United Fire Group, Inc.

2022 Second Quarter Conference Call

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CORPORATE PARTICIPANTS

Randy Ramlo – *President, Chief Executive Officer*

Michael Wilkins – *EVP, Chief Operating Officer*

Eric Martin – *SVP, Chief Financial Officer*

Micah Woolstenhulme – *VP, Chief Risk Officer*

Operator
Good morning. My name is Jordan, and I will be your conference operator, today. At this time, I would like to welcome everyone to the UFG Insurance second quarter of 2022 financial results conference call.

All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key, followed by "0".

After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*", then "1" on your telephone keypad. To withdraw your question, please press "*", then "2".

Please note this event is being recorded.

I will now turn the call over to Eric Martin, Chief Financial Officer. Please go ahead.

PRESENTATION

Eric Martin
Good morning, everyone, and thank you for joining this call. This morning, we issued a press 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 Investors tab.

Joining me today on the call are Chief Executive Officer, Randy Ramlo, and Chief Operating Officer. Mike Wilkins. We also have other members of management available to answer questions at the end of our prepared remarks.

Before I turn the call over to Randy Ramlo, a couple of reminders.

First, 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. The actual results may differ, materially, due to a variety of factors, which are described in our press release and SEC filings.

Also please 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 will now turn the call over to Mr. Randy Ramlo, CEO of UFG Insurance.

Randy Ramlo
Thanks, Eric. Good morning and welcome to our second quarter 2022 conference call.

Today, I'm pleased to report continued improvement in our core loss ratio and for the first time, in two years, premium growth.

Let me start with premium growth. This quarter, we saw some positive signs of growth, after two years of focusing on improving profitability, through non-renewal of underperforming accounts in our commercial auto line of business and our exit of the personal lines business

Profitable growth is our number one consideration when putting new business on the books. Earned premium was up by 2.9% over the same quarter last year, and written premium was up 9.5%. This growth was led by our specialty and assumed reinsurance lines.

In addition, for the fifth consecutive quarter, we saw improvement in our core loss ratio, which removes the impact of catastrophe losses and favorable reserve development.

In the second quarter of 2022, our core loss ratio improved 1.8 percentage points and year-to-date, our core loss ratio improved 10.1 percentage points, as compared to the same periods in the prior year.

For a summary of our core loss ratio calculation, refer to slide 11 in the presentation on our website.

For the second quarter of 2022, we have reported a combined ratio of 100.7 percent, which is slightly lower than the 100.8 percent we reported in the second quarter of last year, despite having above average catastrophe losses in the second quarter of 2022.

Pre-tax catastrophe losses added 12.1 percentage points to the combined ratio in the second quarter of 2022, which is 1.0 point higher than our second quarter historical average and 2.5 points higher than the second quarter of 2021.

During the second quarter of 2022, the higher-than-average catastrophe losses was driven by 18 catastrophic events which, collectively, resulted in above average catastrophe losses.

Before I turn the call over to Mike, I would like to take this opportunity to say thank you, as this will be my last earnings call. It has been an honor to serve as CEO for the past 15 years, and I am proud of the growth and success we have had, during my tenure.

As CEO, it has been my promise to lead UFG with the kind of forethought that will move the needle of success in a positive direction for our shareholders, employees, agents, policyholders and communities.

As I reflect back on my career of 38 years at UFG, I'm proud of our success, and we intend to keep moving it in a positive direction.

Our new CEO, Kevin Leidwinger, will join UFG on Monday, August 22. Kevin will serve as the sixth leader in our company's more than 75-year history. I wish Kevin good luck in the future, and I am confident that he, along with the management team, will take UFG to great new heights. Here's to a successful future for UFG.

I will now turn the call over to Mike Wilkins. Mike.

Michael Wilkins
Thanks, Randy, and good morning, everyone.

As Randy mentioned, we have continued our trend of consistently improving our core loss ratio. A primary contributor to this success has been the decrease in frequency and severity of commercial auto losses, over the last two years.

As part of our portfolio management strategy, we have focused on decreasing the size of our commercial auto portfolio, through targeted reductions in the number of exposure units and implementing targeted rate increases. These efforts have improved the quality and profitability of our commercial auto book of business.

At the end of the second quarter of 2022, commercial auto accounted for 22% of our portfolio composition, compared to 25% at the end of the second quarter of 2021.

At this point, we believe we are close to leveling out our commercial auto unit counts. Also, we are achieving growth in our historically profitable lines of business, with new business premium for general liability increasing from 22% to 26%, and inland marine growing from 11% to 14%, between 2020 and 2022.

Randy mentioned that our specialty and assumed reinsurance lines are leading our premium growth. These lines are also contributing to our improvement in our core loss ratio and profitability in Q2.

Our surety line reported a loss ratio of approximately 20% and assumed reinsurance reported 22.6% in the second quarter of 2022.

Slides 8 and 9 provide a four-year view of our claim counts, by major commercial casualty lines of business. For example, our commercial auto bodily injury and property damage claim counts are down 19%, year-to-date, 2022, as compared to the same period in 2021.

We have also provided commercial general liability, BOP liability and workers' compensation claims counts on these slides, as all are down year-to-date, 2022, which is a positive reflection of our strategic efforts.

Before I turn the call back over to Eric, I'd like to comment on pricing and inflation. From a pricing standpoint, the overall average change in renewal premiums was 8.1%, with 3 % from exposure changes and 5.1 %from rate increases.

The increase in rates was driven by our commercial auto and commercial property lines of business. The commercial auto average renewal rate increase was 7.1%, and the commercial property average renewal rate increase was 9.2%.

We feel the rate increases we are establishing are currently exceeding the overall loss cost inflation impacting our book. This is particularly true in lines like Commercial Property and Commercial Auto, where we are seeing the strongest pricing opportunities.

However, in this dynamic economic environment, we will continue to monitor conditions and make appropriate adjustments to our pricing, portfolio, and underwriting strategies.

With that, I'll turn over the discussion to Eric Martin, Eric.

Eric Martin
Thanks, Mike. and good morning again, everyone.
In the second quarter, we reported consolidated net loss of $10.5 million, compared to net income of $13.8 million in the same period of 2021.

On a year-to-date basis, we reported consolidated net income of $17.9 million, compared to net income of $32.5 million, year-to-date in 2021.

Adjusted operating income, which removes net investment gains and losses, was $6.1 million in the second quarter of 2022, compared to an adjusted operating income in the second quarter of last year of $9 million.

the decrease in net income and adjusted operating income in the second quarter of 2022 was primarily due to an increase in catastrophe losses in the quarter. However, year to date adjusted operating income of $34.8 million in 2022 versus $8.3 million in 2021, primarily driven by our lower core loss ratio in the first half of 2022 and lower catastrophe losses, during that same period.

As Randy mentioned, our combined ratio was nearly unchanged from the second quarter of 2021. The combined ratio benefited from favorable prior accident year reserve development at 3.7 points during the second quarter of 2022, compared to favorable reserve development of 0.8 points in the second quarter of 2021.

Most of the favorable reserve development in the current quarter was in our commercial auto and commercial liability lines of business. As a company, we have reported favorable reserve development every year since 2009, a trend that continued in the first half of 2022.

During the second quarter of 2022, we reported net investment losses of $20.9 million, as compared to net investment gains of $6 million in the second quarter of 2021.

Year-to-date, we reported net investment losses of $21.4 million, as compared to net investment gains of $30.5 million, over the same period in 2021. This is largely driven by the change in the fair value of our equity security investments that are recognized in net income.

The return on our equity portfolio for the quarter was about six points better than the 16% decline in the S&P 500 index.

Net investment income was $9.2 million in the second quarter of 2022, as compared to $13.8 million in the same period of 2021. Year-to-date, net investment income was $20.5 million, compared to net investment income of $30.9 million, year-to-date in 2021. The change between the two periods was, primarily, due to the change recognized in the fair value of our limited liability partnerships.

Moving on to expenses, the underwriting expense ratio for second quarter 2022 was 35.2%, compared to 33.1% for the second quarter of 2021.

On a year-to-date basis, the expense ratio was 34.4 % this year, compared to 30.2 %, last year. The change in the expense ratio between the two periods was, primarily, due to the one-time benefit recognized from the change in the design of our employee post-retirement health benefit in first quarter of 2021.

I will conclude my portion of the call today discussing our capital position. In the second quarter of 2022, statutory surplus decreased approximately 3.5%, primarily, due to fair market value decreases in the equity portfolio and changes in the retirement plan’s effects on surplus more than offsetting net income.

Our annualized Return on Equity was of 4.3%

During the second quarter, we declared and paid a $0.16 per share cash dividend to shareholders of record, as of June 3rd, or a 6.7% increase over the previous dividend, marking our 217th consecutive quarter of consistently paying dividends, dating back to March of 1968.

Lastly, during the quarter, we did not repurchase any shares. The amount and timing of any purchases is at management's discretion and depends on several factors, including the share price, general economic and market conditions, and regulatory requirements.

This concludes our prepared remarks, 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 "*", then "1" on your telephone keypad. If you are using a speaker phone, please pick up the handset, before pressing the keys. To withdraw your question, please press "*", then "2".

At this time, we will pause, momentarily, to assemble a roster.

Our first question comes from Marla Backer from Sidoti. Please go ahead.

Marla Backer
Thank you. So, you've been engaged in a restructuring process, over the past several quarters. As you mentioned in your scripted remarks. the commercial auto book has pretty much right sized, at this point. And there's been a focus on growing some of the higher profit lines of business.

What kind of, if any, changes can we expect, as management transitions?

Randy Ramlo
Marla, this is Randy. Thanks for the question. That's probably a good question. As you know, Kevin is from outside the organization, and we'll have to see what kinds of ideas he has, going forward.

But I think we've proven that our strategy is working and has turned things around, pretty well. So, I would not anticipate any huge changes, but I will not be here. So, that's about the best I can tell you.

Marla Backer
Okay. And then, just a quick follow up to one of the comments in the prepared remarks on surety and marine and other focus lines of business, now.

Are you seeing a more competitive landscape for those types of businesses, at this point?

Randy Ramlo
Maybe I'll let Micah talk about the assumed reinsurance. We are seeing increased competition like the specialty lines, especially.

Surety is always pretty competitive. And it's mostly you compete through service and underwriting. Maybe I'll let Micah comment a little bit on what he's seeing on the assumed reinsurance.

Micah Woolstenhulme
Sure, thanks, Randy. On the assumed side, I would say, no, we don't see that. The business model is similar, and it is different, at the same time. The business that we access through the assumed reinsurance channel is relationship driven.

And we know with whom we want to do business, there, and we have a multiyear strategy with the various partners that we're doing business and partners that we want to do business with, next.

So, it's not necessarily more competitive than it was, before. Our limits there are really—and a lot of the business that we want to support, we're coming into situations, where it's oversubscribed, and we're relying on relationships to get us there.

We're not doing any business that we're not entirely satisfied with. And in fact, one of our underwriting criteria is whether or not we're in love with that treaty.

And so, I don't think competitiveness is a primary concern but rather, the constraints there are whether or not we have access to the business that we want to do and do we have the capital means to support it?

And we've been very successful, so far, and the results are even better than we expected with our business plan. So, we're real excited about what comes next in our assumed reinsurance book.

Marla Backer
Thank you.

CONCLUSION

Operator
This concludes the question-and-answer session. The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.