



# **Transcript of EMC Insurance Group (EMCI) First Quarter 2008 Earnings Conference Call April 24, 2008**

**Vcall**  
601 Moorefield Park Dr.  
Richmond, VA 23236

Phone: 888-301-5399  
Fax: 804-327-7554

info@vcall.com  
www.vcall.com  
www.investorcalendar.c

## **Participants**

### **Executives**

Bruce G. Kelley - President and CEO  
Mark Reese – Senior Vice President & Chief Financial Officer  
Steven Peck - Senior Vice President Actuary  
Rich Schultz - Senior Vice President Claims  
Raymond Davis - Senior Vice President Investments & Treasurer  
Anita Novak - Director of Investor Relations

### **Analysts**

Robert Farnam - Keefe Bruyette & Woods  
David Dusenbury – Dalton, Greiner, Hartman, Maher & Co., LLC

## **Presentation**

### **Operator**

Greetings and welcome to the EMC Insurance Group First Quarter 2008 Earnings conference call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press “\*0” on your telephone keypad. As a reminder, this conference is being recorded.

### **Anita Novak, Asst. Secy. – EMC Insurance Group Inc. - Director of Investor Relations**

Thank you. Good morning, everyone and welcome to EMC Insurance Group’s 2008 first quarter earnings call. A supplemental investor packet is available on the investor relations page of our website, which can be found at [www.emcinsurance.com](http://www.emcinsurance.com). The webcast for replay purposes is also available at this site until July 29, 2008. The transcript of the webcast will be available for one year.

This presentation includes some forward-looking statements about our expectations for our future performance. Actual results could differ materially from those suggested by our comments today. Additional information about factors that could affect future results is addressed in our SEC filings, including forms S-1, 10k, 10q, and 8k. Any information provided today should be read in conjunction with the 2008 first quarter earnings release with accompanying financial tables issued earlier today.

With us today are several members of EMC Insurance Group’s executive management team. They are Mr. Bruce Kelley, President and Chief Financial Officer; Mr. Steven Peck, Senior Vice president, Actuary; Mr. Rich Schulz, Senior Vice President, Claims; Mr. Ray Davis, Senior Vice President, Investments and Treasurer;



and Mr. Mark Reese, Senior Vice President and Chief Financial Officer. At this time it is my pleasure to introduce EMC's Chief Executive Officer, Bruce Kelley.

**Bruce Kelley – EMC Insurance Group Inc. - President and CEO**

Thank you, Anita.

I would like to talk just a little bit about market conditions this morning and what our expectations are for 2008. The rate environment continues to be competitive and we would not expect otherwise given the amount of capital within the industry. However, we believe there is some stability in the rate environment as well. For the most part, we are not seeing a free-fall in pricing, which was prevalent during the last soft market. And, we are requesting and getting slight increases in rates in some states and in some lines of business, though this is not the norm by any means. Overall, we still consider most rates in most lines of business to be adequate. Our expectation is that this competitive environment will continue at least through 2008 due to the high level of capital within the industry and current economic conditions.

Slightly more than 37 percent of our commercial business includes our EMC Choice, Target Market and Safety groups. This program business helps considerably in stabilizing our book of business, especially during soft markets. Our retention levels remain in the 87 percent range, which exceeds industry standards and leads us to believe our rates are competitive.

We have other tools in our arsenal, which we did not have during the last soft cycle and we believe they allow us to effectively compete within the marketplace. We continue to acquire or create sophisticated systems to monitor our underwriting and pricing practices that allow us to analyze data at a summary level or to such a detailed level as to be able to view performance of individual underwriters or individual accounts. We believe these tools will provide ongoing stability in results by creating a more knowledgeable employee base and consistent risk selection and pricing.

We do not expect significant growth in premiums in 2008. Our underlying book of business is performing very well and we are committed to maintaining the integrity of that book of business. Naturally, we would very much like to grow, but again, the underlying stability of a profitable book of business is paramount. For that reason, we will continue to focus on rate adequacy rather than market share. We do expect some organic growth as a result of strategic planning with our existing 3,200 agents and through new business as we engage new agency partners.

M&A activity is not on our radar screen at the moment, but we are always looking at possibilities and given the current economic environment, we suspect there may be some opportunities in the future that may or may not fit into our current structure. We are always willing, however, to explore our options to increase our market presence through acquisition.

As for first quarter results, storms were a significant factor in our earnings performance. In fact, storm losses were more than double the amount experienced in any first quarter since we began reporting catastrophe and storm losses on a quarterly basis in 1996. We experienced only one major loss, but numerous claims associated with the storms in the southeastern United States during February. We estimate that these unusual winter tornadoes added 4 points to our first quarter loss ratio. These storms were not confined to one branch territory, but rather, affected several of our branches throughout the southeastern section of the US.

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Net investment income was relatively flat during the first quarter, which was somewhat unusual for us. This was caused by a significant amount of call activity on our U.S. Government Agency securities. Due to the low interest rate environment, we invested the proceeds from these called securities in short-term investments until more suitable long-term investments could be identified. The immediate affect was a small decline in our investment income for the quarter, but once all the proceeds are reinvested we should once again see growth in our investment income.

With that, I will ask for comments from Mark Reese, Senior Vice President and CFO. We would be happy to answer any questions after his presentation.

**Mark Reese – EMC Insurance Group Inc. - Senior Vice President and Chief Financial Officer**

Thank you, Bruce.

Operating income for the first quarter was 10.1 million dollars, which is down from 13.9 million dollars reported in the first quarter of 2007. Net income for the first quarter was 8.2 million dollars compared to 14.7 million dollars for the same period in 2007.

The declines in operating income and net income reflect an increase in catastrophe and storm losses, a decrease in the amount of favorable development experienced on prior years' reserves, and a moderate, but steady, decline in overall premium rate levels. In addition, net income was negatively impacted by \$2.9 million of "other-than-temporary" investment impairment losses that were recognized on 13 securities in the Company's equity portfolio. These impairment losses were recognized because the Company's equity manager indicated that these securities, which were in an unrealized loss position, would likely be sold before they recovered to their cost basis. As a result, the intent to hold these securities to recovery did not exist.

Net written premiums increased 1.3 percent to 91.1 million dollars in the first quarter.. This increase is attributed to a 12.9 percent increase in the reinsurance segment, as the property and casualty insurance segment experienced a 1.0 percent decline in commercial lines and a 1.5 percent decline in personal lines.

New business premium was down 12.0 percent in commercial lines and up 13.2 in personal lines, with much of that coming in selected territories with greater profit potential.

As Bruce mentioned, catastrophe and storm losses were unusually high in the first quarter, totaling \$0.27 per share compared to \$0.12 per share in 2007. The notable storm losses consisted of approximately 150 claims. Of those claims, only one is considered to be a large claim. Though these claims represent storms that occurred throughout the quarter, the majority of them occurred in the southeast portion of the United States during February.

Investment income was relatively flat at \$11.9 million for the quarter as compared to one year ago. The Company experienced a high level of call activity on its Government Agency securities during the first quarter as a result of the declining interest rate environment. The proceeds from these called securities were invested in short-term securities until attractive long-term opportunities could be identified. As of March 31, 2008, approximately 55% of the \$211 million in proceeds received from the called securities had been reinvested in long-term securities, including \$40 million in municipal bonds yielding 5.0% to 5.4%, \$18 million in 10-year corporate bonds

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yielding 6.0% to 7.25%, and \$7.5 million in commercial mortgage-backed securities yielding 6.7%.

The total rate of return on our equity portfolio for the first quarter of 2008 was negative 10.25 percent, which compares to negative 9.44 percent for the S&P 500. The current annualized yield on our bond portfolio is 4.884 percent and the effective duration is 4.76 years, which is up from 3.75 years at year-end 2007.

Based on first quarter results and our expectations for the remainder of 2008, management is reaffirming the 2008 operating income guidance of \$2.10 per share to \$2.35 per share.

On March 10, 2008, the Company's Board of Directors authorized a \$15 million stock repurchase program. This program became effective immediately and does not have an expiration date. The timing and terms of the purchases will be determined by management based on market conditions and will be conducted in accordance with the applicable rules of the SEC. Common stock purchased under this program will be retired by the Company. As of April 18, 2008, 121,899 shares of common stock had been repurchased at a cost of approximately \$3.4 million. Employers Mutual has about \$4.5 million remaining in its \$15 million stock purchase program. This program will remain dormant while the Company's repurchase program is active.

At this time, I would like to open the phones for questions.

**Operator**

[OPERATOR INSTRUCTIONS] Ladies and gentlemen at this time we will be conducting a question-and-answer session. If you would like to ask a question, you may do so by pressing “\*1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press “\*2” if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the “\*” key.

Our first question today comes from the line of Bob Farnam with Keefe Bruyette & Woods. Please proceed with your question.

**Bob Farnam – Keefe Bruyette & Woods**

Howdy, Good morning. I have a few questions. One is on the growth and the reinsurance segments. You said there were several new contracts. Can you give just more details to what was in those and maybe if we should be expecting a continued growth in that segment?

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

The reinsurance segment has two segments off it, the Mutual Reinsurance Bureau and the Home Offices Assumed Reinsurance Department. The Mutual Reinsurance Bureau's business was relatively flat. However, we were able to pick up some new accounts in our Home Office's Assumed Reinsurance Department, and those accounts we have been working on for many years to secure and we are pleased that they came our way. I wouldn't say that they are harbinger of future accounts but we are hopeful that we will get future accounts from both, the Mutual Reinsurance Bureau and the Home Office Assumed Reinsurance Department.

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**Bob Farnam – Keefe Bruyette & Woods**

Okay. Second question is going into the combined ratio picking out the developmental quarter, taking out the catastrophe losses, looks like it was about a \$107.6 normalized. I know in past we have said that that includes some degree of conservatism and you expect those to develop downwards just going forward. Can you give us an idea of what we should be expecting for the ultimate after the year 08, numbers from here?

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

Well, let us turn it over to Steve Peck, as he can give you his analysis of the ultimate number.

**Steven Peck – EMC Insurance Group Inc. – Senior Vice President Actuary**

I can give you a projection Bob for consolidated basis of...the projection at you are end was in the neighborhood of 101.5 for action year 2008. That would probably differ some for the group and the 101.5 has not been updated since we put together back early in the first quarter.

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

But that is the number that we are using when we are estimating our earnings. So, that is how we get to our earnings range that we project to you.

**Bob Farnam – Keefe Bruyette & Woods**

Okay. So the 101.5 includes some measure of catastrophe losses. Is that correct?

**Steven Peck – EMC Insurance Group Inc. – Senior Vice President Actuary**

That needs to be recognized, Bob. I am sure I think we pointed that out on previous calls as that because of our intent to reserve relatively conservatively, we would expect that the latest facts of the year would tend to develop downward. For example, if you look back at 2007 actual year, by my calculations, and this would be on a statutory basis, we are very close 112% of actual year 2007, at the end of March. By the end of the year, that had come down to the neighborhood of 107.5. By the end of March this year, that is down to about 106 and I would project...I don't have much...giving the figure here, but I imagine that 106, I strongly suspect that 106 will continue to fall from there. If you look back at 2006, and I don't have real figures here but on a consolidated basis, as the combined ratio drops about 8 points after the end of 2006. If you look back at 2005, I don't have the numbers, but you will see a similar pattern. We do have a recent track record of declines in the combined from compared to the earlier evaluations.

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

And I'll just point out Bob, to remind you that the majority of these changes in reserves are as the result of closing the claims and taking down our reserves. So, ever since 2004, when we got our reserves up to a higher level of adequacy, they have been performing as Steve has just presented.

**Bob Farnam – Keefe Bruyette & Woods**



Okay, any...is there, can you give us an idea of the degree of conservatism going into those picks, come down over time or you expect that 08 is pretty much on a similar basis, what we have seen happening for 07 and 06?

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

But there is one point. We are not making loss. We are just telling you what are the aggregates of our claims examiners analysis of claims are, Steve?

**Steven Peck – EMC Insurance Group Inc. – Senior Vice President Actuary**

Yeah, Bob, the...I can tell you as of the yearend on a consolidated basis in the full range of estimates, the credit reserve fell about 5 points to somewhere in the neighborhood of the 85<sup>th</sup> percentile of our full range. We don't really make a point estimate, but if you were to pick a midpoint, the midpoint of our selected range, the credit reserve did fall a bit at the end of 2007 compared to 2006. It fell about a point from roughly 5% down to 4%.

**Bob Farnam – Keefe Bruyette & Woods**

Okay.

**Steven Peck – EMC Insurance Group Inc. – Senior Vice President Actuary**

But yeah, I am sorry, go ahead.

**Bob Farnam – Keefe Bruyette & Woods**

In terms of...it sounds like this is going to another topic. The rate declines sounds like it will be 5.5% for the year, is what you are looking for? Can you give us an idea of what you are seeing in terms of frequency and severity trends? In other words, what type of...putting them all together, what type of deterioration you might be seeing?

**Steven Peck – EMC Insurance Group Inc. – Senior Vice President Actuary**

That is a little bit difficult to say, but on the frequency side on an all lines basis, we were pretty flat compared to the first quarter of 2007, up about 8/10<sup>th</sup> of a percent, but the upper Mid West, as you know, had a fairly tough winter. We saw a lot of freezing claims, lot more freezing claims in 2008 first quarter we did in 2007. Some were collision claims. So, I am not sure if what the 8/10<sup>th</sup> of a percent means right now. On a perspective basis, I don't think it is necessarily a good projector that frequency is going to increase this year. On severity, on a reported basis, the average size of new reported...newly reported claims during the first quarter 2008, compared to first quarter of 2007, severity was actually down about a point and that is excluding storms, and I should also mention the frequency was excluding storms.

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

We also have Rich Schultz here, the Senior Vice President for Claims. Rich, do you have any commentary on frequency or severity?

**Rich Schultz – EMC Insurance Group Inc. – Senior Vice President Claims**

I would just say that 2007, we saw an increase in Work Comp claims, slip and falls and it was weather related and in fact in the earnings call of that quarter, we were asked why the increase in frequency and I think some of the increase...we have got a

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very similar first quarter this year. We saw a lot of increase in some of our Work Comp claims and slip and falls.

**Bob Farnam – Keefe Bruyette & Woods**

Okay. That is ...I will re-queue if I have any other questions. Thank you for that.

**Operator**

[OPERATOR INSTRUCTIONS] Ladies and gentlemen, as a reminder, if you would like to ask a question, you may do so by pressing “\*1” on your telephone keypad. One moment please, while we poll for further questions.

Our next question comes from the line of David Dusenbury with Dalton, Greiner, & Hartman. Please proceed with your question.

**David Dusenbury – Dalton, Greiner, Hartman, Maher & Co., LLC**

Hi, just a question on the reserve development. You were clear to say in the press release and on the call that these are really closed claims. Was there a higher experience of settlements this quarter versus others?

**Rich Schultz – EMC Insurance Group Inc. – Senior Vice President Claims**

No, the closure rate was almost identical to 2007.

**David Dusenbury – Dalton, Greiner, Hartman, Maher & Co., LLC**

Okay. Thank you.

**Operator**

[OPERATOR INSTRUCTIONS] Once again, ladies and gentlemen, if you would like to ask a question, you may do so by pressing “\*1”. One moment please, while we poll for any further questions.

Our next question comes from the line of Bob Farnam with Keefe Bruyette and Woods. Please proceed with your question.

**Bob Farnam – Keefe Bruyette & Woods**

Hi, I had one more question. In terms of exposure in the Mid West and the Tornado in (inaudible) has there been an uptake in terms of losses related to non-Kat weather claims? In general, not specifically for the quarter, but do you see that happening?

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

I would comment and then I am sure Rich Schultz may have a comment also. Certainly, as I mentioned, we saw an uptake in the homeowner’s line, freezing claims, over freezing claims, a lot of them that were not coded as storm claims and then of course, the collision claims also. We are not coding storms as storms on the uptake there. Rich alluded to the first quarter of 2007 and if you want to expand on that, go ahead...

**Rich Schultz – EMC Insurance Group Inc. – Senior Vice President Claims**

Yeah, once again in 2007, we saw an uptake in frequency on the Work Comp claims and when we went back and analyzed it, we were able to see that it was basically slip

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and falls, weather related in Kansas and Iowa, and we are seeing much the same trend. We took a look at some of what we were seeing this year in the first quarter. Once again, we had an increase in actual claim count of about 3% in Work Comp and a good portion of that was once again weather related slip and falls in the Mid West. So, we are not seeing a major trend. We are seeing weather related, we had a bad winter in 2007, and a couple of our states where we write a lot of business and this year once again, we had a heavy winter with a lot of ice and snow.

**Bob Farnam – Keefe Bruyette & Woods**

Okay and is it safe to assume or not that your exposure in these areas has increased year over year?

**Rich Schultz – EMC Insurance Group Inc. – Senior Vice President Claims**

In terms of our policy count, our policy count is, but I don't... from a claims perspective, I am not seeing any substantial difference in the exposure with the types of business we are seeing, the slip and falls occur and is in this type of business, in some of our elementary and secondary schools and we haven't been seeing big gains in our policy count in those areas.

**Bob Farnam – Keefe Bruyette & Woods**

Okay. All right. That is it, thanks.

**Bruce Kelly – EMC Insurance Group Inc. – President & Chief Executive Officer**

Thank you, Bob.

**Operator**

[OPERATOR INSTRUCTIONS] Once again, ladies and gentlemen, to ask a question, you may press “\*1” on your phone keypad. One moment please, while we poll for any further questions. Thank you, but there are no further questions at this time. I would like to turn the call back to management.

**Anita Novak – EMC Insurance Group Inc. – Director Investor Relations**

Thank you ladies and gentlemen. This now concludes this conference call. I would like to remind you that a playback of this call will be available on the company's website at [www.emcinsurance.com](http://www.emcinsurance.com) until May 13<sup>th</sup> and a transcript of this conference call will be available until April 2009, which can be accessed from our website as well later today. We appreciate your interest in EMC Insurance Group and all of us wish you an enjoyable day.

**Operator**

Ladies and gentlemen, this concludes today's teleconference and you may disconnect your lines at this time. Thank you for your participation.

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