United Fire Group Insurance

2022 First Quarter Conference Call

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CORPORATE PARTICIPANTS

Randy Patten - *Assistant Vice President and Corporate Controller*

Randy Ramlo – *Chief Executive Officer*

Mike Wilkins – *Chief Operating Officer*

Micah Woolstenhulme – *Chief Risk Officer*

PRESENTATION

Operator
Good day and welcome to United Fire Group Insurance 2022 first quarter conference call. All participants will be in listen only mode. Should you need assistance, please signal conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded. I would now like to turn the conference over to Randy Patten, Assistant Vice President, and Corporate Controller. Please go ahead.

Randy Patten
Good morning, everyone, and thank you for joining this call. This morning, we issued a news release on results. To find a copy of this document, please visit our website 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 Chief Operating Officer, Mike Wilkins. We also have other members of management available to answer questions at the end of our prepared remarks.

Before I turn the call over to Randy Ramlo, a couple of reminders. First, please note that our presentation today may include forward looking statements as defined in the Private Securities Litigation Reform Act of 1995. The company cautions investors that any forward-looking statements include risk 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 variety of factors, which are described in our press release in SEC filings. Also, please note that in our discussion today, we may use some non-GAAP financial measures. Reconciliations of these measures to the most comparable GAAP measures are also available in our press release and SEC filings.

At this time, I will now turn the call over to Mr. Randy Ramlo, CEO of UFG Insurance.

Randy Ramlo
Thanks, Randy. Good morning, everyone, and welcome to our first quarter 2022 conference call. Today I am pleased to report strong results for the first quarter of 2022, which I am confident in saying is a direct result of our one UFG strategic plan and initiatives aimed at improved profitability. For the second consecutive quarter, we have reported a combined ratio under 90%. This marks the first time in seven years that we've delivered back-to-back quarters with combined ratios below 90% dating back to the fourth quarter of 2014 and the first quarter of 2015. In addition, for the fourth consecutive quarter, we saw improvements in both our core loss ratio and commercial auto loss ratio when compared to the same quarter in the prior year. We are pleased with this significant improvement in our profitability and a promising start to 2022.

In the first quarter of 2022, our core loss ratio, which removes the impact of catastrophe losses and prior year reserve developments, improved 17.4 percentage points. This improvement is being driven by continuing decreases in frequency and severity of claims. For a summary of our core loss ratio calculation, refer to the slide 11 in the presentation on our website.

The improvement in the core loss ratio contributed to the reported combined ratio of 89.5% in the first quarter of 2022, which is a significant improvement over the 107.2% combined ratio reported in the same period in 2021. Contributing to the improvement in our combined ratio is the decrease in catastrophe losses. Our strategic decision to exit from personal lines has paid off in less catastrophe exposure and thus less volatility in the first quarter of 2022.

Pretax catastrophe losses added 2.6 percentage points to the combined ratio in the first quarter of 2022, which is lower than our first quarter historical average of 3.3 percentage points and 8.7 points lower than the 11.3 percentage points added to the combined ratio in the first quarter of 2021. As a reminder, the first quarter of 2021 included losses from winter storm Yuri, which was a full retention loss, with losses in excess of our reinsurance retention of $20 million.

The line of business with the most significant loss ratio improvement was commercial auto, which improved 41.2 percentage points in the first quarter of 2022 as compared to the same period of 2021. The improvement in profitability in our commercial auto line of business was from decreased severity of losses and increased favorable prior year reserve development. The combined ratio also benefited from favorable prior year reserve development at 2.9 points during the first quarter of 2022 compared to favorable reserve development of 5.1 points in the first quarter of 2021. Most of the favorable reserve development in the current quarter was in our commercial auto line of business. As a company, we have reported favorable reserve development every year since 2009, a trend that continued in the first quarter of 2022.

Before I turn the call over to Mike, I would like to take this opportunity to introduce our newest member of our UFG leadership team. Eric Martin is our new Chief Financial Officer, and we are pleased to have him here with us this morning. Eric began with UFG just a couple of weeks ago on April 18th and is quickly getting up to speed in his new role. We are excited to have Eric on board, contributing to the momentum we've experienced in improving our profitability over the last year. Also, as many of you know, after nearly 40 years at UFG, I am planning to retire at the end of October this year. Today, I am confident that the timing is right and UFG is on a solid path forward, evidenced by the recent trend of strong quarterly results. It is an honor to serve as CEO for these past 15 years, and I am proud of the growth and success we have had during my tenure. Our board of directors is actively conducting a search and have some great internal and external candidates. Time will tell who will be named the sixth leader in UFG's history, but I can assure you that our board will choose the very best person for the job, and I am confident UFG is in for an upgrade.

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

Mike Wilkins
Thanks, Randy, and good morning, everyone. As Randy mentioned, UFG delivered another quarter of strong financial performance and improving profitability. We are pleased with the progress we've made over the last year and especially with our trend of consistently improving the quarter loss ratio. The primary contributor to this success has been the decrease in frequency and severity of commercial auto losses over the last two years. As part of our portfolio management strategy, we have focused on decreasing the size of our commercial auto portfolio through targeted reductions in the number of exposure units and implementing targeted rate increases. These efforts have improved the quality and profitability of our commercial auto book of business. As we get closer to our optimal portfolio mix, our expectation is that we will not see as significant a decrease in auto exposure units.

At the first quarter of 2022, commercial auto accounted for 22.6% of our portfolio composition compared to 26.3% at the end of the first quarter of 2021. Commercial auto and new business premium written in the first quarter of 2022 has decreased to 19% as compared to 27% in 2020. Also, we are achieving growth in our historically profitable lines of business, with new business premium for general liability increasing from 22% to 23% and inland marine growing from 10% to 15% between 2020 and 2022. We are also achieving growth objectives in our surety, E&S, and assumed reinsurance lines of business. These lines contributed to the improvement in our core loss ration an underlying profitability in the first quarter of 2022. The most significant growth occurred in our assumed reinsurance line, which represented 12.2% of our portfolio in the first quarter of 2022 as compared to 6.2% in the first quarter of 2021.

Slides eight and nine provide a three-year view of our claim counts by major commercial casualty lines of business. For example, our commercial auto bottling injury and property damage claim counts are down 21% in the first quarter of 2022 as compared to the same quarter and 2021. We've also provided commercial general liability, BOP liability, and workers compensation claims counts on these slides, as all are down in the first quarter of 2022, which is a positive sign of our strategic efforts.

Before I trying turn call over to Randy Patten, I'd like to comment on pricing and inflation. From a pricing standpoint, the overall average change in renewal premium was 7.6%, with 2.4% from disclosure changes and 5.2% from rate increases. Excluding the workers compensation line of business, the overall change in renewal premiums was 9%, with 2.4% from exposure changes and 6.6% from rate increases. The increase in rates was driven by our commercial auto and commercial property lines of business. The commercial auto average renewal rate increase from 7.4%, and the commercial property average renewal rate increase was 10.1%.

We feel the rate increases we are achieving are currently exceeding the overall lost costs inflation, impacting our book. This was particularly true in lines like commercial property and commercial auto where we are seeing the strongest pricing opportunities. Falling claims frequency across all of our major lines of business also contribute to our belief that we are continuing to achieve margin expansion for our overall portfolio business. However, in this dynamic economic environment, we will continue to monitor conditions and make appropriate adjustments to our pricing portfolio and underwriting strategies.

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

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

In the first quarter, we reported consolidated net income of $28.3 million compared to net income of $18.7 million in the same period of 2021. Adjusted operating income, which removed net investment gains and losses, was $28.7 million in the first quarter of 2022 compared to an adjusting operating loss in the first quarter of 2021 of $659,000. The increase in net income and adjusted operating income in the first quarter of 2022 was primarily due to a decrease in catastrophe losses and a decrease in frequency and severity of claims.

During the first quarter of 2022, we reported net investment losses of $465,000 as compared to net investment gains of $24.5 million in the first quarter of 2021. 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 the sale of equity holdings in the first quarter of prior year.

Net investment income was $11.3 million in the first quarter of 2022 as compared to $17.1 million in the same period of 2021. The change between the two periods is primarily due to the change recognized in the fair value of our limited liability partnerships.
Net premiums are decreased 9.6% in the first quarter of 2022 as compared to the first quarter of 2021. The decrease in net premiums was result of our portfolio management strategy to diversify our portfolio by rebalancing our mix in business. This strategy includes reducing our commercial auto book of business, which accounted for 4.9% of the decrease and exiting personal lines, which made up 3.7% of the decrease. These are partially offset by growth and are more profitable lines of business. with the largest increase coming from our assumed reinsurance line of business.

Moving on to expenses, the underwriting expense ratio for the first quarter of 2022 was 33.8% compared to 27.6% for the first quarter of 2021. The change in expense ratio between the two periods is primarily due to the one-time benefit recognized from the change in the design of our employee post-retirement health benefits in first quarter of 2021.

I will conclude my portion of call today discussing our capital position. In first quarter of 2022, statutory surplus increased approximately 2%, primarily due to net income reported in the first quarter. Also, we reported annualized ROE in the first quarter of 2022 at 13.2%, a 4.1% increase over the 9.1% reported in the first quarter of 2021. During the first quarter, we declared and paid a $0.15 per share cash dividend to shareholders of record as of March 4, marking our 216th consecutive quarter of consistently paying dividends dating back to March of 1968. Lastly, during the quarter, we did not repurchase any shares. The amount and 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 concludes our prepared remarks. I will now open the line for questions. Operator.

QUESTION AND ANSWER

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 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'll pause momentarily to assemble our roster. Our first question comes from Marla Backer from Sidoti. Please go ahead.

Marla Backer
So, just wanted to confirm something you just said in your prepared remarks. There are—you were considering further decreases in the commercial auto category, but they won't—any decreases won't be at the same level given that you've really adjusted down the category over the past several quarters. Is that a fair take away from your remark?

Randy Ramlo
Yeah. Hi, Marla. This is Randy. That is a very fair remark. We probably have got that line of business fairly close to where we want it permanently. I think a long term, we'd like to have that to be around 20% of our book of business, and it's very close to that. So, we'll do some tweaking going forward, but it won't be anywhere near the unit reduction that we've done over the last couple of years.

Marla Backer
And you had some really impressive improvement in that category in the quarter. In terms of the reduction in the frequency and severity, would you ascribe most of that to your internal initiatives? But can you parse out to what extent, if any, some of the changes that we've seen in driver behavior during the pandemic and maybe coming out of the pandemic might have contributed to that?

Randy Ramlo
This is Randy again. And of course, we're going to take all the credit for that change in our actions. So, we track the—our frequencies were going down even before the pandemic. So, we're heavy construction book. Construction was very open through most of the pandemic. So, I'm not going to say there wasn't any effect because of the pandemic and a little less driving, but for the most part, the construction industry was (inaudible) all through the pandemic. And I don't think our frequency going down is very much affected by Covid. So, that's my 10 cents worth.

Marla Backer
Okay. And then, lastly, can you give us any additional color on some of those insurance lines that you've targeted for growth, the more profitable lines of business that you've targeted for growth? Can you give us any more color on where you're seeing traction where you might anticipate some headwinds, given changes in the economy right now?

Mike Wilkins
Marla, this is Mike. I'll maybe take a shot at that one. We've had good success across all of our targeted lines for growth, including surety, E&S, and assumed reinsurance. Maybe if I'd had to say an area where there's some headwinds, I'd say the E&S segment has gotten a little bit more competitive in the last quarter or two. Still, we feel like there's a lot of margin in that business, and we're going to continue to try to grow that, but it's maybe not as much margin there as there was say a year ago. I think that a lot of competitors have moved into that space. Continues to be a lot of opportunities in the assumed reinsurance side of things, and our surety operation is at really good success, continuing to grow that segment.

Marla Backer
Thank you for that.

Operator
Again, if you have a question, please press star then one. Our next question comes from Paul Newsome from Piper Sandler. Please go ahead.

Paul Newsome
Good morning. Congrats on the quarter. Was so hoping you could just give us some further thought about what you think of lost trend prospectively for your major lines of business and whether or not that lost trend is accelerating and would require even more price increases, or if you think that there's some moderation there?

Randy Ramlo
Hi, Paul, and thanks for that. You're probably asking us to look at our crystal ball a little bit. I think you're kind of maybe talk a little bit about where inflation is going. And as we've kind of said, we feel that we're getting adequate rates right now to cover inflation. We probably would prefer to get more rate, but right now, rate increases have moderated a little bit but are still adequate in our opinion. And just like a lot of companies, we track the cost of carpet, drywall, doors, paint, shingles, medical expenses, everything. And so, as long as we're able to kind of get additional rates like we are right now, we think, overall, we can cover the additional lost costs. We're more—probably pretty confident on property, confident on auto. Work comp, we're probably not getting enough to cover medical costs increases. So, it kind of varies by line a little bit, but our overall rate increase percentage of the entire book as of today is adequate, I think, to cover the increased costs. But who knows how long these increased costs are going to continue? The experts keep saying it's somewhat temporary, but it's probably not going to turn around tomorrow. I don't know. Mike or Cory, you got any other comments on that?

Mike Wilkins
Maybe. This is my Mike. Hi, Paul. Maybe one comment I would make, I think our portfolio management strategies are also aimed at trying to move away from some lines that we had more concerns about or if not lines segments of business. So, for example, construction defect I think is the area where we have some concerns with the long tail there and an inflationary environment, and I can say our underwriting has done a nice job of moving away from the types of businesses are exposed to construction defect type claims. So, we're trying to be very deliberate in the types of business that we're writing and trying to make sure that we minimize that exposure to UFG as much as we possibly can.

Paul Newsome
And then second question. I was hoping you could talk a little bit more about your assumed reinsurance business and—both the strategy, as well as if that—if there's some limits as to how much you would like to have that business grow relative to the rest of your business.

Randy Ramlo
Paul, I'll start the answer here, and then I'm going to turn over to Micah Woolstenhulme who has really been instrumental in the execution of that assumed reinsurance strategy. We probably have some appetite for that business that would have limits, but it's not probably anything that we're going to disclose in this call at this time. But that segment right now has a lot of opportunities. Again, our strategy there is very deliberate. We're really looking to not only drive that core loss ratio down and improve profit but also to reduce the volatility in results in our overall book, and I'm going to turn it over to Micah whose really been the architect of that strategy.

Micah Woolstenhulme
This is Micah Woolstenhulme. The core objective in growing our assumed insurance operations is to diversify the overall UFG underwriting risk profile. So, when we underwrite new reinsurance treaties, it's the first thing we look at. We look at a marginal impact analysis of our overall corporate portfolio before and after that reinsurance treaty. And, of course, we require a certain level of margin in this business, and we look at relationships and so forth. But the number one objective we're solving for is to round off some of the sharp corners in our risk profile. The strategy that we're pursuing as part of the business plan, a multi-year business plan that we sort of laid the groundwork for in mid-2020, and we just concluded our second renewal season as of 1/1/2022.

There are number of lines—for example, there are a number lines of business that we wouldn't have access to in our direct agency distribution platform. That medical professional liability is one example where, based on our economic capital model, we believe there's some value, some diversification value in that line of business. We don't underwrite it on our own. We're not going to do a lot of it overall, but we know sort of about how much has that kind of diversifying effect and value in our portfolio. So, we have a target for how much of that business we want to do, and, to that end, we have developed the relationships with the brokers that transact that business in the reinsurance space. And we're halfway there in terms of meeting the target for how much that NPL business we want to do.

So, assumed reinsurance is just another channel for accessing P&C insurance risks that diversify our overall risk profile, and we’re kind of two years in to a three-year plan to grow it to a certain level. And once we get to that set of goals, we’ll reevaluate where we are. The last thing I'll note here is that the value and another sort of appealing aspect of the assumed reinsurance as a business, as a model is that, if—market conditions are good right now, but if they turn against us, we can scale back pretty quickly and pretty easily. And in contrast, when market conditions turn from bad to good, we can scale up quickly without having to add a lot of staff at the same time. So, that's part of our strategy there and a little color on our strategy there.

Paul Newsome
Thank you. Much appreciated.

Randy Ramlo
Thanks, Paul.

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 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.