

# FINAL TRANSCRIPT

**Thomson StreetEvents<sup>SM</sup>**

## **EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call**

Event Date/Time: Apr. 23, 2009 / 2:00PM ET

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

## CORPORATE PARTICIPANTS

**Anita Novak**

*EMC Insurance Group - Director of IR*

**Bruce Kelley**

*EMC Insurance Group - President and CEO*

**Mark Reese**

*EMC Insurance Group - SVP, CFO*

**Steve Peck**

*EMC Insurance Group - SVP Actuary*

**Ron Jean**

*EMC Insurance Group - EVP for Corporate Development*

## CONFERENCE CALL PARTICIPANTS

**Paul Newsome**

*Sandler O'Neill & Partners L.P. - Analyst*

**Bob Farnam**

*Keefe, Bruyette & Woods - Analyst*

## PRESENTATION

**Operator**

Greetings and welcome to the EMC Insurance Group first quarter 2009 earnings results conference call. (Operator Instructions) A brief question-and-answer session will follow the formal presentation. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Ms. Anita Novak, Director of Investor Relations for EMC Insurance Group Incorporated. Thank you, Ms. Novak, you may begin.

---

**Anita Novak** - *EMC Insurance Group - Director of IR*

Thank you. Good afternoon, everyone and welcome to EMC Insurance Group's 2009 first quarter earnings conference call. A supplemental investor packet is available on the investor relations page of our Website, which can be found at [www.emcins.com/ir](http://www.emcins.com/ir). The Webcast for replay purposes is also available at this site until April 23, 2010. 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, 10-Q, 10-K and 8K. Any information provided today should be read in conjunction with the 2009 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 Executive Officer; Mr. Ron Jean, Executive Vice President for Corporate Development; Mr. Steve Peck, Senior Vice President Actuary; Mr. Ray Davis, Senior Vice President Investments and Treasurer; Mr. Rick Schulz, Senior Vice President Claims; Mr. Kevin Hovick, Senior Vice President for Business Development; 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.

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Bruce Kelley** - EMC Insurance Group - President and CEO

Thank you, Anita. From an overall perspective, first quarter 2009 ended with a solid result. Net operating income was \$0.86 per share and the GAAP combined ratio was 96%. Our underlying book of business remains sound despite the fact that overall rate levels on a written basis declined 4.2% year-over-year. Premium rates are showing signs of stabilization and we expect them to begin firming somewhat during the second half of 2009, in light of reduced capital levels and continuing uncertainty on the investment side. The lagging effect of previous rate level reductions, however, will reduce rate levels by approximately 3.5%.

Policy counts are up slightly in commercial lines and a little more significantly in personal lines. Average premium per policy is trending downward, reflecting lower rate levels. Frequency is down slightly and severity is up 2.2 percentage points. Retention remains strong at approximately 86% for both commercial and permanent lines. Net written premium declined 2.3% in the first quarter. With regard commercial lines, written premium was down for auto and liability but up for property and workers' compensation lines, as well as surety bonds.

For personal lines, written premiums increased for auto but declined for property and liability. It is important to note that some of the decline in personal lines written premium is a result of strategic decisions to reduce our presence in certain territories. We continue to redirect our personal lines marketing initiatives and resources to territories, which we believe offer greater potential for growth and profit. Personal lines, especially homeowners, are also being affected by ongoing efforts to manage exposure to catastrophic events. You may recall, for example, that we previously decided to reduce our Rhode Island homeowners' exposure by 1/3. That process continues as we work to maintain a balance between geographic diversification and focused marketing initiatives in selected territories.

Catastrophe and storm losses added 4 percentage points to our combined ratio in the first quarter, compared to 6 percentage points in the first quarter of 2008. Development on prior years' reserves continues to be favorable. For the first quarter 2009, favorable development totaled \$21.1 million, compared to \$15.9 million for the same period in 2008, a reflection of consistent and conservative reserving practices. Reserves are reviewed by our actuaries on a quarterly basis and bulk reserve adjustments are made as appropriate to maintain a consistent level of reserve adequacy. This methodology creates a transparent view of our actual reserve position and it is our intention to continue this methodology.

Underwriting results are very important and we take them very seriously. Our corporate objectives are based on profitable underwriting initiatives. We continue to expand our use of modeling tools to enhance the value of traditional underwriting approaches and to improve the effectiveness of our selection and pricing decisions. We maintain a branch structure so that our underwriting staff is strategically located throughout our marketing territories and so that underwriters are well versed in the local marketing environment.

However, underwriting is only one of the elements of our profit potential. As with most financial services organizations, we strategize for profitability in our investment portfolio as well. And like most financial services organizations, we continue to feel the effects of the global financial crisis, especially in the valuation of assets.

Investment income in the first quarter increased 2.8%, as compared to the same period a year ago. However, as reported on our press release earlier today, we recorded other than temporary, investment impairment losses totaling \$8.4 million, or \$0.41 per share after tax, on 24 equity securities and one fixed maturity security in the first quarter of 2009. Clearly, asset impairment continues to have a significant effect on net income. Even so, we remain financially strong and we believe that our conservative investment philosophy has served us well during the financial crisis.

Current speculation suggests that financial market conditions could begin to improve by year-end. Regardless, we will continue to adhere to our long-term strategy, which consists of investing in high-grade securities as opportunities present themselves and avoid riskier investments that we do not understand and that have created such serious problems for so many others. With that, I'll turn the discussion over to our Chief Financial Officer, Mark Reese. Mark?

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Mark Reese** - EMC Insurance Group - SVP, CFO

Thank you, Bruce. Operating income for the first quarter was \$11.4 million, which is an increase of 12.9% from the \$10.1 million reported in the first quarter of 2008. Operating income for the first quarter of 2009 reflects a more normal level of catastrophe and storm losses, a moderate but steady decline in overall premium rate levels, and an increase in the amount of favorable development experience on prior year reserves.

Net income for the first quarter was \$5.8 million, compared to \$8.2 million in the first quarter of 2008. Results for the first quarter were negatively impacted by \$8.4 million of other than temporary investment impairment losses. This is more than 2.5 times the \$2.9 million of other than temporary impairments recognized in the first quarter of 2008. And includes \$2.2 million recognized on fixed maturity securities issued by Great Lakes Chemical Corporation, now known as Chemtura Corporation, as a result of its Chapter 11 bankruptcy filing.

Net written premiums decreased 2.3% in the first quarter. In the property and casualty insurance segment, net written premiums declined 3.5% in the commercial lines of business and 1% in the personal lines of business. In the reinsurance segment, net written premiums increased 1.3%. For the quarter, new business premium was up 5.3%, reflecting an 18.8% increase in personal lines and a 4.1% increase in commercial lines. Investment income increased 2.8% to \$12.3 million for the quarter, due to the purchase of high quality commercial and residential mortgage-backed securities, and the redeployment of over \$165 million of proceeds from called US Government agency securities into higher yielding corporate securities during 2008.

The total rate of return on our equity portfolio for the first quarter of 2009 was negative 8.91%, which compares favorably to the negative 11.01% total return generated by the S&P 500. The current annualized yield on our bond portfolio is 5.26%. And the effective duration is 5.47 years, which is down slightly from 5.6 years at year-end 2008. The net book value of the Company's stock at March 31 was \$21.62 per share, an increase of 1.4% from \$21.32 at December 31. Consolidated assets totaled \$1.1 billion, including \$947.9 million in the investment portfolio. And stockholders' equity was \$286.2 million, an increase of 1.2% from year-end 2008.

In 2008, the Company's Board of Directors authorized a stock repurchase plan totaling \$25 million. The program does not have an expiration date and the timing and terms of the purchases are determined by management based on market conditions and applicable rules of the SEC. As of March 31, 601,119 shares have been repurchased at a cost of approximately \$15 million. Leaving approximately \$10 million available for the purchase of additional shares. At this time, I would like to open the phones for questions.

## QUESTIONS AND ANSWERS

### Operator

Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. (Operator Instructions) Our first question comes from the line of Paul Newsome with Sandler O'Neil Partners.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

Could you talk a little bit about the extraordinarily large reserve release in the first quarter? Was there anything in there that was unusual and perhaps talk about the timing as well? Because it seems to be a recurring pattern of a pretty sizable release in the first quarter. Although, this release is percentage of premiums (Inaudible)?

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Bruce Kelley** - EMC Insurance Group - President and CEO

We'll let Steve Peck maybe address that.

**Steve Peck** - EMC Insurance Group - SVP Actuary

The downward reserve development is somewhat greater than it was a year ago through March. A lot of that increase coming from case reserves and all of that development is on closed claims. The increase in the case reserves, a good deal of that increase is coming from storm claims. As you know, we've had a very unhappy storm season in 2008 and a lot of those claims were paid. An unusual number of storms claims were paid during the first quarter. So, the number's a bit higher but it has to do with the distribution of claims mostly.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

What accident years are the reserve releases coming from?

**Steve Peck** - EMC Insurance Group - SVP Actuary

Case reserve development, about 87% of that is coming from 2004 through 2008. The specific lines were comped, 70% were comp development was -- in those five accident years, 77% of the other liability. So, relatively recent years. And of course, most of the property would have been from accident year 2008.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

Now, I'll put myself in the queue and let some other folks ask questions.

**Operator**

Thank you. Our next question is from the line of Bob Farnam with KBW. Please go ahead.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

Thanks. Good afternoon or good morning. I'm curious about the -- where the reserves are in the range? Just kind of extending on Paul's questions. I know, historically, you've been in the upper quartile. Is that still the case?

**Steve Peck** - EMC Insurance Group - SVP Actuary

Yes. Still in the upper quartile. I believe at the end of 2008, on a consolidated basis, it was in the neighborhood of the 92 percentile, something like that.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

Another question on -- it looks like the property casualty piece, the expense ratio is a bit higher in the first quarter. It looked specifically on the dividend ratio. Anything going on in there that is abnormal?

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Steve Peck** - EMC Insurance Group - SVP Actuary

Well, the increase in the dividend ratio is coming from -- let me back up a step. There are two types of dividend, one is for safety dividend groups, the other type is dividends on individual workers' compensation policies. The ratio is up a bit and that's coming entirely from the workers' compensation type of dividend, the increase is. I'm not aware of exactly where is that coming from but the dollars are not -- the dollar increase is not huge.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

Okay. But these are related to policies from 2008, basically and how they ended, they were more profitable?

**Bruce Kelley** - EMC Insurance Group - President and CEO

Yes, it could have been some from early 2008 and the latter part of 2007.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

Okay. In terms of the assumed reinsurance piece, we hear from others that one-one renewals, were -- there was increases in rates there. Do you have any idea to quantify if you did get rate increases in those -- in the reinsurance piece at one-one?

**Ron Jean** - EMC Insurance Group - EVP for Corporate Development

This is Ron Jean, I can address that. I'm not sure if I have the numbers but we did get some increase on renewals in the January renewals. And I think the April renewals, some of those were coming in even higher. So, we may see more impact going forward. But I don't think the increases were surprising, I think they were kind of expected. And most of the increases came on accounts that had been generating some loss activity, other renewals were maybe a little bit flatter.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

Okay. And the last question before I jump back into the queue. Looking at the -- taking out the catastrophes, this is probably a question more for Steve again, the accident year '09 combined ratio, it was about a 115 or so. I understand that has a cushion in there or it typically does. Steve, can you kind of quantify where you think that that accident year might ultimately end at?

**Steve Peck** - EMC Insurance Group - SVP Actuary

Right. I would point out as a preface to your specific question that we read approximately the same combined ratio at the end of the first quarter 2008. And had we had a normal storm year, the combined would have come in in the neighborhood of 103.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

Okay.

**Steve Peck** - EMC Insurance Group - SVP Actuary

So, that is the -- where the ultimate -- projected combined ratio would have come in.

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

So you're saying it's consistent with the accident year '08, is that --?

**Steve Peck** - EMC Insurance Group - SVP Actuary

Yes, it's very consistent with accident --.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

With where you think the ultimate accident year '08 is going to be.

**Steve Peck** - EMC Insurance Group - SVP Actuary

No, I think the ultimate accident year '09 is going to come in in the neighborhood. This is a statutory number, in the neighborhood of 106.

**Bob Farnam** - Keefe, Bruyette & Woods - Analyst

Okay. Okay, that's for me. Thanks.

**Operator**

Our next question comes from the line of Paul Newsome. Please go ahead.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

With the -- could you talk a little bit about the OTTI writedown and what were the specific triggers for them this quarter versus why we didn't see them the same last quarter, for example?

**Bruce Kelley** - EMC Insurance Group - President and CEO

I'll let Mark Reese answer that question.

**Mark Reese** - EMC Insurance Group - SVP, CFO

Hi, Paul. Obviously, the \$2.2 million is related to one of our fixed maturity securities that went into bankruptcy. We did kind of preannounce that one, we did an 8-K filing back in March. And that stock has been trading in the 26% or \$0.26 on the dollar. And that's what we ended up in paring it down to at the end of the first quarter. We do ultimately expect our recovery to be higher than that but the accounting rules required us to write that down to the current market value at the end of the quarter.

On the equity side, it's really a result of the continuation of the significant decline in the equity markets. Once securities pass a certain timeline of being under water for six months or nine months, we're forced, with the accounting rules, to really look at those for impairment. Even though, ultimately, we expect the value of those to come back up, it is deemed other than temporary. So, that's really where we got into in the first quarter, was with the 24 securities that we ended up writing down. And the majority of those had just been under water for a long enough period of time where we were kind of forced into the impairments.

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

What I'm asking for is to better understand what "long enough" means and "far enough" means. Do you have a specific rule that you're using or even some rough guideline?

**Mark Reese** - EMC Insurance Group - SVP, CFO

Well, rough guidelines, it's something that's been under water for six consecutive months. We have to look at it pretty hard for impairment. Kind of our bright line test, if there is such a thing. But even though a security does meet those guidelines, we do look at each security individually to determine if there's compelling evidence why we shouldn't impair it. Something pointing that we might see a recovery in the near future. So the rules kind of put you in a bad position when you're in a prolonged market where securities are just beat down so severely and for so long. If we can get an increase in the overall market, we should see a significant reduction in impairment losses. But if it continues to go down or even stays at this level, we're going to be seeing, hopefully, not at this level but additional impairment losses going forward.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

Back to the comment on where you folks think the ultimate accident year is. If we are still looking at embedded price declines of around 3.5%, does that mean that we're -- '10 is really kind of looking at somewhere around 109 combined ratio?

**Steve Peck** - EMC Insurance Group - SVP Actuary

Most of the decline in rate levels that we mentioned a few minutes ago, are coming from rate reductions implemented in 2008. And it's a lag impact and they have their effect in 2009 or much of their effect. Actually, we are attempting to get an overall increase in manual rates in 2009. Whether that happens depends, obviously, on the market but that's our intention. I think that there will be relatively little further downward pressure in 2010. At least that is our hope.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

Well, the sort of follow-on thought is, should we be concerned that if the reserve releases go away, considering they eventually do, that you're looking at a Company that currently is not profitable?

**Steve Peck** - EMC Insurance Group - SVP Actuary

Okay. I'm glad you raised that question because I wanted to follow-up on my previous answer, with regard to reserve development. In our reserving process, downward reserve development does not mean that we are deliberately releasing reserves. Well, for the bulk reserves, all we're doing is reallocating between accident years. That's not to say that bulk reserves might not go up or down but the downward development in itself does not imply that we're releasing any reserves. So, the overall effect on the calendar year basis from reserve development is in the neighborhood of zero.

Now, the one exception to that statement is on case reserves, where the fact that is "a release" and does affect the bottom line. But keep in mind, what I said about those, that all of the downward development of case reserves is coming from claims that are closed. It's not that we're reducing, in aggregate, case reserves on open claims. It's just that claims are settling out at a lower level than they were reserved. And as long as case reserves continue to be established at the same -- if case reserves would continue to be established at the same level of adequacy as they were in recent years, then that downward development would continue every year, theoretically.

Apr. 23. 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Mark Reese** - EMC Insurance Group - SVP, CFO

Paul, I'd like to add something to that also. I think it's important to keep in mind that we had that case reserve strengthening occur back in 2004. Since that point in time, we have maintained a very consistent level of reserve adequacy. And that's by design. And so, to say that that reserve releases are going to go away, I think, is probably inaccurate because we intend to maintain that same level of adequacy going forward. So, that's not to say there might be some variation from year to year but overall, we're intending to maintain a very conservative reserve position.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

I think we may have a different view on what is GAAP but that's for another discussion. But the issue, I think folks have is that all of your profits are based upon reserve -- the theoretically reserve redundancies that are in your case reserve. And I think that's what we're basically looking at for the next year or two. Is that an accurate statement?

**Steve Peck** - EMC Insurance Group - SVP Actuary

Well I am not projecting, on an accident year basis, that we will have an underwriting profit. But I would point out, if you go back, say, from the beginning in 2006, maybe 2007, I'm not sure. And go back five or six years, you find five or six years in a row with accident-year combined ratios of less than 100. And we had more downward reserve development in those years than we're having now. And that reserve development, of course, has no effect on the accident year results. We don't know for sure they're going to settle out below 100 but that is the projection. That's where they are right now.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

Fair enough, thanks.

**Operator**

(Operator Instructions) We do have a follow-up from Paul Newsome. Please go ahead.

**Paul Newsome** - Sandler O'Neill & Partners L.P. - Analyst

Just keep my line open. There was no -- I didn't see any mention of earnings guidance, any changes from the fourth quarter, given the first quarter results. Are you -- was that a deliberate choice or any comment?

**Mark Reese** - EMC Insurance Group - SVP, CFO

Yes, Paul, this is Mark again. We deliberately did not change our guidance. Even though we had what we considered to be a strong first quarter, we recognize that there has been, in recent years, a lot of volatility in our cat and storm numbers as we get into the second and third quarters. So at this point, we're kind of waiting it out to see how the second quarter plays out. And we will readdress guidance at that point.

**Bruce Kelley** - EMC Insurance Group - President and CEO

Yes, Paul, this is Bruce Kelley. I agree with Mark, that we're looking at this very closely but we're not able to make the change at this point. We're waiting to see more -- see how the months go ahead but we're looking at it very closely.

Apr. 23, 2009 / 2:00PM, EMCI - Q1 2009 EMC Insurance Group Earnings Conference Call

**Operator**

We have no further questions in the queue at this time.

**Anita Novak** - EMC Insurance Group - 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 investor relations page of the Company's Website at [www.emcins.com/ir](http://www.emcins.com/ir) until May 7, 2009. And a transcript of this conference call will be available until April 23, 2010, which can also be accessed from our investor relations page 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. Please disconnect your lines at this time. Thank you for your participation.

**DISCLAIMER**

Thomson Financial reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON FINANCIAL OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2009, Thomson Financial. All Rights Reserved.