



Transcript of
EMC Insurance Group
Fourth Quarter 2009 Earnings Conference Call
February 25, 2010

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Participants

Anita Novak – EMC Insurance Group Inc. – Assistant Secy, Director of Investor Relations
Bruce G. Kelley – EMC Insurance Group Inc. – President and CEO
Ron Jean - EMC Insurance Group Inc. – EVP for Corporate Development
Rich Schulz - EMC Insurance Group Inc. – SVP Claims
Mark Reese - EMC Insurance Group Inc. – SVP and CFO
Kevin Hovick - EMC Insurance Group Inc. – SVP Business Development
Ray Davis – EMC Insurance Group Inc. – Chief Investment Officer
Scott Jean - EMC Insurance Group Inc. – VP Actuary
Kelvin Sederburg - EMC Insurance Group Inc. – VP Actuary

Analysts

Bob Farnam – KBW
Paul Newsome – Sandler O’Neill

Presentation

Operator

Good morning. At this time

Anita Novak – EMC Insurance Group Inc. – Assistant Secy, Director of Investor Relations

Thank you _____. Good morning, everyone and welcome to EMC Insurance Group’s 2009 fourth 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 May 25, 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 fourth 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. Rich Schulz, Senior Vice President – Claims; Mr. Kevin Hovick, Senior Vice President – Business Development, 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 G. Kelley – EMC Insurance Group Inc. – President and CEO

Thank you, Anita. I'm happy to report that our fourth quarter results were very good. In fact, our results were second only to the record fourth quarter results reported in 2005. For the quarter ended December 31, 2009, operating income was \$0.98 per share, net income was \$2.10 per share and our GAAP combined ratio was 94.7.

Results for the year were also impressive, given current market conditions and an abundance of Midwestern storms. Operating income for the year was \$2.55 per share, net income was \$3.44 per share and our GAAP combined ratio was 100.2. We closed the year with significant increases in total assets, invested assets, stockholders' equity, book value and average return on equity.

On a segment basis, our property and casualty segment performed pretty much as expected given the current competitive nature of the industry; however, the reinsurance segment performed exceptionally well. Factors contributing to the reinsurance segment's success included rate increases, good results from the Mutual Reinsurance Bureau pool and some favorable development on prior years' reserves.

Current Market Conditions

When we began 2009, we hoped, as many others did, that rates would begin to firm by mid-year; however, for a variety of reasons including a very mild hurricane season and a general strengthening in the capital base for the industry, that did not occur. Rates for the most part, remained very competitive, especially in commercial lines of business. However, we continue to feel that we benefit greatly from our branch structure. We have sixteen branch offices strategically located throughout the United States operating on a largely de-centralized basis. Each branch has its own underwriting, claims, risk improvement and marketing departments. This local presence gives each branch a better understanding of the marketing opportunities in its immediate vicinity. Accordingly, we are able to react quickly to pricing opportunities that present themselves. As a result, we are seeing rate increases on some individual accounts and in some lines and territories and we continually see opportunities to review and write new accounts.

New business in 2009 increased approximately 13 percent and accounted for approximately 13 percent of our net written premiums. Approximately 39 percent of our new business came from our Premier and Leading agents, which again emphasizes the importance of building and strengthening our agency relationships. Our Premier and Leading agents are approximately 18 percent of our agency force, but produce 47% of our premiums. New business policy counts increased modestly in commercial lines and moderately in personal lines. And, we appointed more than 150 new agencies in 2009.

We continue to expand our Safety Group, Target Market and Choice Specialty Markets, which produced approximately 20 percent of our new business in 2009. All of these programs currently boast very favorable incurred to earned ratios in the mid-forty to low-fifty percentiles and comprise approximately 42.0 percent of our commercial lines written premium.

Retention for the year declined slightly, but continues to exceed industry averages. Retention was approximately 86 percent in both commercial and personal lines. We attribute the slight declines in our retention rates to our willingness to walk away from

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underpriced business, our efforts to limit our exposures to coastal regions, and our exit from personal lines in some regions of the country.

Catastrophe and Storm Losses

We did not experience many catastrophe and storm losses in fourth quarter of 2009, but for the year as a whole, our cat and storm losses were above our long-term averages. Even so, they were not nearly as severe as the record losses experienced in 2008. For the year, cat and storm losses amounted to 8.2 percent of earned premiums compared to an average of 6.5 percent for the eight year period between 2000 and 2007. As you may recall, there were no reported hurricane losses in the United States in 2009; however, we once again experienced increased claims activity due to the frequency of Midwestern Storms.

Large losses, which the Company defines as losses greater than \$250,000, excluding catastrophe and storm losses, were down approximately 8 percent in 2009.

Both frequency and severity were down slightly in 2009 compared to 2008, excluding three large fire claims. Including these three shock claims, severity was up slightly.

Investments

Our investment portfolio showed much improvement in 2009 due to the improvement in overall market conditions. Net investment income, however, declined approximately 1.3 percent primarily as a result of call activity on our U.S. Government Agency securities during the first half of the year and the low interest rate environment on short-term investments. The sale of our holdings of Verisk Analytics common stock in October at a net price of \$21.12 per share resulted in an after-tax realized gain of \$14.6 million, or \$1.11 per share.

2010 Expectations

Rates seem to be firming already for personal lines in many territories, and we anticipate that rates will begin to firm for commercial lines toward the latter half of the year. We will continue to take rate increases in the low to mid-single digits as warranted.

2010 will be a year of sticking to basics and building on our solid foundation by adhering to our strategic plan, maintaining disciplined underwriting standards, and prudently monitoring and managing both underwriting and investment risk.

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 and CFO

Thank you, Bruce. Overall premium rate levels declined 4.1 percent during 2009, primarily as a result of rate reductions implemented in 2008. Filed rates for 2009 were up a modest 0.4 percent, but represented the first positive change in four years. Rates continue to be very competitive in the commercial lines of business, which we believe is being driven, as least in part, by the weak economy. Companies realize that any proposed rate increases on good business will likely be challenged and could result in the loss of the account. As a result, most companies are content to retain their good business at current pricing levels and wait for the economy to improve. Opportunities for rate increases have been more plentiful in the personal lines of business, but management seeks to implement rate increases wherever warranted.

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Investment income increased 2.4 percent to \$12.5 million in the fourth quarter, but declined 1.3 percent to \$47.8 million for the year. The increase in the fourth quarter is primarily attributed to the reinvestment of short-term holdings into Build America Bonds. The decline for the year is attributed to a high level of call activity experienced on the Company's U.S. Government Agency securities during the first half of the year due to 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.

Catastrophe and storm losses declined significantly from the record level experienced in 2008, but were still 1.7 percentage points higher than the average for the 8-year period from 2000 to 2007. Active weather patterns in the Midwest were once again the primary reason for the high level of storm losses, but management does not believe that these active weather patterns reflect a permanent increase in Midwest storm frequency or severity.

The Company experienced \$9.4 million of favorable reserve development in the fourth quarter, and \$48.6 million dollars for the year. These amounts include \$4.2 million of favorable development that occurred in the reinsurance subsidiary during the fourth quarter as a result of a reduction in bulk IBNR reserves and the winding down of the MAERP Reinsurance Association. These amounts also include \$0.5 million and \$3.5 million, respectively, of favorable reserve development that occurred on prior accident years' storm loss reserves.

When attempting to analyze the financial impact of the reported development amounts, it is important to understand that prudently conservative assumptions are utilized when establishing carried reserves for the current and more recent accident years due to the many uncertainties inherent in the reserve setting process. As time passes and the carried reserves for these accident years run off, the overall expectation is that favorable development will generally occur. However, at the same time that this favorable development is generally being experienced on the run off of those reserves, prudently conservative reserves are again being established for the current and more recent accident years. The net financial impact resulting from these separate but interrelated processes does not generally have a material impact on the Company's results of operations. Management will identify and disclose development amounts that are deemed to have a material impact on the Company's results of operations, such as the favorable development that occurred on prior accident years' storm reserves during 2009 and the favorable development that occurred in the reinsurance subsidiary's bulk IBNR reserve in the fourth quarter.

Since we are discussing reserves, I would like to point out that the most recent actuarial analysis of our carried reserves indicates a level of adequacy consistent with other recent evaluations. From management's perspective, this measure is more relevant to an understanding of the Company's results of operations than the composition of the underwriting results between the current and prior accident years.

Large losses, which we define as losses greater than \$250,000, excluding catastrophe and storm losses, amounted to \$0.58 per share and \$1.74 per share for the fourth quarter and year ended December 31, 2009, compared to \$0.67 per share and \$1.84 per share for the fourth quarter and year ended December 31, 2008.

New business premium was up 13.2 percent, reflecting a 51.8 percent increase in personal lines and an 8.8 percent increase in commercial lines. The increase in personal lines is distorted somewhat by a change from 6 month auto policies to

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annual auto policies. We estimate the impact of this change to be approximately 9 percentage points.

As previously noted, the Company sold 100% of its investment in Verisk Analytics, Inc. common stock in connection with that company's IPO on October 7. As a result of this sale, the Company recorded an after-tax realized investment gain of \$14.6 million, or \$1.11 per share. Management elected to sell all of its Verisk stock primarily to reduce the potential volatility of the Company's equity portfolio; however, there were also some tax considerations involved in the decision.

The total rate of return on our equity portfolio for 2009 was 21.8 percent, which is less than the 26.5 percent total return generated by the S&P 500. During the fourth quarter, our equity portfolio returned 4.3 percent, compared to 6.04 percent for the S&P 500. The current annualized yield on our bond portfolio is 5.27 percent and the effective duration is 6.12 years, which is up from 5.68 years at September 30, 2009.

The net book value of the Company's stock at December 31, 2009 was \$26.11 per share, an increase of 22.5 percent from \$21.32 at December 31, 2008; consolidated assets totaled \$1.2 billion, including \$1.0 billion in the investment portfolio; and stockholders' equity was \$342.4 million, an increase of 21.0 percent from December 31, 2008.

As announced on February 3, 2010, management is projecting that 2010 operating income will be within a range of \$1.90 to \$2.15 per share. This guidance is based on a projected GAAP combined ratio of 103.7 percent for the year.

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 December 31, 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

Our first question comes from Bob Farnam with KBW. Please proceed with your question.

<Q>: The reinsurance premium declined in the quarter. Was that related to the winding down of the MAERP Reinsurance Association as well?

Ron Jean - EMC Insurance Group Inc. – EVP for Corporate Development

Yes, Bob. The MAERP wind down didn't have any impact in the fourth quarter. I think it was more related to loss of, I think it was a crop hail program that we had in place. It was in 2008 and it actually didn't renew then in 2009. That was probably the biggest impact.

<Q>: And I'm assuming that the big increase in the auto premium was because of the change to the 12-month policies. I mean it was a 40% increase for the quarter, but is that basically all explained by the change in policies?

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Ron Jean - EMC Insurance Group Inc. – EVP for Corporate Development

I can probably address that too, Bob. Yes, I think that was part of it. As Mark indicated, that accounted for some of the increase in the new business premiums, but we also are getting good growth in those territories that we've really focused on trying to get good growth in personal lines. Those programs seem to be working out fairly well for us, so we're seeing some nice increase in policy. I don't know if someone else has some comments on that.

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

Bob, the percentages are somewhat misleading in that personal line is still a fairly small part of our total activity, so I mean some growth would kind of make it look a little bit higher than it probably actually is and then you combine that with the annual auto for the personal auto and it pushes it up quite a bit. We have been focusing in on some particular territories to grow our personal lines book. As we mentioned, we pulled out of personal lines in some other territories, so we are actively looking for personal lines in selected territories that we've identified as future profitability.

<Q>: In terms of rates, it sounds like personal lines is going up a bit and commercial lines is still pretty tough. What are the most competitive lines on the commercial line side still?

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

Probably right now I would say commercial automobile, just because it tends to be a fairly large premium type of a line of business and a lot of companies tend to see, well, maybe we could be a little more competitive and give up some of the premium on that to be more competitive on a total overall account.

Commercial property seems to be a little competitive, but we're seeing some flattening out of that basically because rates are awful low. It kind of goes up and down a little bit depending on what territory we're in, but we're trying to maintain some real pricing discipline in worker's compensation.

<Q>: Switching gears a bit on the investment side, how much of your new investments with the fixed income investments have variable interest rates and how much are fixed?

Ray Davis – EMC Insurance Group Inc. – Chief Investment Officer

Bob, we don't do anything in the variable rate area. Everything that we do is fixed rate.

<Q>: That's pretty simple. Okay.

Operator

Our next question comes from Paul Newsome with Sandler O'Neill. Please proceed with your question.

<Q>: My first question is what sort of Cat load are you putting into your expectations for 2010 and how does that compare to what happened in 2009?

Scott Jean - EMC Insurance Group Inc. – VP Actuary

For 2010 we've got a Cat load for the group of 8.1%, which is actually comparable to what we had for 2009 at 8.2% and much lower than what we had in 2008 at 13.5%. It does vary for pool business versus EMC Re.



<Q>: The second question then, related, is what sort of PIF growth are you seeing in your personalized business?

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

PIF growth on personal lines – do you mean like no fault?

<Q>: Policy and source.

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

Scott got the numbers on that also, but we are seeing policies in force increase for both, homeowners and for personal auto. We're seeing document increase especially for new business for homeowners and auto. Scott, do you have some numbers on that?

M

We thought you were talking about the PIP coverages for no fault and we tried to figure out which states we were in that had PIP. Sorry, Paul.

Scott Jean - EMC Insurance Group Inc. – VP Actuary

We saw some good personal lines growth in policy count even after we consider the impact that the annual auto had on policy counts. I guess it would have an impact on our in force at any given time, but we still saw a pretty good increase in personal lines, especially in personal auto.

Commercial: We did see an increase in new business over what we had seen in the past and renewal growth was still pretty firm as far as the policy that we retained from prior years.

<Q>: Do you know what the percentage of PIF growth was for personalized? Do you have that number off the top of your head?

Scott Jean - EMC Insurance Group Inc. – VP Actuary

It's very difficult to get a handle on because of the impact of the annual auto I guess.

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

Paul, I have some counts that come directly off of our agents, which give it directly to us. We're showing that new personal, like homeowners, is up about 31% and new count for automobile is up about 58%. The in force for personal auto is up 16%, again, that could be skewed a little bit because of last year we counted half policies because of six-month policies. The homeowners in force, the renewal count, not in force, but renewal, is down about 3%. A lot of that has to do with some of the actions we are taking and some of the territories where we are withdrawing from personal lines and taking some actions along the northeast on our homeowner's exposure.

Scott Jean - EMC Insurance Group Inc. – VP Actuary

I'm showing that overall personal lines is up 2.4% on policy count.

<Q>: Fabulous. Great. Thank you.

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

Paul, your initial question was about the Cat load and we happen to have Rich Schulz here, who is head of our claims operation. We're pretty accurate in how we're able to analyze Cat. I'd like Rich to chat about that a minute.

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Rich Schulz - EMC Insurance Group Inc. – SVP Claims

We've got a pretty good group in terms of doing the actual case reserve pricing on these storms and going all of the way back to Katrina and Rita we've been within a couple of percent of the eventual outcome within about six months of the storm. So we've been showing consistently favorable development on these storm reserves. We've just been pretty good last year in pricing them up.

<Q>: Great. Thank you.

Operator

We have another question from Bob Farnam with KBW. Please proceed with your question.

<Q>: The increasing effective tax rate: I'm assuming that's probably a function of the sale of the Verisk Holdings. Is that correct?

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

Well, it's certainly going to have an impact on the calculation, yes. But just the overall increase in the profitability of the company is certainly playing a part in that too.

<Q>: Can you give us what you're assuming for your tax rates in your guidance?

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

I think it was pretty similar to that number. We'll have to dig here; 20.5% is the number we've used.

<Q>: Great. Thanks a lot.

Operator

There are no further questions in queue at this time. I would like to turn the call back over to Ms. Novak for closing comments.

Anita Novak – EMC Insurance Group Inc. – Assistant Secy, Director of Investor Relations

Thank you, ladies and gentlemen. This now concludes this conference call. I would like to remind you that a playback of this call will be available on the Company's investor relations page of the Company's website at www.emcins.com/ir until March 11, 2010 and a transcript of this conference call will be available until February 24, 2011, 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.

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