United Fire Group

First Quarter 2023 Results

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CORPORATE PARTICIPANTS

Kevin Leidwinger – *President and Chief Executive Officer*

Eric Martin – *Chief Financial Officer*

Julie Stephenson – *EVP and Chief Operating Officer*

PRESENTATION

Operator
Good morning and welcome to the United Fire Group Incorporated First Quarter 2023 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'll be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Eric Martin, Executive Vice President and Chief Financial Officer. Please go ahead.

Eric Martin
Good morning and thank you for joining this call. Yesterday afternoon, 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 UFG President and Chief Executive Officer Kevin Leidwinger and Executive Vice President and Chief Operating Officer Julie Stephenson.

Before I turn the call over to Kevin, 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 turn the call over to Mr. Kevin Leidwinger, CEO of UFG Insurance.

Kevin Leidwinger
Thank you, Eric. Good morning, everyone. Welcome to our first quarter conference call. I will begin this morning by providing a high level overview of our first quarter results. Following my comments, Julie Stephenson, our Chief Operating Officer, will discuss our underwriting production results and Eric Martin, our Chief Financial Officer, will discuss our financial results.

As indicated in yesterday's press release, despite these mixed results, I'm pleased with the progress we are making in positioning UFG to achieve superior financial and operational performance. We remain committed to the execution of our strategic plan designed to deliver long term profitability, diversified growth and continuous innovation. We also remain intensely focused on reducing the expense ratio while also attracting and retaining talent needed to evolve a company into a top performing commercial lines insurer.

Turning now to the results, net written premium grew 13% to $273 million in the first quarter of 2023 compared to $241 million in the first quarter of 2022. I'm pleased to note, net written premium growth was driven by our core commercial business as well as assumed reinsurance and surety. Growth returned to our core commercial business as a result of increased new business production, improved retention and positive renewal rate change, continuing the momentum we established in the fourth quarter of 2022. The combined ratio was 104% in the first quarter of 2023, compared to 89.5% in the first quarter of 2022.

The deterioration in the combined ratio was driven by an increase in the underlying loss and expense ratios, as well as the lack of favorable prior period development.

Underlying loss ratio in the first quarter of 2023 was 63.5% compared to 57.5% in the first quarter of 2022. The underlying loss ratio increased six points with approximately three points of the increase attributable to a shift in accident year loss ratio assumptions for our assumed reinsurance business as we have more closely aligned expected losses with exposure in that portfolio. Despite the impact on the underlying loss ratio, we remain confident in the performance of our assumed reinsurance business and its expected contribution to our future success.

In addition to the impact from assumed reinsurance, roughly two points of the increase in the underlying loss ratio are attributable to the impact of emerging loss trends that led to adverse prior period development in the third and fourth quarters of 2020. Finally, the increase in reinsurance costs and higher retentions across the broader portfolio impacted the underlying loss ratio by about a point.

Catastrophe losses contributed 4.6% of the combined ratio in the quarter compared to 2.6% in the first quarter of 2022. This was in line with our five-year historical average and consistent with our expectations. Our losses in the first quarter include the wind and thunderstorm event that impacted multiple states on March 31.

Prior period development was slightly adverse for the quarter with a 0.1% impact on the combined ratio compared to 4.4 points of favorable development in the first quarter of 2022. The expense ratio was 35.8% in the first quarter compared to 33.8% in the first quarter of 2022. The increase is the result of investments in senior talent that deepens our underwriting, operational and actuarial expertise. In addition, the expense ratio was impacted by increased costs related to technology and changes in the design of the post retirement benefit programs. Eric will discuss those in more detail in a few minutes.

As I indicated in my opening comments, I'm pleased with the progress we are making. I'm confident we have the right people and the right strategies in place to continue to move our company forward and create long term value for our shareholders.

With that, I would like to introduce Julie Stephenson, our Chief Operating Officer, to discuss our underwriting production results in more detail. Julie?

Julie Stephenson
Thank you, Kevin. We're very pleased with the momentum building across our portfolio of core commercial, assumed reinsurance, specialty excess and surplus, and surety businesses. Our core commercial lines portfolio comprised of small commercial, middle market construction and marine business returned to growth with net written premiums increasing by 10% in the first quarter. Core commercial contributed $38 million in new business for the first quarter, a significant increase compared to the first quarter of 2022.

New business in this portfolio, while well diversified, relies heavily on our aligned underwriting, risk control and claims expertise in construction, contributing just over 40% of our new business for the quarter. The line of business mix is consistent with our expectations. Necessary governance protocols are in place to ensure quality business is being added in support of our long term profitability goals.

The retention ratio for our core business was 81% for the first quarter, a five-point improvement compared to the first quarter of 2022. We are pleased to see retention levels improve, following our re-underwriting efforts and credit the strength of our agency relationships with our ability to retain quality business and return to a steady state of portfolio management.

There was no premium change in our core commercial business with 7.4% for the quarter, a slight contraction from the first quarter of 2022. However, the renewal premium change in property exceeded 17% in the first quarter of 2023 as rate increases are accelerating to mitigate inflation and higher reinsurance costs. We remain committed to keeping price increases on pace with the current loss trend environment.

Our assumed reinsurance portfolio grew net-written premium nearly 30% as we continue to execute our strategy to deliver diversified, profitable, growth to the organization. We continue to optimize this highly curated portfolio through selective growth fueled by a hardening reinsurance market and new partnerships. We also chose to non-renew a portion of our legacy retrocession portfolio at January 1 to pursue other business opportunities that provide better diversification value to UFG.

Net written premium grew 30% in our profitable surety portfolio as we expanded our geographic presence and continue to grow our agency partnerships. Our specialty excess and surplus business saw a slight contraction in net written premium in the first quarter as we continued to manage our portfolio with appropriate attachment points and pricing to provide consistent, profitable results.

New business increased in the quarter compared to the first quarter of 2022 and we took steps to manage volatility through the purchase of a variable quota share treaty.

I'll now turn the call over to Eric Martin to discuss the rest of our financial results.

Eric Martin
Thank you, Julie. Good morning, again.

In the first quarter, we reported net income of $0.03 per diluted share, and non-GAAP adjusted operating income of $0.08 per diluted share.

As Kevin mentioned, our underlying loss ratio has increased six points from the prior year, and I would like to provide some additional context behind those changes. The largest driver of this increase came from our assumed reinsurance business, which is both growing and further diversifying our overall enterprise portfolio. As this book continues to grow, we have refined our allocation of losses to the current accident year to better reflect the exposure for this business. This shift was effectively neutral across the total loss ratio, and this business continues to perform in line with our expectations.

In addition, our underlying loss ratio reflects the higher loss cost assumptions that resulted from the reserve strengthening actions we took in the third and fourth quarters of 2022 in our other liability line of business. Finally, the impact of ceded reinsurance costs and retentions put some upward pressure on our underlying loss ratio in the first quarter as we begin to take the actions Julie mentioned to mitigate the impact on our combined ratio.

Our expense ratio of 35.8% increased two points from the first quarter of 2022. Although the expense ratio benefited from an increase in earned premiums during the quarter, as well as a 4% decline in headcount since the start of the fourth quarter of 2022, expenses increased this quarter from investments in senior leadership talent and higher technology costs for the strategic implementation of our new policy administrative platform.

In addition, our costs increased in 2023 due to a change in the design of employee post-retirement benefit programs. In late 2020, we announced that UFG would no longer contribute to post-retirement medical and dental benefits and move to a participant funded plan at the beginning of 2023. There was a one-

time benefit recognized in the first quarter of 2021 and the remaining liability for that plan was then amortized down through an expense benefit of $3 million each quarter for eight quarters that ended in the fourth quarter of 2022.

In addition, during 2021, we changed our employee pension plan from a traditional plan to a cash-balance plan. That change reduced the ongoing expense of the plan, but the plan expenses are still sensitive to changes in interest rates and equity markets. Due to equity market losses and interest rate increases last year, our expenses have increased by approximately $1 million per quarter.

Our investment portfolio was $1.9 billion of invested assets in the first quarter; 85% of which is allocated to a high quality fixed income book. Net investment income was $12.7 million in the first quarter, up 13% compared to the first quarter of 2022. We continued to realize the benefits of investing in a higher interest rate environment with new money yields of 5.3% helping increase fixed maturity income by 22% compared to a year ago. The positive impact from higher bond yields was partially reduced by negative valuation impacts on our limited partnership portfolio of $1 million and realized investment losses of $2 million driven by negative changes in the valuation of our core equity portfolio.

Our return on equity in the first quarter was 0.4%. And we saw improvement in our unrealized loss position that increased the book value per common share to $29.80.

Our capital management strategies are focused on pursuing top tier shareholder returns, deploying available capital to fund profitable business growth, and returning excess capital to shareholders. During the first quarter, we declared and paid a $0.16 per share cash dividend to shareholders of record as of March 10, 2023, continuing our 55-year history of paying dividends dating back to March 1968.

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

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you're using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we'll pause momentarily to assemble our roster.

Our first question comes from Paul Newsome from Piper Sandler. Please go ahead.

Paul Newsome
Good morning. Thanks for the call. A couple of questions. Maybe just starting off with a place where I'm a little confused. Could you maybe just go over a little bit more this change in the loss ratio related to the assumed reinsurance? It may be an issue of language, but I'm confused about how it increased the loss ratio, but it didn't increase the loss ratio over the total amount? So maybe you could talk about that in terms of traditional loss ratio idea.

Eric Martin
Thank you, Paul. This is Eric. Thanks for joining this morning as well.

So, I'll give just a few more details on that. When you look at our underlying loss ratio and think of that as current accident year of loss ratio, comparing back to the first quarter last year we were at 57.5, and this year we're at 63.5, so a 6-point jump. And really, if you look back to the first quarter last year, that was a very strong quarter and as we went through the year, our underlying loss ratio in the fourth quarter

was around 60 and I think for the full year was maybe 59 or 60. So as we attribute the six-point change here, part of this is related to our assumed RE business and with that business there can be nuances in how premiums are reported to us, and perhaps a difference between accident year and contract year.

So, as we look back, historically, we had done some allocation of those losses, an estimation of those losses between current year and prior year. But as we think about this business as it continues to grow and it continues to help us diversify our overall book, we've refreshed our view on that and really applied a better matching of premiums and losses by including the losses of that in the underlining loss ratio. So, when we look overall at our total loss ratio, though, including development, including the underlying loss ratio, there's no difference here. We continue to be happy with this book, it's performing well, as I said, it's growing, it's diversifying our overall portfolio.

So that's about half of the attribution there. About two points of this reflects the changes that we made in the view of our portfolio in the second half of last year and about one point is due to higher reinsurance costs and higher retentions as we come into 2023.

Paul Newsome
So, the accident year loss ratio for the reinsurance business rose in the first quarter, and the offset is in reserve development?

Eric Martin
That's right, for-

Paul Newsome
Okay. So, there was a reserve benefit that ran through the income statement related to the reinsurance business, which neutralized the calendar year impact.

Eric Martin
That's right. Right, right.

Paul Newsome
Okay. And that was offset by deterioration in the reserves elsewhere. Maybe you could give us a little bit more color about the driver of that offsetting reserve development?

Eric Martin
If you look back, you're talking about the reserve development in Q1 last year?

Paul Newsome
No, I'm talking about just the first quarter. If there was a gain in the first quarter because of the shift in what happened in reserves in reinsurance, then to have roughly breakeven reserves you must have had a negative charge someplace else.

Eric Martin
So, there were some variations by lines of business here in the development in the first quarter of this year, but they were largely offsetting, so that the assumed business didn't have any measurable reserve development, but there were some other lines that had some offsetting stuff. But overall, we got to about a neutral development for the quarter.

Paul Newsome
Okay, I'll take that one offline, because I'm pretty certain I'm confused about the math. Could you give a sense of the intermediate outlook for the expense ratio? You mentioned that you're committed to taking

it down over time, but what sort of timeframe are we talking about to provoke the increase, and hopefully the later decrease and maybe some of the drivers behind what would take that expense ratio down over time?

Kevin Leidwinger
Hi, Paul. It's Kevin. So, thanks for the question.

Just to give you a little color. Clearly, we're focused with a high degree of intensity on the expense ratio. As we indicated, we brought in some very senior talent into the organization to help continue to evolve the company as we look forward. We have a high focus on managing the business very efficiently going forward, we're going to continue to evolve the organization, and we will invest in talent to help us do that. At the same time, we recognize that our expense ratio today is elevated relative to our own expectations and relative to our competitors. And so, as we continue to evolve the company going forward, it's at the top of our list of things to continue to focus on.

So, we recognize we will get some benefit as we continue to grow the book of business and the earned premium begins to improve, then we'll also gain some benefit by the ongoing reduction in costs that we expect to achieve over the course of the coming year. So, we would expect to see some improvement over the course of this year. We think this is probably the high watermark expense ratio for the year.

Paul Newsome
That's great. Any sense about where the reinsurance growth is coming from, from an exposure perspective? Is it casualty, is it property, is it changing the sort of general volatility of the business over time?

Kevin Leidwinger
Just to be clear, are you referencing our assumed reinsurance business?

Paul Newsome
Yes, please.

Kevin Leidwinger
So let me just give you just a little bit of color around our assumed reinsurance business. I think we've not really talked too much about that. So, the company has a sort of a longstanding history in providing reinsurance capacity. The longstanding history, though, has been more around retrocession contracts from our reinsurance partners. But a couple of years ago, we saw an opportunity to drive some diversification into the portfolio. And that's one of the underlying fundamental tenants of the assumed reinsurance business is that it will be diversifying rather than accumulating for the organization. And so, we have, as you heard, Julie describe earlier, built a highly curated portfolio that is diversifying rather than accumulating into our business.

The assumed reinsurance business is primarily made up of standard treaty business, for which there's some excess of loss, some property per risk, and only a relatively modest amount of CAT business in the standard treaty business. There are some funds at Lloyds, which is effectively a collateralized hold account board of share transactions with eight void syndicates. And even though we non renewed a number of the retrocession treaties that Julie referenced earlier, we still have a couple of those left, primarily professional reinsurers with void syndicates, and very little property CAT exposure there. And then there's a little bit of reinsurance around some MGA treaties that we have in place today.

So, most of the growth that we've experienced is coming as a result of engaging in standard treaty business and providing capacity to those who needed it during the most recent renewal cycle, which as

we all know, was one of the hardest that we've seen in a very, very long time. So quite an opportunity for the organization to drive growth, and yet diversify its portfolio.

Paul Newsome
Right, thank you for the help as always, appreciate it.

Kevin Leidwinger
You're welcome.

CONCLUSION

Operator
Again, if you have a question, please press star then one.

There are no more questions in the queue. This concludes our question and answer session. I'd like to turn the conference back over to Kevin Leidwinger, President and CEO for any closing remarks.

Kevin Leidwinger
Thank you for joining us today and we'll see you next quarter.

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