

***Transcript of  
EMC Insurance Group  
Second Quarter 2010 Earnings Conference Call  
July 29, 2010***

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## **Participants**

Bruce G. Kelley, President and CEO  
Ron Jean, EVP for Corporate Development  
Rich Schulz, SVP Claims  
Mark Reese, SVP and CFO  
Kevin Hovick, SVP Business Development  
Scott Jean, VP Actuary  
Kelvin Sederburg, VP Actuary  
Lisa Stange, Asst. VP, Director of Investments & Treasurer  
Anita Novak, Director of Investor Relations

## **Presentation**

### **Moderator**

Greetings. Welcome to the EMC Insurance Group Second Quarter 2010 Earnings Conference call. At this time, all participants are in a listen-only mode. 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. Thank you, Ms. Novak. You may begin.

### **Anita Novak, Assistant Secretary - Director of Investor Relations**

Thank you. Good morning, everyone and welcome to EMC Insurance Group's 2010 second quarter earnings call. A supplemental investor packet is available on the Investor Relations page of our Web site, 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 October 29, 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-K, 10-Q, and 8-K. Any information provided today should be read in conjunction with the 2010 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. 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 – Chief Actuary; Mr. Kelvin Sederburg,



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Vice President – Appointed Actuary; Ms. Lisa Stange, Asst. Vice President, Director of Investments, and Treasurer; 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, President and CEO**

Thank you, Anita.

**Catastrophe and Storm Losses**

Midwestern storms definitely had a big impact on second quarter earnings. The quarter seemed to be a continuous period of storms producing damaging wind and hail and frequently spawning tornadoes. Catastrophe and storm losses in the second quarter added 17.2 percentage points to the combined ratio which is 7.0 percentage points greater than the most recent ten year second quarter average of 10.2 percentage points. Year-to-date, 2010 catastrophe and storm losses added 10.6 percentage points to the combined ratio which is 3.5 percentage points greater than the most recent ten year six-month average of 7.1 percentage points.

The spring quarter tends to generate higher levels of claims activity due to Midwestern storms and is frequently our most active storm quarter, but 2010 has definitely been an unusual quarter even for us.

Unlike 2007 and 2008, which produced EF5 tornadoes greatly affecting our policyholders in Greensburg, Kansas and Parkersburg, Iowa, 2010 storm losses have not been impacted by a single large event. Instead, severe storms were numerous, widespread, and costly; they lasted for longer periods of time and traversed a larger geographic area.

Due to straight-line winds and damaging hail, many of the claims were in our homeowners' line of business. Interestingly, despite widespread flooding in much of the affected areas, claims associated with sewer backup due to flooding were not unusually high.

In the reinsurance segment, catastrophe and storm losses have not been excessive so far this year. We have seen minimal claims activity with the Chilean earthquake. Storm Xynthia in Europe, which mainly affected France, Belgium and the Netherlands, was generally below our catastrophe treaty retentions, so there won't be much loss associated with that storm. We have very little exposure to the oil spill in the Gulf. We may see some additional storm losses associated with the Minnesota storm and tornado activity related to Cat no. 19, but we don't expect them to be significant.

Back to general operations. Though catastrophe and storm losses seemed to be the topic at issue, it's important to note that our strategic and operating plans are still working as expected and our underlying book of business is still performing well. Written premium is up for the quarter and year-to-date, due to moderate rate increases and increased policy counts in personal lines of business, as well as new reinsurance contracts and increases in line sizes on existing reinsurance business.

Commercial lines remain very competitive. Overall, the industry continues to reflect average rate declines in commercial lines of 3% to 6% depending on policy size and line of business; however, our average rate decline for commercial lines is approximately 1.4%, which is significantly better than current industry averages. More importantly, we seem to be maintaining that rate of decline.

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We continue to take rate increases when warranted. Premium adequacy is a top priority and we are well aware of the fact that it is achieved by consistently adhering to well-disciplined underwriting for both renewal and new business.

Frequency was up in commercial property and other liability lines of business and severity was up in the Workers' Compensation and personal liability lines of business. Overall, retention remains at 86%. We are seeing retention levels in personal lines decline somewhat as a direct result of the runoff business announced last year as well as the conversion of personal auto policies from a six month policy term to an annual policy term. But excluding that business, retention levels remain above industry averages.

We continue to evaluate our agency force of approximately 2,300 to insure quality performance. As of this date, we have appointed 100 new agencies in 2010 and terminated 58 agencies that were not performing as expected.

Investment income for the quarter and year-to-date increased 13.3% and 7.4% respectively, and is the result of the deployment of large amounts of cash in 2009 into our higher yielding fixed investments. Bond rates, however, fell significantly during the second quarter, with 10-year Treasury rates down .89%.

The company received \$61 million as a result of called investments during the second quarter. Most of those funds have now been reinvested, but at lower yields than previously applicable. In the second quarter, the S&P declined 11.4% and year-to-date it has declined 6.5%.

Our expectations for the rest of 2010 is more of the same. We expect commercial lines to continue to be competitive. We expect our personal lines to benefit from organic growth as a result of our revised marketing strategy implemented in late 2009 and early 2010. We expect to continue our expansion into newer regions of the Northwest and Southeast in commercial lines of business. And, we expect investments to remain sound. However, we don't expect significant growth in investment income if general market conditions remain sluggish.

With that, I'll ask Mark Reese, our Chief Financial Officer, for a discussion on current quarter results.

**Mark Reese, SVP and CFO**

Thank you, Bruce.

Operating income for the second quarter totaled \$3.8 million, or \$0.29 per share, and for the first six months of 2010 totaled \$13.4 million, or \$1.02 per share. Net income for the second quarter totaled \$3.3 million, or \$0.25 per share, and for the first six months totaled \$13.2 million, or \$1.00 per share. As previously noted by Bruce, the primary factor for the decline in second quarter results was increased storm activity throughout the Midwestern and Eastern sections of the nation.

Overall premium rate levels for all lines of business declined 0.8% during the second quarter, primarily due to increased usage of underwriting modification credits. Rate levels declined 1.4% in commercial lines, but increased 2.5% in personal lines. The homeowners' line of business saw the greatest rate level increase at 3.5%. Rate

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competition continues to be very strong in the commercial lines of business, and we expect this level of competition to continue through the year and probably into 2012.

We experienced \$5.9 million of favorable reserve development in the second quarter compared to \$9.4 million in the second quarter of 2009. For the first six months of 2010, favorable development totaled \$27.4 million, compared to \$30.5 million in 2009. The majority of the development experienced in 2010 is attributed to the final settlement of closed claims. Development amounts can vary significantly from quarter to quarter depending on a number of factors, including the number of claims settled and the settlement terms.

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 now define as losses greater than \$500,000 for the pool or \$150,000 for a group, excluding catastrophe and storm losses, amounted to \$0.18 per share in the second quarter, compared to \$0.15 per share in 2009. For the first six months of 2010, large losses amounted to \$0.35 per share, compared to \$0.37 per share in 2009. Previously, our threshold for large losses was \$250,000; however, that threshold had become less meaningful due to the large number of claims that were exceeding that amount. The new threshold will allow management to better monitor claims that are truly having a significant impact on operating results.

During the second quarter, our equity portfolio returned negative 11.56%, compared to negative 11.43% for the S&P 500. For the first six months of 2010 our equity portfolio outperformed the S&P 500 slightly returning negative 5.81% compared to negative 6.65%. The current annualized yield on our bond portfolio is 5.12% and the effective duration is 5.60 years, which is down from 6.12 years at December 31.

The book value of the Company's stock was \$27.62 per share at June 30, 2010, which is an increase of 19% from June 30, 2009 and an increase of 5.8% year-to-date. The Company's balance sheet remains solid with invested assets of \$1.1 billion, total assets of \$1.2 billion and stockholders' equity of \$361.3 million.

Based on actual results for the first six months of 2010 and management's expectations for the remainder of the year, we are decreasing our 2010 operating income guidance from the previous range of \$1.90 to \$2.15 per share to a revised range of \$1.65 to \$1.90 per share. The revised range is based on a projected GAAP combined ratio of 104.3% for the year.

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

**Moderator**

Our first question comes from Robert Farnam with KBW. Please go ahead.

**Robert Farnam, KBW**

Good morning. In the guidance number, the combined ratio guidance, how much is assuming near the cap load now?

**Bruce G. Kelley, President and CEO**

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We'll have Scott Jean, our Chief Actuary, take that on as he came up with the combined ratio.

**Scott Jean, VP Actuary**

The account ratio estimate for all of 2010 is 9.4%, which is a combination of 8.3% for the pool and then 13.9% for EMC Re, which is due to the higher exposure to hurricane on the reinsurance side.

**Robert Farnam, KBW**

You gave some of the breakdown of some of the frequency and severity trends. I'm just curious whether or not the loss trend, how premium trends are keeping up with loss trends? Should we expect the loss ratios to go up or down for most lines of business?

**Scott Jean, VP Actuary**

For the most part, exposure trend has been fairly flat, but we're not seeing a huge increase in the loss trend, either. So the overall loss ratio trend, I would say, is pretty close to 0%.

**Robert Farnam, KBW**

That should do it for me. Thanks.

**Moderator**

There are no further questions.

**Anita Novak, Assistant Secretary - Director of Investor Relations**

Okay, ladies and gentlemen, this now concludes this conference call. I would like to remind you that a playback Webcast 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 October 29, 2010, and a transcript of this conference call will be available until July 28, 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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