



# EMC Insurance Group

## Third Quarter 2009 Earnings Conference Call

### October 23, 2009

#### Vcall

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## Participants

Bruce G. Kelley - President and CEO  
Bill Murray - EVP and COO  
Rich Schulz - SVP Claims  
Mark Reese - SVP and CFO  
Kevin Hovick - SVP Business Development  
Ray Davis - SVP Investments and Treasurer  
Scott Jean - VP Actuary  
Kelvin Sederburg - VP Actuary

## Presentation

Operator

Good morning. At this time .....

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

Thank you \_\_\_\_\_. Good morning, everyone and welcome to EMC Insurance Group's 2009 third 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](http://www.emcins.com/ir). The webcast for replay purposes is also available at this site until January 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 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. Bill Murray, Executive Vice President and Chief Operating Officer; Mr. Rich Schulz, Senior Vice President – Claims; Mr. Kevin Hovick, Senior Vice President – Business Development, Mr. Ray Davis, Senior Vice President - Investments and Treasurer; Mr. Scott Jean, Vice President – Actuary, Mr. Kelvin Sederburg, Vice President – Actuary, 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 - President and CEO**

Thank you, Anita.

For the property and casualty insurance sector, business is proceeding despite the turmoil of current economic conditions. Our basic operations are normal – we renew existing policies, we write new policies, we pay claims, we develop new products and we compete with our peers for profitable business.

We've tried various risk management strategies in the past and we've found that an emphasis on underwriting profitability is the best method for us – so, we continue to market our products on that premise. We retain close relationships with our independent agency field force through 16 strategically-located branches, growing our business organically through existing agencies and the appointment of new producers. We maintain a financially strong balance sheet - we reserve conservatively and we invest conservatively. In a nutshell, we adhere to our corporate strategic plan whether we are encountering a soft pricing environment or a hard one and that course of action has worked well for us. Our objective is to exit the current soft market financially sound, with a profitable book of business.

Third quarter, for the most part, is right on track with our corporate objectives and expectations. Operating income was \$0.24 per share and net income was \$0.38 per share. Catastrophe and storm losses declined to \$0.79 per share, which was again less than third quarter 2008 results but higher than Company averages due to active Midwest storm patterns. The book value of the Company's stock increased 9.4 percent to \$25.41 in the third quarter and 19.2 percent year-to-date.

Net written premiums for the third quarter increased 2.8 percent, which is a result of some rate increases and an increase in new business policy counts, predominantly in personal lines. Year-to-date, however, net written premiums remain flat due to competitive pricing in the first half of the year, which tends to limit our ability to grow profitably.

As we have discussed on previous calls, we have initiated a marketing strategy for personal lines, which has taken us out of some states, mostly coastal regions, and increased marketing efforts in other states where we believe personal lines can be written profitably over the longer term. Although working off a lower base as a starting point, personal lines new business net written premiums have increased 43.1 percent and new business personal lines policy counts have increased 27.9 percent. We are generally seeing mid-single digit rate increases in most geographic locations and some double-digit increases in some areas in our personal lines. We plan to further expand this marketing strategy going forward.

Commercial lines pricing remains quite competitive, but we are seeing some firming in the Workers' Compensation line of business. Overall new business net written premium for commercial lines have increased approximately 8.7 percent as compared to 2008 and new business commercial lines policy counts have increased 6.8 percent.

Across all lines of business, net written premiums on new business for the nine months ended September 30<sup>th</sup> has increased approximately 11.5 percent as compared to 2008 and policy counts on new business have increased 14.0 percent.

We continue to expand our Safety Group, Target Market and Choice Specialty Markets. All of these programs currently boast incurred to earned ratios in the low to

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mid-forty percentiles and comprise approximately 43.8 percent of our commercial lines written premium.

The Company continues to experience retention levels higher than industry averages and consistent with our expectations. Commercial lines retention is approximately 86 percent and personal lines retention is approximately 87 percent. Commercial retention is slightly lower than the past four years, but demonstrates the ongoing competitiveness of the commercial lines marketplace and our willingness to walk away from underpriced business.

Frequency was down slightly in third quarter 2009; severity is also down when non-storm shock claims are excluded. The Company has experienced three non-storm shock claims in 2009, compared to zero in 2008. As explanation, we consider a non-storm shock claim to be a very large claim outside the usual realm of business.

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 - SVP and CFO**

Thank you, Bruce.

Let me start by stating that our most recent actuarial analysis of reserves indicates a level of adequacy consistent with other recent evaluations. Since management strives to maintain a reasonably consistent level of reserve adequacy at each quarterly reporting date, the financial impact resulting from development of prior accident year reserves is, in effect, being offset by the establishment of equally adequate reserves on current accident year claims. For this reason, management believes the composition of the Company's underwriting results between the current and prior accident years creates potential for misinterpretation and, in any event, is not relevant to an understanding of the Company's results of operations.

Operating income for the third quarter was 3.2 million dollars, which is a significant increase from the 295 thousand dollar loss reported in the third quarter of 2008. Operating income for the third quarter of 2009 reflects a higher than normal level of catastrophe and storm losses and a moderate but steady decline in overall premium rate levels. Operating income for the first nine months of 2009 was 20.9 million dollars, compared to 8.6 million dollars in 2008.

The Company has historically reported catastrophe and storm losses net of development experienced on prior years' catastrophe and storm losses. This has not had a material impact on the reported amounts because development associated with prior years' catastrophe and storm losses has historically been relatively small. During 2009, however, the Company has experienced a larger amount of favorable development related to the record amount of catastrophe and storm losses incurred in 2008. As a result, the Company is changing its reporting of catastrophe and storm losses to include only current accident year events. Any material amount of development experienced on prior accident year catastrophe and storm losses will be reported separately. This change in reporting does not have any impact on the reported amounts of operating income or net income; it only affects the reported amounts of catastrophe and storm losses.

Catastrophe and storm losses totaled \$0.79 per share in the third quarter, compared to \$0.97 per share in 2008. For the first nine months of 2009, catastrophe and storm losses totaled \$1.52 per share, compared to a record \$2.41 per share in 2008.

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**Transcript:**  
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The Company experienced favorable development on prior years' catastrophe and storm losses of \$0.04 per share for the three months ended September 30, 2009, compared to \$0.01 per share for the same period in 2008. For the nine months ended September 30, 2009, favorable development on prior years' catastrophe and storm losses totaled \$0.15 per share, compared to \$0.07 per share for the same period in 2008. Reserves associated with catastrophe and storms losses are event-specific, and are initially established based on known exposures and estimates of loss frequency and severity. As actual loss information is reported, management is better able to project the ultimate cost of a loss event. Changes in the projected ultimate cost of a prior accident year loss event is reported as development, and this development has an impact on the Company's results of operations because the total amount of the Company's carried reserves has changed.

Large losses, which we define as losses greater than \$250,000, excluding catastrophe and storm losses, amounted to \$0.40 per share and \$1.35 per share for the third quarter and first nine months of 2009, respectively, compared to \$0.59 per share and \$1.17 per share for the third quarter and first nine months of 2008.

Net income for the third quarter totaled 5.1 million dollars, compared to a net loss of 9.5 million dollars in 2008. For the first nine months of 2009, net income totaled 17.8 million dollars compared to a 2.2 million dollar loss in 2008. "Other-than-temporary" investment impairment losses totaled 611 thousand dollars in the third quarter and 17.1 million dollars in the first nine months of 2009. This compares to 9.7 million dollars in the third quarter and 21.7 million dollars in the first nine months of 2008.

Net written premiums increased 1.1 percent to \$304.6 million in the first nine months of the year. The reinsurance segment reported an increase of 6.7 percent, while the property and casualty insurance segment was relatively flat. In the property and casualty insurance segment, commercial lines business declined 1.3 percent while personal lines business increased 8.3 percent.

For the first nine months of 2009, new business premium was up 11.7 percent, reflecting a 40 percent increase in personal lines and a 9.1 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 3.6 percent to \$11.8 million in the third quarter and 2.6 percent to \$35.3 million in the first nine 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 half of 2009 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. As of September 30, the majority of the proceeds received from the called securities had been reinvested.

The total rate of return on our equity portfolio for the first nine months of 2009 was 16.77 percent, which is less than the 19.26 percent total return generated by the S&P 500. During the third quarter, our equity portfolio returned 13.61 percent, compared to 15.61 percent for the S&P 500. The current annualized yield on our bond portfolio is 5.31 percent and the effective duration is 5.68 years, which is up from 5.36 years at June 30, 2009.

The net book value of the Company's stock at September 30, 2009 was \$25.41 per share, an increase of 19.2 percent from \$21.32 at December 31, 2008; consolidated

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assets totaled \$1.2 billion, including \$1.0 billion in the investment portfolio; and stockholders' equity was \$334.3 million, an increase of 18.2 percent from December 31, 2008.

Based on actual results for the first nine months of 2009 and our expectations for the remainder of the year, we are reaffirming our 2009 annual operating income guidance range of \$1.80 to \$2.05 per share, which is based on a projected GAAP combined ratio of 103.5 percent.

As previously reported, the Company sold 100% of its investment in Verisk Analytics, Inc. common stock in connection with that company's IPO on October 7, and expects to record an after-tax realized gain on that sale of approximately \$14.6 million, or \$1.10 per share, in the fourth quarter. Management decided to sell all of its Verisk stock to reduce the potential volatility of its equity portfolio and also generate tax gains that can be used to offset tax losses that will be recognized upon the disposition of the Company's holdings of other-than-temporarily impaired securities as the Company rebalances its equity portfolio.

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 the applicable rules of the SEC. As of October 10, 2009, 736,133 shares have been repurchased at a cost of approximately \$17.9 million, leaving \$7.1 million available for the purchase of additional shares

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

**Operator**

[OPERATOR INSTRUCTIONS] Our first question is coming from Paul Newsome of Sand O'Neil & Partners.

<Q>: Hello, folks. Thank you for the call. I wanted to touch a little bit on these new business efforts. Maybe you could report it in the context of— Obviously, the absolute returns on an underwriting basis don't meet the hurdle of underwriting profits. How do we know that increasing profitability or increasing sales at this time, which appears to be kind of the bottom of the soft market, is the right strategy, that it's actually going to improve underwriting profits?

In particular, for example, I was struck by the fact that you're going to a one-year policy from a six-year policy. Typically, that's a loosening in terms of conditions. Isn't that sort of counter to trying to improve profitability?

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

Thanks, Paul, for your question. I appreciate you looking at our marketing. I'll turn the question over to Bill Murray, our Chief Operating Officer.

**Bill Murray - EMC Insurance Group Inc. - EVP and COO**

Good morning, Paul. I think I'll address this pretty much from a personal lines standpoint, if that's okay, because that seems to be where year-over-year comparisons suggest that we're writing quite a bit of new business.

I'd like to begin by saying that commercial lines continues to be front and center in our marketing plan, but personal lines continues to be an important part of the marketing plan in some of our branches. Our overall strategy for personal lines is to write less

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where personal lines hasn't been a growing and an important part of branch plans and where it can therefore hurt you.

We intend and have intended to write more personal lines business where, according to history and according to our studies, personal lines can be written profitably over the longer-term. We took on some studies and made some changes here within the last several years to enable us to do that, including studies of rates, product, and ease of doing business from an agent standpoint.

We've been pretty successful in several of those states, but as Bruce has mentioned in his earlier comments, some of the numbers that we're looking at, both in terms of premium and in count, have pretty low starting points. Actually, growth is pretty much keeping with the plans that we'd established with some of these states where we think we can do business successfully. But, we are certainly monitoring the exposures that we're adding to our book of business and especially the rates in those states where it seems that we have lately been able to get some pretty good rate increases.

Now, some of this business that we've been writing will actually tend to add to our Midwestern exposures, but actually if we've done this correctly from a rating standpoint, we should be able to achieve a better spread of risk in those states where we're writing more business than we have before.

So, it's actually part of a strategy. We believe that it's a well conceived strategy, unless, of course, you happen to have too unusually high Midwestern storm seasons, as we have in 2008 and in 2009. But again, it's a long-term strategy and it's one that we will continue to monitor carefully.

You also had a question as far as—

<Q>: I'm sorry; let me interrupt you because I'm afraid I'm— What you are saying is that these are personalized products that are being sold largely in new areas and that's why you'd expect profitability better than what you're currently having, or are they simply a renewed effort in the same areas? I was a little confused.

**Bill Murray - EMC Insurance Group Inc. - EVP and COO**

No, it would be a renewed effort in areas where we have traditionally written personal lines business generally successfully in the past.

<Q>: And today, you're not successful in making an underwriting profit, right? So, are you selling new business at a profitable level, or not?

**Bill Murray - EMC Insurance Group Inc. - EVP and COO**

Well, we continue to monitor the pricing levels that we have and we'll follow some of those indications from our actuaries. We have been successful in making some personal lines rate filings recently. Like I said, we'll continue to monitor that going forward, but these are not new areas. These are in states where we've written business.

In the past, we maybe have had some agencies that have been more successful with us than others. If they've used us, they've used us pretty frequently. So, we have had high concentrations of business, even on a state basis. By redefining our pricing, we should be able to get better spread of risk within states, even those in the Midwest.

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<Q>: Okay. That makes sense. Then, a separate question. I just want to make sure; is it management's view that the third quarter was typically a worse than normal catastrophe quarter for yourself and/or the industry?

**Scott Jean - EMC Insurance Group Inc. - VP Actuary**

This is Scott Jean, Actuary. For the industry, I would say it was probably a fairly normal catastrophe year for us because we're heavier in the Midwest. We did have a higher catastrophe ratio during the third quarter. The catastrophe ratio for the third quarter was almost six points higher than we had expected it to be, but it just gives you an idea of what catastrophes look like for us compared to what we had expected.

<Q>: What's the possibility that this is not necessarily pure cats, but more a reflection of pricing because obviously a lot of companies have not reported third quarter yet, but those that have, have actually reported an extremely light third quarter, maybe one of the lightest on record. So, it would appear that the industry is having an absolutely wonderful quarter. What's the chance that we're picking up something that's maybe a different than truly catastrophe loss?

**Unidentified Speaker - EMC Insurance Group Inc.**

From our perspective, the total amount of catastrophe losses has been higher in 2008 and 2009. In addition, we analyze catastrophe losses on a current level earned premium basis also; meaning that we adjust cat term premiums to the 2009 rate levels for comparison sake and 2008-2009 were still very historically high when adjusted and looking at it from that perspective.

<Q>: We're talking just about the third quarter.

**Unidentified Speaker - EMC Insurance Group Inc.**

Yes.

<Q>: Okay. Great. Thank you very much.

**Operator**

[OPERATOR INSTRUCTIONS] Our next question comes from Bob Afarnan of ... .and Woods.

<Q>: Hello, there. Good morning. Kind of going on the same theme; we're talking about market conditions. Can you give us an idea; has there been any change in competition? Has anybody been pulling out or alternatively, been getting more aggressive? Any new players?

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

Well, one thing I would comment on before I turn it over to Kevin Hovick would be that we're an independent agency company and we're competing with direct writers. We're seeing that our ability to compete with direct writers has been enhanced by the technology and the fact that the independent agents have access to a number of different companies.

The industry has been stressed by the catastrophes we've had in the last several years, so we've been able to demonstrate our good claims service. We've been able to demonstrate our improved technology and then, there's better pricing. So, we're really able to have a better impact in competing with other companies specifically, direct writers and companies that aren't able to handle the claims like we are. I'll turn it over to Kevin Hovick who is in charge of business development.

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**Kevin Hovick - EMC Insurance Group Inc. - SVP Business Development**

Thanks, Bruce. Just quickly to answer that; we have had our underwriting managers in for a meeting here earlier this week. There doesn't seem to be any significant movement out there as far as what the competition is doing. Again, we're a regional company operating out of a national kind of a footprint. We compete against a lot of the regional companies, and even some of the national companies like Liberty Mutual that has a lot of regional-type of approaches.

What we're seeing right now is that a lot of companies out there are trying to mimic some of the things that we do. We have these target market safety groups, municipal business, governmental entity, we see a lot of companies trying to come in and take that business away from us. We've pretty much established ourselves as a premier writer of some of that business and we're able to fend off some of the competition.

But just again, most of our competition seems to be with the regional-type writers. There are a few companies that were mentioned in our meetings on the East Coast and in the Midwest. In the West Coast, we do tend to go up against some of the national writers, some of the larger stock companies.

<Q>: Scott, with the larger competitors or the regional competitors going after your target markets, are they basically trying to compete on price, or are they offering different things for the agents or whatnot?

**Scott Jean - EMC Insurance Group Inc. - VP Actuary**

Well, it would be tough for them to compete, I think anyway, against some of the programs that we've put together because we've developed them with our risk improvement loss control over the years; again, our branch and claims service. We're getting reports from our branches that some companies are coming in and saying, "We'll cut EMC's premium by such a percent. Just give us a chance to take a look at it."

We see some of that, but once they take a look at it and put it in front of maybe either a school board or a city council and they try to compare coverages to coverages in what they have. Again, we're able to retain it to a certain degree.

We are having to be competitive; there's no doubt about that. We have to offer some programs as far as some dividend programs. I think as Bruce had mentioned in his comments, I mean we do have some walk-away prices and we're only going to go so far. But again, we've been able to use our sales approaches and maintain the business that we've established.

**Bill Murray - EMC Insurance Group Inc. - EVP and COO**

Bob, this is Bill. As Kevin's mentioned, we've seen a fair amount of competition. The interesting thing, I think, going forward will be how companies will respond to basically the lack of a significant hurricane season this year. Of course, we typically don't write huge volumes of business in those coastal areas. So for us, what we need to be is very alert to pricing opportunities in the Midwest where we've had some significant storms in each of the last couple of years. That's what we would intend to do - stay on top of the pricing. That's where our 16 branch office structure gives us a real opportunity to do that because of the local prices.

<Q>: It sounds like you've been getting rate increases in personal lines. Can you give us overall rate change in personal lines versus current lines for the quarter?

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**Unidentified Speaker - EMC Insurance Group Inc.**

So far, year-to-date, we've been able to get in about 2.7% increase on personalized premium. That's as far as what has been filed with the insurance department. Commercial lines we're looking at about 0.1%; so fairly flat.

<Q>: 0.1%? Okay. All right. I know last quarter, we talked about some of the larger non-cat losses and some of them were fire related. Anything specific going on in this quarter with the large losses in terms of types of claims?

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

No. I'll turn it over to Rich Schulz, the head of the claims department, to talk about our third quarter losses through September 30<sup>th</sup>.

**Rich Schulz - EMC Insurance Group Inc. - SVP Claims**

Nothing really has changed. The large losses remain our commercial fire losses. The overall numbers are similar. We've just had a couple of them that were particularly large.

<Q>: The last question for me with the guidance, what is the ... load that you're including in the guidance numbers now?

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

I'm going to turn it over to Scott Jean, who gave that number.

**Scott Jean - EMC Insurance Group Inc. - SVP Actuary**

The fourth quarter ... load was 5.7%, which is 3.5% on the property casualty side and higher on the EMC re side.

<Q>: Okay. Very good. Thanks, guys.

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

Thanks, Bob. I appreciate it.

**Operator**

[OPERATOR INSTRUCTIONS] Thank you. There are no further questions at this time.

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

Thank you, Jackie and 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 Web site at [www.emcins.com/ir](http://www.emcins.com/ir) until November 6, 2009. A transcript of this conference call will be available until October 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.

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