United Fire Group Insurance

2023 Second Quarter Earnings

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CORPORATE PARTICIPANTS

Eric Martin - *Executive Vice President and Chief Financial Officer*

Kevin Leidwinger – *Chief Executive Officer*

Julie Stephenson - *Chief Operating Officer*

Tim Borst – *Director of Investor Relations*

PRESENTATION

Operator
Good morning. My name is Chuck and I'll be your conference operator today. At this time, I would like to welcome everyone to the United Fire Group Insurance Second Quarter 2023 Financial Results Conference call. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. And to withdraw your question, please press star then two. Please note, this event is being recorded.

I would now like to turn the conference over to United Fire Groups ABP and Director of Investor Relations, Mr. Tim Borst. Please go ahead, sir.

Tim Borst
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; Executive Vice President and Chief Operating Officer Julie Stephenson; and Executive Vice President and Chief Financial Officer Eric Martin.

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, Tim. Good morning, everyone. Welcome to our second quarter conference call.

I'll begin this morning by providing a high level overview of our second quarter results. Following my comments, Julie Stephenson, our Chief Operating Officer will discuss our underwriting results in more detail. And Eric Martin, our Chief Financial Officer will discuss our financial results.

As reported in our pre announcement on July 31 and our press release yesterday afternoon, UFG's combined ratio for the second quarter was 133%. Our results were impacted by $53 million of prior period reserves strengthening as well as elevated catastrophe losses.

Before we review the quarters' results in more detail, I'd like to take a minute to comment on our decision to strengthen reserves. UFG is committed to a strong actuarial foundation supporting not only the reserving process, but a broader range of business actions critical for delivering profitable growth. Over the past four quarters, we have deepened our actuarial expertise including hiring UFG's first Chief Actuary. In addition, we've enhanced our actuarial processes, which have increased the breadth and depth of our reserving analysis. The process enhancements have allowed us to better understand the

behavior patterns of individually managed lines of business, resulting in more actionable insights across similar product exposures.

Analyzing trends at the line of business level allowed us to see potential risks sooner than in the past and accelerated our response to changing conditions. With this decision, we believe any major reserve strengthening has been addressed. Of course, as part of our continued advancement of our reserving processes, we'll continually work to evaluate emerging trends and changing environments. As we move forward, we will respond to adverse trends quickly and favorable ones cautiously. While our decision to strengthen reserves resulted in a near term negative impact, we believe the robust actuarial organization we are building and the actual insights they will provide help reduce future risk to the company and create significantly stronger foundation on which to grow our business.

Improving the sophistication of our actuarial capabilities is just one example of the progress we've made in reshaping the company over the past year. In addition, we've reengaged our distribution partners, restored responsible growth in our core commercial business; evolved the underwriting organization to deepen our expertise and better serve the distinctly different needs of small business and middle market customers; reduced our catastrophe footprint; acted to sustainably reduce our expense ratio and funded critical investments in talent and technology. Despite the quarter's results, we believe we are executing the right strategies to move our company forward, deliver consistent profitability and create long term value for our shareholders.

Turning now to the quarters' results, net written premium increased 14.6% to $299 million in the second quarter of 2023 compared to the second quarter of 2022. This marks the fifth consecutive quarter of enterprise premium growth, with core commercial business growing for the second consecutive quarter. Although all our business units except Surety contributed favorably this quarter, I'm especially pleased with the growth in our core commercial business which resulted from increased new business production, improved retention, accelerating rate increases and meaningful exposure growth. The underlying loss ratio was 64.6% in the second quarter, an increase of 5.8 points over the second quarter of 2022. Approximately three points of the increase were the result of small number of large losses in our Surety business, and the impact of reinsurance reinstatement premiums. The Surety business can experience occasional volatility, but has been exceptionally profitable for UFG. We remain confident in its ability to deliver attractive long term returns.

Catastrophe losses contributed 13% to the combined ratio in the quarter compared to 12.1% in 2022. These results are slightly elevated relative to our five- and ten-year averages of approximately 11%. Even though this quarter's results were within a reasonable range of our five- and ten-year averages, we believe the current level of loss activity is unacceptable and continue to take a broad range of actions to reduce and optimize our catastrophe exposure across our portfolio. Prior period reserve strengthening contributed 20.8% to the combined ratio in the quarter compared to the favorable development of 5.4% in 2022.

As mentioned previously, the $53 million in reserves strengthening was across multiple casualty lines and across multiple accident years. The primary drivers included enhancements to our processes as well as the ongoing impact of social and economic inflation. The expense ratio was 34.5% in the second quarter, down seven tenths of a point compared to a year ago. We've been intensely focused on improving the expense ratio as part of our strategic plan and are pleased the actions we've been taking to sustainably reduce cost structure while growing the business are beginning to materialize.

I'm pleased with the progress we're making in reshaping the company as we execute strategies designed to deliver consistent profitability and create long term value for our shareholders. We remain fully confident in our path forward as we position UFG to deliver superior financial and operational

performance.

With that, I'll hand it over to Julie Stephenson, our Chief Operating Officer to discuss our underwriting results in more detail. Julie.

Julie Stephenson
Thank you, Kevin. I'm pleased to see momentum continuing to build across our portfolio of core commercial, assumed reinsurance, specialty excess and surplus and surety businesses. Net written premium in our core commercial business, which includes small business and middle market, grew 10% to $198 million, compared to the second quarter of 2022 with all components of production increasing.

Core commercial new business premium was $39 million in the second quarter, with efforts to reengage with our agents now supporting new business production levels appropriate for sustained measured growth. This, coupled with our refined risk selection and underwriting discipline, provide confidence this business will contribute favorably to our long term profitability.

Retention for our core commercial business increased to 84% in the second quarter, which we view as a steady state number that still allows for responsible pruning of accounts that no longer meet our pricing needs or risk profile. Renewal premium change in our core commercial business accelerated to 8.5% in the second quarter. Average rate increases were up from the first quarter across all lines of business, with total rate achievement at the highest level since the fourth quarter of 2021.

We are pleased with the second quarter property renewal premium change of 19%, with rate increases of 12% and exposure increases of 7%. We remain diligently focused on price adequacy across all lines of business relative to loss trends.

Our assumed reinsurance portfolio grew net written premium over 30% in the second quarter, as we continue to execute our strategy to deliver diversifying profitable growth to the organization. This growth reflects the ongoing impact of January reverse [ph] renewals that enabled us to continue to optimize this highly curated portfolio by selectively adding new partnerships while non renewing a portion of our legacy retrocession portfolio, as well as ongoing growth in our existing partnerships.

Surety net written premium is down compared to the second quarter of 2022 due to reinsurance reinstatement premiums while the business continues to grow on a gross basis as we expand our geographic presence and deepen our agency partnerships. Our specialty excess and surplus business grew modestly in the second quarter, as we continued to manage attachment points in pricing to provide consistent, profitable results.

As Kevin mentioned, our second quarter underlying loss ratio of 64.6% includes 3 points of impact from increased Surety net losses, and associated reinsurance reinstatement premiums. UFG’s Surety business has historically been very profitable. In the second quarter, we experienced a few large losses. This can happen in this line from time to time. While these losses had unique circumstances, we also acknowledge that broader post pandemic economic conditions affecting the availability and cost of materials and labor, combined with robust construction demand are contributing to heightened risk in this line. UFG is responding with increased underwriting rigor, resulting in refined guidelines to ensure the Surety line continues to deliver favorable returns over the long term.

Turning to the strengthening of prior period reserves, I want to first provide some additional insight on the investments and advances we have been making in this area over the past four quarters. With the need for strategic investments and talent and rigor of actuarial process, as Kevin mentioned, UFG has expanded the depth, sophistication and actionability of insights. These enhancements and actuarial

processes enabled us to take actions in the second quarter to strengthen our position relative to loss trends across a range of long tailed liability lines of business. The largest impacts were in other liability and commercial automobile, as seen in our MD and A tables. Other liability experienced approximately 64 points of prior period development across a range of long tailed exposures and prior accident years. The majority of the strengthening occurred in excess and surplus lines excess casualty and construction defect exposures.

The nature of claim discovery for construction defect losses and differences in state legal environments introduces significant variation in loss behavior patterns. Traditional actuarial methods can be difficult to rely on given this uncertainty, so alternative techniques are required to better reflect the unique nature of these patterns. Additionally, frequency and severity can vary significantly across states, so it is necessary to segment the analysis appropriately recognizing these differences.

The excess in surplus lines excess casualty book has grown over the last several years while the risk profile has evolved. Relying solely on longer term loss patterns may not be appropriate and additional benchmarks and loss trend analysis have been added to provide additional insight. This has allowed us to improve our reserve position for this book of business.

More broadly, general liability and commercial auto reserves were also strengthened as additional studies lead to an increased view of ultimate severity. We believe these actions position our reserves to better manage the uncertainty in these longer tailed lines and strengthen our balance sheet position against future risk.

Turning to catastrophe losses, in the second quarter, we experienced 13 points on the combined ratio. Our underwriting teams continue to reduce and optimize our catastrophe exposure by improving our property risk profiles, raising deductibles and driving pricing increases in high risk geographies. As a result, property premiums are increasing, while expected loss ratio, PML's and our catastrophe footprint are decreasing.

I want to take a moment to provide some additional details on how we are evolving and investing in the success of our core commercial business. With nearly 70% of UFG's net written premium coming from core commercial, this business has a significant impact on our overall results and is an area of investment in focus. Over the past year, we have discussed the tenants of UFG's strategic plan focused on long term profitability, diversified growth, continuous innovation, expense management, and attracting and retaining talent. A key part of delivering on the strategic plan is deepening the expertise in our underwriting organization by evolving our core commercial business from a generalist to a specialist, building on the previously established specialization in Surety, Specialty and Assumed Reinsurance.

As the market has evolved and the distribution landscape has changed, underwriting expertise is valued and recognized as a strong competitive advantage. Specialization creates alignment and greater opportunity for success with agency partners. Last month, we took significant steps to accelerate core commercials journey from a generalist to a specialist by establishing distinct business units and operating models for small business and middle market, supported by a centralized business enablement function.

In the small business market, success requires sophisticated and well-tuned analytics, along with cutting edge digital technologies. This creates an efficient agency experience that results in high submission flow and low touch underwriting to attract lower volatility business. At UFG, we are already leveraging these capabilities and actively building others to better serve our agents and small business customers.

Success in middle market requires highly specialized industry segment focused, multi line underwriting strategies supported by equally sophisticated risk control and claims handling processes. Our current

strength in construction lays the foundation for success in other industry verticals, helping us better align with the specialization happening across our distribution partners. We continue to advance our underwriting skill set across all lines of business to ensure appropriately robust risk selection, pricing, contractual integrity and account management.

Developing line of business and industry expertise across the entire portfolio, including increased cross functional integration with actuarial, risk control and claims, creates alignment and greater opportunities for successful acceleration of profitable growth. Driving operational efficiencies reduces the expense ratio and positions UFG to deliver consistently profitable results.

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

Eric Martin
Thank you, Julie. I will first provide some additional commentary on the second quarter expense ratio of 34.5%, which declined seven tenths of a point from a year ago. As previously discussed, we've been intensely focused on reducing the expense ratio as part of our broader corporate strategies to deliver sustainable profitable growth. The most significant of these impacts is a 7% decline in headcount since the beginning of the fourth quarter of 2022, and increased earned premium levels from the rebound in growth. In the second quarter, the benefits of these actions were sufficient to outweigh the upward impact on our expense ratio from strategic technology investments in our new policy administrative platform, and benefits to our prior year expense ratio from a change in the design of employee post-retirement benefits that we discussed last quarter.

Turning to investment results, invested assets into the second quarter at $1.8 billion, 85% of which is allocated to a high quality fixed income book. Within our portfolio, we began reducing our exposure to public equities, which shrank to 7% of assets in the second quarter. This strategic reallocation of public equities to high quality fixed income is an attractive way to reduce volatility and improve risk adjusted returns given current market conditions. We intend to continue executing on this trade as long as these attractive conditions exist.

Net investment income was $11.3 million in the second quarter, up 23% compared to the second quarter of 2022. We continue to realize the benefits of investing in a higher interest rate environment, with new money yields exceeding 5%, helping increase fixed maturity income relative to a year ago.

The positive impact from higher bond yields was partially reduced by negative valuation impacts on our limited partnership portfolio of $4 million in the second quarter. Realized gains of $1 million driven by changes in the valuation of our core equity portfolio rounded out the second quarter investment results.

Second quarter underwriting and investment returns resulted in a net loss of $2.23 per diluted share and a non-GAAP adjusted operating loss of $2.27 per diluted share. Return on equity in the second quarter was a negative 15.7%. And we saw a slight deterioration in our unrealized loss position that decreased the book value per common share to $26.77.

During the second quarter, we declared and paid a $0.16 per share cash dividend to shareholders of record as of June 2, 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

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. If at any time your question has been addressed and you would like to withdraw your question, please press star then two. And at this time, we'll pause momentarily to assemble our roster

And the first question will come from Paul Newsome with Piper Sandler. Please go ahead.

Paul Newsome
Good morning. Thanks for the call. Maybe you could just talk a little bit more about rate versus what you peg as claims inflation for your broad businesses, not just core commercial, but the specialty businesses and reinsurance as well, just to give us a sense of whether or not on an underlying basis you think you're making progress in getting rate versus current levels of claims inflation and by how much?

Julie Stephenson
Hi Paul. This is Julie. Thanks for the question. Certainly, we believe our rate increases are accelerating overall faster than our view of trends, and I think that's important and remains a key focus for us moving forward. We're pleased with the rate achievement that we increased across all of our lines of business, across all of our business units. Certainly, most pleased with what's happening in the property space given the catastrophe results we took for the quarter that remains a focus and will continue to accelerate through the end of the year.

Paul Newsome
How should we think about the debt load prospectively, given what you're doing with your CAT management efforts?

Kevin Leidwinger
Paul, could you repeat the question? We had a hard time hearing you.

Paul Newsome
How should we think about the CAT loan prospectively, given what you're doing with your CAT management efforts?

Eric Martin
So, we’re within expectations, I think, relative to the current CAT loads. As we continue to reduce our CAT footprint, we'll reevaluate those as we go forward. But for the moment, we're within expectations.

Paul Newsome
The underlying combined ratio, if you pull out the three points from the Surety business, deteriorate a little bit, it looks like. Could you talk about the sources of that deterioration?

Julie Stephenson
Julie again. So, we see the underlying loss ratio deteriorating by six points, you already mentioned the impact of Surety. We certainly know that. We also are still feeling the impact of the increase due to reinsurance costs from our one-to-one renewals. That's approximately a point. We also are experiencing a higher underlying loss ratio in our assumed reinsurance as compared to this time last year, which contributes really the remaining difference.

As we stated in our Q1 results, we are enhancing our analysis of that book, and have made some adjustments in the allocation of our loss reserves to better align with the exposures. I know we talked about that extensively last quarter. Although we know this creates some noise in the first and second quarter results, we think that the year to date underlying loss ratio for this book is a good representation

of the portfolio going forward.

Paul Newsome
Obviously, a new chief actuary changes the reserve philosophy, which resulted in the change in the reserves this quarter, but the yearend tends to be when things really change, at least for most companies. Do you anticipate the yearend process will be different than it has in the past?

Kevin Leidwinger
Hi Paul, it's Keven. So, we believe that any major reserve strengthening has been addressed this quarter. And so, as I indicated in my prepared comments, we will continue to obviously pay very close attention to the environmental dynamics going on around us. And, as we also stated previously, we'll be very quick to react to negative trends and will be very cautious about reacting to favorable trends. But we feel very good about where we are based on the decision we made this quarter.

Paul Newsome
Thank you for all your help. Appreciate it.

Kevin Leidwinger
Thank you.

Operator
The next question will come from Cory Wren with Pico Wealth Management. Please go ahead.

Cory Wren
Yes, good morning. Thank you for the conference call. I was looking at your results and I've been following insurance companies since the 1980s. And when people mention the word "reserve strengthening," what you're really saying is your reserves were understated and you're taking a charge for that understatement, is that correct?

Eric Martin
Well, I think the better way for us to characterize that is that we've deepened our analysis around our reserves, and based on additional insights, we've decided to strengthen the reserves. And so, through that process, we believe that we've taken the appropriate action relative to the current reserves on the portfolio.

Cory Wren
Okay. Now, with all these changes that you're making, you're talking about different lines of business, my concern is catastrophe losses, that you're not getting your feet under you. I've seen multiple insurance companies report pretty decent results this year with catastrophe losses included. And I guess my fear is you're a company, a significant company in Cedar Rapids. We're an Iowa based firm and I'm rooting for you, and I can't see the future, I can't see what the results are going to look like in one, two, three years. And I was just wondering, with all these changes and all these strengthening and improvement and re directing the business, the focus that you're going to have, what can we expect as far as a combined ratio? What is the goal for your combined ratio going forward? And what kind of return on equity are you trying to achieve going forward?

Kevin Leidwinger
Well, thanks for the question. We're not in a position to provide guidance, but I can give you some general views. So, you know that the leadership team at the company is relatively new and we're driving a lot of change to reshape the organization with the express purpose of delivering consistent profitability over time. And so, the company has had a track record most recently of underperformance and we are making

significant changes inside the organization to change the trajectory of the company in terms of both its growth and its profitability. And so, you should expect over time to see continued improvement in the company's growth rate, as well as its profitability.

Cory Wren
And are you expecting the rest of the year to be a reflection of these changes, or will next year be a better place to make the analysis on our end?

Kevin Leidwinger
We anticipate seeing improvement through the rest of this year and into next year, but the kinds of changes we're implementing take some time to materialize and oftentimes the results lag the changes that we're making. So, I would expect to see acceleration in improvement as we continue throughout this year into next year and into 2025.

Cory Wren
Okay. Well, thank you and good luck to you guys.

Kevin Leidwinger
Thanks so much.

CONCLUSION

Operator
This concludes our question and answer session. I would like to turn the conference back over to Mr. Kevin Leidwinger for any closing remarks. Please go ahead, sir.

Kevin Leidwinger
Thanks for joining us, and we look forward to chatting next quarter. Thank you.

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