United Fire Group, Inc.

Fourth Quarter and Year-End 2021 Conference Call

February 15, 2022, 9:00 AM Eastern

CORPORATE PARTICIPANTS

Randy Patten - *Co-Chief Financial Officer*

Randy Ramlo - *Chief Executive Officer*

Mike Wilkins - *Chief Operating Officer*

Jeremy Bahl - *Vice President and Chief Underwriting Officer*

PRESENTATION

Operator
Good morning, everyone. My name is Jamie, and I'll be your conference operator, today. At this time, I would like to welcome everyone to the UFG Insurance Fourth Quarter and Year-End 2021 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 "*" key, followed by "0". After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" and then "1". To withdraw your questions, you may press "*" and "2". Please note today's event is also being recorded.

At this time, I'd like to turn the conference call over to Randy Patten, Co-Chief Financial Officer. Sir, please go ahead.

Randy Patten
Good morning, everyone, and thank you for joining this call. This morning, we issued a news 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 Investor Relations tab.

Joining me today on the call are Chief Executive Officer, Randy Ramlo, and Mike Wilkins, Chief Operating Officer. 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'm pleased to present Mr. Randy Ramlo, CEO of UFG Insurance.

Randy Ramlo
Thanks, Randy. Good morning, everyone, and welcome to our Fourth Quarter and Year-end 2021 Conference Call.

I am extremely pleased to report strong fourth quarter results, today. The profitability we reported is a culmination of the hard work and team effort that has gone into developing and executing our One UFG strategic plan, which is aimed at long-term profitability, diversified growth and continuous innovation.

Based on the financial results reported today, it is clear to me that our strategic plan is working and achieving the desired outcome. Though we knew a plan of this scale will take time to fully implement, we believe we've hit our stride and are confident of our path forward.

In the year ahead, we are committed to building on the progress we've made and continuing toward our goal of delivering consistent, sustainable, and profitable results for all UFG stakeholders.

Now, for some highlights from our results.

The fourth quarter marks the third consecutive quarter, we reported improvement in our core loss ratio. Our core loss ratio, which removes the impact of catastrophe losses and favorable prior year reserve development, improved 24.5 percentage points and 8.0 percentage points, respectively, in the fourth quarter and year-to-date 2021, as compared to the same periods of 2020.

This trend of quarterly core loss ratio improvement began in the second quarter of 2021 and is a direct result of our strategic initiatives.

For a summary of our core loss ratio calculation, refer to the Slide 13 in the presentation on our website.

The improvement in the core loss ratio contributed to the reported combined ratio of 83.1% in the fourth quarter, which is our lowest quarterly combined ratio in over 14 years, dating back to the second quarter of 2007.

For the full year of 2021, we reported a combined ratio of 100.3%, an improvement of 15.6 percentage points, over the previous year.

The line of business with the most significant loss ratio improvement was commercial auto, which improved 68.1 percentage points in the fourth quarter and 25.1 percentage points for the full year of 2021, as compared to the same periods of 2020. The improvements in profitability in our commercial auto line of business was from a combination of a decrease in frequency and severity of losses and an increase in favorable prior year reserve development.

The combined ratio also benefited from favorable prior accident year reserve development at 9.5 points and 5.1 points, respectively, during the fourth quarter and full year of 2021, compared to unfavorable prior accident year reserve development of 4.7 points in the fourth quarter of 2020 and favorable prior accident year reserve development of 1.7 points for the full

year of 2020. Most of the favorable prior accident year reserve development this year was in our commercial auto line of business. The favorable reserve development of 5.1 points reported for 2021 continues our historical trend of having overall favorable reserve development every year, since 2009. The annual average favorable development reported since 2009 is 6.3 points.

Also contributing to our profitability in the fourth quarter were below average catastrophe losses. Pre-tax catastrophe losses added 3.5 percentage points to the combined ratio in the fourth quarter of 2021, which is nearly two points lower than our fourth quarter historical average of 5.3 percentage points. The fourth quarter is the first time in eight consecutive quarters that CAT losses were below our historical average, dating back to the third quarter of 2019.

For the full year of 2021, CAT losses added 10.2 percentage points to the combined ratio, compared to 13.5 percentage points in the previous year. This compares to a 10-year historical average of 7.3 percentage points added to the combined ratio for CAT losses.

As part of our strategic plan, we are taking steps to reduce volatility, by limiting our exposure to the level of catastrophe losses experienced in recent quarters. One example of this is our now nearly complete exit from personal lines, which was a contributing factor to below-average CAT losses incurred in the fourth quarter.

In addition to the exit of personal lines, we've also strategically diversified our book of business with less CAT-exposed business such as surety, E&S, Inland Marine and assumed reinsurance business.

Before I turn the call over to Mike, I want to make mention of some additional good news. In December, AM Best affirmed the financial strength rating of A-excellent for the property and casualty subsidiaries of United Fire Group Inc. This is the 28th consecutive year we've earned an A financial strength rating from AM Best. AM Best ratings are a meaningful measure in the insurance industry with an A rating given to companies that have an excellent ability to meet their ongoing insurance obligations.

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

Mike Wilkins
Thanks, Randy, and good morning, everyone. As Randy mentioned, from a combined ratio standpoint, this was our most profitable quarter in over 14 years. This profitability is a reflection of our continued progress in the execution of our enterprise strategy.

Today, I will focus on some key metrics and initiatives that are contributing to the increase in profitability.

A primary contributor was a decrease in frequency and severity of commercial auto losses in the fourth quarter. As part of our portfolio management strategy throughout 2020 and 2021, we are 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.

Exposure units decreased 24% over the past 12 months from 221,000 units in December 2020, to approximately 168,000 units in December 2021. Looking ahead to 2022, our expectation is that we will not see a significant decrease in auto exposure units, as we move closer to our optimal portfolio mix.

Slides 6 and 7 in our presentation on our website, highlights our progress in diversifying our portfolio by rebalancing our mix of business.

At the end of 2021, commercial auto accounted for 24% of our portfolio composition, compared to 28% at the end of 2020. Commercial auto new business premium written in 2021 has decreased to 21%, as compared to 32% in 2019. Also, we are achieving growth in our, historically, profitable lines of business with new business premium for general liability increasing from 22% to 24% and inland marine growing from 9% to 17%, between 2019 and 2021. We are also witnessing growth in our surety, E&S and assumed reinsurance lines of business, which contributed to the improvement in our core loss ratio and underlying profitability in 2021. The most significant growth occurred in our assumed reinsurance line, which represented 7.4% of our portfolio in 2021, as compared to 3.4% in 2020.

Commercial auto claims frequency expressed in claims, per insured units, also continues to decrease with the 12-month moving average declining again in the fourth quarter of 2021, down to 4.51% from 4.56% in the fourth quarter of 2020. This decline is summarized on Slides 8 and 9 in our presentation on our website. It's the 11th consecutive quarter of declining commercial claims frequency, dating back to the second quarter of 2019.

Slides 10 and 11 provide a three-year view of our claim counts by major commercial casualty line of business. For example, our commercial auto bodily injury and property damage claim counts are down 21% in 2021, as compared to 2020. We've also provided commercial general liability, BOP liability and workers' compensation claim counts on these slides, as all are down in 2021, which is a positive sign of our strategic efforts.

From a pricing standpoint, rate increases for the full year of 2021 in our commercial, auto, property and umbrella books of business remained relatively stable and in line with the pricing I shared, during our third quarter call. For 2021, the overall average renewal price increase was 6.4%. Excluding our workers' compensation line of business, the overall average renewal price increase was 7.7%. This increase in pricing was driven by our commercial auto and commercial property lines of business. Year-to-date, the commercial auto average renewal rate increase was 9.5%. The commercial property average renewal rate increase was 8.7%.

Looking ahead to 2022 with the focus on profitability and carefully monitoring inflation, our underwriting initiatives include targeted rate increases with continued focus on commercial auto, commercial property and umbrella along with an emphasis on commercial property risk selection and umbrella limits management. Overall, we will continue to pursue profitable growth opportunities, backed by our strong underwriting and pricing discipline.

Workers' compensation rates continued to decline in 2021. This decline, along with a decrease in prior accident year favorable reserve development and an increase in frequency of losses resulted in deterioration of the workers' compensation loss ratio in 2021. We will be deploying a new analytics model in the first half of 2022 to assist with improving profitability in this line. This is a line we will watch very closely in 2022.

Before I wrap up, I'd like to expand upon comments that Randy made about our efforts to reduce volatility in our results. Randy mentioned the exit from personal lines and the optimization of our portfolio of business. For 2022, we also restructured our catastrophe reinsurance program to provide better protection from both an occurrence and an aggregate loss perspective. Through a new aggregate program, we now have named storm protection for aggregate losses, in addition to the other perils. In prior years, named storms are excluded from UFG's aggregate catastrophe protection. Also, with the new structure, our retention for each catastrophe occurrence is reduced. The mechanics of the structure provides the potential for additional reduction in catastrophe retention for occurrences subsequent to an initial loss to the program.

Before I turn the call over to Randy Patten, I'd like to comment on the progress we are seeing in claims.

Favorable reserve development reported in the fourth quarter of 2021 is being driven by excellent work of our claims team, who have focused on settling claims quicker in the claims cycle, resulting in favorable outcomes and reducing legal fees through litigation management and avoidance.

With that, I'll turn the discussion over to Randy Patten. Randy.

Randy Patten
Thanks, Mike, and good morning, again, everyone.

In the fourth quarter, we reported consolidated net income of $57.7 million, compared to a net loss of $8.9 million in the same period of 2020. For the full year, we reported consolidated net income of $80.6 million, compared to a net loss of $112.7 million for 2020. Net income reported in the fourth quarter and full year 2021, as compared to a net loss in the same period of 2020, was primarily a result of a decrease in the frequency and severity of commercial auto losses, an increase in favorable reserve development, and comparatively lower catastrophe losses.

Also contributing to net income in the fourth quarter and full year of 2021 were net investment gains. For the fourth quarter and full year of 2021, we reported net investment gains of $19.1 million and $47.4 million, respectively, compared to net investment gains of $30 million and net investment losses of $32.4 million in the same period of 2020. The majority of the change between the two periods was driven by a change in the fair value of our equity security investments, which are recognized in net income. The remaining change was driven by net realized investment gains from sales of equity holdings.

Net investment income was $13.3 million and $55.8 million in the fourth quarter and full year of 2021, as compared to $17.4 million and $39.7 million in the same periods of 2020. The change in both periods was primarily due to the change in the fair value of our limited liability partnerships.

Net premiums earned decreased 8.7% in 2021, as compared to 2020. The decrease in net premiums was the result of our portfolio management strategy to diversify our portfolio, by rebalancing our mix of business. This strategy includes reducing our commercial auto book of business, which accounted for 4.6% of the decrease and exiting personal lines, which made up 3.7% of the decrease. These were partially offset by growth in more profitable lines of business, with the largest increase incoming from our assumed reinsurance line of business in 2021.

The decrease in net premiums earned during this quarter did put some pressure on the expense ratio. For the fourth quarter of 2021, the expense ratio was 33.9%, as compared to 30.8% in the same period of 2020. Also, impacting the expense ratio in the fourth quarter, were additions to our profit-sharing accruals for our agents, employees, and program business from improved performance and profitability in our book of business. For the full year 2021, we reported an expense ratio of 32.6%, as compared to 33.5% for the full year 2020.

As mentioned during previous earnings calls this year, we expect an improvement in our expense ratio in 2021, due to prior announced changes to our post-retirement medical plan. The majority of the benefit impacted both expense and loss adjustment expense ratios in the first quarter of 2021, with a smaller ongoing benefit recognized, throughout 2021 through 2022.

I will conclude my portion of the call today, discussing our capital position. In 2021, statutory surplus increased approximately 13%, primarily due to the increase in net income. Also, we reported an ROE in 2021 of 9.5%, finishing the year with our highest reported ROE in six years.

During the fourth quarter, we declared and paid a $0.15 per share cash dividend to shareholders of record as of December 3, marking our 215th consecutive quarter of consistently paying dividends dating back to March of 1968.

Lastly, during the quarter, we did not repurchase any shares. For the year, we repurchased approximately 67,000 shares of our common stock for $2 million. The amount and time in many

purchases is at management's discretion and depends on several factors, including the share price, general economic and market conditions and regulatory requirements.

This now concludes our prepared remarks. I will now open the line for questions. Operator.

QUESTION AND ANSWER

Operator
Ladies and gentlemen, at this time, we'll begin the question-and-answer session. To ask a question, you may press "*" and then "1" using a touchtone telephone. If you are using a speaker phone, we do ask that you please pick up the handset, before pressing the keys. To withdraw your question, you may press "*" and "2". Once again, that is "*" and then "1" to join the question queue.

We'll pause, momentarily, to assemble the roster. And our first question comes from Marla Backer from Sidoti. Please go ahead with your question.

Marla Backer
Thank you. A couple of questions here. First of all, so you've made a lot of progress in reducing the exposure to commercial auto.

You talked in your prepared remarks about your optimal portfolio mix. While the process of pruning exposure to commercial auto is expected to decline in '22, do you still expect to continue that initiative to some degree?

Randy Ramlo
Marla, this is Randy. The answer to that is yes. We'll probably continue at a lesser pace through all of time. But as you know, --our analytics can divide our auto book kind of into 10 deciles, and we'll always be doing some pruning to the higher deciles, which are the least profitable.

But we're substantially through the process. Ultimately, we'd like to get commercial auto down to about 20% of our book, and that would be the long-term balance. We have to write commercial auto. We're a packaged writer.

It's an important part of what we do. But we have to write as little of it as possible and be careful with what we do write, but we'll have kind of an ongoing process with kind of looking at the overall commercial auto book probably for the end of time.

Marla Backer
Okay, great. Thanks. So, on the increase in the expense ratio, it sounds like quite a bit about the seasonal, particularly, in the fourth quarter. Can you speak to that a little bit about what you see for that ratio?

Mike Wilkins
Marla, this is Mike. I'll take a shot at that one. So, I think in the fourth quarter seasonal would be correct. And I think the improvement in our profitability, as Randy Patten mentioned in his comments, we had to increase accruals for some profit sharing programs, both for agents and employees, based on the improved profitability.

Our topline reduction is putting some pressure on our expense ratio, and we hope to make improvements in topline, during 2022, so we won't have that same level of pressure, there. But yeah, fourth quarter the jump up was more related to the improved profitability.

Marla Backer
Okay. And then along those--the same lines of questions, everyone is reading about and talking about inflationary pressure, including wages and difficulties hiring. Can you speak to whether you've included any assumptions for that in some of your outlook for 2022, and beyond?

Randy Ramlo
So, Marla, this is Randy again. This inflation is supposed to be temporary, right? So, we're--so we have kind of inflation guards like a lot of companies. So, our exposure bases get an automatic increase, based on inflationary data. So, we keep our exposures up-to-date.

Part of the rate increases that we're able to get and the risk to the industry is getting is partly driven by that exposure to inflation, as well. It's kind of, interestingly, energy and fuel is up substantially, and that doesn't affect us as much as building materials and used cars are a big hassle.

Someone gets their car ruined and we have to try to find a replacement. The car prices are up, considerably. So, the rate increases are enough to, I think, make up for most of the inflationary amounts.

We continue to increase our exposure basis on every renewal to try to keep up with the cost of construction inflation. But we're also trying to listen to the economists and say, this inflation won't be here forever, but we're planning on it being here for at least, most of 2022.

Marla Backer
Okay, thanks, fair enough.

Randy Ramlo
Thank you, Marla.

Operator
And our next question comes from Paul Newsome from Piper Sandler. Please go ahead with your question. Mr. Newsome, is it possible that your phone is on mute?

Paul Newsome
It is possible. Can you hear me now? Good morning and congratulations on the quarter. Could you give us a few thoughts about the sustainability of the underlying loss ratio in the fourth quarter as we look out, prospectively? The slides in the presentation show a fairly measured and gradual improvement in commercial auto.

I assume they're doing other things, elsewhere. But it was a pretty dramatic improvement in the last really quarter or two. So, can you talk about sort of the--connecting the two, and how sustainable you think the fourth quarter would be as a run rate on the underlying loss ratio?

Randy Ramlo
So Paul, this is Randy. I don't know if we expect to see a low-80s combined, going forward. But our frequency reductions are very material and have actually started dropping, before the pandemic. And so, we think that's going to help; being out of personal lines in some areas will help. Mike mentioned in his remarks being very deliberate on offering high limits.

We've seen a lot of severity improvement and a lot of that is driven by the refusal to offer large liability limits, especially in certain parts of the country. And I think a lot of the underlying, we're going to see kind of regular improvement.

Mike also mentioned, just the work of our claims department trying to get losses settled quickly and fairly and trying to stay out of court, wherever we can.

So, I think a lot of those things are very sustainable, and we should see probably not low 80s combined, necessarily. But certainly, sub-100 combines, I think, is very sustainable. And that coupled with the good rate environment that we're still seeing, so far.

Paul Newsome
And you're talking about overall or the underlying because obviously, there's a material difference when you're thinking about sub-100?

Randy Ramlo
I think, Mike's going to take a shot at that.

Mike Wilkins
Yeah, Paul, if you look at the core loss ratio, ex-CAT, ex-prior year reserve development for the full year at low 60s. I actually think we can--we expect to see continued improvement in that number, as we go forward. We still--the trajectory is good on a lot of our lines of business. We still are working to improve more in some areas. And I think that our expectation is that will continue to improve.

As you know for the full year, we still had more of an impact from CATs than we would expect. So going forward, especially with personal lines being gone now, we expect less impact from

CAT losses in future quarters. So yeah, I think our--we have a lot of optimism for results in the coming quarters.

Paul Newsome
That's great. Just kind of banging on the commercial auto, again. Now that the dust has settled on the vast majority of the business that you non-renewed, can you maybe talk about just in hindsight, what were the pieces that didn't work?

Was it just about businesses with large limits, or were there other characteristics to the commercial auto book that you, ultimately, realized were the sort of pieces that were a problem, underwriting business?

Jeremy Bahl
Hey, Paul, this is Jeremy. Kind of a combination of legal environment in areas we were exposed, particularly, on the auto line whether that's California, Texas and elsewhere. I think we found ourselves with more limits on heavier exposures and whether heavier means heavy wheel or just heavier exposure accounts.

And then I would say the last thing is the larger the size of the fleet has a tendency to sometimes drive the price and rate environment down, without a corresponding benefit in the rate risk. And I think we found that that's not a terribly good environment for us.

Paul Newsome
Thank you. And good luck for the next year.

Randy Ramlo
Thanks, Paul.

CONCLUSION

Operator
Once again, if you like to ask a question, please press “*” and then “1”. To withdraw your questions, you may press “*”, and “2”,

And ladies and gentlemen, at this time I'm showing no additional questions. I'd like to turn the floor back over to Mr. Patten for any closing remarks.

Randy Patten
This now concludes our conference call. Thank you for joining us and have a great day.

Operator
And ladies and gentlemen, with that we will conclude today's presentation. We do thank you for joining. You may now disconnect your lines.