



**Transcript of  
EMC Insurance Group Inc. (EMCI)  
Third Quarter 2008 Earnings Conference  
Call  
October 24, 2008**

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## **Participants**

Anita Novak, Director of Investor Relations  
Bruce Kelly, President and CEO  
Ron Jean, EVP for Corporate Development  
Steve Peck, SVP Actuary  
Rick Schulz, SVP Claims  
Ray Davis, SVP Investments and Treasurer  
Mark Reese, SVP and CFO  
William Murray, EVP and COO

## **Presentation**

### **Operator**

Greetings and welcome to the EMC Insurance Group Inc. third quarter 2008 earnings results conference call. [Operator Instructions]. It is now my pleasure to introduce your host Ms. Anita Novak. Thanks Ms. Novak you may begin.

### **Anita Novak, Asst. Secy. – Director of Investor Relations**

Thank you. Good morning, everyone and welcome to EMC Insurance Group's 2008 third 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 January 24, 2009. 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 third 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 Executive Officer; Mr. William A. Murray, Executive Vice President and Chief Operating Officer; Mr. Scott Jean, Asst. Vice President, Actuary; Mr. Rich Schulz, Senior Vice President, Claims; Mr. Ray Davis, Senior Vice President, Investments and Treasurer; and Mr.



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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, President and CEO**

Thank you, Anita.

Storms are again the dominant topic of discussion during third quarter 2008 as well as for the year. For the second quarter in a row, the Company is reporting a net operating loss. The third quarter loss was \$0.02 per share, which compares with net operating income of \$0.50 per share in 2007. Year-to-date, we are reporting net operating income of \$0.63 per share, which compares to \$2.52 per share last year at this time.

**Storm Losses**

On September 1, 2008, Hurricane Gustav made landfall along the Louisiana coast as a very strong Category 2 hurricane. Fortunately, Gustav lost momentum and strength as it traveled through Louisiana. Industry estimates of damages caused in the U.S. by Gustav were \$15 billion. The Company sustained losses of approximately \$3.1 million or \$0.15 per share after tax. More than 500 claims have been filed to date as a result of Hurricane Gustav. Of those claims, approximately 50 percent have been closed and all of them have been adjusted.

On September 13, 2008, Hurricane Ike made landfall at Galveston, Texas also as a Category 2 hurricane. At one time during its development, Hurricane Ike was the most massive Atlantic hurricane ever recorded with a diameter of more than 240 miles. 82 U.S. deaths have been attributed to Hurricane Ike and 202 persons are still missing. Many more coastal residents remain displaced as a result of this severe storm. Industry damages are estimated to be \$31.5 billion in the U.S. Hurricane Ike was the third costliest U.S. hurricane of all time. The Company sustained few losses in Texas as a result of Hurricane Ike.

However, as the massive hurricane advanced away from the coast, Hurricane Ike merged with a cold front traveling across the Midwest and generated significant amounts of wind damage as the system traveled north, eventually reaching Canada. Damages affecting the Company were especially significant in Ohio and Kentucky. Total losses incurred as a result of Hurricane Ike were \$5.4 million or \$0.27 per share after tax. More than 1500 claims have been filed to date as a result of Hurricane Ike. Of those claims, over 50 percent have been paid.

Similar to second quarter, the third quarter of 2008 gave rise to significant catastrophe and storms losses in all regions of the U.S. Given that we have branch offices throughout the U.S. we usually have one or two significant branches affected by storms; however, that certainly is not the case in 2008. Storms have occurred over a very wide geographic region and have affected several of our branch offices.

Total catastrophe and storm losses for the third quarter were a record \$19.8 million and added 20.6 percentage points to the loss ratio compared to \$7.2 million in 2007,

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which added 7.5 percentage points to the loss ratio. On a year-to-date basis, catastrophe and storm losses were a record 49.1 million and added 17 percentage points to the loss ratio. As mentioned in our earnings release earlier today, storm losses have averaged about 5.4 percentage points on an annual basis over the past ten years.

With that, I will call on Mark Reese, Senior Vice President and CFO to discuss the financials for the quarter. We would be happy to answer any questions after his presentation.

**Mark Reese, Senior Vice President and Chief Financial Officer**

Thank you, Bruce.

As Bruce indicated, record storm losses during the third quarter resulted in an operating loss of \$295 thousand dollars, compared to third quarter 2007 operating income of 6.9 million dollars. Net loss for the third quarter totaled 9.4 million dollars, compared to net income of 6.7 million dollars in 2007.

In addition to the record storm losses, the operating and net loss for the second quarter reflect an expected decline in the amount of favorable development experienced on prior years' reserves, and a moderate, but steady, decline in overall premium rate levels. In addition, the net loss reflects \$17.1 million dollars of "other-than-temporary" investment impairment losses recognized on 10 securities in the Company's investment portfolio. Most of these impairment losses were associated with the perpetual preferred stock of Freddie Mac and Fannie Mae, which we announced on September 25. Those losses amounted to 14.9 million dollars or \$0.72 per share after tax. The 2.2 million dollars of impairment losses on the remaining 8 equity securities were recognized because the Company's outside equity manager indicated that these securities, which were in an unrealized loss position, would likely be sold before they could recover to their cost basis. As a result, the intent to hold these securities to recovery did not exist.

Net written premiums decreased 1.1 percent to 301.2 million dollars in the first nine months of this year. This reflects declines of approximately 1.1% in the commercial lines of business and 1.4% in the personal lines of business in the property and casualty insurance segment and a 0.3% increase in the reinsurance segment.

As of September 30, 2008, new business premium was down 6.5 percent in commercial lines and up 12.1 percent in personal lines when compared to third quarter 2007, with much of the increase in the personal lines coming in select territories with greater profit potential. For personal lines, increased policy count was the driving factor in the increase in new business premium. For commercial lines, the decline is attributed to rate reductions.

Investment income was flat at \$12.3 million dollars for the third quarter and increased 0.8 percent to \$36.2 million dollars in the first nine months of 2008.

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The total rate of return on our equity portfolio for the first nine months of 2008 was negative 18.7 percent, which compares favorably to the negative 19.3 percent generated by the S&P 500. During the third quarter, our equity portfolio returned negative 12.2 percent, compared to negative 8.37 percent for the S&P 500. The current annualized yield on our bond portfolio is 5.6 percent and the effective duration is 5.99 years, which is up from 5.11 years at June 30, 2008.

The net book value of the Company's stock at September 30, 2008 was \$22.72 per share, a decrease of 13.1 percent from \$26.15 per share at December 31, 2007; consolidated assets totaled \$1.1 billion, including \$956.8 million in the investment portfolio; and stockholders' equity was \$303.4 million.

Based on actual results for the first nine months of 2008 and our expectations for the remainder of the year, management is reaffirming the 2008 annual operating income guidance of \$0.65 per share to \$0.95 per share that was announced on September 25, 2008.

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 are determined by management based on market conditions and are conducted in accordance with the applicable rules of the SEC. Common stock purchased under this program is being retired by the Company. As of September 30, 2008, approximately 475,000 shares of stock had been repurchased at a cost of \$12.3 million dollars. Additional repurchases have been made during October, bringing the total, as of October 20, 2008, to approximately 508,000 shares at a cost of \$13.1 million dollars. Employers Mutual has about \$4.5 million dollars remaining in its \$15 million dollar 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**

Thank you. [Operator Instructions]. Thank you. Our first question is coming from the line of Bob Farnam (ph) with KBW. Please proceed with your question sir.

**Bob Farnam (ph) with KBW**

Thank you. I have a few questions. The CAT losses in the quarter, it looked like more than half of the CAT losses came from events that were not hurricane Ike and Gustav. Can you just go through what else was going on in the quarter that was sizable?

**Unidentified Member of Management**

Thank you, Bob, for your question. We will turn to Rich Shultz who runs our Claim Department. He can give you a little granular detail on that.

**Rich Schulz - EMC Insurance - SVP Claims**

Bob, this is Rich. From my numbers, almost all of our quarterly CAT activity came from Gustav and Ike.

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**Bob Farnam (ph) with KBW**

And did I read it right that you had about 96 cents of CAT losses?

**Rich Schulz - EMC Insurance - SVP Claims**

That is correct.

**Bob Farnam (ph) with KBW**

For the quarter. And it looked like you had \$0.27 from Ike and \$0.15 from Gustav. Well, that is from the press release.

**Rich Schulz - EMC Insurance - SVP Claims**

Right. We also had some early July and August wind, hail, and -- wind, tornado, and hail damage as well. So it has been still a very active time in the Midwest.

**Bob Farnam (ph) with KBW**

Right. So even taking out the Hurricanes, it sounds like it was a pretty sizable CAT quarter.

**Rich Schulz - EMC Insurance - SVP Claims**

Yes, it was.

**Bob Farnam (ph) with KBW**

Okay the second question that I had -- there was -- you had modest adverse development in the property-casualty segment. Can you give us an idea where the reserves are in terms of the actuarial range? It sounds like maybe Stephen wasn't there, but that may be a question for Scott.

**Unidentified Member of Management**

We have Scott here from the actuarial department and he will be happy to answer that question.

**Scott Jean - EMC Insurance - Asst. VP Actuary**

Hi, this is Scott. Basically, I took a look at some of the numbers this morning and we have a procedure in place to help maintain adequate case reserves. Looking at what I saw, we have not seen a change in the adequacy of our overall case reserves. So from that perspective, we are looking good. And our actuarial estimates are in the upper end of the indication. So, we're looking pretty good from that perspective as well.

**Bob Farnam (ph) with KBW**

Okay, so the reserves are still held in kind of the upper quartile?

**Scott Jean - EMC Insurance - Asst. VP Actuary**

Yes.

**Bob Farnam (ph) with KBW**



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All right. So with the modest adverse developments in the quarter, was that on case or was that IBNR? What was driving that?

**Scott Jean - EMC Insurance - Asst. VP Actuary**

What adverse development?

**Bob Farnam (ph) with KBW**

It looks like you had modest adverse developments in the property and casualty segments.

**Scott Jean - EMC Insurance - Asst. VP Actuary**

For EMC or for the industry overall?

**Bob Farnam (ph) with KBW**

EMC.

**Scott Jean - EMC Insurance - Asst. VP Actuary**

Okay, for EMC.

**Bob Farnam (ph) with KBW**

If not, if you don't know offhand I can talk to you offline.

**Scott Jean - EMC Insurance - Asst. VP Actuary**

Probably would be best.

**Bob Farnam (ph) with KBW**

Okay, and the third question is, given the overall market environment out there with the AIG issue and the economy and the investment charges, do you see this as potentially hardening the market or do you think this soft market pricing will continue?

**Unidentified Member of Management**

Bob, let me just make a comment and then we will turn it over to Bill Murray, our Chief Operating Officer. The market will harden once the industry recognizes an overall decline in industry surplus. Maybe with all the turmoil that we're having, that is not apparent. But every indication is that the industry's surplus is being severely impacted by this turmoil and that may mean that there will be a turn in the market. But I think Bill can focus on a little bit more what we are seeing out there.

**William Murray - EMC Insurance - EVP and COO**

Good morning Bob, it is Bill Murray. I think it is probably easiest to go back and think about what the market was like maybe before the announcements concerning AIG. Throughout the year, we were seeing reductions earlier in the year and we were sort of seeing a leveling that was taking place in the first half. Then certainly, with the announcement of AIG, maybe there have been a few more opportunities for selective increases. Intuitively I guess, you would believe that there would be the potential for that going forward. I think it is probably a little early for us to be able to identify where some of those opportunities may be. But we are certainly -- that is one nice thing about our 16-branch office structure, we have people out there with people on the

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ground that can look at the rating situation in their own territories specific to the lines of business that they write. So I think the bottom line to that is, yes, we were seeing some leveling. We have seen some selective opportunities for increases and intuitively we believe that there is the potential for some increases going forward but we're monitoring that carefully.

**Bob Farnam (ph) with KBW**

Okay, and have you seen much in terms of AIG policyholders shopping around?

**William Murray - EMC Insurance - EVP and COO**

I would say on a direct basis that we did not consider them to be one of our -- one of the strong competitors for EMC.

**Bob Farnam (ph) with KBW**

Okay. Thank you.

**William Murray - EMC Insurance - EVP and COO**

So probably not so much.

**Bob Farnam (ph) with KBW**

Got it. Thank you.

**Operator**

Thank you. [Operator Instructions]. Gentlemen, our next question is coming from the line of John Zabold (ph) with Flint Bridge Capital. Please proceed with your question.

**John Zabold (ph) with Flint Bridge Capital**

Thank you. Good morning. Just wanted to go back to I think during your Investor Day you mentioned that you were looking at, I believe getting a little more involved on the mortgage side and changing some of the characteristics of your investment portfolio. Can you sort of tell us where we're at particularly given the turmoil, what specifically are you doing to either take advantage of the situation or to protect yourself given everything that is going on today?

**Unidentified Member of Management**

John, thank you for your question. I appreciate your continued interest in EMC. Ray Davis, our Chief Investment Officer is here. I think he can give you some more information on what has happened since our Investor Day.

**Ray Davis - EMC Insurance - SVP Investments and Treasurer**

Hi, John. We have a program, as we mentioned, for residential mortgage-backed securities. It is about 4% of our total bond portfolio. It is not a huge program. We started that, in June, and we are about 90% completed on the program. We committed \$40 million to an outside manager to manage these assets for us. We have been in close contact with him as far as what they are buying and the yields they are getting. We feel like the quality is very high and we are getting yields in the 7.5% to 8% area. So we are real comfortable with what we have done and expect to get good returns on it.

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**John Zabold (ph) with Flint Bridge Capital**

Okay. On your balance sheet, the short-term investments at cost, now would those just the Treasuries mostly then or what would that be?

**Ray Davis - EMC Insurance - SVP Investments and Treasurer**

Mostly money-market funds.

**John Zabold (ph) with Flint Bridge Capital**

Money-market, okay. So we did not have a problem with that, obviously, during the quarter.

**Ray Davis - EMC Insurance - SVP Investments and Treasurer**

No, not all.

**John Zabold (ph) with Flint Bridge Capital**

I am sorry if I missed this. I was trying to see if you put this anywhere on the Web site, but what would be the amount of cash at the holding company level?

**Unidentified Member of Management**

I think we are checking that out. We do have a substantial amount of cash at the holding company level because we are using that to buy back stock. Mark Reese has that information.

**Mark Reese - EMC Insurance - SVP and CFO**

The actual cash at the holding company level is about \$300,000. But we do have short-term investments of \$7.2 million. We have dividend money up from our subs to not only handle the annual dividend or the quarterly dividend but also the repurchase program. So we are adequately funded at the holding company level for those obligations.

**John Zabold (ph) with Flint Bridge Capital**

Okay, so, do you have the ability to pull more cash out of the subsidiaries to further fund the share repurchase program and the dividend?

**Mark Reese - EMC Insurance - SVP and CFO**

Yes, we could pull another \$22 million up from the subsidiaries, but we really don't have the need to do that because we have adequate funds at the holding company level.

**John Zabold (ph) with Flint Bridge Capital**

Uh-huh. So as I sort of look out at what you said about the share repurchase program, and by the way, do have a 10b5-1 in place, or is that how you bought the stock in October or --

**Mark Reese - EMC Insurance - SVP and CFO**

That is correct. We do.



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**John Zabold (ph) with Flint Bridge Capital**

Okay, and that is an ongoing program.

**Mark Reese - EMC Insurance - SVP and CFO**

Yes.

**John Zabold (ph) with Flint Bridge Capital**

So would it be fair to say that as long as the stock is trading below book value, that EMC would be buying back stock before the mutual company would be buying back stock? Is that sort of a fair way of looking at it or not?

**Mark Reese - EMC Insurance - SVP and CFO**

Yes, the holding company we will try to get that program completed before the end of the year. And the when that program is completed, the purchase program that Employers Mutual has in place will be activated again.

**John Zabold (ph) with Flint Bridge Capital**

Okay. Obviously, you know, with the CAT losses and the investment turmoil, would you say that you are very adequately capitalized and there are no capital issues either at your level or at the mutual level?

**Unidentified Member of Management**

No. We don't have any capitalization issues at this point. I looked at the leverage ratios of our insurance subsidiaries and they're all running on an annualized basis about 1.7, so well below any regulatory concerns.

**John Zabold (ph) with Flint Bridge Capital**

Okay. Well thank you. Just one last thing, going back to the previous question about the potential of rate increases, do you think that the capital destruction really needs to come more in the form of catastrophes or can there be enough pressure coming in from the investment portfolio losses of the industry to change the thinking on pricing? Which is the greater sort of factor?

**Bruce Kelly - EMC Insurance - President and CEO**

John, this is Bruce Kelly again. In my opinion, it doesn't matter where it comes from. It just has to be substantial enough to get the attention of the players in the market to firm up their pricing. I don't believe it matters if it is investment losses or if it is catastrophes or if it is losses from underpricing of business. I think they're all equal.

**John Zabold (ph) with Flint Bridge Capital**

Okay. Let's say we get this -- the thing everyone is hoping for here and that is a harder market. Given the economic circumstances, do you think that you would see your clients trying to buy down their packages and do something to alleviate that price increase or is that happening now? Maybe you could comment a little bit about that.

**Unidentified Member of Management**

I will turn it over to Bill Murray for some comments on what he sees in the market.



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**William Murray - EMC Insurance - EVP and COO**

In answer to the first part of your question, we thought for some time that there was enough capital out there so that it probably wouldn't take any one single event to turn things around. And maybe it shouldn't. But there has certainly been a series of events, like some of these storms have just been huge, extending from Colorado to Parkersburg, Iowa. Extending all the way from Galveston to Cincinnati and Kentucky. And then you take in addition to that, some of the changes or some of the reductions in equity as a result of things like Fannie and Freddie and you look at the economic downturn, the disruption in the market. All of those things together we think are probably going to result in some changes. They nearly have to. As far as what we are sort of looking at, on our own book of business and what we want to monitor carefully, is how those -- whether we're seeing policy changes due to economic conditions. So, yes, we have not seen much in terms of deductibles or less coverage or anything yet, but we are monitoring carefully the collections, the premium basis on the policies that we write that are on an adjustable basis. You would expect that there would be fewer business openings. You would expect there would be closings. You would expect that maybe some people will not be able to maintain the loss control programs they have in place over time. All of those things are the things we're going to get to be very, very careful of going forward. What is a little different -- this time then from -- when we came out of the last soft market, is we came out of the last soft market when economic conditions were favorable. Now there may be an opportunity for some price increases but we will be trying to apply those rate increases in different economic conditions. So we are wondering are people going to be able to pay those premiums that we can charge. So it will be an interesting time ahead of us I think as we work our way through this recession period.

**John Zabold (ph) with Flint Bridge Capital**

Okay. Thank you. I appreciate the answers.

**Operator**

Thank you [Operator Instructions]. Thank you. Gentlemen there are no further questions at this time. I like to turn the floor over to you for closing comments.

**Anita Novak - EMC Insurance - Asst. Secy - Director of IR**

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 web site at [www.EMCinsurance.com](http://www.EMCinsurance.com) until November 7th. A transcript of this conference call will be available until October 2009, which can be accessed from our web site as well later today. We appreciate your interest in the EMC Insurance Group and all of us wish to an enjoyable day.

**Operator**

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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