



Transcript of EMC Insurance Group (EMCI) 2009 Second Quarter Earnings Conference Call July 23, 2009

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Participants

Bruce G. Kelley, President and CEO
Bill Murray, EVP and COO
Ron Jean, EVP for Business Development
Mark Reese, SVP and CFO
Steve Peck, SVP Actuary
Ray Davis, SVP Investments and Treasurer
Rich Schulz, SVP Claims

Presentation

Operator

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

Anita Novak – EMC Insurance Group Inc. – Asst. Secy. Director IR

Thank you Diago. Good morning, everyone and welcome to EMC Insurance Group's 2009 second quarter earnings call. A supplemental investor packet is available on the investor relations page of our website, which can be found at www.emcins.com/ir. The webcast for replay purposes is also available at this site until July 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, 10k, 10q, and 8k. Any information provided today should be read in conjunction with the 2009 second 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. Bill Murray, Executive Vice President and Chief Operating 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. Rich Schulz – Senior Vice President - Claims; 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.



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Bruce G. Kelley – EMC Insurance Group Inc. – President & CEO

Thank you, Anita.

Second quarter operating income was \$0.48 per share and net income was \$0.53 per share. Catastrophe and storm losses declined to a more normal level of \$0.45 per share and the book value of the Company's stock increased 8.9 percent to \$23.22. Given current economic conditions, management is pleased with the second quarter results.

Through the first six months of 2009, both production and underwriting profitability tallied better than our original expectations. We had a good first quarter, but we were a little apprehensive about the second quarter after last year's historic storm losses. Now that we are through the worst of the Midwest storm season, we are comfortable in increasing our annual operating income guidance for 2009. There are still many challenges ahead of us as we continue to cope with the weak economy; however, with our decentralized branch structure and conservative investment philosophy we are well prepared to handle those challenges.

While current year financial results are much improved over last year, it is important to keep in mind that results for the second quarter and first six months of 2008 were severely impacted by a record level of storm losses. So, I would like to begin my discussion today by addressing some of the market trends we are seeing, rather than a quarter to quarter comparison.

Market Trends

Some industry reports indicate increased pricing opportunities in both commercial and personal lines of business. While we have not experienced this on a broad basis, we have been able to implement moderate price increases in select lines of business and geographic locations. We also continue to see smaller industry rate reductions, which leads us to believe that the soft market is beginning to ease. We still expect to see some rate improvement in the second half of the year, with overall price levels declining less than 2007 or 2008. Furthermore, we are seeing increased premium replacement in the form of new business.

There was some speculation that reinsurance pricing would begin to harden in 2009 and we did see some hardening with January renewals, and again with July renewals, but not to the extent anticipated a year ago after major events such as Hurricane Ike. Our expectation is that overall rates for reinsurance lines of business will not reach the industry's expectations of double digit rate increases this year. We are currently seeing mid to high single digit increases at best.

The Company continues to experience retention levels higher than industry averages. Commercial lines retention is approximately 85 percent and personal lines retention is approximately 88 percent. These figures are reasonably consistent with historic levels for the Company. Commercial retention is slightly lower than the past four years, but reflects the ongoing competitiveness of the commercial lines marketplace and our willingness to walk away from underpriced business.

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Frequency of loss is down slightly for the first half of 2009 and our expectation for the full year is that frequency will be similar to 2008. Severity of loss is down for the quarter but is up approximately one percent for the first half of the year and we expect this to continue through the remainder of the year.

Development

As reported in our first quarter 10-Q and reiterated in our July 10th press release, the Company is no longer reporting on a quarterly basis the amount of development experienced on prior years' reserves. This change in reporting is being implemented because management believes that there is potential for confusion among investors regarding the perceived impact development has on the Company's results of operations. Management has determined that continued reporting of the composition of the Company's underwriting results between the current and prior accident years increases the potential for misinterpretation and, in any event, is not material or relevant to an understanding of the Company's results of operations. From management's perspective, the more important issue is consistency of reserve adequacy. If reserves are maintained at a consistent level of adequacy (and all else remains equal), then development should be fairly consistent from year to year. Therefore, the source of earnings (current or prior accident years) is not relevant.

Steve Peck Retirement

Effective September 1, Steve Peck, senior vice president and chief actuary, will retire. Steve joined the Company in 1984 and has been the head of our actuarial department since July 2000. Steve is a highly respected member of our management team and his contributions to EMC's success are many. We wish him only the best as he begins a new chapter in his life affectionately termed "retirement".

Though Steve will be greatly missed, we have two very talented replacements, a testament to the overall depth of our in-house actuarial department, which employs 5 Fellows and 4 Associates of the Casualty Actuarial Society.

Scott Jean will be assuming the role of Chief Actuary. Scott began his career with EMC as an intern during his college years. He is a 1993 graduate of Iowa State University, a Fellow of the Casualty Actuarial Society, and a member of the American Academy of Actuaries. Scott is the son of Ron Jean, Executive Vice President for Corporate Development. Because of this relationship, Scott will report to me.

Kelvin Sederburg will assume the position of the Company's Appointed Actuary. Kelvin's primary responsibility will be the analysis of the Company's loss and loss expense reserves, and will include the preparation of the Statement of Actuarial Opinion on Loss and Loss Expense Reserves. Kelvin is a 1989 graduate of Iowa State University, an Associate of the Casualty Actuarial Society and a member of the American Academy of Actuaries. Kelvin will report to Scott Jean.

As I alluded to earlier, both Scott and Kelvin have spent their EMC careers under the keen guidance of Steve Peck. Their combined experience includes manual ratemaking, reserving, large account pricing, actuarial modeling, database

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development and a wide variety of special project assignments. Both have demonstrated strong management and capabilities and are expected to contribute to the ongoing success of the Company.

With that, I'll turn the discussion over to Mark Reese, chief financial officer, for additional discussion with regard to our financial results.

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

Thank you, Bruce.

Let me start by stating that our most recent actuarial analysis of reserves indicates a level of adequacy consistent with recent evaluations. From management's perspective, if reserves are being maintained at a consistent level of adequacy (and all else remains equal), then development on prior years' reserves would be expected to be fairly consistent from year to year. Therefore, the source of the Company's earnings (whether it be current or prior accident years) is not relevant to an understanding of the Company's results of operations.

Operating income for the second quarter was 6.4 million dollars, which is a significant increase from the 1.2 million dollar loss reported in the second quarter of 2008 when the Company experienced a record 23.5 million dollars of storm losses. Operating income for the second quarter of 2009 reflects a more normal level of catastrophe and storm losses and a moderate but steady decline in overall premium rate levels. Operating income for the first six months of 2009 was 17.8 million dollars, compared to 8.9 million dollars in 2008.

Catastrophe and storm losses declined to a more normal level of \$0.45 per share in the second quarter from the record \$1.12 per share experienced in 2008. For the first six months of 2009, catastrophe and storm losses totaled \$0.63 per share, compared to \$1.39 per share in 2008. The improvement in catastrophe and storm losses was partially offset by an increase in large losses, which we define as losses greater than \$250,000, excluding catastrophe and storm losses. Large losses amounted to \$0.36 per share and \$0.75 per share for the second quarter and first six months of 2009, respectively, compared to \$0.30 per share and \$0.58 per share for the second quarter and first six months of 2008.

Net income for the second quarter totaled 7.0 million dollars, compared to a net loss of 940 thousand dollars in 2008. For the first six months of 2009, net income totaled 12.8 million dollars compared to 7.3 million dollars in 2008. "Other-than-temporary" investment impairment losses totaled 759 thousand dollars in the second quarter and \$9.1 million dollars in the first six months of 2009. This compares to 1.7 million dollars in the second quarter and \$4.6 million dollars in the first six months of 2008.

Net written premiums increased 0.1 percent to \$188.1 million in the first six months of the year. The reinsurance segment reported an increase of 5.9 percent, while the property and casualty insurance segment reported a decline of 1.1 percent. In the property and casualty insurance segment, commercial lines business declined 2.1 percent while personal lines business increased 5.2 percent.

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For the first six months of 2009, new business premium was up 12.3 percent, reflecting a 32.8 percent increase in personal lines and a 10.5 percent increase in commercial lines. The increase in personal lines is distorted somewhat by a change from 6 month auto policies to annual auto policies. We estimate the impact of this change to be approximately 9 percentage points.

Investment income decreased 6.9 percent to \$11.2 million in the second quarter and 2.0 percent to \$23.5 million in the first six months of 2009. This decline in investment income is attributed to a high level of call activity experienced on the Company's U.S. Government Agency securities during the first quarter as a result of the low interest rate environment, a decline in yield on short-term investments and the elimination of dividends on the Freddie Mac and Fannie Mae preferred stocks in 2008. The proceeds from the called securities are being invested in short-term securities until attractive long-term opportunities can be identified.

The total rate of return on our equity portfolio for the first six months of 2009 was 2.79 percent, which is less than the 3.16 percent total return generated by the S&P 500. During the second quarter, our equity portfolio returned 12.84 percent, compared to 15.93 percent for the S&P 500. The current annualized yield on our bond portfolio is 4.95 percent and the effective duration is 5.36 years, which is down slightly from 5.47 years at March 31, 2009.

The net book value of the Company's stock at June 30, 2009 was \$23.22 per share, an increase of 8.9 percent from \$21.32 at December 31, 2008; consolidated assets totaled \$1.1 billion, including \$1.0 billion in the investment portfolio; and stockholders' equity was \$307.3 million, an increase of 8.6 percent from December 31, 2008.

Based on actual results for the first six months of 2009 and our expectations for the remainder of the year, management is increasing its 2009 annual operating income guidance from the previous range of \$1.45 to \$1.70 per share to a range of \$1.80 to \$2.05 per share. The revised guidance is based on a projected GAAP combined ratio of 103.5 percent.

In 2008, the Company's Board of Directors authorized a stock repurchase plan totaling \$25 million dollars. 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 the applicable rules of the SEC. As of June 30, 2009, 601,119 shares have been repurchased at a cost of approximately \$15.0 million, leaving \$10.0 million dollars available for the purchase of additional shares.

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

Operator

Thank you. We will now be conducting a question and answer session. If you would like to ask a question, please press *1 on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You can press *2 if you would like to

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remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the * keys.

Our first question comes from Paul Newsome with Sandler O'Neill. Please state your question.

<Q>: Good morning gentlemen.

Bruce G. Kelley – EMC Insurance Group Inc. – President & CEO

Good morning.

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

Good morning, Paul.

<Q>: The first question, could you talk specifically about the guidance change? Is it really a change in expectation of catastrophe losses or is there other pieces to that guidance change?

Bruce G. Kelley – EMC Insurance Group Inc. – President & CEO

Paul, this is Bruce Kelley. Yes, there are a number of different aspects of that, and I think that both Mark Reese and Steve Peck can speak for that.

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

Paul, the basic assumptions we began the year with have not really changed. The primary reason for the reduction in the projected combined ratio from original projection is, as Bruce said earlier, the first half of the year was somewhat better than expected. And therefore, to get the new projection I simply take what happened in the first quarter, of first half and make projection for the second half, better than expected first half resulted in a decline in the expected combined ratio. Is that what you are looking for?

<Q>: Well, when you are looking at the two projections, obviously was it catastrophe losses and ended up being a loss than you anticipated or was it underlying profitability? Was it reserve releases? Was it investment income? What was the major component to it? It would suggest that your guidance had a very conservative second quarter expectation, and I guess is that, is essentially the second quarter is what's driving the \$0.35 increase in your guidance?

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

Please note that the drop in the combined ratio is not all that large. It's about 2.5 points. So it doesn't take a whole lot to get to that difference. I'm sorry, frequency and severity were a bit lower combined than I would have expected. I has assumed about a 2.5% of combined frequency/severity change. The actual change was about 1.5%. A second component of that is the LAE ratio dropped about 0.4 point. That is due to an unexpected allocated expense reserve change primarily in the first quarter. So I don't know if there is any one thing I can point to. Those are two things that are involved. There maybe, there are obviously others. But I don't have the numerated here.

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<Q>: Let me try smoothing else, just a clarification, separate question. Clarification on your pricing commentary. Obviously there are a lot of moving pieces, but it sounds like I just want to make sure I'm clear, it sounds like you expect pricing in the second half of '09 to still be down overall. Is that right or did I, because I got a little confused, I'm sure it's my own fault, but if you look at the big picture, are we still looking at second half '09 pricing likely to be down?

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

I think there are two ways to look at this. What happens to the actual rate level and what is the change in the implemented rates, and those are, as I said two different things. Carrying over from 2008, we believe there will be a continuation of the decline in rate level, but the decline by the end of the year will be less than the decline at the end of June. At the end of June we estimated that the written premium rate level is down about 3%, 3.5%. By the end of the year, I think it will be down in the neighborhood of 2.5%. As far as— so that's what's happening to the rate level. It will be negative at the end of the year, I believe. As far as what we are currently implementing, during the first six months we have implemented many more increases than decreases in the various states and lines. Overall, the rate level implemented to date is about flat in 2009, that's from a filed manual rate standpoint. By end of the year, I believe, the current indicator shows that number will be slightly positive. Now, what happens to subjective underwriting mods, that's another question. Those were down some we believe during the first half, but less than during prior years. And of course it's a little bit of a guess right now what's going to happen to second half. But I would guess by the end of the year the average underwriting mod will have dropped a bit from the end of 2008.

<Q>: So you expect to offer more discounts off the rate than last year but not at the level that you were during last year?

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

Right, the decrease will be smaller this year than it was last year.

<Q>: So if we roll up, sort of you know the discounts plus rate we are probably looking at something that is mid to low single digits?

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

I would say between underwriting mods and implemented manual rates, we are looking at somewhere around minus 1 probably.

<Q>: Excellent. That's perfect. And before I let other people do, I know we talked about this offline. But just for the record, I am disappointed that you are not giving us the reserve release data, and we obviously talked about this offline. But I want to make sure what's on the record that I would much rather see it. And related to that, when is your, when do you expect to file your statutory quarterly numbers?

Bruce G. Kelley – EMC Insurance Group Inc. – President & CEO

The statutory numbers?



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<Q>: Yes. The clearing statutory numbers.

Bruce G. Kelley – EMC Insurance Group Inc. – President & CEO

It will be a couple of weeks.

<Q>: Okay, great. Thank you very much.

Operator

Thank you, just a reminder to all of you who would like to ask a question, please press *1 on your telephone keypad. To remove yourself from the queue, please press *2. Our next question comes from Bob Barnum with KBW. Please state your question.

<Q>: Hi there, good morning. Two quick questions. One you had large losses increasing. I am just curious if you have an idea what's driving that?

Bruce G. Kelley – EMC Insurance Group Inc. – President & CEO

Yes, Bob. I have Rich Schulz here, Head of our Claims Department. He can comment on the large losses we've been experiencing this year.

Rich Schulz – EMC Insurance Group Inc. – SVP Claims

Well, we've actually had, in terms of the consolidated claims on the case side we've had couple of large fires in the first half of the year, some commercial fires. We've also had a number of large commercial auto losses. Is there anything else?

<Q>: But no specific trends in there that we should be expecting an increase in large losses like that?

Rich Schulz – EMC Insurance Group Inc. – SVP Claims

No trends.

<Q>: Okay.

Bill Murray – EMC Insurance Group Inc. – EVP & COO

Bob, Bill Murray. One thing I did want to mentioned, since the large losses are up a little bit this year, we have a process where those losses that are in excess of \$250,000 are all critiqued, first in the branch and then they are referred in here to the home office for a review as well. And of those losses that we've seen this year I don't know that we've seen anything that would represent necessarily a trend or a great concern from an underwriting standpoint.

<Q>: Okay. Good, I was just curious. And can you just remind us, it sounds like the worst of your cat's season is done, at least in the Midwest. Is the second quarter completed a highest cat quarter or can you just kind of go into it and remind us which quarters you generally have higher cat losses.

Mark Reese – EMC Insurance Group Inc. – SVP & CFO



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Yes. For the pool of the quarters, the first half expected loss is very similar to the second expected loss.

<Q>: Okay. So there is really not much change between first half, second half in terms of cat losses?

Mark Reese – EMC Insurance Group Inc. – SVP & CFO

But it's not for the pool. For EMC Re tends to get hit by hurricanes more than, I mean the hurricane losses are the largest losses typically that EMC Re experiences. And that ratio is higher by about 3.5 points in the second half. Overall, the group of the EMC Group, the whole year, I'm sorry, the second half storm ratio is about 7 points higher expected ratio than the first half, 0.7 point higher.

<Q>: 0.7 point, okay. And last one was just probably shifting gears to you're talking about reinvesting the funds in short term investments right now. Have you seen any opportunities for longer terms investments yet?

Bruce G. Kelley – EMC Insurance Group Inc. – President & CEO

Yes, Ray Davis is going to answer that question, our Chief Investment Officer.

Ray Davis – EMC Insurance Group Inc. – SVP Investments & Treasurer

Hi, Bob. Yes, we think we've found some good opportunities. We've been buying some real high grade commercial mortgage backed securities in the 2 to 5 year range, pretty high yielding. We've been buying some the new Build America Bonds that have rugged return. If you are willing to go out a little farther on the yield curve. And we've been buying some corporates and also found some good opportunities in the municipal bond market. So we've been putting the money back to work. We are just not in any real hurry to get it all invested at once. We are trying to be prudent and get it invested as best we can.

<Q>: Great. Okay. Thanks a lot. That's it for me.

Operator

Thank you. Ladies and gentlemen, there are no further request for questions at this time. I will turn the conference back over to management for closing comments. Thank you.

Anita Novak – EMC Insurance Group Inc. – Asst. Secy. Director 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 until August 6, 2009 and a transcript of this conference call will be available until July 23, 2010, which can also be accessed from our investor relations page later today. We appreciate your interest in EMC Insurance Group Inc. and all of us wish you an enjoyable day.

Operator

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

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