UNITED FIRE GROUP INC
Form 10-Q
May 08, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

for the quarterly period ended March 31, 2013

Commission File Number 001-34257

UNITED FIRE GROUP, INC.
(Exact name of registrant as specified in its charter)

Iowa	45-2302834
(State of Incorporation)	(IRS Employer Identification No.)

118 Second Avenue, S.E., Cedar Rapids, Iowa 52407
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (319) 399-5700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. YES R NO o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
YES R NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer R Non-accelerated filer o Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO R

As of May 6, 2013, 25,281,042 shares of common stock were outstanding.

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FORWARD-LOOKING INFORMATION

It is important to note that our actual results could differ materially from those projected in our forward-looking statements. Information concerning factors that could cause actual results to differ materially from those in the forward-looking statements is contained in Part I, Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and Part II, Item 1A “Risk Factors.”

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PART I — FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

United Fire Group, Inc.
Consolidated Balance Sheets

(In Thousands, Except Share Data)	March 31, 2013 (unaudited)	December 31, 2012
ASSETS		
Investments		
Fixed maturities		
Held-to-maturity, at amortized cost (fair value $1,668 in 2013 and $1,681 in 2012)	$1,638	$1,655
Available-for-sale, at fair value (amortized cost $2,666,902 in 2013 and $2,657,800 in 2012)	2,807,582	2,808,078
Trading securities, at fair value (amortized cost $12,470 in 2013 and $12,645 in 2012)	13,738	13,353
Equity securities		
Available-for-sale, at fair value (cost $67,464 in 2013 and $66,892 in 2012)	195,677	177,127
Trading securities, at fair value (cost $1,772 in 2013 and $1,772 in 2012)	2,131	2,018
Mortgage loans	4,581	4,633
Policy loans	6,566	6,671
Other long-term investments	30,646	30,028
Short-term investments	800	800
	3,063,359	3,044,363
Cash and cash equivalents	101,948	107,466
Accrued investment income	30,079	30,375
Premiums receivable (net of allowance for doubtful accounts of $888 in 2013 and $866 in 2012)	207,920	188,289
Deferred policy acquisition costs	113,088	105,300
Property and equipment (primarily land and buildings, at cost, less accumulated depreciation of $34,060 in 2013 and $34,093 in 2012)	42,328	43,090
Reinsurance receivables and recoverables	120,140	114,399
Prepaid reinsurance premiums	3,218	2,963
Income taxes receivable	2,386	16,536
Goodwill and intangible assets	27,624	28,259
Other assets	12,600	13,613
TOTAL ASSETS	$3,724,690	$3,694,653
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Future policy benefits and losses, claims and loss settlement expenses		
Property and casualty insurance	$971,239	$971,911
Life insurance	1,484,362	1,498,176
Unearned premiums	326,320	311,650
Accrued expenses and other liabilities	157,801	164,111
Deferred income taxes	26,826	19,628
TOTAL LIABILITIES	$2,966,548	$2,965,476
Stockholders' Equity		
	$25	$25

Common stock, $0.001 par value; authorized 75,000,000 shares; 25,266,295 and 25,227,463 shares issued and outstanding in 2013 and 2012, respectively		
Additional paid-in capital	209,472	208,536
Retained earnings	444,035	425,428
Accumulated other comprehensive income, net of tax	104,610	95,188
TOTAL STOCKHOLDERS' EQUITY	$758,142	$729,177
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$3,724,690	$3,694,653

The Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

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United Fire Group, Inc.
Consolidated Statements of Income and Comprehensive Income (Unaudited)

(In Thousands, Except Share Data)	Three Months Ended March 31, 2013	2012
Revenues		
Net premiums earned	$176,817	$161,503
Investment income, net of investment expenses	26,464	29,146
Net realized investment gains		
Other-than-temporary impairment charges	—	—
All other net realized gains (includes reclassifications for net unrealized gains on available-for-sale securities of $1,909 in 2013; and $2,794 in 2012; previously included in accumulated other comprehensive income)	1,909	2,794
Total net realized investment gains	1,909	2,794
Other income	115	256
Total revenues	$205,305	$193,699
Benefits, Losses and Expenses		
Losses and loss settlement expenses	$97,470	$91,484
Future policy benefits	8,236	10,138
Amortization of deferred policy acquisition costs	38,081	34,551
Other underwriting expenses (includes reclassifications for employee benefit costs of $1,242 in 2013; and $643 in 2012; previously included in accumulated other comprehensive income)	22,348	21,994
Interest on policyholders' accounts	9,320	10,656
Total benefits, losses and expenses	$175,455	$168,823
Income before income taxes	$29,850	$24,876
Federal income tax expense (includes reclassifications of $234 in 2013; and $752 in 2012; previously included in accumulated other comprehensive income)	7,457	5,692
Net income	$22,393	$19,184
Other comprehensive income		
Change in net unrealized appreciation on investments	$15,161	$13,603
Change in liability for underfunded employee benefit plans	—	—
Other comprehensive income, before tax and reclassification adjustments	$15,161	$13,603
Income tax effect	(5,306)	(4,761)
Other comprehensive income, after tax, before reclassification adjustments	$9,855	$8,842
Reclassification adjustment for net realized gains included in income	$(1,909)	$(2,794)
Reclassification adjustment for employee benefit costs included in expense	1,242	643
Total reclassification adjustments, before tax	$(667)	$(2,151)
Income tax effect	234	752
Total reclassification adjustments, after tax	$(433)	$(1,399)
Comprehensive income	$31,815	$26,627
Weighted average common shares outstanding	25,245,497	25,505,962
Basic earnings per common share	$0.89	$0.75
Diluted earnings per common share	0.88	0.75
Cash dividends declared per common share	0.15	0.15

The Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

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United Fire Group, Inc.
Consolidated Statement of Stockholders' Equity (Unaudited)

(In Thousands, Except Per Share Data)	Three Months Ended March 31, 2013
Common stock	
Balance, beginning of year	$25
Shares issued for stock-based awards (38,832 shares)	—
Balance, end of period	$25
Additional paid-in capital	
Balance, beginning of year	$208,536
Compensation expense and related tax benefit for stock-based award grants	333
Shares issued for stock-based awards	603
Balance, end of period	$209,472
Retained earnings	
Balance, beginning of year	$425,428
Net income	22,393
Dividends on common stock ($0.15 per share)	(3,786)
Balance, end of period	$444,035
Accumulated other comprehensive income, net of tax	
Balance, beginning of year	$95,188
Change in net unrealized investment appreciation (1)	8,614
Change in liability for underfunded employee benefit plans(2)	808
Balance, end of period	$104,610
Summary of changes	
Balance, beginning of year	$729,177
Net income	22,393
All other changes in stockholders' equity accounts	6,572
Balance, end of period	$758,142

(1) The change in net unrealized appreciation is net of reclassification adjustments and income taxes.
(2) The change in liability for underfunded employee benefit plans is net of income taxes.

The Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

United Fire Group, Inc.
Consolidated Statements of Cash Flows (Unaudited)

	Three Months Ended March 31,	
(In Thousands)	2013	2012
Cash Flows From Operating Activities		
Net income	$22,393	$19,184
Adjustments to reconcile net income to net cash provided by operating activities		
Net accretion of bond premium	3,981	3,520
Depreciation and amortization	1,785	2,285
Stock-based compensation expense	411	396
Net realized investment gains	(1,909)	(2,794)
Net cash flows from trading investments	46	(1,343)
Deferred income tax expense	460	5,011
Changes in:		
Accrued investment income	296	(344)
Premiums receivable	(19,631)	(14,560)
Deferred policy acquisition costs	(2,917)	1,526
Reinsurance receivables	(5,741)	(23,199)
Prepaid reinsurance premiums	(255)	2,650
Income taxes receivable	14,150	3,926
Other assets	1,013	2,691
Future policy benefits and losses, claims and loss settlement expenses	6,364	20,596
Unearned premiums	14,670	15,228
Accrued expenses and other liabilities	(5,068)	5,721
Deferred income taxes	1,665	(3,409)
Other, net	31	(1,200)
Total adjustments	$9,351	$16,701
Net cash provided by operating activities	$31,744	$35,885
Cash Flows From Investing Activities		
Proceeds from sale of available-for-sale investments	$2,810	$3,000
Proceeds from call and maturity of held-to-maturity investments	19	75
Proceeds from call and maturity of available-for-sale investments	127,514	149,285
Proceeds from short-term and other investments	407	2,590
Purchase of available-for-sale investments	(142,615)	(252,345)
Purchase of short-term and other investments	(900)	(2,950)
Net purchases and sales of property and equipment	(386)	(893)
Net cash used in investing activities	$(13,151)	$(101,238)
Cash Flows From Financing Activities		
Policyholders' account balances		
Deposits to investment and universal life contracts	$25,369	$40,390
Withdrawals from investment and universal life contracts	(46,219)	(33,743)
Repayment of trust preferred securities	—	(8,047)
Payment of cash dividends	(3,786)	(3,826)
Issuance of common stock	603	43
Tax impact from issuance of common stock	(78)	9
Net cash used in financing activities	$(24,111)	$(5,174)
Net Change in Cash and Cash Equivalents	$(5,518)	$(70,527)
Cash and Cash Equivalents at Beginning of Period	107,466	144,527

Cash and Cash Equivalents at End of Period	$101,948	$74,000

The Notes to Unaudited Consolidated Financial Statements are an integral part of these statements.

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UNITED FIRE GROUP, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, unless otherwise noted)

NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Business

United Fire Group, Inc. ("United Fire", "Registrant", the "Company", "we", "us", or "our") and its consolidated subsidiaries and affiliates are engaged in the business of writing property and casualty insurance and life insurance and selling annuities through a network of independent agencies. We report our operations in two business segments: property and casualty insurance and life insurance. We are licensed as a property and casualty insurer in 43 states, plus the District of Columbia, and as a life insurer in 36 states.

Basis of Presentation

We maintain our records in conformity with the accounting practices prescribed or permitted by the insurance departments of the states in which we are domiciled. To the extent that certain of these practices differ from U.S. generally accepted accounting principles ("GAAP"), we have made adjustments to present the accompanying unaudited Consolidated Financial Statements in conformity with GAAP. Certain financial information that is included in our Annual Report on Form 10-K, including certain financial statement footnote disclosures, are not required by the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial reporting and have been condensed or omitted.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The financial statement categories that are most dependent on management estimates and assumptions include: investments; deferred policy acquisition costs; reinsurance receivables and recoverables (for net realizable value); future policy benefits and losses, claims and loss settlement expenses; and pension and postretirement benefit obligations.

In the preparation of the accompanying unaudited Consolidated Financial Statements, we have evaluated all material subsequent events or transactions that occurred after the balance sheet date through the date on which the financial statements were issued for potential recognition or disclosure.

Certain prior year amounts have been reclassified to conform to the current year presentation.

In the opinion of the management of United Fire, the accompanying unaudited Consolidated Financial Statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for the periods presented. All significant intercompany transactions have been eliminated in consolidation. The results reported for the interim periods are not necessarily indicative of the results of operations that may be expected for the year. The unaudited Consolidated Financial Statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2012. The review report of Ernst & Young LLP as of and for the three-month period ended March 31, 2013, accompanies the unaudited Consolidated Financial Statements included in Part I, Item 1 "Financial Statements."

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash, money market accounts, and non-negotiable certificates of deposit with original maturities of three months or less.

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For the three-month periods ended March 31, 2013 and 2012, we made payments for income taxes totaling $5 and $151, respectively. We received a tax refund of $8,744 during the three months ended March 31, 2013. We received no tax refunds during the three months ended March 31, 2012.
For the three-month period ended March 31, 2013, we made no interest payments. For the three-month period ended March 31, 2012, we made interest payments totaling $492. These payments exclude interest credited to policyholders' accounts.
Deferred Policy Acquisition Costs ("DAC")

Certain costs associated with underwriting new business (primarily commissions, premium taxes and variable underwriting and policy issue expenses associated with successful acquisition efforts) are deferred. The following table is a summary of the components of DAC, including the related amortization recognized for the three-month period ended March 31, 2013.

	Property & Casualty	Life Insurance	Total
Recorded asset at beginning of period	$64,947	$40,353	$105,300
Underwriting costs deferred	39,835	1,163	40,998
Amortization of deferred policy acquisition costs	(36,355)	(1,726)	(38,081)
Ending unamortized deferred policy acquisition costs	$68,427	$39,790	$108,217
Change in "shadow" deferred policy acquisition costs	—	4,871	4,871
Recorded asset at end of period	$68,427	$44,661	$113,088

Property and casualty policy acquisition costs are deferred and amortized as premium revenue is recognized. The accounting method we follow in computing DAC limits the amount of such deferred costs to their estimated realizable value. This takes into account the premium to be earned, losses and loss settlement expenses to be incurred and certain other costs expected to be incurred as the premium is earned.

For traditional life insurance policies, DAC is amortized to income over the premium-paying period in proportion to the ratio of the expected annual premium revenue to the expected total premium revenue. For non-traditional policies, DAC is amortized over the anticipated terms in proportion to the ratio of the expected annual gross profits to the total expected gross profits. Expected premium revenue and gross profits are based on the same mortality and withdrawal assumptions used in determining future policy benefits. For non-traditional policies, changes in the amount or timing of expected gross profits result in adjustments to the cumulative amortization of these costs. The effect on amortization of DAC for revisions to estimated gross profits is reported in earnings in the period the estimated gross profits are revised.

The effect on DAC that results from the assumed realization of unrealized gains (losses) on investments allocated to non-traditional life insurance business is recognized with an offset, or "shadow" DAC, to net unrealized investment appreciation as of the balance sheet date. The "shadow" DAC adjustment decreased the DAC asset by $33,824 and $38,695 at March 31, 2013 and December 31, 2012, respectively.
Income Taxes
Deferred tax assets and liabilities are established based on differences between the financial statement bases of assets and liabilities and the tax bases of those same assets and liabilities, using the currently enacted statutory tax rates. Deferred income tax expense is measured by the year-to-year change in the net deferred tax asset or liability, except for certain changes in deferred tax amounts that affect stockholders' equity and do not impact federal income tax expense.

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We reported a federal income tax expense of $7,457 and $5,692 for the three-month periods ended March 31, 2013 and 2012, respectively. Our effective tax rate is different than the federal statutory rate of 35.0 percent due principally to the effect of tax-exempt municipal bond interest income and non-taxable dividend income.

We did not recognize any liability for unrecognized tax benefits at March 31, 2013 or December 31, 2012. In addition, we have not accrued for interest and penalties related to unrecognized tax benefits. However, if interest and penalties would need to be accrued related to unrecognized tax benefits, such amounts would be recognized as a component of federal income tax expense.

We file a consolidated federal income tax return. We also file income tax returns in various state jurisdictions. We are no longer subject to federal or state income tax examination for years before 2009. The Internal Revenue Service is conducting an examination of our income tax return for the 2011 tax year.

Recently Issued Accounting Standards

Adopted Accounting Standards

Comprehensive Income

In February 2013, the Financial Accounting Standards Board ("FASB") issued guidance (Accounting Standards Update ("ASU") 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income). The new guidance requires significant items that are reclassified out of accumulated other comprehensive income ("AOCI") to net income in their entirety in the same reporting period, to be reported to show the effect of the reclassifications on the respective line items of the statement where net income is presented. These reclassifications can be presented either on the face of the statement where net income is presented or in the notes to the financial statements. For items that are not reclassified to net income in their entirety in the same reporting period a cross reference to other disclosures currently required under GAAP is required in the notes to the financial statements. The new guidance also requires companies to report changes in the accumulated balances of each component of AOCI. This new guidance is effective for annual and interim periods beginning after December 15, 2012. The Company adopted the new guidance effective January 1, 2013. The adoption of the new guidance affects presentation only and therefore had no impact on the Company's results of operations or financial position.

Adopted Accounting Standards in 2012

Comprehensive Income

In June and December 2011, the FASB issued guidance (ASU 2011-05, Presentation of Comprehensive Income and ASU 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05) amending the presentation of comprehensive income and its components. Under the new guidance, a reporting entity has the option to present comprehensive income in a single continuous statement or in two separate but consecutive statements. This new guidance is to be applied retrospectively. The Company adopted the new guidance in the first quarter of 2012 by electing to report comprehensive income in a single continuous statement as shown in the accompanying Consolidated Statements of Income and Comprehensive Income. The adoption of the new guidance affects presentation only and therefore had no impact on the Company's results of operations or financial position.

Fair Value Measurements

In May 2011, the FASB issued updated accounting guidance (ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards ("IFRS")) that changed the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements to ensure consistency between GAAP and IFRS. The guidance also requires additional disclosures for fair value measurements that are estimated using significant unobservable (i.e., Level 3) inputs. The Company adopted the updated guidance on a prospective basis effective

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January 1, 2012, and has provided the additional disclosures required in "Note 3 Fair Value of Financial Instruments". The adoption of the new guidance did not have any impact on the Company's financial position or results of operations.

Indefinite-Lived Intangible Assets

In July 2012, the FASB issued guidance (ASU 2012-02, Intangibles - Goodwill and Other) for the testing of indefinite-lived intangible assets for impairment. The new guidance provides an option to perform a qualitative approach to test indefinite-lived intangible assets for impairment. If an entity concludes that it is more likely than not that the indefinite-lived intangible asset is impaired, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. However, if an entity concludes otherwise, then the entity is not required to take further action. This new guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, and early adoption is permitted. The Company early adopted the updated guidance for purposes of the impairment test performed for 2012. The adoption of the new guidance did not have any impact on the Company's financial position or results of operations.

NOTE 2. SUMMARY OF INVESTMENTS

Fair Value of Investments

A reconciliation of the amortized cost (cost for equity securities) to fair value of investments in held-to-maturity and available-for-sale fixed maturity and equity securities as of March 31, 2013 and December 31, 2012, is as follows:

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March 31, 2013

Type of Investment	Cost or Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
HELD-TO-MATURITY				
Fixed maturities				
Bonds				
States, municipalities and political subdivisions	$1,187	$18	$—	$1,205
Corporate bonds - financial services	200	—	—	200
Mortgage-backed securities	242	12	—	254
Collateralized mortgage obligations	9	—	—	9
Total Held-to-Maturity Fixed Maturities	$1,638	$30	$—	$1,668
AVAILABLE-FOR-SALE				
Fixed maturities				
Bonds				
U.S. Treasury	$36,845	$845	$4	$37,686
U.S. government agency	84,527	440	243	84,724
States, municipalities and political subdivisions	731,004	52,291	1,662	781,633
Foreign bonds	200,286	11,035	31	211,290
Public utilities	231,379	14,804	7	246,176
Corporate bonds				
Energy	167,556	8,717	—	176,273
Industrials	260,157	13,345	101	273,401
Consumer goods and services	190,279	9,015	99	199,195
Health care	106,528	6,151	133	112,546
Technology, media and telecommunications	122,922	5,792	701	128,013
Financial services	252,334	14,759	377	266,716
Mortgage-backed securities	24,808	756	26	25,538
Collateralized mortgage obligations	253,855	7,130	1,450	259,535
Asset-backed securities	4,044	430	—	4,474
Redeemable preferred stocks	378	4	—	382
Total Available-for-Sale Fixed Maturities	$2,666,902	$145,514	$	