



Transcript of EMC Insurance Group

Third Quarter 2011 Earnings Conference Call November 8, 2011

Vcall
601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399
Fax: 804-327-7554

info@vcall.com
www.vcall.com

Participants

Anita Novak, Asst. Secy. – Director of Investor Relations
Bruce G. Kelley – President and Chief Executive Officer
Jason Bogart – VP Branch Operations
Rich Schulz – SVP Claims
Mark Reese – SVP and CFO
Mel Appenzeller – AVP Actuary
Kelvin Sederburg – VP and Appointed Actuary
Lisa Stange – VP, Chief Investment Officer & Treasurer
Mick Lovell – VP, Director of Business Development
Ron Hallenbeck – VP and President, EMC Reinsurance Company

Analysts

Paul Newsome – Sandler O’Neill
Neil Cybart – KBW
John Dasher - Pinnacle

Presentation

Operator

Good morning. At this time

Anita Novak, Asst. Secy. – Director of Investor Relations

Good morning everyone, and welcome to EMC Insurance Group’s 2011 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. The webcast for replay purposes is also available at this site until February 8, 2012. 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 2011 third quarter earnings release with accompanying financial tables issued earlier today.

Mr. Bruce Kelley, President and Chief Executive Officer and Mr. Mark Reese, Senior Vice President and Chief Financial Officer will have prepared remarks this morning and other executive officers are available to answer questions. At this time it is my pleasure to introduce EMC’s Chief Executive Officer, Bruce Kelley.

Bruce G. Kelley – President and Chief Executive Officer

Thank you, Anita.



Catastrophes

Once again, I must report that catastrophes had a significant impact on our quarterly operations. Earlier today, we reported an operating loss of \$1.9 million or \$0.14 per share after tax and a combined ratio of 114.5% for the quarter. Catastrophe losses accounted for 24.5 percentage points of our third quarter combined ratio and totaled \$26.4 million or \$1.33 per share after tax. This compares to the historical third quarter 10-year average of 14.4 percentage points.

On a year-to-date basis, catastrophe losses totaled an unprecedented \$76.8 million or \$3.86 per share after tax and accounted for 25.2 percentage points of our year-to-date combined ratio of 120.3%. Our 10-year average for catastrophe losses during the first nine months of the year is 11.3 percentage points. We cannot deny that catastrophe losses have dominated our discussions this year; however, there are a lot of other issues impacting our operations, and many of them are considerably more positive.

Pricing

We continue to request and receive some commercial lines rate increases and we continue to achieve a higher level of rate adequacy in our personal lines. So far in 2011, we have requested and received more than 100 commercial lines rate increases and more than 35 personal lines rate increases. New business premium is down slightly, but overall premium is increasing.

Net written premiums increased 12% during third quarter and 8% for the first nine months of 2011. In the commercial lines, net written premiums increased 10.7% for the third quarter and 6.6% for the first nine months. In personal lines, net written premiums increased 10% for the third quarter and 6.6% for the first nine months.

Competition for new business remains; however, we are beginning to experience less disparity between renewal rates and new business rates. We are committed to price adequacy across our book of business. Retention levels remain high in both commercial and personal lines, with commercial lines retention at 87% and personal lines retention at 89%.

We continue to evaluate our agency force of approximately 2,300 to insure quality performance. As of this date, we have appointed 101 new agencies in 2011 and terminated 109 agencies that were not performing as expected.

We continue to expand our Safety Group, Target Market and Choice Specialty Markets. These programs currently comprise approximately 45% of our commercial lines written premium, and have historically generated favorable results. As of September 30, 2011, earned premium for the EMC Choice Specialty programs was up 10.2%; target market programs was up 8.7%; and safety group programs was down 1%. These programs provide stability to the commercial lines of business and are not generally subject to extreme price competition due to the high level of risk improvement services involved.

The reinsurance segment reported a 21% increase in net written premiums for the quarter and 13.9% for the first nine months. These increases are primarily attributed to increased participation in the MRB pool and an increase in facility business, which includes reinsurance business from small to mid-size insurance companies, and new property business in central and Eastern Europe.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



With that, I'll turn the discussion over to Mark Reese our Chief Financial Officer.

Mark Reese – SVP and CFO

Good morning, everyone.

Summary

Net loss, including realized investment gains and losses, totaled \$4.1 million or \$0.32 per share for the third quarter of 2011, compared to net income of \$7.5 million or \$0.57 per share for the third quarter of 2010. Net loss for the first nine months of 2011 was \$11.4 million or \$0.88 per share, compared to net income of \$20.6 million or \$1.58 per share for the same period in 2010.

During the third quarter of 2011, the Company recognized \$4.9 million, or \$0.25 per share after tax, of "other-than-temporary" investment impairment losses on 27 equity securities because management determined that it would likely not hold those securities until they recovered to their cost basis. This compares to \$366,000 or \$0.02 per share after tax in the third quarter of 2010. During the first nine months of 2011, "other-than-temporary" investment impairment losses totaled \$5.8 million or \$0.29 per share after tax, compared to \$2.3 million or \$0.11 per share after tax in 2010.

Premiums earned increased 10.4% for the quarter and 6.5% year-to-date. The Company reported an increase in net written premiums in all lines of business during the third quarter, and nearly all lines of business year-to-date.

Investment Results

Investment income decreased 7.4% in the third quarter and 6.8% for the nine months ended September 30, 2011. These decreases are primarily attributed to a persistent decline in the annualized yield of the Company's fixed maturity portfolio over the past several years and an increase in short-term investments, which carry even lower yields. The higher level of short-term investments is being used to pay the record storm claims of 2011.

Looking ahead, we expect investment income to decline approximately 8.4% for calendar year 2011, and anticipate that a similar decline could occur in calendar year 2012 if current economic conditions, including the low interest rate environment, continue. Our equity portfolio return was (-15.44%) for the quarter compared to (-13.87%) for the S&P 500. For the first nine months of 2011, our equity portfolio returned (-7.30%), compared to (-8.68%) for the S&P 500. The average coupon rate on our fixed maturity security portfolio declined to 4.61% at September 30th from 4.98% at December 31. The effective duration of the portfolio declined to 4.90 years, from 5.75 years at December 31.

Large Losses

Large losses, which we define as losses greater than \$500,000 for the EMC pool, excluding catastrophe losses, declined to \$0.24 per share in the third quarter from \$0.33 per share in 2010. For the first nine months of 2011, large losses remained fairly constant at \$0.65 per share, compared to \$0.67 per share in 2010.

Development

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



Transcript:
EMC Insurance Group
Third Quarter 2011 Earnings Conference Call
November 8, 2011

As noted in this morning's press release, we continued to experience favorable development on prior years' reserves totaling \$8.6 million in the third quarter and \$21.7 million in the first nine months of the year. This compares to favorable development of \$18.8 million and \$46.2 million during the same periods in 2010. Approximately \$6.7 million of the decline in the nine month numbers is attributed to a change in the methodology used to allocate the property and casualty insurance segment's bulk reserves to the various accident years that was implemented December 31, 2010.

Under the revised methodology, a larger portion of the current quarter's bulk reserves is being allocated to prior accident years. This has reduced the amount of favorable development reported in the first nine months of 2011 when compared to 2010. The reinsurance segment also experienced a decline in favorable development in 2011 due to uncharacteristic adverse development in the HORAD book of business during the first quarter. We continue to focus on maintaining a consistent level of reserve adequacy. The most recent actuarial analysis of our carried reserves indicates a level of adequacy consistent with other recent evaluations.

Balance Sheet

The book value of the Company's stock decreased to \$27.69 per share at September 30, from \$28.52 at year-end 2010. Excluding accumulated other comprehensive income from the calculation, book value decreased to \$25.21 per share from \$26.63 per share at year-end. The Company's balance sheet remains solid with invested assets of \$1.1 billion, total assets of \$1.3 billion and stockholders' equity of \$356.4 million.

Capital Management

As previously announced, on November 3rd the Company's Board of Directors declared its 120th consecutive quarterly dividend. The dividend of \$0.20 per share represents an increase of 5.3% over the previous quarterly dividend of \$0.19 per share. It is the Board's position that due to the strength of the Company's balance sheet and future business expectations, a dividend increase was warranted at this time.

The Company's Board of Directors also authorized a new \$15 million stock repurchase program on November 3rd. This program became effective immediately and does not have an expiration date. The timing and terms of the purchases will be determined by management based on market conditions and will be conducted in accordance with the applicable rules of the Securities and Exchange Commission. Common stock repurchased under this new program will be retired. The Company's parent organization, Employers Mutual Casualty Company, also has a stock purchase program in place, with about \$4.5 million of its \$15 million authorization remaining. This program is currently dormant and will remain so while the Company's repurchase program is active.

Other Board Actions

In other Board actions, the Inter-Company Committees of the boards of the Company and Employers Mutual have approved a change to the terms of the excess of loss reinsurance agreement between the Company's reinsurance subsidiary, EMC

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



Reinsurance Company, and Employers Mutual for 2012. Effective January 1, 2012, pending regulatory approval, the current \$3.0 million retention, or cap, on losses assumed per event will be increased to \$4.0 million. This change is a result of efforts to ensure that the terms of the agreement are fair and equitable to both parties. The cost of the coverage will continue at 10% of total assumed reinsurance premiums.

The Inter-Company Committees of the boards have also approved an inter-company loan agreement that will allow Employers Mutual and any of its insurance company subsidiaries and affiliates, including the Company's insurance and reinsurance subsidiaries, to borrow funds from one another on a short-term basis (up to 180 days) at market-based interest rates. The purpose of this agreement is to minimize instances where a participating company is forced to sell investment securities to meet operating needs while other participating companies have excess cash on hand. This agreement will become effective January 1, 2012, pending regulatory approval.

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

Q&A Segment:

Operator

Our first question is from the line of Paul Newsome with Sandler O'Neill.

<Q>: I wanted to focus in on the increased costs of the cat reinsurance for the mutual. Doesn't this suggest that the mutual beliefs is the catastrophe risk prospectively is higher because they're going to charge more? And if that's the case shouldn't we as analysts also be thinking of a higher cat load prospectively as well?

Bruce G. Kelley – President and Chief Executive Officer

That's a good question, Paul, and we have Kelvin Sederburg who was involved in the actuarial analysis of it as well as Ron Hollenbeck who did the underwriting, so I'll turn it over to Kelvin for his input.

Kelvin Sederburg – VP & Appointed Actuary

Thank you, Bruce. Good morning, Mr. Newsome. It would be incorrect to make a correlation between the cat loads that we expect on our direct business and what is going on with the inter-company excessive loss agreement. The excess of loss agreement between the reinsurance company and the mutual company is completely separate analysis and there are several factors that come into play on why the terms for change, not the least of which is the fact that outside retro-coverage is purchased on the reinsurance business and that coverage has changed over the years exposing the mutual company to greater losses and before the coverage kicks in than what has happened in the past. That is part of what has gone into the pricing, the situation there.

The reinsurance company was basically forced with a decision of to choose whether to keep the same retention levels as in the past or a higher premium or increase the retention level and keep the premium the same. So there really is no correlation between what's going on in the inter-company agreement. And we also must keep in mind with the reinsurance company, that we have foreign exposure there that has grown to some extent that is not covered under our retro-sessional agreement and that exposes the mutual company to greater risk as well. So those were some of the factors that went into that decision. It really has nothing at all to do with our expected catastrophe loads and experience on the direct side.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



<Q>: So the mutual is paying more for its retro and so that's getting passed down to the subsidiary.

Kelvin Sederburg – VP & Appointed Actuary

The mutual is not necessarily paying more; its retro. The mutual is taking on more risk because the retro coverage is kicking in a higher level.

<Q>: There's no economic difference between taking less retro and paying more for the same, right?

Kelvin Sederburg – VP & Appointed Actuary

I would have to ask you to repeat that for a second.

<Q>: There economic difference between taking more risk at the same price than paying more for the same coverage. Price is a function of risk versus dollars paid. So if you're accepting more risk at the same price, the cost of retro effective

Kelvin Sederburg – VP & Appointed Actuary

I see what you're saying there. In that sense perhaps that could be a correct assumption, but yes, the fact remains that the mutual company and to purchase the same retro-sessional coverage we had in the past would be more expensive, even keeping the same retention levels. So those were the factors that went into that particular decision.

Bruce G. Kelley – President and Chief Executive Officer

I might add, Paul that we place our retro at May 1st and that was not particularly good timing of the last two years. We had the Chilean earthquake in 2010 and obviously the Japan earthquake this year. So we went into the retro market and they were not in a very good mood. Also this year was the New Zealand earthquake, so the worldwide markets do impact the retro pricing substantially.

Operator

Our next question is from the line of Neil Cybart with KBW.

<Q>: You reported double digit premium growth in the P&C segment, which would mark the first time since 2005. Could you break down how much of that growth was as a result of new policies and how much was due to higher rate?

Kevin Hovick – General Counsel

A significant part of it is due to higher rates. Our new business for commercial and personal line is down just a small amount from last year, so we're about flat with new business. We are seeing rate increases, significant rate increases in our personal lines, especially in our homeowners line of business. We are starting to see a growing rate increase with our commercial lines. We are also seeing increased retention levels for both personal lines and commercial lines. We're also starting to see our commercial policies, endorsements are up. Some of our insured, the economy is not getting any worse, whereas it's not getting any better, but at least it's maintaining, so they're starting to add a few more exposures to their policy, not at significant rate.

We're also on our premium audit. At this time last year, we were returning about a million dollars a month on premium audits based off of payroll and salaries. Now that has flattened out to about a wash, about zero, so we're not returning anything, we're

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



not billing for a lot extra either, so most of our growth, the growth is not coming from an increase in new business from the prior year.

<Q>: And concerning the commercial rate increases, how does that compare to current loss cost trends that you're seeing?

Mel Appenzeller – AVP Actuary

Really with the exposure, counting the exposure and the rate increases, we're keeping up with the loss cost that we are observing currently on our book.

<Q>: Moving on to the expenses, your overall expense ratio dipped below 30, which is pretty unusual for you guys. Are there any moving parts going on there, a shift in business mix, for example?

Bruce G. Kelley – President and Chief Executive Officer

I think Mark can do a good job of responding to that, but I'll just say on thing. Our bonuses are only paid if we have a good year and this was not a good year.

Mark Reese – SVP and CFO

And that's part of the reason, too, that all of our accruals for bonuses are kind of reduced not much there anymore. A couple of other factors, we had reductions in commission, contingent commission in the quarter and we're also seeing, the third quarter is generally a rather large premium quarter, so that has an impact on the ratios that we report in the third quarter.

<Q>: So it sounds like more or less one-time events versus any significant trend.

Mark Reese – SVP and CFO

Yes, there's nothing significant going on, though.

<Q>: My final question is on share buyback. Could you remind us how you look at your buyback, especially with your shares trading where they are? Is the pace dependent on the cat season? Would you be looking to maybe increase the pace of buyback of shares could change where they are, given your low liquidity?

Bruce G. Kelley – President and Chief Executive Officer

On the share buyback it's related to more to the market price. It's basically an effort between Mark Reese and Lisa Sang and I'll let them speak on how they determine how we buy it back.

Mark Reese – SVP and CFO

Obviously we know that our float isn't where we'd like it to be to begin with, so we're not real excited about buying back more shares and reducing that float even more. Having said that, we recognize that when the stock gets down to a certain level, it's hard to say we don't want to buy it back. So historically and on a going forward basis, our purchase is going to be based more on what the price of the stock is doing rather than our desire to buy the stock back.

Operator

Our next question is from the line of John Dasher with Pinnacle.

<Q>: The \$4.9 million other than temporary investment charge, I was curious why that was triggered. You say it was related to 27 equity securities that management determined would not likely be held until the costs there recovered. Obviously the

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



third quarter was a difficult quarter for everyone, but I'm just wondering what prompted you to take that loss during the third quarter, given that the whole market was down.

Lisa Stange – VP, Chief Investment Officer & Treasurer

Our impairment policies have been in place for some time, so when this bad equity quarter came up where the market was down about 15%. We as every quarter surveyed our outside equity managers to determine whether they thought they would recover that value in those equity securities prior to selling. They send us back a list of those that they intend to sell in the near term and whether they think they will recover the previous value. And in this case because the losses were quite large in the third quarter, there were several securities that they did not think would recover losses. Now we had a tremendous October and in retrospect many of those recovered all or most of their losses, but our impairment policy is a long term policy and we did not change for this quarter and it did cause a number of securities to be impaired.

<Q>: The equity manager is Harris Bank, is that still correct?

Lisa Stange – VP, Chief Investment Officer & Treasurer

It is Harris Investment Management, a subsidiary of BMO.

<Q>: Remind us again what kind of shop that is. Is that a quant shop or buy and hold shop or exactly what is their investment mandate as it pertains to you, the client?

Lisa Stange – VP, Chief Investment Officer & Treasurer

It's a large core equity mandate. It is a 12-18 month holding period and they do use quantitative models to signal buy and sell. But they generally trade about once a month, so it's a long term hold strategy.

<Q>: Trade once a month for a certain percentage of the portfolio you mean?

Lisa Stange – VP, Chief Investment Officer & Treasurer

That when they would rebalance the portfolio based on their model's output. They do it sometimes more frequently than that if the signals are very strong, but typically once a month is the optimal rebalancing.

<Q>: Then just to close here, they recommend or suggest the securities that they don't think will recover and then it's up to management to agree or disagree with that. Is that correct?

Lisa Stange – VP, Chief Investment Officer & Treasurer

That is correct.

Operator

We have no further questions at this time. I'll turn the floor back over to management for any closing comments.

Anita Novak, Asst. Secy. – Director of Investor Relations

Final Remarks:

Thank you 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 website at www.emcins.com/ir until November 18, 2012 and a transcript of this conference call will be available for

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com



**Transcript:
EMC Insurance Group
Third Quarter 2011 Earnings Conference Call
November 8, 2011**

one year, 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.

Vcall

601 Moorefield Park Dr.
Richmond, VA 23236

Phone: 888-301-5399

Fax: 804-327-7554

info@vcall.com

www.vcall.com

www.investorcalendar.com