United Fire Group, Inc.

2016 First Quarter Earnings Conference Call

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CORPORATE PARTICIPANTS

Randy Patten - *Director of SEC and Financial Reporting, and Investor* Relations

Randy Ramlo - *President and Chief Executive Officer*

Michael Wilkins - *Executive Vice President and Chief Operating Officer*

Dawn Jaffray - *Senior Vice President and Chief Financial Officer*

PRESENTATION

Operator
Good morning. My name is Denise, and I will be your conference operator today. At this time, I would like to welcome everyone to the United Fire Group First Quarter 2016 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, then one on your telephone keypad. To withdraw your question, please press star, then two. Please note this event is being recorded.

Thank you. And I'll now turn the call over to Randy Patten, Director of SEC Reporting and Investor Relations. Please go ahead, sir.

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'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 first quarter 2016 conference call. This morning we reported another quarter with solid performance. First quarter 2016 is off to a good start with operating income of $0.83 per share and a GAAP combined ratio of 92.3%. This compares with operating income of $0.92 per share and a GAAP combined ratio of 89.7% in the first quarter of 2015. Also, in the first quarter of 2016, our book value per share increased to $36.69 from $34.94 at December 31, 2015, and our return on equity was 9.9%.

In the property and casualty segment, net premiums earned increased 10% and is the result of organic growth and geographic expansion. Rate increases on commercial lines were flat to slightly higher on renewal business, and rate increases on personal lines were in the mid-single-digits, primarily in our homeowners and personal auto lines business. I'll let Mike address more specifics with respect to P&C

market conditions and performance in a few moments.

Catastrophe losses in the first quarter of 2016 at 2 percentage points of the combined ratio were slightly better than we would normally expect in the first quarter of any given year. Our historical average in the first quarter is 2.4 percentage points of the combined ratio. Our expectations for catastrophe losses in any given year is 6 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, due to spring and summer convective storms and hurricanes.

The first quarter of 2016 expense ratio was higher by 1.7 percentage points compared to the first quarter of 2015. The increase in the expense ratio was due to several non-recurring employee-related expenses and accruals, along with an increase in deferred acquisition cost amortization from continued organic growth, both partially offset by a decrease in the post-retirement benefit expenses.

Strategically, our approach in 2016 remains unchanged from year-end. We are focusing on executing our initiatives, which includes expanding our geographic footprint and agency plant and penetration, growing our specialty business, leveraging 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.

Moving on to our life segments, for the first quarter we reported net income of $400,000 or $0.02 per diluted share, as compared to $600,000 or $0.02 cents per diluted share for the first quarter in 2015. Sales of single premium whole life policies remained strong this quarter as we continue to focus on executing our strategy of selling traditional life products and expanding geographically. Net premiums earned increased 62% in the first quarter 2016 as compared to the first quarter 2015.

Deferred annuity deposits decreased 38% in the first quarter 2016 as compared to the same period of 2015. We continue to execute our strategy to maintain profitability rather than market share, as spreads increased 32 basis points as compared to the same period of 2015.

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

Michael Wilkins
Thanks, Randy, and good morning, everyone. During the first quarter, competitive market conditions continued for both renewals and new business. Commercial lines renewal pricing varied by region, with average percentage increases nearly flat to slightly positive on most small and midmarket accounts. Elevated competition in most lines has made it more challenging to obtain increases.

In general, larger accounts are more competitive than smaller accounts. Poor industry results in the commercial auto line have allowed us to obtain rate increases in this line. This is the 18th consecutive quarter of commercial lines pricing increases on our overall book of business, but we have seen the size of the increases decline for the past five consecutive quarters. Personal lines renewal price average percentage increases were in the mid-single digits, primarily in homeowners and personal auto line of business.

Premiums written from new business increased from the first quarter and the fourth quarter of 2015. Our success ratio on quoted accounts remains unchanged from prior two quarters and remains at an acceptable level with most success in accounts with premiums less than 25,000.

Premium and policy retention have remained strong at 84% and 83% respectively with changes from prior quarter of less than 1% respectively. Premiums from audits continue to have positive trends increasing compared to both first and fourth quarter 2015. Premiums from endorsements increased from the first quarter of 2015, but decreased from the fourth quarter of 2015.

During the first quarter, property and casualty premiums written increased 10% as compared to first quarter 2015. Two percent is attributed to new business, 3% is attributed to endorsements, and 5% is attributed to rate change and exposure increases.

As we discussed in the fourth quarter 2015, this year we're working on executing several growth strategies, including proactively targeting growth in small business owners' product segment, further expanding our service center to capitalize on this area business growth while expanding automation to allow us the opportunity to more efficiently underwrite these products, continuing to grow our personal lines business which remains profitable, expanding geographically with the addition of Ohio in the fourth quarter of 2015 and expansion in the Kentucky and adding workers' compensation in the State of Texas later this year, along with continuing to expand our specialty line of business.

As Randy mentioned, catastrophe losses for the first quarter 2016 were slightly less than we would normally expect historically for our first quarter. Pre-tax catastrophe losses for the quarter totaled $4.3 million or $0.11 per diluted share, compared to $0.2 million or $0.01 per diluted share in the same period of 2015. Our expectation for catastrophe losses in any given year are approximately 6 percentage points on the combined ratio.

During first quarter 2016, our catastrophe losses included ten catastrophes with our largest single pre-tax catastrophe loss less than $700,000. Three of these ten catastrophe events had losses in the state of Texas. Looking forward to the second quarter, there been a few large catastrophe hailstorms in the state of Texas in the month of April. We are anticipating that we will incur catastrophe losses from these storms, but at this time, we're still assessing the magnitude of these events and are not able to quantify the losses. We believe the combination of disciplined underwriting and the use of sophisticated mapping software to effectively manage our concentration risk has helped us manage our exposure.

Again, in the first quarter of 2016, we have experienced deterioration in the commercial auto, much like the industry. Our commercial auto loss ratio increased approximately nine points in the first quarter 2016 as compared to the same period in 2015. We continue to successfully push rates in this line of business as well as modified underwriting guidelines to address these trends.

Large losses, which we define as losses greater than $500,000, totaled $18 million in the first quarter of 2016. This compares to $22 million in the first quarter of 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 8% in the first quarter of 2016 as compared to the first quarter of the prior year but as a percentage of written premium decreased 2%. This increase was spread across most of our lines of business and our region was impacted by weather-related activity in our Gulf Coast region and in particular the state of Texas.

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

Dawn Jaffray

Thanks, Mike. And good morning. For the first quarter of 2016, we reported consolidated net income of $22.4 million or $0.88 per diluted share compared to $23.7 million or $0.94 per diluted share in the first quarter of 2015, representing a decrease of $1.3 million and $0.06 per diluted share. Our shareholder's equity increased 6% to $929 million at March 31, 2016 from $879 million at December 31, 2015.

Book value increased to $36.69, an increase of the $1.75 from $34.94 at December 31, 2015. The increases in shareholders' equity and book value are primarily due to net income of $22.4 million and an increase on unrealized investment gains, which increased $27.4 million to $155.8 million at March 31, 2016.

Return on equity was 9.9% in the first quarter of 2016, as compared to 11.4% in the first quarter of 2015. Further adjusting ROE to exclude the impact of unrealized gains, adjusted ROE was 11.8% in the first quarter 2016 as compared to 14% in the first quarter of 2015. The decrease in ROE as compared to the same quarter last year was primarily due to a combination of decreases in net income and increases in shareholder equity.

As Randy mentioned, the combined ratio in the first quarter of 2016 was 92.3% as compared to 89.7% in the same period of 2015. Removing the impact of catastrophes at 2 percentage points for 2016 and 0.1 percentage points for 2015 along with removing the impact of favorable reserve development of 10.9 percentage points for 2016 and 8.4 percentage points for 2015, the quarterly loss ratio would be 69.4% versus 67.9%, resulting in a quarter-over-quarter increase of 1.5 percentage points. We attribute this increase in the loss ratio to an increasing claim frequency in our commercial auto and commercial property lines of business. Commercial property line was impacted by weather-related activity in our Gulf Coast region, and in particular as we have discussed earlier, the state of Texas.

Losses and loss settlement expenses increased by $15.7 million or 12.4% during the first quarter of 2016, compared to the first quarter of 2015. As has been historically consistent reserving practice for UFG, we are conservative in setting initial reserves. 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 first quarter of 2016 was $23.9 million, compared to $16.7 million in the first quarter of 2015. The impact on net income for the quarter in 2016 was $0.51 per share, compared to $0.43 per share in 2015.

Two lines combined provided the majority of the favorable development. The largest single contributor was commercial liability with $19.8 million of favorable development followed by workers' compensation with $5.4 million of favorable development. Both of these lines benefited from successful claims management and continued successful management of litigation expenses. The favorable development is also attributable to reductions in reserves for reported claims as well as reductions in required reserves for incurred but not reported claims.

Loss reserve reductions were more than sufficient to offset claim payments. These lines were slightly offset by $6.9 million of adverse development in the commercial fire line of business, which experienced an increase in paid claims.

Following Mike's comment with respect to catastrophes, our book of business remains primarily in regions of the country that are susceptible to seasonal weather, including winter and spring convective storms. As a result, I caution our listeners that we may experience volatility in our results from quarter to quarter and year to year. On March 31, 2016, our total reserves remained relatively flat and within our actual estimates.

Moving on to investments, consolidated net investment income was $22.2 million for the first quarter of 2016, which was a 9% decrease as compared to $24.4 million in first quarter of 2015. The decrease in net investment income for the quarter was primarily driven by the change in value of our investments in limited liability partnerships as compared to the same period in 2015 and 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.

During the first quarter, we declared and paid a $0.22 per share cash dividend of stockholder 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 upon a number of factors, including the share price, general economic and market conditions, and corporate and regulatory requirements.

During the first 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'll 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 telephone keypad. If you're using a speakerphone, please pick up your handset prior to pressing the keys. To withdraw your question, please press star, then two. At this time, we will pause momentarily to assemble our roster.

We have a question from Paul Newsome from Sandler O'Neill. Please go ahead.

Paul Newsome
Good morning. Could you give me a little bit more detail about the—I'm looking at the accident year combined ratio for the year and wondering if that's sort of a good run rate or not. You had a couple of really low numbers in the back half of last year, but this actually is a little bit closer to what you historically run. What's the right way to think about that?

Randy Ramlo
Well, this is Randy, Paul. I think we've shown a pretty good track record of reserving, so I always caution people about our accident year loss ratio should be a little bit redundant from the reserving that we've done. So, is it a good run rate? We expect that usually to come down a little bit as those claims end up being settled. So, if you look at our historic kind of reserve redundancy, maybe if you're kind of looking for a run rate, you might take that off of that accident year loss ratio. That'd be one way to look at it.

Paul Newsome
I think you've historically done an accident year loss ratio above 100. You didn't do that in a back half of 2015, so I don't know if something changed. Just good results to the back half of last year from an accident year perspective or what?

Randy Ramlo
We don't think we've changed anything in our reserving practices. It's a couple of quarters, but I would personally look at as we just had some good results.

Paul Newsome
Okay.

Michael Wilkins
Paul, this is Mike. I think if you look at our trend over last four or five years, we've made consistent improvement in that accident year loss ratio over that time. So, I think, just as those improvements continue to accumulate, we eventually end up at an accident year combined under 100. And rates are holding up okay at this point. And we don't see loss cost inflation changing. So, I feel like our run rate can continue forward as it's been recently.

Paul Newsome
You a couple of times have warned about Texas storms. Is it just too early to give us a general sense of how serious it could be? And, I mean, I usually have the second quarter is the largest cat load for your company by—I usually have about 10, 11 percent points of cat load there. Is it looking like kind of a typical second quarter, which almost always has a few storms in it or is it something we should be more serious about it?

And I guess relatedly, this isn't related to the storms that hit Dallas in the first quarter. It sounds like—at least your results suggest you, knock on the wood, missed those losses.

Randy Ramlo
Yes. This is Randy again. I think it's pretty early to tell, but second quarter is probably starting off for the most part of way we expected. More of our losses are going to come from the San Antonio area. Obviously, if the April storms were a big deal, we would do a press release. I don't anticipate doing that. So it is too early to tell, but I don't think it's going to be anything material.

In the Dallas area, we do write more commercial lines than personal lines. That is a known hail area. It's an area that we are very careful from personal line standpoint. We do write more personal lines in the San Antonio area. So our guess, it's probably going to come more from the San Antonio area. Our strategy in Texas is to—like many states--the key is to really use a lot of spread of risk, and we try to manage where we write, from San Antonio to Houston to Dallas and into West Texas.

So, it's too early to tell, but we're not anticipating anything alarming.

Paul Newsome
Great. Thanks for the call.

Randy Ramlo
Thank you, Paul.

Operator
Again, if you would like to ask a question, please press star, then one on your touchtone phone.

CONCLUSION

Operator
At this time, this will conclude our question-and-answer session. I would like to turn the conference back over to Randy Patten for any closing remarks.

Randy Patten
That 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.

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