United Fire Group, Inc.

2016 Fourth Quarter and Year End Earnings Conference Call

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CORPORATE PARTICIPANTS

Randy Ramlo, *Chief Executive Officer*

Michael Wilkins, *Chief Operating Officer*

Dawn Jaffray, *Chief Financial Officer*

Barrie Ernst, *Chief Investment Officer*

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

PRESENTATION

Operator
Good day and welcome to the United Fire Group, Inc. 2016 Fourth Quarter and Year End Earnings 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 a touchtone phone. To withdraw your question, please press star, then 2. 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. The press release 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 UFG Insurance Fourth Quarter and Year End 2016 Conference Call. Earlier this morning, we reported net income and operating income of 46 cents per diluted share and a GAAP combined ratio of 102.6 percent for the fourth quarter 2016. This compares with net income and operating income of $1.21 per diluted share and a GAAP combined ratio of 86.8 percent in the fourth quarter of 2015.

For the year 2016, net income was $1.93 per diluted share, operating income $1.78 per diluted share, and our GAAP combined ratio was 100.3 percent. This compares to prior year net income of $3.53 per diluted share, operating income of $3.46 per diluted share, and a GAAP combined ratio of 92 percent.

Dawn will address the quarterly and full year financial results in a few minutes.

The full year of 2016 results were primarily impacted by two items. First, an increase in catastrophe losses as compared to 2015. 2015 was a quiet year for catastrophe losses, only adding 3.8 percentage points to the combined ratio as compared to 2016, when catastrophe losses added 6.5 percentage points to the combined ratio. The level of catastrophe losses in

2016 is within our expectations and is normally what we would expect in a given year, aligning closely with our ten-year historical average of 6.7 percentage points on the combined ratio.

The second item impacting our 2016 results was a deterioration in our core loss ratio. A portion of this deterioration was driven by an increase in large losses, which we define as losses greater than $500,000. The large losses were primarily in our commercial automobile and commercial property lines. In a few moments, Mike will go over into more detail regarding these losses and the strategies we have put in place or will be putting in place to address this deterioration.

Last year at this time, we announced a milestone of $1 billion in total revenue for the first time in company history. Again in 2016, we achieved another milestone, earning $1 billion in net premiums. This milestone included a 9.9 percent increase in net premiums earned in 2016 as compared to 2015. Although we are proud of this milestone, looking ahead to 2017 and where we are in the current softening market cycle, we believe that the pace of our premium growth will slow moderately compared to the level of growth we have experienced since the beginning of 2014.

As we have discussed all year, 2016 was a challenging year for our life segment. For the year 2016, we had a net income of $786,000 as compared to $3.8 million in 2015. As we mentioned in our third quarter call, beginning on January 1, 2017, we implemented a number of strategies to improve the profitability of the life segment. The changes already implemented include product pricing adjustments and restructuring of our commissions. We are also looking at our current product mix and exploring opportunities to expand our product offerings in the states we currently write business. We believe these strategies are positive steps to improve profitability on our life insurance segment.

Since the second quarter of 2016, our expense ratio has been at or below 30.3 percentage points. We are satisfied with the progress we have made this year to reduce our expenses and maintain an expense ratio near 30 percentage points. We will always continue to look for efficiencies, but we believe we have achieved an acceptable operating expense level.

2016 proved to be another year of milestones and accomplishments for UFG. In addition to the premium milestones accomplished this year, we also recognized our 70th year in business, our 45th year as a publicly-held company, and our 30th year being listed on the NASDAQ, which we celebrated by ringing the NASDAQ opening bell in April. Besides these milestones, UFG also received several outstanding recognitions, including being named to *Forbes*' America's 50 Most Trustworthy Financial Companies list for *the* third year in a row and being selected as a top workplace by *The Des Moines Register*.

While we are proud of the accomplishments in 2016, we are disappointed with the deterioration in our core loss ratio. In response to this, we are reviewing and working on implementing more rigorous loss control efforts, stricter underwriting guidelines, rate increases, and new analytical tools, which Mike Wilkins will now discuss in more detail. Mike.

Michael Wilkins
Thanks, Randy, and good morning, everyone. As Randy indicated, one of the items impacting our results in 2016 was an increase in catastrophe losses as compared to an exceptionally low CAT year in 2015. This year's catastrophe losses are in line with our expectations for any given year, adding 6.5 points to the combined ratio, which aligns with our ten-year historical average

of 6.7 points of the combined ratio. The majority of this year's catastrophe losses occurred in the second and third quarters, primarily due to weather-related events.

The second item, which impacted our results in 2016, was a deterioration in our core loss ratio, impacted by an increase in large losses primarily in our commercial automobile and commercial property lines. During 2016, large losses totaled $108 million compared to $86 million in 2015.

As we discussed during last quarter's call, the majority of the large commercial property losses occurred in the third quarter when we incurred five large commercial fire losses for a total of $9.6 million. These fires were geographically spread out with no recurring pattern; however, we have implemented many loss control initiatives to reduce commercial fire losses, including more emphasis on electrical systems, HVAC, and other systems, especially in older buildings and buildings in unprotected areas, strict compliance to loss control recommendations, and expanded use of technology such as infrared thermography.

For commercial auto, losses continued to deteriorate in the fourth quarter of 2016 due to an increase in the severity of claims. We are currently asking for and receiving rate increases between 3 and 10 percent, depending on the region, for new business and renewal premiums. Along with implementing these rate increases, we have already implemented many loss control initiatives to reduce commercial auto losses, including enforcement of vehicle use policies, required driver training, vehicle maintenance programs, and reducing umbrella and excess limits in certain regions. Further loss control initiatives, including implementing predictive analytics into our underwriting process in mid-2017. For personal auto, we are achieving rate increases in the mid- to upper-single digit range, and we continue to expand the use of telematics and the use of analytics.

As compared to exceptional results in 2015, our loss ratio on workers' compensation deteriorated in the fourth quarter. In the fourth quarter, our loss ratio on workers' compensation increased 35 points over the fourth quarter of 2015. We attribute this change to an increase in severity of claims over $100,000. Workers' compensation losses can be volatile quarter-over-quarter. Therefore, we will continue to monitor this line of business.

During the fourth quarter, we saw an increase in competition and a further softening of the market, which was most evident in our Midwest region. Overall commercial lines renewal pricing for the group was flat to a slight increase. Pricing varied by region and size of account. Commercial auto and commercial property rate increases continue to be in the mid- to upper-single digits. Other casualty lines and workers compensation rate increases are flat or slightly negative. We believe that loss cost trends are approximately 3 percent.

Personal lines renewal pricing increased with average percentage increases in the low- to mid-single digits, primarily in homeowners and personal auto. Premium and policy retention remained strong at 84 and 82 percent, respectively, with changes from the prior quarter of approximately 1 percent. Our success ratio on quoted accounts was up 4 percent from the prior quarter, remaining at an acceptable level.

During the fourth quarter, property and casualty premiums written increased 4 percent as compared to the fourth quarter of 2015. Two percent is attributed to new business, and 4 percent is attributable to endorsements and audits. Both of these are partially offset by a 2 percent decline in rate and exposure changes.

For the year 2016, property and casualty written premiums increased 9 percent as compared to 2015. Three percent is attributable to new business, and the remaining increase is due to rate changes, endorsements, audits, and exposure increases.

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

Dawn Jaffray
Thanks, Mike, and good morning. For the fourth quarter 2016, we reported consolidated net income of $12 million, or 46 cents per diluted share, compared to $30.9 million, or $1.21 per diluted share in the fourth quarter of 2015. For the year 2016, consolidated net income was $49.9 million and $1.93 per diluted share compared to $89.1 million and $3.53 per diluted share in 2015.

The decrease in net income in the fourth quarter and full year 2016 as compared to 2015 is primarily due to an increase in catastrophe losses and a deterioration in our core loss ratio, a portion of which was due to an increase in large losses previously discussed by Randy and Mike. Our shareholders' equity increased 7 percent to $942 million at December 31, 2016, from $879 million at December 31, 2015. Book value increased $2.10 to $37.04 at December 31, 2016, from $34.94 at December 31, 2015.

The increases in shareholders' equity and book value are primarily due to net income of $49.9 million, an increase in unrealized investment gains of $5.5 million to $134 million, a change in benefits and valuation of our post-retirement obligations, which contributed $23 million, all partially offset by a payment of shareholders' dividends of $24.6 million.

On a positive note, the changes we implemented to take effect at the beginning of 2017 will result in an estimated $5 million net decrease in future expenses for our post-retirement benefit plan.

Return-on-equity was 5.5 percent for 2016 compared to 10.5 percent for 2015. 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 6.4 percent for 2016.

Losses and loss settlement expenses increased by $57 million, or 45 percent, during the fourth quarter 2016 compared to the fourth quarter of 2015. For the year 2016, losses and loss settlement expenses increased by $135 million, or 25 percent, when compared to 2015. Again, the primary driver of the increases in 2016 were large losses and catastrophe losses as we've discussed.

Favorable reserve development for the fourth quarter of 2016 was $4.2 million compared to $16.3 million in fourth quarter 2015. The impact on net income for the fourth quarter in 2016 was 10 cents per diluted share compared to 41 cents per diluted share in the fourth quarter of 2015. For the 2016 year, favorable reserve development totaled $31.2 million compared to $40.4 million in 2015. The impact on net income in 2016 was 79 cents per diluted share compared to $1.04 per diluted share in 2015.

For the fourth quarter of 2016, the majority of the favorable development came from two lines—commercial liability, with $9 million of favorable development, and personal fire, with $2.3 million. The favorable development was offset by reserve strengthening in commercial auto, with $6.7 million, and assumed reinsurance, with $2.9 million of adverse development.

For the year 2016, the majority of favorable development came from two lines—commercial liability, with $25.4 million, and workers compensation, with $12.2 million. The favorable development was offset by reserve strengthening in commercial property lines, with $6.4 million, and commercial auto, with $5.5 million of adverse development. The combined ratio in the fourth quarter 2016 was 102.6 percent and 100.3 percent for the year 2016. 2015 comparatives were 86.8 percent for the fourth quarter and 92 percent for the year.

Removing the impact of catastrophe losses and reserve development, our core loss ratio deteriorated 11.7 points in the fourth quarter and 4.6 points for the year when compared with 2015. The primary drivers of the deterioration in the core loss ratio are an increase in large commercial property and commercial auto losses as well as workers' compensation losses. Referring 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.

Now, moving to investments, consolidated net investment income was $33.4 million for the fourth quarter of 2016, or a 26 percent increase, as compared to 26.6 million in the fourth quarter of 2015. Year-to-date 2016 consolidated net investment income was $106.8 million, which represents a 6 percent increase when compared to 2015. The increase in net investment income for the fourth quarter and full year was primarily driven by the change in value of our investments in limited liability partnerships as compared to the same periods in 2015 and not due to a change in our investment philosophy. This resulted in an increase of $7.1 million and $7.5 million, respectively, in investment income during the fourth quarter and full year 2016 as compared to the same periods of 2015.

With respect to capital management activity, during the fourth quarter, we declared and paid a 25 cent-per-share cash dividend to stockholders of record on December 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 upon a number of factors, including the share price, general economic and market conditions, and corporate and regulatory requirements. During the fourth quarter, we repurchased 22,923 shares of our common stock at an average price of $38.32, for a total cost of $0.9 million. For the year 2016, we repurchased 90,415 shares of our common stock at an average price of $41.43, with a total cost of $3.8 million.

We are authorized by the Board of Directors to purchase an additional 2,938,471 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 1 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 2. At this time, we will pause momentarily to assemble our roster.

The first question comes from Paul Newsome of Sandler O'Neill. Please go ahead.

Paul Newsome
Good morning.

Randy Ramlo
Hi, Paul.

Paul Newsome
Could you talk perhaps just a little bit more about what the results would have been if you pull out the large losses themselves? Was there also a deterioration in the underwriting if you'd just pull out those large losses?

Michael Wilkins
Paul, this is Mike Wilkins. The answer would be yes, there was deterioration if you pull out the large losses. The large losses probably, if you look at that core deterioration, made up a little over a third of the deterioration, and the rest of the deterioration was just core deterioration.

Paul Newsome
Any notable patterns in that core deterioration?

Michael Wilkins
Well, I would say it was in auto and property lines that we've talked about and also work comp. The issue with work comp is the results we had in 2016, we still are pleased with. It was just 2015 was such a good year that the difference between the two led to some of the deterioration in the difference between our loss ratio numbers between the two years.

Paul Newsome
The non-workers comp, what's going on with that deterioration X the big cat—the big losses?

Michael Wilkins
I'm not sure I understand your question, Paul.

Randy Ramlo
I think he's probably just—this is Randy, Paul. We've probably been talking about commercial auto for a while, and we all know the usual suspects, you know, mileage is up, qualified drivers are difficult to find. We see a lot of evidence of distracted driving. We're going to be, as we mentioned, raising rates fairly aggressively on this line and walking away from business if we have to. The commercial auto line rates will help that for us, but that can't be the only answer, so we have a lot of loss control initiatives trying to help our insured people to just be better drivers.

And then on the property, if I had to characterize anything, it's probably having to do with a little bit older properties, and then the catastrophic losses that we did have in 2016, those kind of were another area where some of those property lines came from. We had some notable activity in the Gatlinburg, Tennessee wildfires. We normally don't have a lot of exposure to wildfires as we don't write a lot of property out West, but that happened in the fourth quarter, which normally our fourth quarter's a pretty quiet cat quarter, but this time that contributed a little bit to that as well. So those are kind of the main areas we're seeing, the commercial auto on the severity side and on the property side as well.

Paul Newsome
The—two quick ones. I think you said it, but I missed it. The cost savings from the pension change, what would that be in 2017?

Dawn Jaffray
It will be $5 million per year.

Paul Newsome
Okay. And then it looked like there was a very good quarter for investment income. Anything that was unusual in the quarter?

Barrie Ernst
Well, the financials were up strong in the fourth quarter, and we have some large investments in the financial area in our LLCs—this is Barrie—so I think that was the cause of most of the increase in investment income, and that flows through to the investment income.

Paul Newsome
Great. Thank you.

Randy Ramlo
Thanks, Paul.

Operator
The next question comes from Quentin McMillan of KBW. Please go ahead.

Quentin McMillan
Hi, good morning, guys. Thanks very much. I just wanted to talk about the growth initiatives that you guys have in there in the press release for 2017. You said that you're going to sort of moderate—you know, that growth was slow moderately. Could you give a little bit more color? You have grown double digits consistently over the past couple of years, so obviously that's been pretty impressive, but what does moderate mean? Are we definitely still looking for growth? And any kind of range would be maybe helpful.

Randy Ramlo
Yes, we're—this is Randy—we are still looking to grow in 2017. In the past, as you said, we've probably been growing around 10 percent or a hair more, and I would say we still hope to be able to grow at about half that pace, so the 4 to 6 range would be pretty satisfactory in this market cycle, I think.

Quentin McMillan
Okay, great. And then you talked about the profitability initiatives in there in the life insurance operation. Previously, you've also dividended some of the capital from the life back to the P&C. Did you do any of that this year, and would that also be sort of part of a plan as the P&C operations are earning a little bit better than what the life are currently?

Randy Ramlo
Yes, we did not dividend this year, Quentin, and our plans are sometime in the very near future to continue that.

Quentin McMillan
Okay, perfect. And then I just—just a numbers question. I think that you said in your remarks that AOCI finished the year at 1.34, and I don't have the number in the press release, but that would be flat with the third quarter. Is that actually right? Because that would indicate you guys didn't have any unrealized losses in the quarter.

Dawn Jaffray
It's down slightly.

Quentin McMillan
Okay, so there was some degree of book value hit associated with a loss in AOCI as everybody else saw, obviously, right?

Dawn Jaffray
Year-over-year it was more. There was a significant drop from third quarter to fourth quarter, but year-over-year it was up about—I believe it was $5 million.

Quentin McMillan
Okay. Thanks very much. And then just one last quick question. In terms of the commercial auto book, obviously you talked about some of the initiatives that you're sort of taking and obviously getting the price in—you know, a lot of price and a lot of rate is going to be a good thing that will earn in over time, but do you have any sort of indication as to what you target the loss ratio of that book to be or sort of qualitatively where you need it to be for it to make sense for you to write that?

Michael Wilkins
Quentin, this is Mike. We probably look at account loss ratio more than individual lines, but we expect all the lines to stand on their own as well, so we look at it on an overall basis by line, but an individual account, you know, sometimes it—the auto pricing, we can have some flexibility with. We're probably 10 points from where we'd like that line to be on a loss ratio basis.

Quentin McMillan
Okay, great. And, yes, that's all I have. Thanks very much, guys.

Randy Ramlo
Thank you.

Operator
Again, if you have a question, please press star, then 1 on a touchtone phone. 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
This now 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 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.