UNITED FIRE GROUP INC
Form 10-K
March 04, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
R Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2012
OR

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ______ to ______
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 SE
PO Box 73909
Cedar Rapids, Iowa 52407-3909
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (319) 399-5700
Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.001 par value	The NASDAQ Global Select Market

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES £ NO R

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES £ NO R

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 £

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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 £

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. £

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

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

The aggregate market value of voting stock held by nonaffiliates of the registrant as of June 30, 2012, was approximately $444.7 million. For purposes of this calculation, all directors and executive officers of the registrant are considered affiliates. As of February 28, 2013, 25,240,538 shares of common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Form 10-K incorporates by reference certain information from the registrant’s definitive proxy statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, for its annual stockholders meeting to be held on May 15, 2013.

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PART I.
ITEM 1. BUSINESS

FORWARD-LOOKING INFORMATION
It is important to note that our actual results could differ materially from those projected in 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 1A, "Risk Factors," and Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

GENERAL DESCRIPTION
The terms the "Company," "we," "us," or "our" refer, as the context requires, to United Fire Group, Inc., United Fire & Casualty Company, United Fire Group, Inc. and its consolidated subsidiaries and affiliate, or to United Fire & Casualty Company and its consolidated subsidiaries and affiliate. We are engaged in the business of writing property and casualty insurance and life insurance and selling fixed annuities through a network of independent agencies. The Company is currently licensed as a property and casualty insurer in 43 states, plus the District of Columbia and as a life insurer in 36 states. United Fire & Casualty Company was incorporated in Iowa in January 1946. Our principal executive office is located at 118 Second Avenue SE, P.O. Box 73909, Cedar Rapids, Iowa 52407-3909. Telephone: 319-399-5700.

Holding Company
On February 1, 2012, we completed a holding company reorganization (the "Reorganization") of United Fire Group, Inc., United Fire & Casualty Company, and UFC MergeCo, Inc., an Iowa corporation formed for the purpose of facilitating the Reorganization. The Reorganization agreement was approved and adopted by United Fire & Casualty Company stockholders at a special meeting of stockholders, held on January 24, 2012.

The Reorganization agreement provided for the merger of United Fire & Casualty Company with UFC MergeCo, Inc., with United Fire & Casualty Company surviving the merger as a wholly owned subsidiary of United Fire Group, Inc. Each share of common stock, par value $3.33 1/3 per share, of United Fire & Casualty Company issued and outstanding immediately prior to the effective time of the merger, converted into one duly issued, fully paid and nonassessable share of common stock, par value $0.001 per share, of United Fire Group, Inc. In addition, each outstanding option to purchase or other right to acquire shares of United Fire & Casualty Company common stock was automatically converted into an option to purchase or right to acquire, upon the same terms and conditions, an identical number of shares of United Fire Group, Inc. common stock.

Upon completion of the Reorganization, United Fire Group, Inc., an Iowa corporation, replaced United Fire & Casualty Company, an Iowa corporation, as the publicly held corporation, and the holders of United Fire & Casualty Company common stock now hold the same number of shares at the same ownership percentage of United Fire Group, Inc. as they held of United Fire & Casualty Company immediately prior to the Reorganization. On February 2, 2012, shares of United Fire Group, Inc. common stock commenced trading on the NASDAQ Global Select Market under the ticker symbol "UFCS."

The directors and executive officers of United Fire Group, Inc. immediately following the Reorganization were the same individuals who were directors and executive officers, respectively, of United Fire & Casualty Company immediately prior to the Reorganization.

Immediately following the Reorganization, United Fire Group, Inc. owns 100 percent of one subsidiary, United Fire & Casualty Company. United Fire & Casualty Company owns 100 percent of six subsidiaries: United Life Insurance Company, Addison Insurance Company, Mercer Insurance Group, Inc., Lafayette Insurance Company, United Fire & Indemnity Company and American Indemnity Financial Corporation.

In addition, Mercer Insurance Group, Inc. owns 100 percent of two subsidiaries: Mercer Insurance Company and Financial Pacific Insurance Group, Inc. Mercer Insurance Company owns 100 percent of three subsidiaries: Mercer

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Insurance Company of New Jersey, Inc., Franklin Insurance Company and BICUS Services Corporation. Financial Pacific Insurance Group, Inc. owns 100% of two subsidiaries: Financial Pacific Insurance Company and Financial Pacific Insurance Agency. United Fire & Indemnity Company has one affiliate: United Fire Lloyds. American Indemnity Financial Corporation owns 100% of one subsidiary: Texas General Indemnity Company.

Employees

As of December 31, 2012, we employed 896 full-time employees and 13 part-time employees. We are not a party to any collective bargaining agreement.

Reportable Segments

We report our operations in two business segments: property and casualty insurance and life insurance. Our property and casualty insurance segment is comprised of commercial lines insurance, including surety bonds, personal lines insurance and assumed reinsurance. Our life insurance segment is comprised of deferred and immediate fixed annuities, universal life insurance products and traditional life insurance products. A table reflecting revenues, net income and assets attributable to our operating segments is included in Part II, Item 8, Note 10 “Segment Information.” All intercompany transactions have been eliminated in consolidation.

All of our property and casualty insurance subsidiaries and affiliate belong to an intercompany reinsurance pooling arrangement, with the exception of Texas General Indemnity Company. Pooling arrangements permit the participating companies to rely on the capacity of the entire pool’s capital and surplus, rather than being limited to policy exposures of a size commensurate with each participant’s own surplus level. Under such arrangements, the members share substantially all of the insurance business that is written and allocate the combined premiums, losses and expenses based on percentages defined in the arrangement.

Our life insurance segment consists solely of the operations of United Life Insurance Company.

Available Information

United Fire Group provides free and timely access to all Company reports filed with the Securities and Exchange Commission (“SEC”) in the Investor Relations section of our website at www.unitedfiregroup.com. Select “Financial Information” and then “SEC Filings” to view the list of filings, which includes annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, beneficial ownership reports on Forms 3, 4 and 5 and amendments to reports filed or furnished pursuant to Section 13(a), 15(d) or 16(a) of the Exchange Act. Such reports are made available as soon as reasonably practicable after they are filed with or furnished to the SEC.

Our Code of Ethics is also available at www.unitedfiregroup.com in the Investor Relations section. To view it, select “Corporate Governance” and then “Code of Ethics and Business Conduct.”

Free paper copies of any materials that we file with or furnish to the SEC can also be obtained by writing to Investor Relations, United Fire Group, Inc., P.O. Box 73909, Cedar Rapids, Iowa 52407-3909.

Acquisition of Mercer Insurance Group, Inc.

On March 28, 2011, we acquired 100 percent of the outstanding common stock of Mercer Insurance Group for $191.5 million. The acquisition was funded through a combination of cash and $79.9 million of short-term debt. Accordingly, the results of operations for Mercer Insurance Group have been included in the accompanying Consolidated Financial Statements from that date forward. After the acquisition, we market our products primarily in the Midwest, West, East Coast and South. In addition, the acquisition allowed us to diversify our exposure to weather and other catastrophe risks across our geographic markets.

This transaction was accounted for under the acquisition method in accordance with Accounting Standards Codification ("ASC") 805 Business Combinations, using Mercer Insurance Group's historical financial information and applying fair value estimates to the acquired assets, liabilities and commitments as of the acquisition date.

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MARKETING AND DISTRIBUTION

We market our products through our home office in Cedar Rapids, Iowa, and four regional locations: Westminster, Colorado, a suburb of Denver; Galveston, Texas; Pennington, New Jersey; and Rocklin, California. We are represented through approximately 1,200 independent property and casualty agencies.

Property and Casualty Insurance Segment

In 2012, 2011 and 2010 the direct premiums written by our property and casualty insurance operations were distributed as follows:

	Years Ended December 31,			% of Total		
(In Thousands)	2012	2011	2010	2012	2011	2010
Texas	$88,046	$74,845	$68,655	12.9 %	12.9 %	15.8 %
Iowa	83,906	73,762	68,373	12.3	12.7	15.7
California	79,485	61,500	13	11.6	10.6	—
New Jersey	47,859	33,793	—	7.0	5.8	—
Missouri	44,736	42,202	40,342	6.6	7.3	9.3
Louisiana	38,508	36,685	37,263	5.6	6.3	8.6
Illinois	35,237	32,241	31,330	5.2	5.6	7.2
Colorado	31,790	29,250	28,775	4.7	5.0	6.6
All Other States	232,823	196,610	160,955	34.1	33.8	36.8
Direct Statutory Premiums Written (1)	$682,390	$580,888	$435,706	100.0 %	100.0 %	100.0 %

(1) The Measurement of Results section of Part II, Item 7, defines data prepared in accordance with statutory accounting practices, which is a comprehensive basis of accounting other than GAAP.

We staff our regional offices with underwriting, claims and marketing representatives and administrative technicians, all of whom provide support and assistance to the independent agencies. Also, home office staff technicians and specialists provide support to our subsidiaries, regional offices and independent agencies. We use management reports to monitor subsidiary and regional offices for overall results and conformity to our business policies.

Competition

The property and casualty insurance industry is highly competitive. We compete with numerous property and casualty insurance companies in the regional and national market, many of which are substantially larger and have considerably greater financial and other resources. Except for regulatory considerations, there are limited barriers to entry into the insurance industry. Our competitors may be domestic or foreign, as well as licensed or unlicensed. The exact number of competitors within the industry is not known. Insurers compete on the basis of reliability, financial strength and stability, ratings, underwriting consistency, service, business ethics, price, performance, capacity, policy terms and coverage conditions.

In addition, because our products are marketed exclusively through independent insurance agencies, most of which represent more than one company, we face competition within each agency and competition to retain qualified independent agents. Our competitors include companies that market their products through agents, as well as companies that sell insurance directly to their customers.

Because we rely solely on independent agencies, we offer a competitive commissions program and a rewarding profit-sharing plan as incentives for agents to place high-quality property and casualty insurance business with us. We estimate property and casualty insurance agencies will receive profit-sharing payments of $16.9 million in 2013, based on business produced by the agencies in 2012. In 2012 for 2011 business, agencies received $9.7 million in profit-sharing payments and in 2011 for 2010 business, agencies received $7.0 million in payments.

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Our competitive advantages include our commitment to:

- Strong agency relationships —
  - The average tenure of our employees, approximately 12.0 years, allows our agents to work with the same, highly-experienced personnel each day.
  - Our organization is relatively flat, allowing our agents to be close to the highest levels of management and ensuring that our agents will receive answers quickly to their questions.
  - We have relatively fewer agents appointed to each state than our competitors, which is valued by our agents, as they do not have to compete with other agents in their area to represent the Company.
- Exceptional service — our agents and policyholders always have the option to speak with a real person.
- Fair and prompt claims handling — we view claims as an opportunity to prove to our customers that they have chosen the right insurance company.
- Disciplined underwriting — we empower our underwriters with the knowledge and tools needed to make good decisions for the Company.
- Superior loss control services — our loss control representatives make multiple visits to businesses and job sites each year to ensure safety.
- Effective and efficient use of technology — we use technology to provide enhanced service to our agents and policyholders, not to replace our personal relationships, but to reinforce them.

Life Insurance Segment

Our life insurance subsidiary is represented by approximately 900 independent agencies that market our products primarily in the Midwest, East Coast and West. In 2012, 2011 and 2010 the direct statutory premiums written by our life insurance operations were distributed as follows:

	Years Ended December 31			% of Total		
(In Thousands)	2012	2011	2010	2012	2011	2010
Iowa	$60,761	$51,132	$45,336	38.8 %	29.7 %	32.6 %
Minnesota	16,987	20,409	11,875	10.8	11.9	8.5
Illinois	16,312	17,643	13,629	10.4	10.2	9.8
Wisconsin	14,505	16,507	13,942	9.3	9.6	10.0
Nebraska	9,192	16,553	11,317	5.9	9.6	8.1
All Other States	38,800	49,915	42,901	24.8	29.0	31.0
Direct Statutory Premiums Written (1)	$156,557	$172,159	$139,000	100.0 %	100.0 %	100.0 %

(1) The Measurement of Results section of Part II, Item 7, defines data prepared in accordance with statutory accounting practices, which is a comprehensive basis of accounting other than GAAP.

Competition

We also encounter significant competition in all lines of our life and fixed annuity business from other life insurance companies and other providers of financial services. Since our products are marketed exclusively through independent life insurance agencies that typically represent more than one company, we face competition within our agencies. Competitors include companies that market their products through agents, as well as companies that sell directly to their customers. Given the nature of the insurance industry, the exact number of competitors within the industry is not known.

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To attract and maintain relationships with our independent life insurance agencies, we offer competitive commission rates and other sales incentives. Our life insurance segment achieves a competitive advantage by offering products that are simple and straightforward, by providing outstanding customer service, by being accessible to our agents and customers, and by using technology in a variety of ways to assist our agents and improve the delivery of service to our policyholders.

OPERATING SEGMENTS

Information specific to the reportable business segments in our operations, including products, pricing and seasonality of premiums written is incorporated by reference from Note 10 “Segment Information” contained in Part II, Item 8, “Financial Statements and Supplementary Data.” Additionally, for a detailed discussion of our operating results by segment, refer to the Results of Operations section in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

REINSURANCE

Incorporated by reference from Note 4 “Reinsurance” contained in Part II, Item 8, “Financial Statements and Supplementary Data.”

RESERVES

Property and Casualty Insurance Segment

Property insurance indemnifies an insured with an interest in physical property for loss of, or damage to, such property or the loss of its income-producing abilities. Casualty insurance primarily covers liability for damage to property of, or injury to, a person or entity other than the insured. In most cases, casualty insurance also obligates the insurance company to provide a defense for the insured in litigation, arising out of events covered by the policy.

Liabilities for loss and loss settlement expenses reflect management's best estimates at a given point in time of what we expect to pay for claims that have been reported and those that have been incurred but not reported (“IBNR”), based on known facts, circumstances, and historical trends.

The determination of reserves (particularly those relating to liability lines of insurance that have relatively longer delays for claim reporting) requires significant work to reasonably project expected future claim reporting and payment patterns. If, during the course of our regular monitoring of reserves, we determine that coverages previously written are incurring higher than expected losses, we will take action that may include, among other things, increasing the related reserves. Any adjustments we make to reserves are reflected in operating results in the year in which we make those adjustments. As required by state law, we engage an independent actuary, Regnier Consulting Group, Inc. (“Regnier”), to render an opinion as to the adequacy of our statutory reserves annually. The actuarial opinion is filed in those states where we are licensed.

On a quarterly basis, United Fire's internal actuary performs a detailed actuarial review of IBNR reserves. This review includes a comparison of results from the most recent analysis of IBNR reserves completed by both our internal and external actuaries. Senior management meets with our internal actuary to review, on a quarterly basis, the adequacy of carried reserves based on results from these actuarial analyses. There are two fundamental types or sources of IBNR reserves. We record IBNR reserves for “normal” kinds of claims and also specific IBNR reserves related to unique circumstances or events. A major hurricane is an example of an event that might necessitate the recognition of specific IBNR reserves because an analysis of existing historical data would not provide an appropriate estimate.

We do not discount loss reserves based on the time value of money. There are no material differences between our reserves established under U.S. generally accepted accounting principles ("GAAP") and our statutory reserves.

The following table illustrates the change in our estimate of loss reserves for our property and casualty insurance companies for the years 2002 through 2012. The first section shows the amount of the liability, as originally

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reported, at the end of each calendar year in our Consolidated Financial Statements. These reserves represent the estimated amount of losses and loss settlement expenses for losses arising in that year and all prior years that are unpaid at the end of each year, including an estimate for our IBNR losses, net of applicable ceded reinsurance. The second section displays the cumulative amount of net losses and loss settlement expenses paid for each year with respect to that liability. The third section shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the losses for individual years. The last section compares the latest re-estimated amount with the original estimate. Conditions and trends that have affected development of loss reserves in the past may not necessarily exist in the future. Accordingly, it would not be appropriate to project future redundancies or deficiencies based on this table.

(In Thousands) Years Ended December 31	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 [1]	2012
Gross liability for loss and loss settlement expenses	$392,649	$427,049	$464,889	$620,100	$518,886	$496,083	$586,109	$606,045	$603,090	$945,051	$971,911
Ceded loss and loss settlement expenses	35,760	27,309	28,609	60,137	40,560	38,800	52,508	33,754	39,000	120,359	103,870
Net liability for loss and loss settlement expenses	$356,889	$399,740	$436,280	$559,963	$478,326	$457,283	$533,601	$572,291	$564,090	$824,692	$868,041
Cumulative net paid as of:											
One year later	$107,271	$100,895	$110,016	$230,455	$148,593	$140,149	$195,524	$165,046	$146,653	$194,156	
Two years later	172,158	167,384	166,592	321,110	235,975	265,361	304,622	260,872	230,800		
Three years later	214,307	203,861	213,144	380,294	332,768	345,092	373,765	312,451			
Four years later	237,150	231,278	242,579	456,919	390,763	392,676	406,773				
Five years later	253,026	250,787	264,015	502,455	422,669	416,656					
Six years later	265,304	263,631	276,214	527,136	441,202						
Seven years later	273,066	272,826	282,654	540,740							
Eight years later	280,152	277,645	287,825								
Nine years later	283,635	281,930									

Ten years later	286,790										
Net liability re-estimated as of:											
End of year	$356,889	$399,740	$436,280	$559,963	$478,326	$457,283	$533,601	$572,291	$564,090	$824,692	$868,041
One year later	344,590	361,153	358,796	534,998	433,125	457,831	559,816	526,413	502,995	751,265	
Two years later	340,502	331,693	330,137	508,774	453,474	502,177	547,824	497,136	457,532		
Three years later	324,582	317,187	319,335	538,451	497,629	503,992	537,912	461,677			
Four years later	313,745	309,146	326,340	574,484	500,071	503,720	514,763				
Five years later	308,304	316,227	327,626	582,343	507,507	494,027					
Six years later	312,188	314,522	327,741	592,772	503,510						
Seven years later	314,680	316,705	322,875	589,661							
Eight years later	316,378	311,385	320,893								