United Fire Group, Inc.

2017 First Quarter Earnings Conference Call

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CORPORATE PARTICIPANTS

Randy Patten – *Assistant Vice President, Finance and Investor Relations*

Randy Ramlo – *Chief Executive Officer*

Michael Wilkins – *Chief Operating Officer*

Dawn Jaffray – *Chief Financial Officer*

PRESENTATION

Operator
Good day and welcome to the United Fire Group, Inc. 2017 First Quarter Earnings Conference Call and Webcast. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on a touchtone phone. To withdraw your question, press star then two. Please note, this event is being recorded.

I would now like to turn the conference over to Mr. Randy Patten, Assistant Vice President of Finance and Investor Relations. Please go ahead.

Randy Patten
Good morning, everyone, and thank you for joining this call. Earlier today, we issued a news release on our results. To find a copy of this document, please visit our website at ufginsurance.com. Press releases and slides are located under the Investor Relations tab.

Our speakers today are Chief Executive Officer, Randy Ramlo; Michael Wilkins, our Chief Operating Officer; and Dawn Jaffray, Chief Financial Officer.

Please note that our presentation today may include forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risks and uncertainties and are not a guarantee of future performance. These forward-looking statements are based on management's current expectations and we assume no obligation to update them. The actual results may differ materially due to a variety of factors, which are described in our press release and SEC filings.

Please also note that in our discussion today, we may use some non-GAAP financial measures. Reconciliations of these measures to the most comparable GAAP measures are also available in our press release and SEC filings.

At this time, I'm pleased to present Mr. Randy Ramlo, Chief Executive Officer of United Fire Group.

Randy Ramlo
Thanks, Randy. Good morning, everyone, and welcome to the UFG Insurance First Quarter 2017 Conference Call.

Earlier this morning, we reported net income of $0.77 per diluted share, operating income of $0.67 per share, and a GAAP combined ratio of 96.5% for the first quarter of 2017. This compares with net income of $0.88 per diluted share, operating income of $0.83 per diluted share, and a GAAP combined ratio of 92.3% in the first quarter of 2016.

During the first quarter of 2017, our growth in premiums and total revenues slowed moderately compared to the last few years. Net premiums earned grew 5.2%, which is in line with our expectation of 4% to 6% growth for the full year 2017. Likewise, total revenues also grew 6.5%.

During the first quarter of 2017, we had an increase in losses in our P&C segment driven by two items: first, an increase in catastrophe losses; and second, a deterioration in our core loss ratio, primarily in our commercial and personal auto lines of business. For the quarter, catastrophe losses added 4.1 percentage points to the combined ratio compared to 2.0 percentage points in the first quarter of 2016. Our ten-year historical average for the first quarter is 2.6 percentage points. This increase in the first quarter of 2017 was primarily due to hailstorms in the southern United States in the month of March. The deterioration in the core loss ratio added 3.3 percentage points to the combined ratio. This deterioration was driven by an increase in frequency and severity of losses in our auto lines of business.

As we mentioned during our fourth quarter conference call, we are continuing to implement many new initiatives including pricing increases, stricter underwriting guidelines, new analytical tools, and more rigorous loss control requirements. These new initiatives are focused on improving our underwriting performance, particularly in our auto lines of business, where we are tailoring our marketing, underwriting and loss control efforts to address distracted driving, an issue that continues to drive the increase in frequency and severity of losses.

Also, during the first quarter, we held our annual underwriting meetings, visiting each of our regional branches. The main focus on this year's meetings was on these new initiatives and improving the underwriting results of our auto book. Our expectation is that it will take a few quarters before we will see the benefits of these efforts in our financial results. Mike will go into more detail regarding losses and the strategies we have put in place to address this deterioration.

And another one of our initiatives is adding new analytical tools as we recognize the need to have more sophisticated approach to analyzing data. To assist with this initiative, we have added three new analytics professionals to help us make strategic decisions related to selecting and pricing risks, identifying trends and entering new markets to name a few.

For the Life segment, we reported net income of $1.4 million or $0.05 per diluted share in the first quarter of 2017 compared to $400,000 or $0.02 per diluted share for the first quarter of 2016. The increase in net income was primarily driven by the sale of a previously impaired fixed maturity security, which resulted in an after tax gain of $800,000 in the first quarter of 2017, partially offset by an increase in death benefits in our traditional life business. As we mentioned last year, we will be implementing many new strategies in 2017 to improve profitability in our Life segment, many of which have already been put in place, including product pricing adjustments and restructuring our commissions. As expected, these changes resulted in a decrease in sales of our single premium whole life products. We believe these strategies are positive steps to improve profitability in our insurance segment.

Before I turn the discussion over to Mike Wilkins, I will end my portion on a positive note. Our expense ratio continues to meet our expectations with the fourth straight quarter of an expense ratio right around or at about 30 percentage points. Even with the significant progress we have made in lowering and maintaining our expense ratio near 30 percentage points, we will always continue to look for efficiencies.

In closing, we were once again named to *Forbes* 2017 list of America's 50 most trustworthy financial companies for the fourth consecutive year. We are honored to be recognized in this prestigious list amongst these top-rated financial companies.

With that, I will turn the discussion over to our Chief Operating Officer, Mike Wilkins. Mike.

Michael Wilkins
Thanks, Randy, and good morning, everyone. As Randy indicated, one of the items impacting our results in 2017 was an increase in catastrophe losses as compared to the first quarter of 2016. This year's catastrophe losses for the most part were driven by an increase in frequency of claims related to hailstorms in the southern United States in the month of March. In the first quarter of 2017, we received 389 catastrophe claims compared to a 190 catastrophe claims in the first quarter of 2016.

The second item which impacted our results in the first quarter of 2017 was a deterioration in our core loss ratio impacted by an increase in frequency in severity losses in our auto lines of business. As Randy mentioned, we believe the majority of this increase is due to distracted driving which we are addressing with the following initiatives: implementation of a distracted driving campaign aimed at our agency partners and our insureds; enhanced focus on distracted driving in our loss control efforts including the enforcement of vehicle use policies; driver training programs and driver screening processes; and continuing to evaluate and pilot telematic solutions that have the capability to identify distracted driving issues as well as other risky driving behaviors.

In addition to the efforts to address distracted driving, we continue to push rate, especially on marginally performing accounts, evaluate predictive analytics solutions including the implementation of a new model targeted for Q2, and emphasize our auto lines as an area focus with all of our regional profit centers, as Randy mentioned in his comments.

Also to improve profitability in our commercial auto book, we are currently asking for and receiving rate increases in the mid to upper single digits. We believe we can continue to push for rate increases in our commercial auto line while also continuing to review and non-renew underperforming accounts.

Continuing on with our discussions on loss ratios, our commercial other liability loss ratio improved significantly in the first quarter of 2017 as compared to prior year, primarily due to favorable reserve development and a reallocation of IBNR reserves, while we saw deterioration in our loss ratio and our workers' compensation and assumed reinsurance lines of business.

The deterioration in workers' compensation was due to four claims received in the first quarter of 2017 over $500,000. Despite the deterioration, the loss ratio continues to be within our expectations for this line of business. The deterioration in our assumed reinsurance is primarily attributable to the emergence of prior year catastrophe losses in programs which we participate, which are reported on a lag basis. It is not unusual to see significant quarter-to-quarter variability in assumed business premium and loss bookings.

During the first quarter, we continued to experience a softening of the market and an increase in competition. We were most successful on accounts with less than $50,000 in premiums but also had success in accounts over $50,000 in certain regions, specifically in our Rocky Mountain, Gulf Coast and East Coast regions.

Overall, commercial lines average renewal pricing was flat compared to fourth quarter 2016. Filed commercial auto and commercial property rate increases continue to be in the mid to upper single digits with negative rate changes for our other casualty lines and workers' compensation lines of business.

Premium and policy retention were comparable to the fourth quarter of 2016 at 84% and 81% respectively. Our success ratio on quoted accounts decreased 1% from the prior quarter to 34% as we continue to address the deterioration in our auto book of business, premium and policy retention may be negatively impacted.

During the first quarter of 2017, property and casualty premiums written increased 8% as compared to the first quarter of 2016 with the majority of the increase due to rate and exposure and endorsement and audits. Less than 1% is attributable to new business.

With that, I'll turn the financial discussion over to Dawn Jaffray.

Dawn Jaffray
Thanks, Mike, and good morning. For the first quarter of 2017 we reported consolidated net income of $19.9 million or $0.77 per diluted share compared to $22.4 million or $0.88 per diluted share in the first quarter of 2016. The decrease in net income in the first quarter as compared to 2016 is primarily due to an increase in catastrophe losses and deterioration in our core loss ratio, previously discussed by Randy and Mike.

Consolidated net premiums earned increased 5.2% in the first quarter 2017 as compared to 2016, in line with previously mentioned expectations. Consolidated net investment income was $25 million for the first quarter 2017 or a 12.6% increase compared to $22 million in the first quarter of 2016. The increase in net investment income for the first quarter was primarily driven by the change in value of our investments and limited liability partnerships as compared to the same periods in 2016 and not due to a change in our investment philosophy. This resulted in an increase of $2.5 million in investment income during the first quarter as compared to the same period during 2016.

Losses and loss settlement expenses increased by $25 million or 17.9% during first quarter 2017 compared to first quarter 2016. The two primary drivers of the increase in 2017 were an increase in catastrophe losses and increase in commercial and personal auto losses as we previously discussed.

Favorable reserve development for the first quarter 2017 was $24.9 million compared to $23.9 million in the first quarter 2016. The impact on net income for the first quarter 2017 was $0.63 per diluted share compared to $0.61 per diluted share in the first quarter 2016.

As a reminder, our first quarter favorable development is generally higher than other quarters with the annual shift of IBNR reserves from prior accident years to the current accident year. For example, as you look to our other liability line of business loss ratio at 16.3% first quarter 2017 versus 48.1% for the comparative quarter of 2016, this reflects the favorable indications and development associated with this line of business and shift of IBNR to other lines of business in the current accident year.

Specifically, decomposing favorable development in the first quarter of 2017, the majority of the favorable development impacted two lines, commercial liability with $25.7 million and workers' compensation with $4 million of favorable development. This favorable development was offset by reserve strengthening in commercial and fire and allied with $2.5 million and assumed reinsurance with $6 million of adverse development.

The combined ratio in the first quarter 2017 was 96.5% compared to 92.3% for the first quarter 2016. Removing the impact of catastrophe losses and reserve development, our core loss ratio deteriorated 3.3 percentage points in the first quarter 2017. The primary driver of the deterioration in the core loss ratio is an increase in auto losses as previously discussed. If you refer to slide 9 in our slide deck on our website, we've provided a detailed reconciliation of the impact of catastrophes and development on the combined ratio.

As Randy noted, our first quarter 2017 expense ratio at 30.3% represented a decrease of 1.5 percentage points compared to first quarter 2016. The decrease is primarily due to a decrease in post-retirement benefit expenses of $2 million before tax, which is associated with the change in benefits we discussed during the fourth quarter and a reduction in our accrual for contingent commission based on the deterioration in the loss ratio.

Moving on to a discussion of our capital and capital management activity in the quarter, shareholders' equity increased 2% to $960 million at March 31, 2017 from $942 million at December 31, 2016. Book value increased $0.86 to $37.90 at March 31, 2017 from $37.04 at December 31, 2016. The increases in shareholders' equity and book value are primarily due to net income of $19.9 million and an increase in unrealized investment gains of $7.5 million to $141 million, partially offset by payment of shareholder dividends of $6.4 million and share repurchases of $5.7 million.

Return on equity was 8.4% for first quarter of 2017 compared to 9.9% in 2016. The decrease in ROE, as compared to the same quarter last year, was primarily due to a combination of decrease in net income and increase in shareholders' equity. Our return on equity, excluding unrealized investment gains, was 9.8% in the first quarter of 2017.

During the first quarter, we declared and paid a $0.25 per share of cash dividend to stockholders of record on March 1, 2017. We have paid a quarterly dividend every quarter since March 1968.

Also to note, during the first quarter of 2017, we have been more active with our share repurchase program. During the first quarter, we repurchased 134,981 shares of our common stock at an average price of $42.59 and a total cost of $5.7 million. Year-to-date through April, we have repurchased $11.7 million of our United Fire stock.

We purchase United Fire common stock from time to time on the open market and/or through privately negotiated transactions as the opportunity arises. The amount and timing of any purchases will be at management's discretion and will depend on a number of factors including the share price, general economic and market conditions, and corporate and regulatory requirements. We are authorized by the board of directors to purchase an additional 2.7 million shares of common stock under our share repurchase program, which expires in August 2018.

And with that I will now open the line for questions. Operator?

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star then two. At this time we will pause momentarily to assemble our roster.

Our first question comes from Paul Newsome with Sandler O'Neill. Please go ahead.

Paul Newsome
Good morning, everyone. I was wondering if you could talk a little bit about sort of what we should see from a net price increasing or decreasing situation for the firm. I understand that the commercial auto and the personal auto prices are up, but it also looks like you're lowering prices for the other businesses. Do you see there's a crossover point or do you think that the current situation is—basically flat pricing is the most likely scenario for the near-term?

Michael Wilkins
Paul, this is Mike. I'll try to take this question. We think overall pricing is pretty flat. I would say that probably over the last quarter we saw a little bit of a rebound, maybe tick back up a little with trouble in the auto line helping to support that line a little bit, but overall, pretty flat. We're seeing decreases in liability and work comp that mostly offset increases in the auto lines.

Paul Newsome
I'm sorry. That sounds like the commentary in the market. I was asking about your own positioning.

Michael Wilkins
Our own would be the same, Paul. The commentary that was given was on our own pricing.

Paul Newsome
Okay. Thank you.

Operator
Again, if you have a question, please press star then one. This concludes our question and answer session. I would like to turn the conference back over to Randy Patten for any closing remarks.

CONCLUSION

Randy Patten
That concludes our conference call. As a reminder, a transcript of this call will be available on the company website at ufginsurance.com. On behalf of management of United Fire Group, I wish all of you a pleasant day. Thank you.

Operator
The conference is now concluded. Thank you for attending today's presentation.