United Fire Group, Inc.

2nd Quarter 2015 Earnings Conference Call

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CORPORATE PARTICIPANTS

Anita Novak, *Assistant Vice President Investor Relations*

Randy A. Ramlo, *President and Chief Executive Officer*

Michael T. Wilkins, *Executive Vice President and Chief Operating Officer*

Dawn M. Jaffray, *Senior Vice President and Chief Financial Officer*

David E. Conner, *Vice President and Chief Claims Officer*

Barrie W. Ernst, *Vice President and Chief Investment Officer*

Michael J. Sheeley, *Vice President and Chief Operating Officer, United Life Insurance Company*

PRESENTATION

Operator
Good morning. My name is Jamie, and I'll be your conference operator today. At this time, I would like to welcome everyone to the United Fire Group 2015 second quarter financial results conference call. All participants will be in a 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 and then 1 using your telephone keypads. To withdraw your question, please press star and 2. Please also note that today's event is being recorded.

At this time, I would like to turn the conference call over to Anita Novak, Assistant Vice President of Investor Relations. Ma'am, please go ahead.

Anita Novak
Thank you, Jamie. 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 www.unitedfiregroup.com. Press releases and slides are located under the Investor Relations tab.

Our speakers today are Randy Ramlo, President and Chief Executive Officer, Michael Wilkins, Executive Vice President and Chief Operating Officer, and Dawn Jaffray, Senior Vice President, and Chief Financial Officer. Other members of our executive team are also available for the question-and-answer session that will follow our prepared remarks.

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 vary 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 am pleased to present Randy Ramlo, President and Chief Executive Officer of United Fire Group.

Randy A. Ramlo
Thank you, Anita. Good morning, everyone, and welcome to United Fire's 2015 second quarter conference call.

This morning, we reported another solid quarter. Our operating income was 57 cents per share, net income was 59 cents per share, and our GAAP combined ratio was 97.7. Year-to-date, operating income was $1.50 per share, net income was $1.54 per share and our GAAP combined ratio was 93.8 percent. Our return on equity as of June 30, was 9.4 percent, and book value was $33.21 per share.

Equally as exciting for us is the growth pattern we have developed over the last few years. Total revenues grew for the quarter by 10 percent, consolidated earned premium increased 13.6 and consolidated written premium increased 11.3 percent. We are currently on track to achieve $1 billion in total revenues on a consolidated basis during 2015, which will be a milestone for us.

Mike Wilkins will be commenting in a few minutes on market conditions being more competitive than we have seen in several years, and that would suggest that perhaps our growth is somewhat more aggressive than practical. I would argue that our growth is very calculated and deliberate. For several quarters now, we have been talking about our 20/20 vision and the strategies for meeting the objectives of that plan, which are designed to result in profitable organic growth.

As a reminder, we are expanding our geographic reach through agency growth in regions where we feel we are underutilized. Over the last few years, we have added approximately 100 new agencies per year. We take these partnerships very seriously and work diligently to create a successful partnership for both parties. We are now seeing the rewards of our efforts. Of course, assigning new agents is only half the battle. We continue to assess existing relationships for profitability and mutual benefit.

We continue to grow our lines of business. A prime example would be our E&S specialty division which is expected to expand into additional states by the end of 2015 as we extend our concentration from West to East. To facilitate the expected growth in this line, we have re-activated Texas General Indemnity Company, renamed it UFG Specialty Insurance Company and redomesticated it to Iowa. UFG Specialty will become our admitted carrier for this segment of business.

With the addition of the Mercer Insurance companies, we initiated our association business. As we become more familiar and experienced in writing that business, we see the benefit of expanding not only our existing relationships but into additional programs. These programs are written based on the experience of the entire group of companies instead of each individual company. Loss ratios tend to improve as a result, thereby strengthening our underlying book of business. Programs that began as regional trials have now become national.

Additionally, related to Mercer — the Mercer acquisition we have introduced United Fire & Casualty products in our Western region. This has generated material premium volume in classes other than those that are contractor related. This has had the desired effect of diversifying away from our heavy contractor book in this region.

We continue to target our small business owners' products. These are generally accounts less than $10,000 in premium and include a complete insurance package. Going forward, we will have some exciting new automation to help us be more competitive and profitable in this line, including up to date our online quote and application submission process. More updates to come as the year progresses.

Additionally, we continue to add enhancements to our single premium whole life products including our qualified care rider which we have discussed previously. Mike Wilkins will be touching on the P&C segment in a few minutes, but as long as we are on the subject of life — the life company, I would like to make a few comments.

Sales of our single premium whole life policies improved during second quarter due to implemented enhancements to various products and improved commission schedules which allowed us to offer a better payout to our clients. However, deferred annuity deposits decreased 68.1 percent and 49.5 percent, respectively, for the quarter and year to date compared to the same periods of 2014 due to gradual lowering of the credited rate offered on our deferred annuity products. Plain and simple, other competitors are offering rates above where we can. As a result, we have seen accounts move to lower-rated competitors offering higher rates.

Losses and loss settlement expenses increased $.1 million for the second quarter when compared to the same period in 2014 and $.6 million year to date due to corresponding increases in death benefits paid. Fluctuations in the timing of death benefits occur from quarter to quarter and year to year.

Interest credited decreased $1.8 million for the quarter and $3.2 million for the year to date due to net annuity withdrawals decreasing the base on which interest is paid, along with the periodic reduction in the interest rate credited on annuity products throughout 2014 and continuing into 2015.

Net income for the life insurance segment declined slightly year to date compared to 2014.

I would be remiss if I did not remind our audience today that we recently initiated a branding campaign. Going forward, our organization will be known as UFG rather than United Fire.

With that, I'll turn this morning's discussion over to Mike Wilkins, our Vice President and Chief Operating Officer.

Michael T. Wilkin
Thanks, Randy, and good morning everyone.

We continue to request and receive rate increases in lines of business and in geographic regions where warranted, but, we are also experiencing competitive market conditions on both renewals and on new business. As we enter a softening market, holding true to our underwriting strategy of targeting specific market segments and managing our hazard class mix of business within our risk appetite becomes that much more important. We are an underwriting company. Our actions include repricing and/or eliminating our lowest level of underperforming accounts where appropriate. In evaluating new regions for expansion of our footprint, we assess the potential impact of geographic concentration risk through mapping tools such as cartography. Evaluation of walk-away price will become a key component of renewal underwriting as we progress through the softening market. We underwrite, we take calculated risk, and we price our business accordingly.

Commercial lines renewal pricing varied by region, with average percentage increases in the mid- to low-single digits on smaller accounts. Larger accounts were more competitive, with flat to low-single digit decreases on quality accounts. Nonetheless, this is the 15th consecutive quarter of overall commercial lines pricing increases.

Personal lines renewal pricing increased slightly during the second quarter.

Premium written from new business remained strong, up from the prior quarter when compared to the same quarter a year ago. Our success ratio on quoted accounts decreased slightly but remains at an acceptable level

Current rate increases continue to meet or exceed loss cost trends depending on the line of business. We continue to believe loss cost trends will remain at low levels in 2015, but the gap between loss costs and rate increases will narrow as 2015 progresses. We currently believe that loss costs are approximately 3 percent. We base this belief on data from multiple resources, including JLT.

Policy retention remains strong at 82 percent, increasing slightly from the prior quarter, for the group and several regions. Premium retention was down from the previous quarter but remained strong at 85 percent, which is consistent with our expectations as the market trends — market trends toward softening. Policies in force were up 2.5 percent compared to the second quarter 2014, mostly in general liability and commercial umbrella. New policies written were sufficient to offset policies lost or non-renewed.

The U.S. economy continues to grow at a slow rate. Premium from endorsements and premium audit continued positive trends, up from the same quarter a year ago. During the second quarter, direct premiums written increased 9.2 percent. Approximately 3 percent is attributed to rate and exposure changes, 3 percent is attributed to premium audits and endorsements, and 3 percent is attributed to new business.

Our expectations for rate increases for the balance of 2015 continue to be low single digits for another quarter but likely flat by the end of the year.

Pre-tax catastrophe losses for the quarter totaled $20.2 million, or 52 cents per share, after tax compared to $20.6 million, or 53 cents per share, after tax. The impact on second quarter combined ratio was 9.6 percentage points. Year-to-date pre-tax catastrophe losses totaled $20.4 million, or 53 cents per share, after tax compared to $23.9 million, or 61 cents per share, after tax. The impact on the six-month year-to-date combined ratio was 5.0 percentage points.

As you may recall, first quarter was essentially void of catastrophe losses. Second quarter events were mostly Midwestern storms during April and May. These storms included the St. Louis hail storm in early April, Texas wind and hail storms in the latter half of April, and a hail and wind storm in Kansas and Texas in the latter half of May.

Our expectation for catastrophe losses in any given year is 6 percentage points of the combined ratio. It’s important to note, however, that our book of business remains primarily in regions of the country that are susceptible to seasonal weather events such as winter and spring convective storms, which will likely result in volatility in our results from quarter to quarter, especially during the second and third quarters. As a company, we don’t get too excited about this volatility since our final analysis is based on annual results.

Large losses, which we define as losses greater than $500,000, totaled $20.7 million in the second quarter. This compares to $20.3 million in the second quarter of 2014. Second quarter 2015 large losses remain within our expectations. Year-to-date, large losses totaled $42.6 million compared to $43.3 million in 2014. Though the current comparison seems pretty consistent from period to period, this is not typical. Large losses vary from quarter to quarter and year to year.

Frequency for the quarter and year to date was down significantly as compared to the same periods in 2014. As you may recall, second quarter 2014 was a high-CAT loss quarter, so our claims counts in 2015 are more consistent with our expectations.

Severity for the quarter and year to date was up slightly but still within our expectations.

During the first half of 2015, commercial property lines had double-digit improvement in loss ratio due to a decline in the frequency of claims associated with severe winter and spring storms during 2014 and a noticeable reduction in the number of large fire losses in 2015 as compared to 2014.

We have also seen much improved loss ratios during the first half of 2015 in our workers' compensation line of business due to the combined effects of a decrease in severity and frequency of claims, favorable reserve development, and recent proactive underwriting initiatives.

Our personal lines have seen the most improvement in loss ratio in the first half of 2015 due to the improved frequency and severity of claims in 2015 as compared to 2014, improved pricing and the implementation of policy underwriting adjustments.

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

Dawn M. Jaffray
Thanks Mike. Consolidated net income, including net realized investment gains and losses, was $15.0 million, or 59 cents per share, for the quarter compared to $10.7 million, or 42 cents per share. last year. Year-to-date 2015 consolidated net income, including net realized investment gains and losses, was $38.7 million, or $1.54 per share, compared to $24.0 million, or 94 cents per share for 2014.

Losses and loss settlement expenses increased by $7.6 million, or 5.4 percent, compared to the second quarter of 2014. Year-to-date losses and loss settlement expenses increased $8.8 million, or 3.3 percent. Our loss ratio was 68.4 percent compared with 72.1 percent for the second quarter of 2014, representing an improvement of 3.7 points. The 2015 year-to-date loss ratio was 64.1 versus 69.2 percent for the comparable six months, representing a 5.1 point improvement.

Favorable reserve development included in these results for the second quarter was $6.7 million, or 3.2 percentage points on the loss ratio, compared with $11.3 million, or 6 points for the second quarter of 2014. The positive impact on net income for the quarter was 17 cents per share compared with 29 cents per share in 2014. Year-to-date 2015 favorable reserve development was $23.4 million, or 5.7 loss ratio percentage points, compared to $25.8 million, or 7 points, for 2014. The positive impact on net income for the six-month comparable was 61 cents per after tax, versus 65 cents per share after tax for 2014.

As we have stated on many occasions, reserve development will vary from quarter to quarter and year to year due to the number of claims settled and the settlement terms. During the second quarter, the decrease in favorable reserve development is attributable to the timing of paid claims. The largest single contributor was workers' compensation with $5.9 million of favorable development. The majority of the releases were from accident years 2012 through 2014.

I remind our audience that we are an underwriting company with a bias for maintaining a conservative reserving philosophy and approach. At June 30, 2015, our total reserves remained within our actuarial estimates.

For investments, consolidated net investment income was $25.8 million for the second quarter, which was a decrease of 6.6 percent as compared to $27.6 million in the second quarter of 2014. Year-to-date consolidated net investment income was $50.2 million compared to $54.4 million, which is a decrease of 7.7 percent. The decreases are due to the decline in the reinvestment interest rates from the continued low interest rate environment.

We continue to feel the impact of lower investment yields on the majority of our investment portfolio, and we expect a continuation of low interest rates as 2015 progresses. The weighted average effective duration of our fixed maturity securities portfolio at June 30, 2015, was 5.2 years. Our overall portfolio yield was 3.6 percent.

Consolidated net realized investment gains for the quarter were $.8 million compared to net realized investment gains of $2.7 million in 2014. Year-to-date consolidated net realized investment gains were $1.7 million compared to $4.9 million.

Consolidated net unrealized investment gains, net of tax, totaled $132.7 million as of June 30, 2015, which is a decrease of $16.9 million, or 11.3 percent, from December 31, 2014. The majority of the decrease in net unrealized gains is a result of a decrease in the fair value of the fixed maturity investment portfolio due to interest rate increases at June 30, 2015.

The expense ratio for the second quarter was 29.3 percentage points, compared to 29.6 percentage points for the same quarter of 2014. Year to date, the expense ratio is 29.7 percent compared to 31.5 percent for 2014. The expense ratio continues to improve, and we are focused on maintaining expense discipline in line with a softening market. As we indicated in our earnings release this morning, we are now seeing improvement from reduced expenses associated with the completion of the Mercer Insurance integration, along with investments in core development and technology over the last few years. I would like to caution our audience that we do expect the 2015 expense ratio to be somewhat impacted by pension and postretirement benefit costs as the year progresses.

With respect to balance sheet highlights, our stockholders' equity increased 1.8 percent to $831.9 million at June 30, 2015, from $817.4 million at December 31, 2014. The increase was primarily attributable to net income of $38.7 million offset by a decrease in net unrealized investment gains of $16.9 million, net of tax, during the first six months of 2015, along with shareholder dividends of $10.5 million. At June 30, 2015, the book value per share of our common stock was $33.21 compared to $32.67 at December 31, 2014.

In regards to capital management, during the second quarter, we declared and paid a 22 cent per share cash dividend to shareholders of record on May 2, 2015. In addition, during the second quarter we repurchased 12,068 shares of United Fire common stock at an average price of $29.84. Year to date, we have purchased 49,705 shares of our stock — common stock at an average price of $29.04 per share.

As a reminder, under our current share repurchase program, we may purchase United Fire common stock on the open market or through privately negotiated transactions. 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 1.6 million shares of common stock under the new program which expires August 31, 2016.

And, with that, I'll now open the line for questions.

QUESTIONS AND ANSWERS

Operator
Ladies and gentlemen, at this time, we will begin the question-and-answer session. To ask a question, you may press star and then 1. If you are using a speaker phone, we do ask that you please pick up your handset before pressing the keys to ensure the best sound quality. To withdraw your question, you may press star and 2. Again, it is star and then 1 to ask a question. At this time, we will pause momentarily to assemble the roster.

Once again, to ask a question, please press star and 1. And, ladies and gentlemen, at this time and showing no questions, I'd like to turn the floor back over to Ms. Novak for any closing remarks.

CONCLUSION

Anita Novak

Thanks, Jamie. This now concludes our conference call. As a reminder, a transcript of this call will be available on the company website at www.unitedfiregroup.com. On behalf of the management of United Fire Group, I wish all of you a very pleasant day.

Operator
Ladies and gentlemen, that does conclude today's conference call. We do thank you for attending. You may now disconnect your telephone lines.