United Fire Group, Inc. Q2 2021 Conference Call

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CORPORATE PARTICIPANTS

Randy Patten – *Interim Co-Chief Financial Officer*

Randy Ramlo – *Chief Executive Officer*

Mike Wilkins – *Chief Operating Officer*

PRESENTATION

Operator
Good morning and welcome to the United Fire Group, Inc. Q3 2021 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 will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. 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 Randy Patten. 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 third quarter 2021 conference call.

I will begin today by discussing the strong improvement in our core loss ratio in the third quarter, which improved 10.1 percentage points as compared to the same period last year. On a year-to-date basis, our core loss ratio improved 2.6 percentage points compared to the same period last year. When taking into consideration the recovery of $7.1 million and $22.5 million respectively in the third quarter and year-to-date last year under our all lines aggregate reinsurance program, our core loss ratio improved 12.8 percentage points and 5.5 percentage points respectively.

A summary of our core loss ratio, which removes the impact of catastrophe losses and favorable prior-year reserve development, can be found on slide 13 in the presentation on our website. We are pleased with this significant improvement, which is a direct result of our strategic initiatives.

For the third quarter, we reported a combined ratio of 109.7%, a decrease of 14.7 percentage points as compared to third quarter of last year. Year-to-date, we reported a combined ratio of

106.1%, a decrease of 7.4 percentage points as compared to year-to-date 2020. The most significant improvement was in our commercial auto loss ratio, which improved 43.7 percentage points in the third quarter and 11.8 percentage points year-to-date 2021, as compared to the same periods last year.

The combined ratio continued to benefit from favorable prior accident year reserve development at 4.6 points and 3.6 points respectively during the third quarter and year-to-date 2021, compared to 2.4 points and 3.8 points in the same periods last year. Most of the favorable prior accident year reserve development this year was in our commercial auto line of business.

Offsetting the improvement in our core loss ratio was higher than average catastrophe losses. Pretax catastrophe losses added 16.5 percentage points to the combined ratio in the third quarter of 2021, compared to our third quarter historical average of 9.2 percentage points. During the third quarter, we experienced 19 catastrophic events, with the most significant events being Hurricane Ida and the European floods from our assumed reinsurance business.

As part of our portfolio management strategy, throughout 2020 and 2021 we have focused on reducing the size of our commercial auto portfolio by reducing the number of exposure units and implementing nearly double digit rate increases, which has increased the quality and profitability of our commercial auto book. We also continue to experience a decrease in the frequency and severity of commercial auto claims. Slides six and seven in our presentation on our website highlights our progress in diversifying our portfolio by rebalancing our mix of business.

Commercial auto now makes up 24.8% of our portfolio year-to-date this year compared to 28% for the same period last year. Commercial auto new business premium written year-to-date in 2021 has decreased to 21% as compared to 33% in 2019. Also, we are achieving growth in our more profitable lines of business, with new business premium for general liability increasing from 21% to 24% and inland marine growing from 9% to 16% between 2019 to 2021. We are also seeing 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 year-to-date.

Before I turn the call over to Mike, I would like to take this opportunity to share some progress on our strategic plan. It is clear to me that our strategic plan is working, as is evident from the improvement in our core loss ratio the last two quarters. A plan of this scale takes time to be fully implemented, and we believe we are seeing significant progress and gaining momentum in all three pillars of our One UFG Boldly Forward strategic plan, including long-term profitability, diversified growth, and continuous innovation.

In the profitability pillar, we are relentlessly focused on core skill execution with an emphasis on consistency, quality, and continuous improvement. We have fostered a One UFG mindset to identify and scale best practices across our organization. We are now managing our portfolio to tightly fit our risk appetite across all underwriting branches of UFG, with best in class data and analytic tools to assist our underwriters in making effective decisions.

In the growth pillar, we are scaling our business in direct standard markets that we know well and can write profitably with the right partners. We are expanding our presence in surety, E&S, and inland marine lines. We have also developed and deployed a state-of-the-art digital quoting platform for small business within our online division. Finally, we have broadened our market scope through our assumed reinsurance strategies.

In our innovation pillar, we have up-skilled and developed a growth mindset in our employees. We have deployed analytics and data-driven decision-making across the enterprise, including working on strengthening our cat modeling capabilities. We have strengthened and optimized our key agency partnerships. We have expanded our business agility to drive faster delivery and speed to market. We have transformed UFG by creating an environment that inspires innovative ideas into action.

As I mentioned, a plan of this scale takes time. In 2020, we laid the foundation for our plan, and in 2021 we are seeing the plan take root. Overall, we wish things were progressing faster, but all metrics are improving and we are convinced we're on the right path to deliver consistent, sustainable, and profitable results.

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

Mike Wilkins
Thanks, Randy, and good morning, everyone. I will echo Randy's comments that we are transforming UFG and believe we are on the correct course to improving our profitability. Our focus on reducing the size of our commercial auto portfolio by non-renewing underperforming accounts and reducing the number of exposure units continued to show progress in the third quarter of 2021.

Through our strategic efforts, I am pleased to report that exposure units decreased 24% over the past 12 months, from 235,000 units in September of 2020 to approximately 179,000 units in September of 2021. This decrease is the result of targeted reductions in our worst-performing accounts as part of our strategic plan.

Commercial auto claims frequency, expressed in claims per insured units, also continues to decrease, with the 12 month moving average declining again in the third quarter of 2021, down to 4.42% from 4.78% in the third quarter of 2020. This decline is summarized on slides eight and nine in our presentation on our website. It is important to note that the decline in frequency began prior to the pandemic and continues to decline, despite an increase in miles driven in 2021. We believe this continued decline is a direct result of our strategic underwriting actions.

Slides 10 and 11 provide a three-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 22% year-to-date 2021 as compared to the same period in 2020. We have also provided commercial general liability, BOP liability, and workers' compensation claim counts on these slides, as all are down year-to-date 2021, which is a positive sign of our strategic efforts.

Part of our strategic plan is to focus on pricing adequacy in our commercial auto, property, and umbrella books of the business. Year-to-date, the overall average renewal price increase was 6.3%. Excluding our workers' compensation line of business, the overall average renewal pricing increase was 7.6%. The 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%. Commercial property average renewal rate increase was 8.7%. These rate changes are very consistent with the second quarter of 2021. We will continue to be aggressive with rate increases and reduce undesirable exposures.

Our claims initiatives also continued to progress extremely well during the third quarter and are contributing to net income, primarily from a reduction in legal fees through litigation management and avoidance by settling claims quicker in the claims cycle.

Before I turn the call over to Randy Patten, I want to discuss our strategic plan to reduce the volatility in our catastrophe losses experienced in recent quarters. We continually review our book of business and model for catastrophe losses. We have recently hired a CAT modeling professional and brought CAT modeling capabilities in-house, where in the past we relied on reinsurance broker modeling capabilities. Earlier this year, we also did an RFP for our CAT reinsurance program with select reinsurance brokers as part of the effort to optimize our CAT reinsurance program.

In addition to these efforts to reduce the impact of CATs, we are also strategically diversifying our book of business with non-CAT exposed business such as surety, E&S, inland marine, and non-CAT exposed assumed reinsurance business. In addition, our strategic plan to exit personal lines of business, which is materially completed, will significantly reduce our volatility and exposure to catastrophe losses.

It is important to note that the increase in loss ratio in our assumed reinsurance line of business during the third quarter of 2021 was due to CAT losses on our legacy book of business, which has been in place for many years. During 2021, part of our diversification strategy is to grow our non-CAT assumed reinsurance business, as it has been very profitable for us traditionally with combined ratios below 100%.

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

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

In the third quarter, we reported a consolidated net loss of $9.6 million compared to a net loss of $37.2 million in the same periods in 2020. Year-to-date, we reported consolidated net income of $22.9 million compared to a net loss of $103.8 million year-to-date prior year.

As Randy mentioned, our core loss ratio continued to improve in the third quarter but was offset by $39.5 million of catastrophe losses, which is $17.5 million or 7.3 points higher than our average for third quarter.

Also contributing to net income in the third quarter and year-to-date 2021 was an increase in investment income. Net investment income was $11.6 million and $42.4 million in the third quarter and year-to-date 2021 as compared to $7.2 million and $22.3 million in the same periods of 2020. The increase in both periods was primarily due to the change in the fair value of our bank fund limited liability partnerships, which increased in value by $1.3 million and $10.8 million in the third quarter and year-to-date 2021, compared to a decrease of $4.6 million and $13.8 million in the same periods of 2020.

We reported net realized investment losses of $2 million in the third quarter of 2021 and net realized investment gains of $28.2 million year-to-date as compared to net realized investment gains of $15.2 million and investment losses of $62.4 million in the same periods of 2020. The majority of the change between the two periods was driven by a change in the fair value of our equity security investment, which is required to be reported in net income. The remaining change was primarily driven by actual sales of equity holdings.

As mentioned during our earnings call this year, we expect improvement in the expense ratio in 2021 because of the previously announced changes to our postretirement medical plan. A 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 and 2022. Year-to-date, we reported an expense ratio of 32.2% compared to 34.4% year-to-date 2020, or 2.2 points of improvement.

For the third quarter of 2021, we did see an increase in expense ratio of 2.5 points as compared to the third quarter of 2020. This is due to improved performance in our book of business, resulting in additions to our profit-sharing accruals for our agents, employees, and program business. We still anticipate approximately 1.5 to 2 points of improvement in the expense ratio for the full year of 2021 as compared to the full year of 2020.

I will conclude my portion of the call today discussing our capital position. As of September 30th, 2021, the statutory surplus increased approximately 2% year-to-date. During the third quarter, we declared and paid a $0.15 per share cash dividend to shareholders of record as of September 3rd, marking our 214th consecutive quarter of consistently paying dividends dating back to March of 1968.

Lastly, during the quarter we repurchased about $1 million or just over 36,000 shares of our common stock. 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 star then one on your touchtone phone. If you are 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 will pause momentarily to assemble our roster.

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

Marla Backer
Thank you. So, you've done a very strong job at reducing exposure in commercial auto. How much more pruning do you think you want to do in that category?

Randy Ramlo
Marla, this is Randy. I would say we're substantially through it. There's more to go. I think we've highlighted kind of what percentage our book of business is in auto, and ultimately we'd like to get that down to about 20% or so. So, we do have a little ways to go, but I think we're substantially through it right now.

Marla Backer
Okay. And then on the flipside, some of the categories where you're emphasizing greater growth, again, we've seen some nice growth in many of those categories. I'm specifically curious right now about inland marine and how that category is doing right now. Is there any impact also from some of the global logistics issues that are impacting a lot of other sectors?

Randy Ramlo
I'm not sure what you mean by global logistics, but that line is doing well. We have a couple of underwriters that really specialize in that business. We do a lot of insuring buildings in course of construction, builder's risk, in that area. But I don't think we have seen any material impact on that line from kind of the global shortages that we're seeing.

Marla Backer
Okay. And then finally, last question is back we were more at the height, I guess, of the pandemic, there was a lot of talk around the potential risk of business interruption claims. And I think that you've said in the past that that's not a risk that you foresee regarding your book of business, but has there been any updates within the industry overall regarding business interruption as a potential risk factor?

Randy Ramlo
So, we didn't mention it in our conference call, which I guess is a good thing. There has been a couple of court cases in the last quarter and they've been positive ones. We've kind of continued to say it's not zero exposure, but it's a very manageable exposure. As a reminder, we have the requirement of direct physical loss, plus we have the virus exclusion on almost every policy that we write.

So, we continue to watch the court cases as they develop, but everything we've seen in the last quarter has been, for the most part, positive. And what we have seen in claims, if we had to pay all of them, would be very manageable. But so far, it looks like the courts are upholding that it is not going to be a covered cause of loss.

Operator
Again, if you'd like to ask the question, it is star then one; star then one to ask a question.

There being no further questions, this will conclude our question and answer session. I would like to turn the conference back over to Randy Patten for any closing remarks.

CONCLUSION

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

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