrel		
United States – Eagle Ford Shale	$ 34.81	43.75
– Gulf of Mexico	35.18	46.17
Canada – heavy	6.89	19.57
– offshore	30.70	52.62
– synthetic	33.81	44.80
Malaysia – Sarawak2	37.89	49.31
– Block K2	36.03	55.08
Natural gas liquids – dollars per barrel		
United States – Eagle Ford Shale	$ 8.20	12.28
– Gulf of Mexico	9.31	14.67
Canada1	28.63	22.45
Malaysia – Sarawak2	41.21	67.11
Natural gas – dollars per thousand cubic feet		
United States – Eagle Ford Shale	$ 1.47	2.55
– Gulf of Mexico	1.74	2.58
Canada1	1.55	2.41
Malaysia – Sarawak2	3.67	4.50
– Block K	0.24	0.24

1 U.S. dollar equivalent.

2 Prices are net of payments under terms of the respective production sharing contracts.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Results of Operations (Contd.)

Exploration and Production (Contd.)

OIL AND GAS OPERATING RESULTS – THREE MONTHS ENDED MARCH 31, 2016 AND 2015

(Millions of dollars)	United States	Canada Conven-tional	Synthetic	Malaysia	Other	Total
Three Months Ended March 31, 2016						
Oil and gas sales and other operating revenues	$ 174.7	57.6	48.5	148.2	0.1	429.1
Lease operating expenses	55.5	17.6	38.1	47.9	–	159.1
Severance and ad valorem taxes	10.4	1.1	1.1	–	–	12.6
Depreciation, depletion and amortization	168.8	45.0	13.4	54.1	1.4	282.7
Accretion of asset retirement obligations	4.2	2.6	1.2	4.1	–	12.1
Impairment of assets	–	95.1	–	–	–	95.1
Exploration expenses						
Dry holes	0.3	–	–	(0.4)	–	(0.1)
Geological and geophysical	0.3	2.9	–	0.3	4.3	7.8
Other	1.1	0.3	–	–	7.3	8.7
	1.7	3.2	–	(0.1)	11.6	16.4
Undeveloped lease amortization	8.9	1.3	–	–	0.3	10.5
Total exploration expenses	10.6	4.5	–	(0.1)	11.9	26.9
Selling and general expenses	22.5	7.6	0.2	3.4	10.1	43.8
Other expenses (benefits)	0.2	(1.5)	–	–	1.0	(0.3)
Results of operations before taxes	(97.5)	(114.4)	(5.5)	38.8	(24.3)	(202.9)
Income tax provisions (benefits)	(31.9)	(31.0)	(1.6)	16.5	1.9	(46.1)
Results of operations (excluding corporate overhead and interest)	$ (65.6)	(83.4)	(3.9)	22.3	(26.2)	(156.8)
Three Months Ended March 31, 2015						
Oil and gas sales and other operating revenues	$ 280.1	97.1	55.2	445.7	–	878.1
Lease operating expenses	101.8	25.6	43.9	61.1	–	232.4
Severance and ad valorem taxes	18.3	1.4	1.1	–	–	20.8
Depreciation, depletion and amortization	204.8	60.1	13.8	198.6	1.5	478.8
Accretion of asset retirement obligations	4.8	1.7	1.4	3.9	–	11.8
Exploration expenses						
Dry holes	46.7	–	–	–	31.9	78.6

Geological and geophysical		1.7	–	–	–	15.1	16.8
Other		1.7	0.2	–	–	9.8	11.7
		50.1	0.2	–	–	56.8	107.1
Undeveloped lease amortization		16.8	4.2	–	–	0.6	21.6
Total exploration expenses		66.9	4.4	–	–	57.4	128.7
Selling and general expenses		22.4	6.8	0.2	0.7	14.7	44.8
Other expenses		5.7	44.0	–	–	–	49.7
Results of operations before taxes		(144.6)	(46.9)	(5.2)	181.4	(73.6)	(88.9)
Income tax benefits		(50.7)	(12.3)	(1.3)	(41.7)	(1.6)	(107.6)
Results of operations (excluding corporate overhead and interest)	$	(93.9)	(34.6)	(3.9)	223.1	(72.0)	18.7

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Results of Operations (Contd.)

Corporate

Corporate activities, which include interest income and expense, foreign exchange effects, and corporate overhead not allocated to operating functions, had net cost of $42.7 million in the 2016 first quarter compared to a net cost of $15.2 million in the same 2015 quarter. The $27.5 million increased cost in the 2016 period is primarily due to lower benefits from foreign currency exchange offset by lower administrative costs. An after-tax gain of $1.7 million occurred in 2016 on transactions denominated in foreign currencies, while the 2015 quarter had an after-tax gain of $33.8 million.

Discontinued Operations

The Company has presented refining and marketing operations in the U.K. as discontinued operations in its consolidated financial statements. In June 2015, the Company completed an agreement to sell the remaining U.K. downstream assets.

The after-tax results of these operations for the three-month period ended March 31, 2016 and 2015 are reflected in the following table.

		Three Months Ended March 31,	
(Millions of dollars)		2016	2015
Income (loss) from discontinued operations - U.K. refining and marketing	$	0.7	(17.9)

Financial Condition

Net cash provided by continuing operating activities was $43.3 million for the first three months of 2016 compared to $533.8 million during the same period in 2015. The decline in cash provided by continuing operations activities in 2016 was primarily attributable to significantly lower realized sales prices for the Company's oil and gas production and lower volume sold during the current year, offset in part by lower lease operating expenses. Changes in noncash operating working capital from continuing operations used cash of $104.3 million during the first three months of 2016, compared to generating cash of $258.8 million in 2015. The use of cash in 2016 included $253.2 million associated with pay-off of cancelled deepwater rig contracts that were previously charged to expense in 2015. Proceeds from sales of property and equipment generated cash of $33 thousand in 2016 compared to $417.2 million in 2015 with the prior year amount primarily relating to proceeds received upon sale of a 10% interest in Malaysian assets. Other significant sources of cash included $87.0 million in the 2016 period and $301.5 million in 2015 from maturity of Canadian government securities that had maturity dates greater than 90 days at acquisition. The Company had net borrowings of $371.0 million in the three-month period of 2016 compared to a net repayment of $295.0 million in the 2015 quarter. The net borrowings were primarily related to day rate commitments associated with deepwater rig contract exits costs and to fund capital development activities.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Financial Condition (Contd.)

The most significant use of cash in both years was for property additions and dry holes, which including amounts expensed, were $210.0 million and $823.8 million in the three-month period ended March 31, 2016 and 2015, respectively. Total cash dividends to shareholders amounted to $60.3 million in 2016 and $62.3 million in 2015. Also, the purchase of Canadian government securities with maturity dates greater than 90 days at acquisition used cash of $49.3 million in the 2016 period and $265.7 million in the 2015 period.

Total accrual basis capital expenditures were as follows:

	Three Months Ended March 31,	
(Millions of dollars)	2016	2015
Capital Expenditures		
Exploration and production	$ 136.5	603.5
Corporate	8.4	9.4
Total capital expenditures	$ 144.9	612.9

The reduction in capital expenditures in the exploration and production business in 2016 compared to 2015 was primarily attributable to lower development drilling in the Eagle Ford Shale area in the United States and offshore Malaysia and lower spending on exploration drilling in the Gulf of Mexico and other international operations.

A reconciliation of property additions and dry hole costs in the Consolidated Statements of Cash Flows to total capital expenditures for continuing operations follows

	Three Months Ended March 31,	
(Millions of dollars)	2016	2015

Property additions and dry hole costs per cash flow statements	$ 210.0	823.8
Geophysical and other exploration expenses	16.5	28.5
Capital expenditure accrual changes and other	(81.6)	(239.5)
Total capital expenditures	$ 144.9	612.8

Working capital (total current assets less total current liabilities) at March 31, 2016 was $321.2 million, $547.4 million more than December 31, 2015, with the increase attributable to lower accounts payable for deepwater rig contract exit cost and other operating activities and an increase in current assets held for sale related to a Canadian subsidiary of the Company.

At March 31, 2016, long-term debt of $3,409.5 million had increased by $368.9 million compared to December 31, 2015. A summary of capital employed at March 31, 2016 and December 31, 2015 follows.

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	March 31, 2016		December 31, 2015	
(Millions of dollars)	Amount	%	Amount	%
Capital employed				
Long-term debt	$ 3,409.5	39.6 %	$ 3,040.6	36.4 %
Stockholders' equity	5,205.1	60.4	5,306.7	63.6
Total capital employed	$ 8,614.6	100.0 %	$ 8,347.3	100.0 %

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Financial Condition (Contd.)

Cash and invested cash are maintained in several operating locations outside the United States. At March 31, 2016, cash, cash equivalents and cash temporarily invested in Canadian government securities held outside the U.S. included U.S. dollar equivalents of approximately $243.7 million in Canada and $288.6 million in Malaysia. In addition $5.6 million of cash was held in the United Kingdom, but was reflected in current Assets Held for Sale on the Company’s Consolidated Balance Sheet at March 31, 2016. In certain cases, the Company could incur taxes or other costs should these cash balances be repatriated to the U.S. in future periods. This could occur due to withholding taxes and/or potential additional U.S. tax burden when less than the U.S. Federal tax rate of 35% has been paid for cash taxes in foreign locations. A lower cash tax rate is often paid in foreign countries in the early years of operations when accelerated tax deductions are permitted to spur oil and gas investments; cash tax rates are generally higher in later years after accelerated tax deductions in early years are exhausted. Canada collects a 5% withholding tax on any cash repatriated to the United States through a dividend to the U.S. parent.

Accounting and Other Matters

Leases

In February 2016, The Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) to increase transparency and comparability among companies by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous generally accepted accounting principles (GAAP) and this ASU is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The new standard is effective for financial statements issued for annual periods beginning after December 15, 2018 and interim periods within those annual periods. Early adoption is permitted for all entities. The Company anticipates adopting this guidance in 2019 and is currently evaluating the standard and its impact on its consolidated financial statements and footnote disclosures.

Compensation-Stock Compensation

In March 2016, the FASB issued an ASU intended to simplify the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification within the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim period or annual period. The Company will adopt this guidance in 2017 and is currently evaluating the impact on its consolidated financial statements and footnote disclosures.

Outlook

Average worldwide crude oil prices in April 2016 have improved over the average prices during the first quarter of 2016 when, at one point, the West Texas Intermediate market reached 14 year lows. Global crude oil balances are beginning to tighten as non-OPEC production slides, but massive inventory levels will be slow to clear. North American natural gas prices weakened in the 2016 first quarter as seasonal demand slumped due to an abnormally mild winter heating season coupled with year on year production growth. The Company expects its total oil and natural gas production to average 177,000 to 180,000 barrels of oil equivalent per day in the second quarter 2016. The Company currently anticipates total capital expenditures for the full year 2016 to be approximately $580 million.

The Company will primarily fund its capital program in 2016 using operating cash flow, but supplements funding where necessary using borrowings under available credit facilities. The Company's 2016 budget calls for borrowings of long-term debt during the year to fund a portion of the capital program. If oil and/or natural gas prices weaken, actual cash flow generated from operations could be reduced such that higher than anticipated borrowings might be required during the year to maintain funding of the Company's ongoing development projects. The Company's revolving credit facility matures in June 2017, and the Company currently expects to execute a new agreement prior to expiry of the existing facility. A new credit facility may include different terms compared to the existing facility.

The significant reduction in the sales prices of crude oil has caused the Company to reduce capital expenditures, including development drilling and completion operations in North America. The Company currently projects that its capital spending program in 2016 will be well below 2015 levels. The reduced level of capital expenditures, if it continues, could lead to lower production levels in future periods. A continuation of low oil and/or gas prices or further deterioration therein, could lead to negative future effects on the Company, which could include reductions in proved reserves, additional impairment charges, the necessity for further cost containment measures, higher debt levels, and a reconsideration of the level of dividends on its Common stock.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS (Contd.)

Outlook (Contd.)

As of May 2, 2016 the Company has entered into derivative or forward fixed-price delivery contracts to manage risk associated with certain future oil and natural gas sales prices as follows:

Commodities	Contract or Location	Dates	Average Volumes per Day	Average Prices
U.S. Oil	West Texas Intermediate	Apr. – Dec. 2016	20,000 bbls/d	$52.01 per bbl.
U.S. Oil	West Texas Intermediate	July – Dec. 2016	5,000 bbls/d	$45.30 per bbl.
Canadian Natural Gas	TCPL–NOVA System	Apr. – Dec. 2016	59 mmcf/d	C$3.19 per mcf

Forward-Looking Statements

This Form 10-Q contains forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These statements, which express management's current views concerning future events or results, are subject to inherent risks and uncertainties. Factors that could cause actual results to differ materially from those expressed or implied in our forward-looking statements include, but are not limited to, the volatility and level of crude oil and natural gas prices, the level and success rate of Murphy's exploration programs, the Company's ability to maintain production rates and replace reserves, customer demand for Murphy's products, adverse foreign exchange movements, political and regulatory instability, adverse developments in the U.S. or global capital markets, credit markets or economies generally and uncontrollable natural hazards. For further discussion of risk factors, see Murphy's 2015 Annual Report on Form 10-K on file with the U.S. Securities and Exchange Commission and page 29 of this Form 10-Q report. Murphy undertakes no duty to publicly update or revise any forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risks associated with interest rates, prices of crude oil, natural gas and petroleum products, and foreign currency exchange rates. As described in Note J to this Form 10-Q report, Murphy makes use of derivative financial and commodity instruments to manage risks associated with existing or anticipated transactions.

There were commodity transactions in place at March 31, 2016 covering certain future U.S. crude oil sales volumes in 2016. A 10% increase in the respective benchmark price of these commodities would have decreased the recorded net asset associated with these derivative contracts by approximately $22.9 million, while a 10% decrease would have increased the recorded net asset by a similar amount.

There were derivative foreign exchange contracts in place at March 31, 2016 to hedge the value of the U.S. dollar against the Canadian dollar for certain U.S. dollar receivables to be collected in April 2016. A 10% strengthening of the U.S. dollar against the Canadian dollar would have decreased the recorded net asset associated with these contracts by approximately $1.1 million, while a 10% weakening of the U.S. dollar would have increased the recorded net asset by approximately $1.2 million. Changes in the fair value of these derivative contracts generally offset the financial statement impact of an equivalent volume of foreign currency exposures associated with other assets and/or liabilities.

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ITEM 4. CONTROLS AND PROCEDURES

Under the direction of its principal executive officer and principal financial officer, controls and procedures have been established by the Company to ensure that material information relating to the Company and its consolidated subsidiaries is made known to the officers who certify the Company’s financial reports and to other members of senior management and the Board of Directors.

Based on the Company’s evaluation as of the end of the period covered by the filing of this Quarterly Report on Form 10-Q, the principal executive officer and principal financial officer of Murphy Oil Corporation have concluded that the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by Murphy Oil Corporation in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

During the quarter ended March 31, 2016, the Company continued to implement a new global Enterprise Resource Planning (ERP) system, which will handle the business and financial processes within the company’s operations and its corporate and administrative functions. The Company has modified its existing internal controls related to the ERP system implementation. While the Company believes that this new system and the related changes to internal controls will ultimately strengthen its internal controls over financial reporting, there are inherent risks in implementing a new ERP system and the Company will continue to evaluate and test control changes in order to provide certification as of its fiscal year ending December 31, 2016 on the effectiveness, in all material respects, of its internal controls over financial reporting.

During the quarter ended March 31, 2016, there were no other changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Murphy is engaged in a number of legal proceedings, all of which Murphy considers routine and incidental to its business. Based on information currently available to the Company, the ultimate resolution of environmental and legal matters referred to in this note is not expected to have a material adverse effect on the Company’s net income, financial condition or liquidity in a future period.

ITEM 1A. RISK FACTORS

The Company’s operations in the oil and gas business naturally lead to various risks and uncertainties. These risk factors are discussed in Item 1A Risk Factors in its 2015 Form 10-K filed on February 26, 2016. The Company has not identified any additional risk factors not previously disclosed in its 2015 Form 10-K report.

ITEM 6. EXHIBITS

The Exhibit Index on page 31 of this Form 10-Q report lists the exhibits that are hereby filed or incorporated by reference.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MURPHY OIL CORPORATION

(Registrant)

By /s/ KEITH CALDWELL
Keith Caldwell, Senior Vice President and Controller (Chief Accounting Officer and Duly Authorized Officer)

May 5, 2016

(Date)

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EXHIBIT INDEX

Exhibit No.	
12	Computation of Ratio of Earnings to Fixed Charges
31.1	Certification required by Rule 13a-14(a) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification required by Rule 13a-14(a) pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101. INS	XBRL Instance Document
101. SCH	XBRL Taxonomy Extension Schema Document
101. CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101. DEF	XBRL Taxonomy Extension Definition Linkbase Document
101. LAB	XBRL Taxonomy Extension Labels Linkbase Document
101. PRE	XBRL Taxonomy Extension Presentation Linkbase

Exhibits other than those listed above have been omitted since they are either not required or not applicable.