United Fire Group, Inc.

Second Quarter 2016 Financial Results Conference Call

August 3, 2016 at 10:00 a.m. Eastern

CORPORATE PARTICIPANTS

Randy Ramlo, *President & Chief Executive Officer*

Michael Wilkins, *Chief Operating Officer*

Dawn Jaffray, *Chief Financial Officer*

Randy Patten, *Assistant Vice President, Finance & Investor Relations*

PRESENTATION

Operator
Good morning. My name is William, and I'll be your conference operator today. At this time, I would like to welcome everyone to the United Fire Group Second Quarter 2016 Financial Results Conference Call. 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 1 on your telephone keypad. To withdraw your question, please press star, then 2. Please note that this event is being recorded. Thank you.

I would now like to turn the event over to Randy Patten, Assistant Vice President of Finance and Investor Relations.

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 unitedfiregroup.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 am pleased to present Mr. Randy Ramlo, Chief Executive Officer of United Fire Group.

Randy Ramlo
Thanks Randy. Good morning, everyone, and welcome to UFG Insurance second quarter 2016 conference call.

Earlier this morning we reported net income of 12 cents per diluted share, operating income of 8 cents per diluted share and a GAAP combined ratio of 104.8 percent for the second quarter. This compares with net income of 59 cents per diluted share, operating income of 57 cents per diluted share and a GAAP combined Ratio of 97.7 percent in the second quarter of 2015.

Our second quarter 2016 results were impacted by catastrophe losses from hail and wind storms in Texas and the Midwest. During the second quarter, we were affected by over a dozen catastrophe-designated storms for a total of $35.5 million of catastrophe losses. These losses added 15.3 percentage points to the combined ratio which is 5 percentage points above our 10-year historical average for second quarter catastrophe losses of 10.3 percentage points. Mike and Dawn will go into more detail on our catastrophe losses and the impact to our loss ratio in a few moments.

Our expectations for catastrophe losses in any given year is six percentage points of the combined ratio, with second and third quarters being the most significant quarters with storms and catastrophe events in geographic areas where we conduct much of our business.

In the Property and Casualty segment, net premiums earned increased 11 percent and are the result of continued organic growth and geographical expansion. Rate increases on commercial lines were in the low single digits in the second quarter in our commercial auto and commercial property lines of business. Rate increases on personal lines were in the low-single digits, primarily in our homeowners and personal auto lines of business. I'll let Mike address more specifics with respect to P&C market conditions and performance in a few moments.

Moving on to our life segment, the current interest rate environment has presented challenges during 2016. For the remainder of this year, our expectation is for profitability to be difficult in this segment. We are continually working on making adjustments to our strategy to adapt to the persistent low rate environment. These include changes to life product pricing and marketing changes that will result in reductions in operating expenses and an increase in life insurance interest spreads.

Our sales of our Single Premium Whole Life product remained strong in second quarter 2016 and we continued to execute our strategy to maintain profitability rather than market share on our deferred annuity deposits, by increasing our spreads by 42 basis points as compared to the same period of 2015. By design, this has led to a decrease in the size of our annuity book and consequently has also resulted in a decrease in invested assets, which, in combination with the low interest yield environment, has also resulted in a decline in net investment income.

The second quarter 2016 expense ratio was higher by 1 percentage point, compared to the second quarter of 2015, but within our expectations at 30.3 percent. The increase in the expense ratio was due to an increase in deferred acquisition cost amortization from our continued organic growth partially offset by a decrease in post-retirement benefit expenses.

Strategically, our approach for the remaining half of 2016 remains unchanged. We are focusing on executing our initiatives which we have shared the last few quarters, which include: continuing to focus on expanding our geographic footprint and agency plant and penetration, growing our specialty business, expanding our program and association business, leveraging the expansion of our product portfolio while maintaining true to our core underwriting discipline in a flat to diminishing rate environment and growing our book of business profitably. We are also pursuing additional opportunities in growing small business products including expanding our service center.

To summarize our thoughts on profitability, while the loss ratio for the quarter did not meet our expectations due to the 15.3 points of catastrophe storm losses, we are encouraged by the continued improvement in severe losses greater than $500,000, which Mike will discuss shortly, and also by the improvement in our core loss ratio when we exclude the impact of catastrophe losses and reserve development.

With that, I'll turn the discussion over to our Chief Operating Office, Mike Wilkins.

Mike Wilkins
As Randy indicated and as we pre-released this quarter, we experienced an increase in catastrophe losses during second quarter. In the second quarter, we had 13 catastrophe designated events, with 5 of those events accounting for a majority of the total catastrophe losses during the quarter. The losses were due to hail and wind storms in Texas and the Midwest. In Texas, the most significant losses were to commercial property in the San Antonio area. The losses throughout the remaining parts of the Midwest and Texas impacted our commercial property, commercial auto, personal auto and homeowners lines of business.

In 2016, we continue to see an improvement in large losses, excluding catastrophe losses, which we define as losses greater than $500 thousand. Large losses totaled $19 million in the second quarter 2016 compared to $21 million in the second quarter 2015. Year-to-date, large losses totaled $37 million in 2016 compared to $43 million in 2015. The decrease in large losses is due to an improvement in severity. By their very nature we expect large losses to vary from quarter-to-quarter and year-to-year.

Claim counts increased 11 percent in the first half 2016 as compared to the first half of the prior year, but as a percent of written premiums are flat. This increase was impacted by the weather related catastrophe activity in Texas and the Midwest as previously discussed.

During 2nd quarter, our loss ratio on workers' compensation increased 32 points over an unusually low loss ratio in 2nd quarter 2015. We attribute this change to an increase in severity of claims over $100,000 and a decrease in favorable reserve development on prior year claims. Despite the increase, the loss ratio continues to be within our expectations for this line of business. Workers' compensation losses can be volatile quarter over quarter, therefore, we will continue to monitor this line of business, but our expectations are that this trend will not continue.

During 2nd quarter, we continue to see competitive market conditions for both renewals and new business. Commercial lines renewal pricing varied by region, with average percentage increases up slightly from 1st quarter 2016. We had the most success with increases in commercial auto and commercial property lines of business, offset by a decrease in workers' compensation rates. This is the 19th consecutive quarter of commercial lines pricing increases on our overall book of business. Personal lines renewal pricing average percentage increases were in the low-single digits, decreasing slightly from the mid-single digits in the 1st quarter 2016. The increases continue to be in homeowners and personal auto lines of business.

Premiums written from new business increased compared to the same quarter prior year. Our success ratio on quoted accounts remains unchanged from the prior three quarters and remains at an acceptable level, with the most success in accounts with premium less than $25 thousand.

Premium and policy retention remained strong, at 85 and 83 percent respectively with changes from prior quarter of less than 1 percent, respectively.

During the second quarter Property & Casualty premiums written increased 12 percent as compared to second quarter 2015: 3 percent is attributed to new business, the remaining increase is due to rate changes, endorsements, audits and exposure increases. Year-to-date, Property & Casualty written increased 11 percent as compared to the same period of 2015: 3 percent is attributed to new business, the remaining increase is due to rate changes, endorsements, audits and exposure increases.

As we have discussed for a few quarters now, we continue to execute on a number of our growth strategies. We are on track with our expansion into Kentucky, adding workers' compensation in the state of Texas and with our small business pursuit during the third quarter of this year. Our expansion into the State of Ohio in the fourth quarter of 2015 continues meet expectations with $4.2 million of premiums written since we entered the state.

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

Dawn Jaffray
Thanks, Mike, and good morning. For the second quarter of 2016, we reported consolidated net income of $3.1 million, or 12 cents per diluted share, compared to $15 million, or 59 cents per diluted share, in the second quarter of 2015. Through six months, 2016 year-to-date consolidated net income was $25.5 million and $1.00 per diluted share as compared to $38.7 million and $1.54 per diluted share in 2015.

The decrease in net income in the second quarter and year to date as compared to 2015, is primarily due to the catastrophe losses previously discussed by Randy and Mike. Our shareholders' equity increased 9 percent, to $961 million at June 30, 2016, from $879 million at December 31, 2015. Book value increased $2.91 to $37.85 at June 30, 2016, from $34.94 at December 31, 2015. The increases in shareholders' equity and book value are primarily due to net income of $25.5 million and an increase in unrealized investment gains of $59 million. Consolidated unrealized investment gains are $187.4 million at June 30, 2016.

Return on equity was 5.6 percent in the first half of 2016 compared to 9.4 percent in the first half of 2015. Further adjusting ROE to exclude the impact of unrealized gains, our adjusted ROE was 6.7 percent in the first half of 2016 as compared to 11.3 percent in the first half of 2015. The decrease in ROE compared to the same quarter last year was primarily due to a combination of a decrease in net income and an increase in shareholders' equity.

Losses and loss settlement expenses increased by $30 million, or 20 percent, during the second quarter 2016 as compared with the second quarter of 2015. On a year-to-date basis, losses and loss settlement expenses increased by $45.8 million, or 16.5 percent, compared to the same period of 2015. The primary driver of the increase in second quarter is catastrophe losses as we have previously discussed.

As has been historical reserving practice at UFG, we set initial reserves conservatively. As a result, we often have favorable reserve adjustments that vary from year to year across our book of business. Favorable reserve development for the second quarter 2016 was $2.5 million compared to $6.7 million in the second quarter of 2015. The impact on net income for the second quarter in 2016 was 6 cents per share compared to 17 cents per share in 2015. On a year-to-date basis, favorable reserve development for 2016 totaled $26.4 million compared to $23.4 million in 2015. The impact on net income in 2016 was 67 cents per share compared to 61 cents per share in 2015.

Three lines together provided the majority of the favorable reserve development in the first half of 2016. The largest contributors to our favorable development work — commercial liability, with $13.8 million, followed by workers compensation, with $7.2 million, and commercial auto, with $6.2 million. All of these lines benefited from successful claims management and continued successful management of litigation expenses. The favorable development is attributable to reductions in reserves for reported claims as well as reductions in required reserves for incurred, but not reported claims, along with continued successful management of litigation expenses. These lines were slightly offset by $4.4 million of adverse development in the commercial fire line of business, which experienced an increase in paid claims.

As Randy mentioned, the combined ratio in the second quarter of 2016 was 104.8 percent and 98.7 percent year to date; 2015 comparatives were 97.7 percent for the second quarter and 93.8 percent year to date. Removing the impact of catastrophe losses and reserve development, our core loss ratio improved 1.7 percentage points in the second quarter and 0.1 percentage points year to date, when compared with 2015 results. Referring to Slide 10 in our slide deck on our website, we've provided a detailed reconciliation of the impact of catastrophes and development on the combined ratio. In summary, the adjusted loss and loss settlement expense ratio, removing the impact of catastrophes and favorable development for the quarter, would be 60.3 percent versus 62 percent and 64.7 percent versus 64.8 percent for the year-to-date comparative.

Moving on to investments, consolidated net investment income was $24.5 million for the second quarter 2016, or a 5 percent decrease as compared to $25.8 million in the second quarter of 2015. Year to date, 2016 consolidated net investment income was $46.7 million, which represents a 7 percent decrease when compared to 2015. The decrease in net investment income for the quarter and year to date was primarily driven by the change in the value of investments and limited liability partnerships as compared to the same periods in 2015, along with the low interest rate environment. The impact of low investment yields continues to impact the majority of our investment portfolio, and we expect a continuation of low interest rates for the remainder of 2016.

With respect to capital management, during the second quarter, we declared and paid a 25 cent-per-share cash dividend to stockholders of record on March 1, 2016. We have paid a quarterly dividend every quarter since March 1968.

Under our share repurchase program, we may purchase United Fire common stock from time to time 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. During the second quarter, we did not repurchase any shares of our common stock. We are authorized by the Board of Directors to purchase an additional 1,528,886 shares of common stock under our share repurchase program which expires in August 2016.

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

QUESTIONS AND ANSWERS

Operator
We will now begin the question-and-answer session. To ask a question, you may press star, then 1 on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then 2. At this time, we will pause momentarily to assemble our roster. Again, if you have a question, please press star, then 1.

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

Paul Newsome
Good morning. At one point in time, I think there was a project to develop some internal models to figure out just how much excess capital United Fire had, in your opinion. Were those projects completed, and, if so, what were the results?

Randy Ramlo
Yes, they were. I'd probably characterize those as ongoing, but we look at our capital structure from kind of two different, separate sources, and we do have excess capital, but we don't disclose the amount we have. So, yes, we continually monitor that from year to year.

Paul Newsome
Was there any change, in your opinion, because of these projects?

Randy Ramlo
Not really, no.

Paul Newsome
Fair enough. Thanks.

Randy Ramlo
Thank you, Paul.

Operator
Again, if you have a question, please press star, then 1. There are no further questions, so this concludes our question-and-answer session. I would now like to turn the conference back over to Randy Patten for any closing remarks.

CONCLUSION

Randy Patten

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

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.