

Edgar Filing: UNITED FIRE GROUP INC - Form 10-Q

UNITED FIRE GROUP INC

Form 10-Q

November 07, 2018

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us-gaap:FairValueMeasurementsRecurringMember us-gaap:USStatesAndPoliticalSubdivisionsMember  
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ufcs:WestMember us-gaap:FairValueInputsLevel1Member us-gaap:FairValueMeasurementsRecurringMember  
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ufcs:location

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the quarterly period ended September 30, 2018**

or

**[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**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 52401  
(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 NO

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files).  
YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act:  
Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company  
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 5, 2018, 25,071,751 shares of common stock were outstanding.

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**FORWARD-LOOKING INFORMATION**

This report may contain forward-looking statements about our operations, anticipated performance and other similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), for forward-looking statements. The forward-looking statements are not historical facts and involve risks and uncertainties that could cause actual results to differ from those expected and/or projected. Such forward-looking statements are based on current expectations, estimates, forecasts and projections about United Fire Group, Inc. ("UFG," the "Registrant," the "Company," "we," "us," or "our"), the industry in which we operate, and beliefs and assumptions made by management. Words such as "expect(s)," "anticipate(s)," "intend(s)," "plan(s)," "believe(s)," "continue(s)," "seek(s)," "estimate(s)," "goal(s)," "target(s)," "forecast(s)," "project(s)," "predict(s)," "should," "could," "may," "will," "might," "hope," "can" and other words and terms of similar meaning or expression in connection with a discussion of future operations, financial performance or financial condition, are intended to identify forward-looking statements. See Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 and Part II, Item 1A "Risk Factors" of this report for more information concerning factors that could cause actual results to differ materially from those in the forward-looking statements.

Risks and uncertainties that may affect the actual financial condition and results of the Company include, but are not limited to, the following:

- The frequency and severity of claims, including those related to catastrophe losses and the impact those claims have on our loss reserve adequacy; the occurrence of catastrophic events, including international events, significant severe weather conditions, climate change, acts of terrorism, acts of war and pandemics;
- The adequacy of our reserves for property and casualty insurance losses and loss settlement expenses;
- Geographic concentration risk in the property and casualty insurance business;
- The potential disruption of our operations and reputation due to unauthorized data access, cyber-attacks or cyber-terrorism and other security breaches;
- Developments in general economic conditions, domestic and global financial markets, interest rates and other-than-temporary impairment losses that could affect the performance of our investment portfolio;
- Our ability to effectively underwrite and adequately price insured risks;
- Changes in industry trends, an increase in competition and significant industry developments;
- Litigation or regulatory actions that could require us to pay significant damages, fines or penalties or change the way we do business;
- Lowering of one or more of the financial strength ratings of our operating subsidiaries or our issuer credit ratings and the adverse impact such action may have on our premium writings, policy retention, profitability and liquidity;
  - Governmental actions, policies and regulations, including, but not limited to, domestic health care reform, financial services regulatory reform, corporate governance, new laws or regulations or court decisions interpreting existing laws and regulations or policy provisions; changes in laws, regulations and stock exchange requirements relating to corporate governance and the cost of compliance;
- Our relationship with and the financial strength of our reinsurers; and
- Competitive, legal, regulatory or tax changes that affect the distribution cost or demand for our products through our independent agent/agency distribution network.

These are representative of the risks, uncertainties, and assumptions that could cause actual outcomes and results to differ materially from what is expressed in forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report or as of the date they are made. Except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission ("SEC"), we do not have any intention or obligation to update publicly any forward-looking statements, whether as a result of new information, future events, or otherwise.



Table of Contents**PART I — FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

United Fire Group, Inc.  
Consolidated Balance Sheets

*(In Thousands, Except Share Data)*

|   | <b>September 30,<br/>2018</b> | December 31,<br>2017 |
|---|-------------------------------|----------------------|
|   | <i>(unaudited)</i>            |                      |
| <b>ASSETS</b>   |                               |                      |
| Investments   |                               |                      |
| Fixed maturities  |                               |                      |
| Held-to-maturity, at amortized cost (fair value \$0 in 2018 and \$150 in 2017)  | \$ —                          | \$ 150               |
| Available-for-sale, at fair value (amortized cost \$1,764,380 in 2018 and \$1,516,610 in 2017)  | <b>1,730,031</b>              | 1,535,070            |
| Trading securities, at fair value (amortized cost \$12,047 in 2018 and \$14,582 in 2017)  | <b>14,399</b>                 | 16,842               |
| Equity securities at fair value (cost \$65,458 in 2018 and \$63,275 in 2017)  | <b>276,253</b>                | 287,344              |
| Mortgage loans  | <b>14,896</b>                 | —                    |
| Other long-term investments   | <b>40,432</b>                 | 49,352               |
| Short-term investments  | <b>175</b>                    | 175                  |
|   | <b>2,076,186</b>              | 1,888,933            |
| Cash and cash equivalents   | <b>52,252</b>                 | 95,562               |
| Accrued investment income   | <b>16,873</b>                 | 13,841               |
| Premiums receivable (net of allowance for doubtful accounts of \$968 in 2018 and \$1,255 in 2017)   | <b>379,293</b>                | 328,513              |
| Deferred policy acquisition costs   | <b>95,140</b>                 | 88,102               |
| Property and equipment (primarily land and buildings, at cost, less accumulated depreciation of \$50,431 in 2018 and \$51,603 in 2017)                | <b>88,882</b>                 | 68,992               |
| Reinsurance receivables and recoverables  | <b>66,148</b>                 | 63,194               |
| Prepaid reinsurance premiums  | <b>5,856</b>                  | 3,749                |
| Income taxes receivable   | <b>10,269</b>                 | 6,031                |
| Goodwill and intangible assets  | <b>23,429</b>                 | 23,971               |
| Other assets  | <b>16,632</b>                 | 16,409               |
| Assets held for sale  | —                             | 1,586,134            |
| <b>TOTAL ASSETS</b>   | <b>\$ 2,830,960</b>           | \$ 4,183,431         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                               |                      |
| <b>Liabilities</b>  |                               |                      |
| Losses and loss settlement expenses   | <b>\$ 1,278,077</b>           | \$ 1,224,183         |
| Unearned premiums   | <b>508,850</b>                | 465,391              |
| Accrued expenses and other liabilities  | <b>158,761</b>                | 167,396              |
| Deferred income taxes   | <b>1,056</b>                  | 5,953                |
| Liabilities held for sale   | —                             | 1,347,135            |
| <b>TOTAL LIABILITIES</b>  | <b>\$ 1,946,744</b>           | \$ 3,210,058         |
| <b>Stockholders' Equity</b>   |                               |                      |
| Common stock, \$0.001 par value; authorized 75,000,000 shares; 25,066,384 and 24,916,806 shares issued and outstanding in 2018 and 2017, respectively | <b>\$ 25</b>                  | \$ 25                |
| Additional paid-in capital  | <b>201,361</b>                | 196,334              |
| Retained earnings   | <b>752,581</b>                | 608,700              |
| Accumulated other comprehensive income (loss), net of tax   | <b>(69,751)</b>               | ) 168,314            |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>\$ 884,216</b>             | \$ 973,373           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <b>\$ 2,830,960</b>           | \$ 4,183,431         |

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)

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
| <i>(In Thousands, Except Share Data)</i>   | <b>2018</b>               | <b>2017</b> | <b>2018</b>              | <b>2017</b> |
| <b>Revenues</b>  |                           |             |                          |             |
| Net premiums earned  | <b>\$264,747</b>          | \$255,758   | <b>\$766,767</b>         | \$737,424   |
| Investment income, net of investment expenses  | <b>13,192</b>             | 13,792      | <b>43,933</b>            | 38,561      |
| Net realized investment gains (includes reclassifications for net unrealized investment gains/(losses) on available-for-sale securities of (\$496) and (\$655) in 2018 and \$419 and \$5,799 in 2017; previously included in accumulated other comprehensive income) | <b>13,971</b>             | 67          | <b>7,404</b>             | 3,397       |
| <b>Total revenues</b>  | <b>\$291,910</b>          | \$269,617   | <b>\$818,104</b>         | \$779,382   |
| <b>Benefits, Losses and Expenses</b>   |                           |             |                          |             |
| Losses and loss settlement expenses  | <b>\$193,667</b>          | \$223,208   | <b>\$527,541</b>         | \$568,356   |
| Amortization of deferred policy acquisition costs  | <b>51,758</b>             | 52,986      | <b>152,207</b>           | 154,845     |
| Other underwriting expenses (includes reclassifications for employee benefit costs of \$1,661 and \$4,982 in 2018 and \$1,352 and \$4,056 in 2017; previously included in accumulated other comprehensive income)  | <b>33,887</b>             | 25,817      | <b>105,994</b>           | 69,900      |
| <b>Total benefits, losses and expenses</b>   | <b>\$279,312</b>          | \$302,011   | <b>\$785,742</b>         | \$793,101   |
| Income (loss) from continuing operations before income taxes   | <b>\$12,598</b>           | \$(32,394 ) | <b>\$32,362</b>          | \$(13,719 ) |
| Federal income tax expense (benefit) (includes reclassifications of \$453 and \$1,184 in 2018 and \$327 and (\$610) in 2017; previously included in accumulated other comprehensive income)  | <b>1,528</b>              | (13,312 )   | <b>771</b>               | (13,330 )   |
| <b>Income (loss) from continuing operations</b>  | <b>\$11,070</b>           | \$(19,082 ) | <b>\$31,591</b>          | \$(389 )    |
| <b>Income (loss) from discontinued operations, net of taxes</b>  | <b>—</b>                  | 1,218       | <b>(1,912 )</b>          | 5,419       |
| <b>Gain on sale of discontinued operations, net of taxes</b>   | <b>—</b>                  | —           | <b>27,307</b>            | —           |
| <b>Net income (loss)</b>   | <b>\$11,070</b>           | \$(17,864 ) | <b>\$56,986</b>          | \$5,030     |
| <b>Other comprehensive income (loss)</b>   |                           |             |                          |             |
| Change in net unrealized appreciation on investments   | <b>\$(15,389 )</b>        | \$18,995    | <b>\$(73,402 )</b>       | \$64,614    |
| Change in liability for underfunded employee benefit plans   | <b>—</b>                  | —           | <b>—</b>                 | —           |
| Other comprehensive income (loss), before tax and reclassification adjustments   | <b>\$(15,389 )</b>        | \$18,995    | <b>\$(73,402 )</b>       | \$64,614    |
| Income tax effect  | <b>3,232</b>              | (6,648 )    | <b>15,414</b>            | (22,615 )   |
| Other comprehensive income (loss), after tax, before reclassification adjustments  | <b>\$(12,157 )</b>        | \$12,347    | <b>\$(57,988 )</b>       | \$41,999    |
| Reclassification adjustment for net realized investment (gains) losses included in income  | <b>\$496</b>              | \$(419 )    | <b>\$655</b>             | \$(5,799 )  |
| Reclassification adjustment for employee benefit costs included in expense   | <b>1,661</b>              | 1,352       | <b>4,982</b>             | 4,056       |
| Total reclassification adjustments, before tax   | <b>\$2,157</b>            | \$933       | <b>\$5,637</b>           | \$(1,743 )  |
| Income tax effect  | <b>(453 )</b>             | (327 )      | <b>(1,184 )</b>          | 610         |
| Total reclassification adjustments, after tax  | <b>\$1,704</b>            | \$606       | <b>\$4,453</b>           | \$(1,133 )  |
| <b>Comprehensive income (loss)</b>   | <b>\$617</b>              | \$(4,911 )  | <b>\$3,451</b>           | \$45,896    |
| <b>Diluted weighted average common shares outstanding</b>  | <b>25,626,951</b>         | 24,960,086  | <b>25,607,305</b>        | 25,666,405  |
| <b>Earnings (loss) per common share from continuing operations:</b>  |                           |             |                          |             |
| <b>Basic</b>   | <b>\$0.44</b>             | \$(0.77 )   | <b>\$1.26</b>            | \$(0.01 )   |
| <b>Diluted</b>   | <b>0.43</b>               | (0.77 )     | <b>1.23</b>              | (0.01 )     |
| <b>Earnings (loss) per common share:</b>   |                           |             |                          |             |
| <b>Basic</b>   | <b>\$0.44</b>             | \$(0.72 )   | <b>\$2.28</b>            | \$0.20      |
| <b>Diluted</b>   | <b>0.43</b>               | (0.72 )     | <b>2.23</b>              | 0.20        |

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)

| <i>(In Thousands, Except Share Data)</i>                                  | <b>Nine<br/>Months<br/>Ended<br/>September<br/>30, 2018</b> |
|---|---|
| <b>Common stock</b>   |   |
| Balance, beginning of year  | \$ 25   |
| Shares repurchased (120,372 shares)                                       | —   |
| Shares issued for stock-based awards (269,950 shares)                     | —   |
| Balance, end of period  | \$ 25   |
| <b>Additional paid-in capital</b>   |   |
| Balance, beginning of year  | \$ 196,334  |
| Compensation expense and related tax benefit for stock-based award grants | 4,040   |
| Shares repurchased  | (5,404 )  |
| Shares issued for stock-based awards                                      | 6,391   |
| Balance, end of period  | \$ 201,361  |
| <b>Retained earnings</b>  |   |
| Balance, beginning of year  | \$ 608,700  |
| Cumulative effect of change in accounting principle                       | 191,244   |
| Net unrealized investment depreciation of discontinued operations, sold   | (6,714 )  |
| Net income  | 56,986  |
| Dividends on common stock (\$3.90 per share)                              | (97,635 )   |
| Balance, end of period  | \$ 752,581  |
| <b>Accumulated other comprehensive income (loss), net of tax</b>          |   |
| Balance, beginning of year  | \$ 168,314  |
| Cumulative effect of change in accounting principle                       | (191,244 )  |
| Change in net unrealized investment appreciation <sup>(1)</sup>           | (50,756 )   |
| Change in liability for underfunded employee benefit plans <sup>(2)</sup> | 3,935   |
| Balance, end of period  | \$ (69,751 )  |
| <b>Summary of changes</b>   |   |
| Balance, beginning of year  | \$ 973,373  |
| Net income  | 56,986  |
| All other changes in stockholders' equity accounts                        | (146,143 )  |
| Balance, end of period  | \$ 884,216  |

(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 reclassification adjustments and income taxes.

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

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

| <i>(In Thousands)</i>  | <b>Nine Months Ended</b> |                |
|--|--------------------------|----------------|
|  | <b>September 30,</b>     |                |
|  | <b>2018</b>              | <b>2017</b>    |
| <b>Cash Flows From Operating Activities</b>                                      |                          |                |
| Net income   | <b>\$56,986</b>          | \$5,030        |
| Less net income (loss) from discontinued operations, net of taxes                | <b>(1,912)</b>           | ) 5,419        |
| Adjustments to reconcile net income to net cash provided by operating activities |                          |                |
| Net accretion of bond premium  | <b>6,518</b>             | 6,663          |
| Depreciation and amortization  | <b>4,015</b>             | 3,501          |
| Stock-based compensation expense   | <b>4,040</b>             | 3,456          |
| Net realized investment gains  | <b>(7,404)</b>           | ) (3,397 )     |
| Net cash flows from equity and trading investments                               | <b>21,253</b>            | 816            |
| Deferred income tax benefit  | <b>(6,259)</b>           | ) (4,979 )     |
| Changes in:  |                          |                |
| Accrued investment income  | <b>(3,032)</b>           | ) (1,294 )     |
| Premiums receivable  | <b>(50,780)</b>          | ) (45,208 )    |
| Deferred policy acquisition costs  | <b>(7,038)</b>           | ) (4,115 )     |
| Reinsurance receivables  | <b>(2,954)</b>           | ) (5,409 )     |
| Prepaid reinsurance premiums   | <b>(2,107)</b>           | ) (39 )        |
| Income taxes receivable  | <b>(4,238)</b>           | ) (7,075 )     |
| Other assets   | <b>(223)</b>             | ) (1,358 )     |
| Losses and loss settlement expenses  | <b>53,894</b>            | 113,384        |
| Unearned premiums  | <b>43,459</b>            | 46,641         |
| Accrued expenses and other liabilities   | <b>(3,654)</b>           | ) (12,430 )    |
| Deferred income taxes  | <b>(8,298)</b>           | ) 1,794        |
| Other, net   | <b>3,951</b>             | 1,920          |
| Cash from operating activities - continuing operations                           | <b>41,143</b>            | 92,871         |
| Cash from operating activities - discontinued operations                         | <b>4,024</b>             | 23,814         |
| Cash from operating activities - gain on sale of discontinued operations         | <b>(34,851)</b>          | ) —            |
| Total adjustments  | <b>\$10,316</b>          | \$116,685      |
| Net cash provided by operating activities  | <b>\$69,214</b>          | \$116,296      |
| <b>Cash Flows From Investing Activities</b>                                      |                          |                |
| Proceeds from sale of available-for-sale investments                             | <b>\$129,865</b>         | \$3,388        |
| Proceeds from call and maturity of available-for-sale investments                | <b>101,837</b>           | 134,503        |
| Proceeds from short-term and other investments                                   | <b>8,527</b>             | 4,846          |
| Proceeds from the sale of discontinued operations                                | <b>276,055</b>           | —              |
| Purchase of available-for-sale investments                                       | <b>(485,656)</b>         | ) (162,121 )   |
| Purchase of mortgage loans   | <b>(14,896)</b>          | ) —            |
| Purchase of short-term and other investments                                     | <b>(3,824)</b>           | ) (4,864 )     |
| Net purchases and sales of property and equipment                                | <b>(23,760)</b>          | ) (11,630 )    |
| Cash from investing activities - continuing operations                           | <b>(11,852)</b>          | ) (35,878 )    |
| Cash from investing activities - discontinued operations                         | <b>14,343</b>            | 31,517         |
| Net cash provided by (used in) investing activities                              | <b>\$2,491</b>           | \$ (4,361 )    |
| <b>Cash Flows From Financing Activities</b>                                      |                          |                |
| Payment of cash dividends  | <b>\$ (97,635)</b>       | ) \$ (20,364 ) |
| Repurchase of common stock   | <b>(5,404)</b>           | ) (29,784 )    |
| Issuance of common stock   | <b>6,391</b>             | 2,960          |
| Cash from financing activities - continuing operations                           | <b>(96,648)</b>          | ) (47,188 )    |
| Cash from financing activities - discontinued operations                         | <b>(11,547)</b>          | ) (46,239 )    |
| Net cash used in financing activities  | <b>\$ (108,195)</b>      | ) \$ (93,427 ) |
| <b>Net Change in Cash and Cash Equivalents</b>                                   | <b>\$ (36,490)</b>       | ) \$ 18,508    |

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|   |                 |                 |          |
|---|-----------------|-----------------|----------|
| <b>Less: increase in cash and cash equivalents - discontinued operations</b>        | <b>(6,820</b>   | <b>) (9,092</b> | <b>)</b> |
| <b>Net (decrease) increase in cash and cash equivalents - continuing operations</b> | <b>(43,310</b>  | <b>) 9,416</b>  |          |
| <b>Cash and Cash Equivalents at Beginning of Period - Continuing Operations</b>     | <b>95,562</b>   | <b>89,194</b>   |          |
| <b>Cash and Cash Equivalents at End of Period - Continuing Operations</b>           | <b>\$52,252</b> | <b>\$98,610</b> |          |

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, except share amounts or as otherwise noted)*

**NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION**

**Nature of Business**

United Fire Group, Inc. ("UFG," the "Registrant," the "Company," "we," "us," or "our") and its consolidated subsidiaries and affiliates are engaged in the business of writing property and casualty insurance through a network of independent agencies. Our insurance company subsidiaries are licensed as a property and casualty insurer in 46 states and the District of Columbia.

**Discontinued Operations**

We have historically reported our operations in two business segments: property and casualty insurance and life insurance. On September 18, 2017, the Company signed a definitive agreement to sell its subsidiary, United Life Insurance Company ("United Life"), to Kuvare US Holdings, Inc. ("Kuvare") and on March 30, 2018, the sale closed. As a result, the life insurance business, previously a separate segment, was considered held for sale and reported as discontinued operations in the Consolidated Balance Sheets, Consolidated Statements of Income and Comprehensive Income and Consolidated Statements of Cash Flows for all periods presented in this Form 10-Q (collectively, the "Consolidated Financial Statements"). Subsequent to the announcement of this sale, our continuing operations were reported as one business segment. All current and prior periods reflected in this Form 10-Q have been presented as continuing and discontinued operations, as applicable, unless otherwise noted. For more information, refer to Note 11. Discontinued Operations.

**Basis of Presentation**

The unaudited consolidated interim financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial reporting and with the instructions to Form 10-Q and Regulation S-X promulgated by the SEC. Certain financial information that is included in our Annual Report on Form 10-K for the year ended December 31, 2017, including certain financial statement footnote disclosures, is not required by the rules and regulations of the 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; future policy benefits and losses, and loss settlement expenses; and pension and postretirement benefit obligations.

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

Management of UFG believes 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, 2017. The review report of Ernst & Young LLP as of September 30, 2018 and for the three- and nine-month periods ended September 30, 2018 and 2017 accompanies the unaudited Consolidated Financial Statements included in Part I, Item 1 "Financial Statements."

Table of Contents**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.

For the nine-month periods ended September 30, 2018 and 2017, we made payments for income taxes for continuing operations totaling \$24,055 and \$7,648, respectively. We received a tax refund of \$1,503 and \$10,000 for the nine-month periods ended September 30, 2018 and 2017, respectively.

For the nine-month periods ended September 30, 2018 and 2017, we made no interest payments (excluding 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 nine-month period ended September 30, 2018.

|  | <b>Continuing<br/>Operations<br/>Property<br/>&amp; Life<br/>Casualty<br/>Insurance</b> | <b>Discontinued<br/>Operations<br/>Insurance</b> | <b>Total</b> |
|--|---|--|--------------|
| Recorded asset at beginning of period                                  | \$88,102  | \$ 71,151  | \$ 159,253   |
| Underwriting costs deferred  | 159,245   | 1,376  | 160,621      |
| Amortization of deferred policy acquisition costs                      | (152,207)   | (1,895 )   | (154,102 )   |
| Ending unamortized deferred policy acquisition costs                   | \$95,140  | \$ 70,632  | \$ 165,772   |
| Impact of unrealized gains and losses on available-for-sale securities | —   | 7,274  | 7,274        |
| Sale of discontinued operations  | —   | (77,906 )  | (77,906 )    |
| Recorded asset at September 30, 2018                                   | \$95,140  | \$ —   | \$95,140     |

Property and casualty insurance policy acquisition costs deferred are amortized as premium revenue is recognized. The method followed 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 expected 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. Expected premium revenue and gross profits are based on the same mortality and withdrawal assumptions used in determining future policy benefits. These assumptions are not revised after policy issuance unless the recorded DAC asset is deemed to be unrecoverable from future expected profits.

For non-traditional life insurance 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. 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 to net unrealized investment appreciation as of the balance sheet date. The impact of unrealized gains and losses on available-for-sale securities decreased the DAC asset by \$6,294 at December 31, 2017. There was no impact of unrealized gains and losses on available-for-sale



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securities on the DAC asset at September 30, 2018 because the non-traditional life insurance business is part of discontinued operations, which was sold on March 30, 2018.

### **Income Taxes**

The Tax Cuts and Jobs Act of 2017 (the "Tax Act") was enacted on December 22, 2017. The Tax Act significantly revised the U.S. corporate income tax laws including lowering the U.S. federal corporate tax rate from 35 percent to 21 percent, effective January 1, 2018.

In December 2017, the SEC staff issued Staff Accounting Bulletin No. 118, which addresses how a company recognizes provisional amounts when a company does not have the necessary information available, prepared or analyzed in reasonable detail to complete its accounting for the effect of the changes in the Tax Act. The measurement period ends when a company has obtained, prepared and analyzed the information necessary to finalize its accounting, but cannot extend beyond one year. As of September 30, 2018 we had not completed accounting for the tax effects of enactment of the Tax Act, however for certain items, we have made a reasonable estimate of the effects on our deferred tax balances. For other items where we could not make a reasonable estimate, we are still using existing accounting guidance and the provisions of the tax laws that were in place prior to the enactment. The Company will continue to refine this estimated provisional adjustment as we gain a more thorough understanding of the effects of enactment of the Tax Act on the Company, and the Company will take future guidance into consideration when it becomes available.

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.

We reported consolidated federal income tax expense from consolidated continuing operations and discontinued operations of \$1,528 and \$8,878 for the three- and nine-month periods ended September 30, 2018, respectively, compared to income tax benefit of \$12,650 and \$10,400 during the same periods of 2017. Our effective tax rate is different than the federal statutory rate of 21 percent, due principally to the effect of tax-exempt municipal bond interest income and non-taxable dividend income.

The Company performs a quarterly review of its tax positions and makes a determination of whether it is more likely than not that the tax position will be sustained upon examination. If, based on review, it appears not more likely than not that the positions will be sustained, the Company will calculate any unrecognized tax benefits and, if necessary, calculate and accrue any related interest and penalties. We did not recognize any liability for unrecognized tax benefits at September 30, 2018 or December 31, 2017. 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.

With regard to the sale of the life insurance subsidiary, federal income taxes were allocated to continuing and discontinued operations in accordance with the Company's tax allocation agreement and the terms of the definitive agreement related to the sale.

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 2015.

### **Subsequent Events**

In the preparation of the accompanying financial statements, the Company has 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 in the Company's financial statements. The Company concl



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uded there are no material subsequent events or transactions that have occurred after the balance sheet date through the date on which the financial statements were issued.

**Recently Issued Accounting Standards*****Accounting Standards Adopted in 2018****Revenue Recognition*

In May 2014, the FASB issued comprehensive new guidance on revenue recognition which supersedes nearly all existing revenue recognition guidance under GAAP. The new guidance requires a company to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. The standard creates a five-step model that requires companies to exercise judgment when considering the terms of the contract(s) and all relevant facts and circumstances. Insurance contracts are not within the scope of this new guidance. The new guidance is effective for annual and interim periods beginning after December 15, 2017. The Company adopted the guidance as of January 1, 2018. The adoption of the new guidance had no impact on the Company's reporting and disclosure of net premiums earned from insurance contracts, net investment income or net realized gains and losses, as these revenue streams are not within the scope of this new guidance. The remaining revenue streams are immaterial and not impacted by the new standard.

*Financial Instruments*

In January 2016, the FASB issued guidance updating certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments in this update supersede the guidance to classify equity securities with readily determinable fair values into different categories (for example, trading or available-for-sale) and require equity securities to be measured at fair value with changes in the fair value recognized through net income. The new guidance also simplifies the impairment process for equity investments without readily determinable fair values. The new guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those years. The Company adopted the new guidance as of January 1, 2018. The adoption of the new guidance resulted in a reclassification from accumulated other comprehensive income to retained earnings of \$191,244 after tax, which is equal to the amount of net unrealized gains and losses on available-for-sale equity securities on January 1, 2018. Also, in the three- and nine-month periods ended September 30, 2018, the Company recognized an after-tax net realized investment gain from continuing operations of \$11,361 and \$4,343, respectively, in net income from the change in value of equity securities due to the adoption of this new accounting guidance.

*Statement of Cash Flows - Classification of Certain Cash Receipts and Payments*

In August 2016, the FASB issued an update that clarifies the classification of certain cash receipts and payments in the Statement of Cash Flows. The update addresses eight existing cash flow issues by clarifying the correct classification to establish uniformity in practice. The updated guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those years. The Company adopted the new guidance as of January 1, 2018. The adoption had no impact on the Company's financial position and results of operations.

*Defined Benefit Retirement Plan Cost*

In March 2017, the FASB issued guidance on the presentation of net periodic benefit costs of defined benefit retirement benefit plans in the Statements of Income. The new guidance requires the service cost component of net periodic benefit cost of defined benefit plans to be presented in the same line in the Statements of Income as other employee compensation expenses. Also, under the new guidance, the service cost component of the net periodic benefit costs will be the only portion of costs subject to be capitalized in assets. The new guidance is effective for annual periods beginning after December 15, 2017 and interim periods within those years. The Company adopted the new guidance as of January 1, 2018. The adoption of the new guidance resulted in a change in the capitalization of deferred acquisition costs to only include the pension and post retirement service costs in place of the total net periodic benefit costs. The adoption had an immaterial impact on the Company's financial position and results of

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operations. Additionally, the adoption did not impact the Company's presentation in the Statements of Income as all net periodic benefit costs and employee compensation expenses are included within the same category in the Statements of Income.

*Share-Based Payments*

In May 2017, the FASB issued new guidance which clarifies and addresses the diversity in practice when there is a change in the terms of a share-based payment award. The updated guidance clarifies when to use modification accounting when there is a change in the terms of a share-based payment and provides three conditions where modification accounting should not be applied. The new guidance is effective for annual and interim periods beginning after December 15, 2017. The Company adopted the new guidance as of January 1, 2018. The adoption had no impact on the Company's financial position and results of operations.

***Pending Adoption of Accounting Standards****Intangibles - Other Internal Use Software*

In August 2018, the FASB issued guidance to align the requirements for capitalizing implementation costs incurred in a cloud computing hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The guidance requires the Company to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. The new guidance is effective for annual and interim periods beginning after December 15, 2019. The Company will adopt the new guidance as of January 1, 2020. Management currently believes that the adoption will not have an impact on the Company's financial position or results of operations.

*Leases*

In February 2016, the FASB issued guidance on the accounting for leases. The new guidance requires lessees to place a right-of-use asset and a lease liability on their balance sheets. The lease liability will be based on the present value of the future lease payments and the right-of-use asset will be based on the liability. Expenses will be recognized on the income statement in a similar manner as previous methods. The new guidance also requires companies to classify all leases as operating leases or financing leases. We believe all of our leases will be classified as operating leases. The new guidance is effective for annual periods beginning after December 15, 2018 and interim periods within those years. The Company will adopt the new guidance under a modified retrospective transition approach using the package of practical expedients and the Company will not adopt the hindsight practical expedient as of January 1, 2019. We expect to use the accounting standard adoption date as our date of initial application.

The Company has created an inventory of its operating leases and has calculated the total undiscounted future minimum lease payments, which are disclosed in Note 13 Lease Commitments of the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The undiscounted future minimum lease payments at December 31, 2017 are \$22.5 million, which represents less than 1.0 percent of the Company's total assets at December 31, 2017. The Company plans to use their incremental borrowing rate of their credit facility described in Note 9 Credit Facility of this Form 10-Q, as the discount rate for calculating the minimum lease payments. For leases that exist prior to the date of initial application, the Company has elected to use the remaining lease term as of the date of initial application to measure its incremental borrowing rate. The Company has reviewed and updated its processes and controls under the new guidance. Management currently believes that the adoption will not have a significant impact on the Company's financial position or results of operations.

*Financial Instruments - Credit Losses*

In June 2016, the FASB issued new guidance on the measurement of credit losses for most financial instruments. The new guidance replaces the current incurred loss model for recognizing credit losses with an expected loss model for instruments measured at amortized cost and requires allowances to be recorded for available-for-sale debt securities rather than reduce the carrying amount. These allowances will be remeasured each reporting period. The new guidance is effective for annual periods beginning after December 15, 2019 and interim periods within those





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years. The new guidance will impact the Company's portfolio of mortgage loan investments which are carried at amortized cost and are impairment model related to our available-for-sale portfolio. The Company will adopt the new guidance as of January 1, 2020 and is currently evaluating the impact on the Company's financial position, results of operations and key processes.

*Income Taxes - Intra-entity Transfers*

In October 2016, the FASB issued new guidance on the income tax treatment of intra-entity transfers. The new guidance replaces the current guidance which prohibits the recognition of current and deferred income taxes of intra-entity transfers until the asset is sold externally. Under the new guidance, the exemption is eliminated and income taxes will be recognized on transfers of intra-entity assets. The new guidance is effective for annual periods beginning after December 15, 2018 and interim periods beginning after December 15, 2019. The Company will adopt the new guidance as of January 1, 2019. Management currently believes that the adoption will not have a significant impact on the Company's financial position and results of operations.

*Goodwill*

In January 2017, the FASB issued new guidance which simplifies the test for goodwill impairment. The new guidance eliminates the implied fair value calculation when measuring a goodwill impairment charge. Under the new guidance, impairment charges will be based on the excess of the carrying value over fair value of goodwill. The new guidance is effective for annual and interim periods beginning after December 15, 2019. The Company will adopt the new guidance as of January 1, 2020 and it currently believes the adoption will have no impact on the Company's financial position and results of operations.

*Financial Instruments - Disclosures*

In August 2018, the FASB issued new guidance which modifies the disclosure requirements on fair value measurements of financial instruments. The new guidance removes the requirement for disclosing the amount and reason for transfers between Level 1 and Level 2 investment securities and the valuation processes for Level 3 fair value measurements. The guidance also requires additional disclosures on the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The new guidance is effective for annual and interim periods beginning after December 15, 2019. The Company will adopt the new guidance as of January 1, 2020. The new guidance will modify existing fair value disclosures, but will not have an impact on the Company's financial position and results of operations.

*Defined Benefit Plans - Disclosures*

In August 2018, the FASB issued new guidance which modifies the disclosure requirements for employers that sponsor defined benefit pension and postretirement plans. The new guidance removes the requirement for disclosing the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit costs in the next year and the sensitivity of postretirement health plans to one-percentage-point changes in medical trend rates. The new guidance is effective for annual periods beginning after December 15, 2019. The Company will adopt the new guidance as of January 1, 2020. The new guidance will modify existing disclosures, but will not have an impact on the Company's financial position and 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, presented on a consolidated basis, including both continuing and discontinued operations as of September 30, 2018 and December 31, 2017, is as follows:

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September 30, 2018

| Type of Investment                                | Cost or<br>Amortized<br>Cost | Gross<br>Unrealized<br>Appreciation | Gross<br>Unrealized<br>Depreciation | Fair Value         |
|---|------------------------------|-------------------------------------|-------------------------------------|--------------------|
| <b>AVAILABLE-FOR-SALE</b>                         |                              |                                     |                                     |                    |
| Fixed maturities:                                 |                              |                                     |                                     |                    |
| Bonds   |                              |                                     |                                     |                    |
| U.S. Treasury                                     | \$27,195                     | \$ —                                | \$ 354                              | \$26,841           |
| U.S. government agency                            | 212,542                      | 310                                 | 5,862                               | 206,990            |
| States, municipalities and political subdivisions |                              |                                     |                                     |                    |
| General obligations:                              |                              |                                     |                                     |                    |
| Midwest   | 99,023                       | 574                                 | 1,359                               | 98,238             |
| Northeast   | 37,389                       | 251                                 | 289                                 | 37,351             |
| South   | 115,440                      | 333                                 | 2,559                               | 113,214            |
| West  | 107,993                      | 643                                 | 1,998                               | 106,638            |
| Special revenue:                                  |                              |                                     |                                     |                    |
| Midwest   | 140,245                      | 817                                 | 1,735                               | 139,327            |
| Northeast   | 63,758                       | 240                                 | 1,901                               | 62,097             |
| South   | 241,007                      | 611                                 | 6,177                               | 235,441            |
| West  | 145,072                      | 737                                 | 3,411                               | 142,398            |
| Foreign bonds                                     | 9,722                        | 49                                  | 24                                  | 9,747              |
| Public utilities                                  | 54,606                       | 129                                 | 1,191                               | 53,544             |
| Corporate bonds                                   |                              |                                     |                                     |                    |
| Energy  | 26,929                       | 77                                  | 320                                 | 26,686             |
| Industrials                                       | 56,127                       | 103                                 | 699                                 | 55,531             |
| Consumer goods and services                       | 52,398                       | 42                                  | 763                                 | 51,677             |
| Health care                                       | 18,062                       | 58                                  | 134                                 | 17,986             |
| Technology, media and telecommunications          | 26,622                       | 34                                  | 534                                 | 26,122             |
| Financial services                                | 77,788                       | 164                                 | 1,888                               | 76,064             |
| Mortgage-backed securities                        | 7,985                        | 13                                  | 260                                 | 7,738              |
| Collateralized mortgage obligations               |                              |                                     |                                     |                    |
| Government national mortgage association          | 78,797                       | 121                                 | 3,602                               | 75,316             |
| Federal home loan mortgage corporation            | 108,666                      | 7                                   | 2,957                               | 105,716            |
| Federal national mortgage association             | 53,776                       | 2                                   | 1,924                               | 51,854             |
| Asset-backed securities                           | 3,238                        | 318                                 | 41                                  | 3,515              |
| <b>Total Available-for-Sale Fixed Maturities</b>  | <b>\$1,764,380</b>           | <b>\$ 5,633</b>                     | <b>\$ 39,982</b>                    | <b>\$1,730,031</b> |

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December 31, 2017

| Type of Investment                                | Cost or Amortized Cost | Gross Unrealized Appreciation | Gross Unrealized Depreciation | Fair Value          |
|---|------------------------|-------------------------------|-------------------------------|---------------------|
| <b>HELD-TO-MATURITY</b>                           |                        |                               |                               |                     |
| Fixed maturities:                                 |                        |                               |                               |                     |
| Bonds   |                        |                               |                               |                     |
| Corporate bonds - financial services              | \$ 150                 | \$ —                          | \$ —                          | \$ 150              |
| Mortgage-backed securities                        | 34                     | —                             | —                             | 34                  |
| <b>Total Held-to-Maturity Fixed Maturities</b>    | <b>\$ 184</b>          | <b>\$ —</b>                   | <b>\$ —</b>                   | <b>\$ 184</b>       |
| <b>AVAILABLE-FOR-SALE</b>                         |                        |                               |                               |                     |
| Fixed maturities:                                 |                        |                               |                               |                     |
| Bonds   |                        |                               |                               |                     |
| U.S. Treasury                                     | \$ 17,073              | \$ 4                          | \$ 186                        | \$ 16,891           |
| U.S. government agency                            | 121,574                | 1,311                         | 717                           | 122,168             |
| States, municipalities and political subdivisions |                        |                               |                               |                     |
| General obligations:                              |                        |                               |                               |                     |
| Midwest   | 107,689                | 2,446                         | 439                           | 109,696             |
| Northeast   | 47,477                 | 1,174                         | 10                            | 48,641              |
| South   | 139,870                | 2,462                         | 813                           | 141,519             |
| West  | 111,123                | 2,351                         | 463                           | 113,011             |
| Special revenue:                                  |                        |                               |                               |                     |
| Midwest   | 155,475                | 3,620                         | 351                           | 158,744             |
| Northeast   | 79,028                 | 1,351                         | 619                           | 79,760              |
| South   | 260,145                | 5,218                         | 1,851                         | 263,512             |
| West  | 156,576                | 2,929                         | 1,198                         | 158,307             |
| Foreign bonds                                     | 51,361                 | 1,441                         | 49                            | 52,753              |
| Public utilities                                  | 206,028                | 3,386                         | 270                           | 209,144             |
| Corporate bonds                                   |                        |                               |                               |                     |
| Energy  | 93,191                 | 1,972                         | 110                           | 95,053              |
| Industrials                                       | 218,067                | 3,881                         | 241                           | 221,707             |
| Consumer goods and services                       | 183,253                | 3,498                         | 494                           | 186,257             |
| Health care                                       | 74,125                 | 1,312                         | 29                            | 75,408              |
| Technology, media and telecommunications          | 146,853                | 2,376                         | 250                           | 148,979             |
| Financial services                                | 277,824                | 5,769                         | 442                           | 283,151             |
| Mortgage-backed securities                        | 13,828                 | 101                           | 238                           | 13,691              |
| Collateralized mortgage obligations               |                        |                               |                               |                     |
| Government national mortgage association          | 157,836                | 1,921                         | 2,274                         | 157,483             |
| Federal home loan mortgage corporation            | 201,320                | 1,879                         | 4,047                         | 199,152             |
| Federal national mortgage association             | 104,903                | 1,703                         | 1,174                         | 105,432             |
| Asset-backed securities                           | 4,282                  | 362                           | 8                             | 4,636               |
| <b>Total Available-for-Sale Fixed Maturities</b>  | <b>\$ 2,928,901</b>    | <b>\$ 52,467</b>              | <b>\$ 16,273</b>              | <b>\$ 2,965,095</b> |
| Equity securities:                                |                        |                               |                               |                     |
| Common stocks                                     |                        |                               |                               |                     |

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|   |                    |                  |                 |                    |
|---|--------------------|------------------|-----------------|--------------------|
| Public utilities                                  | \$6,394            | \$16,075         | \$30            | \$22,439           |
| Energy  | 6,514              | 8,171            | 120             | 14,565             |
| Industrials                                       | 13,117             | 53,522           | 120             | 66,519             |
| Consumer goods and services                       | 10,110             | 15,742           | 164             | 25,688             |
| Health care                                       | 7,763              | 32,340           | —               | 40,103             |
| Technology, media and telecommunications          | 6,067              | 11,556           | 115             | 17,508             |
| Financial services                                | 11,529             | 104,985          | 67              | 116,447            |
| Nonredeemable preferred stocks                    | 992                | 305              | —               | 1,297              |
| <b>Total Available-for-Sale Equity Securities</b> | <b>\$62,486</b>    | <b>\$242,696</b> | <b>\$616</b>    | <b>\$304,566</b>   |
| <b>Total Available-for-Sale Securities</b>        | <b>\$2,991,387</b> | <b>\$295,163</b> | <b>\$16,889</b> | <b>\$3,269,661</b> |

The following table is 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 for continuing and discontinued operations by investment type at September 30, 2018 and December 31, 2017:

September 30, 2018

| Type of Investment                               | Cost or<br>Amortized<br>Cost | Gross<br>Unrealized<br>Appreciation | Gross<br>Unrealized<br>Depreciation | Fair Value         |
|--|------------------------------|-------------------------------------|-------------------------------------|--------------------|
| <b>AVAILABLE-FOR-SALE</b>                        |                              |                                     |                                     |                    |
| Fixed maturities:                                |                              |                                     |                                     |                    |
| Continuing operations                            | <b>\$1,764,380</b>           | <b>\$ 5,633</b>                     | <b>\$ 39,982</b>                    | <b>\$1,730,031</b> |
| Discontinued operations                          | —                            | —                                   | —                                   | —                  |
| <b>Total Available-for-Sale Fixed Maturities</b> | <b>\$1,764,380</b>           | <b>\$ 5,633</b>                     | <b>\$ 39,982</b>                    | <b>\$1,730,031</b> |

Note: The sale of the life insurance business was completed on March 30, 2018.

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December 31, 2017

| Type of Investment                                | Cost or<br>Amortized<br>Cost | Gross<br>Unrealized<br>Appreciation | Gross<br>Unrealized<br>Depreciation | Fair Value          |
|---|------------------------------|-------------------------------------|-------------------------------------|---------------------|
| <b>HELD-TO-MATURITY</b>                           |                              |                                     |                                     |                     |
| Fixed maturities:                                 |                              |                                     |                                     |                     |
| Continuing operations                             | \$ 150                       | \$ —                                | \$ —                                | \$ 150              |
| Discontinued operations                           | 34                           | —                                   | —                                   | 34                  |
| <b>Total Held-to-Maturity Fixed Maturities</b>    | <b>\$ 184</b>                | <b>\$ —</b>                         | <b>\$ —</b>                         | <b>\$ 184</b>       |
| <b>AVAILABLE-FOR-SALE</b>                         |                              |                                     |                                     |                     |
| Fixed maturities:                                 |                              |                                     |                                     |                     |
| Continuing operations                             | \$ 1,516,610                 | \$ 27,412                           | \$ 8,952                            | \$ 1,535,070        |
| Discontinued operations                           | 1,412,291                    | 25,055                              | 7,321                               | 1,430,025           |
| <b>Total Available-for-Sale Fixed Maturities</b>  | <b>2,928,901</b>             | <b>52,467</b>                       | <b>16,273</b>                       | <b>2,965,095</b>    |
| <b>Equity securities:</b>                         |                              |                                     |                                     |                     |
| Continuing operations                             | \$ 57,387                    | \$ 224,065                          | \$ 539                              | \$ 280,913          |
| Discontinued operations                           | 5,099                        | 18,631                              | 77                                  | 23,653              |
| <b>Total Available-for-Sale Equity Securities</b> | <b>62,486</b>                | <b>242,696</b>                      | <b>616</b>                          | <b>304,566</b>      |
| <b>Total Available-for-Sale Securities</b>        | <b>\$ 2,991,387</b>          | <b>\$ 295,163</b>                   | <b>\$ 16,889</b>                    | <b>\$ 3,269,661</b> |

**Maturities**

The amortized cost and fair value of held-to-maturity, available-for-sale and trading fixed maturity securities at September 30, 2018, by contractual maturity, are shown in the following tables. The table below includes investments from continuing operations. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Asset-backed securities, mortgage-backed securities and collateralized mortgage obligations may be subject to prepayment risk and are therefore not categorized by contractual maturity.

**Maturities**

| September 30, 2018                    | Available-For-Sale  |                     | Trading           |                  |
|---------------------------------------|---------------------|---------------------|-------------------|------------------|
|                                       | Amortized<br>Cost   | Fair Value          | Amortized<br>Cost | Fair<br>Value    |
| Due in one year or less               | \$48,539            | \$48,703            | \$3,347           | \$3,431          |
| Due after one year through five years | 212,322             | 211,709             | 6,835             | 8,797            |
| Due after five years through 10 years | 518,809             | 513,464             | —                 | —                |
| Due after 10 years                    | 732,248             | 712,016             | 1,865             | 2,171            |
| Asset-backed securities               | 3,238               | 3,515               | —                 | —                |
| Mortgage-backed securities            | 7,985               | 7,738               | —                 | —                |
| Collateralized mortgage obligations   | 241,239             | 232,886             | —                 | —                |
|                                       | <b>\$ 1,764,380</b> | <b>\$ 1,730,031</b> | <b>\$ 12,047</b>  | <b>\$ 14,399</b> |

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Net realized gains on disposition of investments are computed using the specific identification method and are included in the computation of net income. A summary of the components of net realized investment gains (losses) is as follows:

|   | <b>Three Months<br/>Ended<br/>September 30,<br/>2018</b> |        | <b>Nine Months<br/>Ended<br/>September 30,<br/>2017</b> |          |
|---|--|--------|---|----------|
| Net realized investment gains (losses) from continuing operations:        |  |        |   |          |
| Fixed maturities:   |  |        |   |          |
| Available-for-sale  | <b>\$22</b>  | \$ 118 | <b>\$(171)</b>  | \$ 645   |
| Trading securities  |  |        |   |          |
| Change in fair value  | <b>351</b>   | (43 )  | <b>92</b>   | 504      |
| Sales   | <b>171</b>   | 72     | <b>1,076</b>  | 117      |
| Equity securities   | <b>13,944</b>  | (80 )  | <b>6,924</b>  | 1,842    |
| Real estate   | <b>(517)</b>   | —      | <b>(517)</b>  | 289      |
| Total net realized investment gains from continuing operations            | <b>\$13,971</b>  | \$ 67  | <b>\$7,404</b>  | \$ 3,397 |
| Total net realized investment gains (losses) from discontinued operations | —  | 296    | <b>(1,057)</b>  | 3,600    |
| Total net realized investment gains                                       | <b>\$13,971</b>  | \$ 363 | <b>\$6,347</b>  | \$ 6,997 |

The proceeds and gross realized gains on the sale of available-for-sale fixed maturity securities from continuing operations are as follows:

|                       | <b>Three Months<br/>Ended September<br/>30,<br/>2018</b> |          | <b>Nine Months<br/>Ended September<br/>30,<br/>2017</b> |          |
|-----------------------|--|----------|---|----------|
| Proceeds from sales   | <b>\$105,871</b>   | \$ 2,293 | <b>\$129,865</b>  | \$ 3,388 |
| Gross realized gains  | —  | —        | <b>140</b>  | 1,046    |
| Gross realized losses | <b>(94)</b>  | —        | <b>(401)</b>  | —        |

The proceeds and gross realized gains on the sale of available-for-sale fixed maturity securities from discontinued operations are as follows:

|                       | <b>Three<br/>Months<br/>Ended<br/>September<br/>30,<br/>2018</b> |          | <b>Nine<br/>Months<br/>Ended<br/>September<br/>30,<br/>2017</b> |          |
|-----------------------|--|----------|---|----------|
| Proceeds from sales   | <b>\$—</b>   | \$ 1,844 | <b>\$—</b>  | \$ 5,807 |
| Gross realized gains  | —  | —        | —   | 1,254    |
| Gross realized losses | —  | —        | —   | (78 )    |

Note: The sale of the life insurance business was completed on March 30, 2018.

There were no sales of held-to-maturity securities during the three- and nine-month periods ended September 30, 2018 and 2017.

Our investment portfolio includes trading securities with embedded derivatives. These securities are primarily convertible securities which are recorded at fair value. Income or loss, including the change in the fair value of these trading securities, is recognized currently in earnings as a component of net realized investment gains. Our portfolio of trading securities had a fair value of \$14,399 and \$16,842 at September 30, 2018 and December 31, 2017, respectively.



Table of Contents**Funding Commitment**

Pursuant to an agreement with one of our limited liability partnership investments, we are contractually committed through July 31, 2028 to make capital contributions upon request of the partnership. Our remaining potential contractual obligation was \$23,702 at September 30, 2018.

**Unrealized Appreciation**

A summary of the changes in net unrealized investment appreciation during the reporting period is as follows:

|   | <b>Nine Months Ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
|   | <b>2018</b>              | <b>2017</b> |
| Change in net unrealized investment appreciation                        |                          |             |
| Available-for-sale fixed maturities                                     | <b>\$ (80,023 )</b>      | \$34,837    |
| Available-for-sale equity securities                                    | —                        | 27,559      |
| Deferred policy acquisition costs                                       | <b>7,274</b>             | (3,582 )    |
| Income tax effect   | <b>15,279</b>            | (20,584 )   |
| Net unrealized investment depreciation of discontinued operations, sold | <b>6,714</b>             | —           |
| Cumulative change in accounting principles                              | <b>(191,244 )</b>        | —           |
| Total change in net unrealized investment appreciation, net of tax      | <b>\$ (242,000 )</b>     | \$38,230    |

We continually monitor the difference between our cost basis and the estimated fair value of our investments. Our accounting policy for impairment recognition requires other-than-temporary impairment ("OTTI") charges to be recorded when we determine that it is more likely than not that we will be unable to collect all amounts due according to the contractual terms of the fixed maturity security or that the anticipated recovery in fair value of the equity security will not occur in a reasonable amount of time. Impairment charges on investments are recorded based on the fair value of the investments at the measurement date or based on the value calculated using a discounted cash flow model. Credit-related impairments on fixed maturity securities that we do not plan to sell, and for which we are not more likely than not to be required to sell, are recognized in net income. Any non-credit related impairment is recognized as a component of other comprehensive income. Factors considered in evaluating whether a decline in value is other-than-temporary include: the length of time and the extent to which fair value has been less than cost; the financial condition and near-term prospects of the issuer; our intention to hold the investment; and the likelihood that we will be required to sell the investment.

The tables on the following pages summarize our fixed maturity and equity securities that were in an unrealized loss position on a consolidated basis, including both continuing and discontinued operations at September 30, 2018 and December 31, 2017. The securities are presented by the length of time they have been continuously in an unrealized loss position. It is possible that we could recognize OTTI charges in future periods on securities held at September 30, 2018, if future events or information cause us to determine that a decline in fair value is other-than-temporary.

We have evaluated the near-term prospects of the issuers of our fixed maturity securities in relation to the severity and duration of the unrealized loss and determined that these losses did not warrant the recognition of an OTTI charge at September 30, 2018 or at September 30, 2017. We have no intent to sell, and it is more likely than not that we will not be required to sell, these securities until the fair value recovers to at least equal our cost basis or the securities mature.



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| September 30, 2018                                | Less than 12 months |                   |                               | 12 months or longer |                   |                               | Total               |                               |
|---|---------------------|-------------------|-------------------------------|---------------------|-------------------|-------------------------------|---------------------|-------------------------------|
| Type of Investment                                | Number of Issues    | Fair Value        | Gross Unrealized Depreciation | Number of Issues    | Fair Value        | Gross Unrealized Depreciation | Fair Value          | Gross Unrealized Depreciation |
| <b>AVAILABLE-FOR-SALE</b>                         |                     |                   |                               |                     |                   |                               |                     |                               |
| Fixed maturities:                                 |                     |                   |                               |                     |                   |                               |                     |                               |
| Bonds   |                     |                   |                               |                     |                   |                               |                     |                               |
| U.S. Treasury                                     | 5                   | \$ 18,989         | \$ 107                        | 5                   | \$ 7,852          | \$ 247                        | \$ 26,841           | \$ 354                        |
| U.S. government agency                            | 34                  | 158,156           | 4,096                         | 7                   | 34,516            | 1,766                         | 192,672             | 5,862                         |
| States, municipalities and political subdivisions |                     |                   |                               |                     |                   |                               |                     |                               |
| General obligations                               |                     |                   |                               |                     |                   |                               |                     |                               |
| Midwest   | 17                  | 26,098            | 234                           | 5                   | 21,109            | 1,125                         | 47,207              | 1,359                         |
| Northeast   | 5                   | 14,211            | 152                           | 1                   | 3,500             | 137                           | 17,711              | 289                           |
| South   | 23                  | 46,353            | 700                           | 12                  | 29,344            | 1,859                         | 75,697              | 2,559                         |
| West  | 21                  | 47,340            | 680                           | 8                   | 24,676            | 1,318                         | 72,016              | 1,998                         |
| Special revenue                                   |                     |                   |                               |                     |                   |                               |                     |                               |
| Midwest   | 31                  | 56,940            | 672                           | 8                   | 20,569            | 1,063                         | 77,509              | 1,735                         |
| Northeast   | 7                   | 18,451            | 336                           | 11                  | 27,327            | 1,565                         | 45,778              | 1,901                         |
| South   | 40                  | 102,910           | 1,578                         | 32                  | 70,521            | 4,599                         | 173,431             | 6,177                         |
| West  | 19                  | 37,030            | 573                           | 23                  | 52,433            | 2,838                         | 89,463              | 3,411                         |
| Foreign bonds                                     | 1                   | 2,973             | 24                            | —                   | —                 | —                             | 2,973               | 24                            |
| Public utilities                                  | 19                  | 39,011            | 916                           | 1                   | 4,860             | 275                           | 43,871              | 1,191                         |
| Corporate bonds                                   |                     |                   |                               |                     |                   |                               |                     |                               |
| Energy  | 10                  | 17,219            | 320                           | —                   | —                 | —                             | 17,219              | 320                           |
| Industrials                                       | 16                  | 39,427            | 513                           | 1                   | 3,860             | 186                           | 43,287              | 699                           |
| Consumer goods and services                       | 18                  | 40,446            | 737                           | 1                   | 974               | 26                            | 41,420              | 763                           |
| Health care                                       | 5                   | 11,515            | 134                           | —                   | —                 | —                             | 11,515              | 134                           |
| Technology, media and telecommunications          | 9                   | 20,569            | 406                           | 1                   | 1,833             | 128                           | 22,402              | 534                           |
| Financial services                                | 24                  | 54,884            | 1,445                         | 2                   | 6,154             | 443                           | 61,038              | 1,888                         |
| Mortgage-backed securities                        | 32                  | 2,355             | 55                            | 13                  | 3,602             | 205                           | 5,957               | 260                           |
| Collateralized mortgage obligations               |                     |                   |                               |                     |                   |                               |                     |                               |
| Government national mortgage association          | 11                  | 27,027            | 856                           | 18                  | 39,403            | 2,746                         | 66,430              | 3,602                         |
| Federal home loan mortgage corporation            | 21                  | 77,751            | 967                           | 11                  | 27,390            | 1,990                         | 105,141             | 2,957                         |
| Federal national mortgage association             | 16                  | 29,346            | 684                           | 8                   | 22,072            | 1,240                         | 51,418              | 1,924                         |
| Asset-backed securities                           | 1                   | 2,882             | 41                            | —                   | —                 | —                             | 2,882               | 41                            |
| <b>Total Available-for-Sale Fixed Maturities</b>  | <b>385</b>          | <b>\$ 891,883</b> | <b>\$ 16,226</b>              | <b>168</b>          | <b>\$ 401,995</b> | <b>\$ 23,756</b>              | <b>\$ 1,293,878</b> | <b>\$ 39,982</b>              |



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| December 31, 2017                                 | Less than 12 months |                   |                               | 12 months or longer |                   |                               | Total             |                               |
|---|---------------------|-------------------|-------------------------------|---------------------|-------------------|-------------------------------|-------------------|-------------------------------|
| Type of Investment                                | Number of Issues    | Fair Value        | Gross Unrealized Depreciation | Number of Issues    | Fair Value        | Gross Unrealized Depreciation | Fair Value        | Gross Unrealized Depreciation |
| <b>AVAILABLE-FOR-SALE</b>                         |                     |                   |                               |                     |                   |                               |                   |                               |
| Fixed maturities:                                 |                     |                   |                               |                     |                   |                               |                   |                               |
| Bonds   |                     |                   |                               |                     |                   |                               |                   |                               |
| U.S. Treasury                                     | 5                   | \$ 10,370         | \$ 67                         | 2                   | \$ 5,765          | \$ 119                        | \$ 16,135         | \$ 186                        |
| U.S. government agency                            | 11                  | 64,842            | 390                           | 5                   | 19,372            | 327                           | 84,214            | 717                           |
| States, municipalities and political subdivisions |                     |                   |                               |                     |                   |                               |                   |                               |
| General obligations                               |                     |                   |                               |                     |                   |                               |                   |                               |
| Midwest   | 2                   | 2,177             | 8                             | 3                   | 19,729            | 431                           | 21,906            | 439                           |
| Northeast   | —                   | —                 | —                             | 1                   | 3,644             | 10                            | 3,644             | 10                            |
| South   | 3                   | 7,959             | 32                            | 11                  | 29,545            | 781                           | 37,504            | 813                           |
| West  | 2                   | 5,944             | 18                            | 8                   | 25,755            | 445                           | 31,699            | 463                           |
| Special revenue                                   |                     |                   |                               |                     |                   |                               |                   |                               |
| Midwest   | 2                   | 3,486             | 15                            | 7                   | 19,130            | 336                           | 22,616            | 351                           |
| Northeast   | 1                   | 4,471             | 37                            | 11                  | 28,476            | 582                           | 32,947            | 619                           |
| South   | 8                   | 7,749             | 107                           | 27                  | 69,917            | 1,744                         | 77,666            | 1,851                         |
| West  | 3                   | 5,424             | 16                            | 22                  | 56,753            | 1,182                         | 62,177            | 1,198                         |
| Foreign bonds                                     | 1                   | 857               | 49                            | —                   | —                 | —                             | 857               | 49                            |
| Public utilities                                  | 8                   | 19,186            | 79                            | 5                   | 8,446             | 191                           | 27,632            | 270                           |
| Corporate bonds                                   |                     |                   |                               |                     |                   |                               |                   |                               |
| Energy  | 1                   | 2,236             | 13                            | 1                   | 1,606             | 97                            | 3,842             | 110                           |
| Industrials                                       | 10                  | 27,773            | 146                           | 2                   | 4,275             | 95                            | 32,048            | 241                           |
| Consumer goods and services                       | 14                  | 32,781            | 248                           | 3                   | 6,813             | 246                           | 39,594            | 494                           |
| Health care                                       | 4                   | 9,947             | 29                            | —                   | —                 | —                             | 9,947             | 29                            |
| Technology, media and telecommunications          | 12                  | 35,319            | 122                           | 3                   | 10,413            | 128                           | 45,732            | 250                           |
| Financial services                                | 22                  | 50,144            | 256                           | 4                   | 11,389            | 186                           | 61,533            | 442                           |
| Mortgage-backed securities                        | 10                  | 2,458             | 18                            | 10                  | 6,641             | 220                           | 9,099             | 238                           |
| Collateralized mortgage obligations               |                     |                   |                               |                     |                   |                               |                   |                               |
| Government national mortgage association          | 20                  | 49,764            | 629                           | 17                  | 46,969            | 1,645                         | 96,733            | 2,274                         |
| Federal home loan mortgage corporation            | 11                  | 37,543            | 577                           | 20                  | 75,679            | 3,470                         | 113,222           | 4,047                         |
| Federal national mortgage association             | 11                  | 31,958            | 342                           | 11                  | 20,123            | 832                           | 52,081            | 1,174                         |
| Asset-backed securities                           | 1                   | 992               | 8                             | —                   | —                 | —                             | 992               | 8                             |
| <b>Total Available-for-Sale Fixed Maturities</b>  | <b>162</b>          | <b>\$ 413,380</b> | <b>\$ 3,206</b>               | <b>173</b>          | <b>\$ 470,440</b> | <b>\$ 13,067</b>              | <b>\$ 883,820</b> | <b>\$ 16,273</b>              |
| Equity securities:                                |                     |                   |                               |                     |                   |                               |                   |                               |
| Common stocks                                     |                     |                   |                               |                     |                   |                               |                   |                               |
| Public utilities                                  | —                   | \$ —              | \$ —                          | 1                   | \$ 278            | \$ 30                         | \$ 278            | \$ 30                         |
| Energy  | 2                   | 528               | 120                           | —                   | —                 | —                             | 528               | 120                           |
| Industrials                                       | 1                   | 99                | 13                            | 5                   | 193               | 107                           | 292               | 120                           |
| Consumer goods and services                       | —                   | —                 | —                             | 2                   | 151               | 164                           | 151               | 164                           |
| Technology, media and telecommunications          | 2                   | 466               | 95                            | 1                   | 4                 | 20                            | 470               | 115                           |
| Financial services                                | 2                   | 193               | 55                            | 1                   | 9                 | 12                            | 202               | 67                            |
| <b>Total Available-for-Sale Equity Securities</b> | <b>7</b>            | <b>\$ 1,286</b>   | <b>\$ 283</b>                 | <b>10</b>           | <b>\$ 635</b>     | <b>\$ 333</b>                 | <b>\$ 1,921</b>   | <b>\$ 616</b>                 |
| <b>Total Available-for-Sale Securities</b>        | <b>169</b>          | <b>\$ 414,666</b> | <b>\$ 3,489</b>               | <b>183</b>          | <b>\$ 471,075</b> | <b>\$ 13,400</b>              | <b>\$ 885,741</b> | <b>\$ 16,889</b>              |



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The tables on the following pages are a reconciliation for continuing and discontinued operations of our total fixed maturity and equity securities that were in an unrealized loss position at September 30, 2018 and December 31, 2017. The sale of our life insurance business was completed on March 30, 2018. The securities are presented by the length of time they have been continuously in an unrealized loss position:

| September 30, 2018                               | Less than 12 months |                  | 12 months or longer           |                  | Total            |                               |                    |                               |
|--|---------------------|------------------|-------------------------------|------------------|------------------|-------------------------------|--------------------|-------------------------------|
| Type of Investment                               | Number of Issues    | Fair Value       | Gross Unrealized Depreciation | Number of Issues | Fair Value       | Gross Unrealized Depreciation | Fair Value         | Gross Unrealized Depreciation |
| <b>AVAILABLE-FOR-SALE</b>                        |                     |                  |                               |                  |                  |                               |                    |                               |
| Fixed maturities:                                |                     |                  |                               |                  |                  |                               |                    |                               |
| Continuing operations                            | 385                 | \$891,883        | \$ 16,226                     | 168              | \$401,995        | \$ 23,756                     | \$1,293,878        | \$ 39,982                     |
| Discontinued operations                          | —                   | —                | —                             | —                | —                | —                             | —                  | —                             |
| <b>Total Available-for-Sale Fixed Maturities</b> | <b>385</b>          | <b>\$891,883</b> | <b>\$ 16,226</b>              | <b>168</b>       | <b>\$401,995</b> | <b>\$ 23,756</b>              | <b>\$1,293,878</b> | <b>\$ 39,982</b>              |

Note: The sale of the life insurance business was completed on March 30, 2018.

| December 31, 2017                                 | Less than 12 months |                  | 12 months or longer           |                  | Total            |                               |                  |                               |
|---|---------------------|------------------|-------------------------------|------------------|------------------|-------------------------------|------------------|-------------------------------|
| Type of Investment                                | Number of Issues    | Fair Value       | Gross Unrealized Depreciation | Number of Issues | Fair Value       | Gross Unrealized Depreciation | Fair Value       | Gross Unrealized Depreciation |
| <b>AVAILABLE-FOR-SALE</b>                         |                     |                  |                               |                  |                  |                               |                  |                               |
| Fixed maturities:                                 |                     |                  |                               |                  |                  |                               |                  |                               |
| Continuing operations                             | 88                  | \$232,489        | \$ 1,791                      | 112              | \$302,815        | \$ 7,161                      | \$535,304        | \$ 8,952                      |
| Discontinued operations                           | 74                  | 180,891          | 1,415                         | 61               | 167,625          | 5,906                         | 348,516          | 7,321                         |
| <b>Total Available-for-Sale Fixed Maturities</b>  | <b>162</b>          | <b>\$413,380</b> | <b>\$ 3,206</b>               | <b>173</b>       | <b>\$470,440</b> | <b>\$ 13,067</b>              | <b>\$883,820</b> | <b>\$ 16,273</b>              |
| Equity securities:                                |                     |                  |                               |                  |                  |                               |                  |                               |
| Continuing operations                             | 5                   | \$ 1,129         | \$ 236                        | 6                | \$385            | \$ 303                        | \$1,514          | \$ 539                        |
| Discontinued operations                           | 2                   | 157              | 47                            | 4                | 250              | 30                            | 407              | 77                            |
| <b>Total Available-for-Sale Equity Securities</b> | <b>7</b>            | <b>\$ 1,286</b>  | <b>\$ 283</b>                 | <b>10</b>        | <b>\$635</b>     | <b>\$ 333</b>                 | <b>\$1,921</b>   | <b>\$ 616</b>                 |
| <b>Total Available-for-Sale Securities</b>        | <b>169</b>          | <b>\$414,666</b> | <b>\$ 3,489</b>               | <b>183</b>       | <b>\$471,075</b> | <b>\$ 13,400</b>              | <b>\$885,741</b> | <b>\$ 16,889</b>              |

Table of Contents**NOTE 3. FAIR VALUE OF FINANCIAL INSTRUMENTS**

Current accounting guidance on fair value measurements includes the application of a fair value hierarchy that requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Our financial instruments that are recorded at fair value are categorized into a three-level hierarchy, which is based upon the priority of the inputs to the valuation technique. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets (i.e., Level 1) and the lowest priority to unobservable inputs (i.e., Level 3). If the inputs used to measure fair value fall within different levels of the hierarchy, the category level is based on the lowest priority level input that is significant to the fair value measurement of the financial instrument. Financial instruments recorded at fair value are categorized in the fair value hierarchy as follows:

*Level 1:* Valuations are based on unadjusted quoted prices in active markets for identical financial instruments that we have the ability to access.

*Level 2:* Valuations are based on quoted prices for similar financial instruments, other than quoted prices included in Level 1, in markets that are not active or on inputs that are observable either directly or indirectly for the full term of the financial instrument.

*Level 3:* Valuations are based on pricing or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement of the financial instrument. Such inputs may reflect management's own assumptions about the assumptions a market participant would use in pricing the financial instrument.

We review our fair value hierarchy categorizations on a quarterly basis at which time the classification of certain financial instruments may change if the input observations have changed. Transfers between levels, if any, are recorded as of the beginning of the reporting period.

To determine the fair value of the majority of our investments, we utilize prices obtained from independent, nationally recognized pricing services. We obtain one price for each security. When the pricing services cannot provide a determination of fair value for a specific security, we obtain non-binding price quotes from broker-dealers with whom we have had several years' experience and who have demonstrated knowledge of the subject security. We request and utilize one broker quote per security.

In order to determine the proper classification in the fair value hierarchy for each security where the price is obtained from an independent pricing service, we obtain and evaluate the vendors' pricing procedures and inputs used to price the security, which include unadjusted quoted market prices for identical securities, such as a New York Stock Exchange closing price, and quoted prices for identical securities in markets that are not active. For fixed maturity securities, an evaluation of interest rates and yield curves observable at commonly quoted intervals, volatility, prepayment speeds, credit risks and default rates may also be performed. We have determined that these processes and inputs result in fair values and classifications consistent with the applicable accounting guidance on fair value measurements.

When possible, we use quoted market prices to determine the fair value of fixed maturities, equity securities, trading securities and short-term investments. When quoted market prices do not exist, we base estimates of fair value on market information obtained from independent pricing services and brokers or on valuation techniques that are both unobservable and significant to the overall fair value measurement of the financial instrument. Such inputs may reflect management's own assumptions about the assumptions a market participant would use in pricing the financial instrument. Our valuation techniques are discussed in more detail throughout this section.

The mortgage loan portfolio consists entirely of commercial mortgage loans. The fair value of our mortgage loans is determined by modeling performed by our third party fund manager based on the stated principal and coupon payments provided for in the loan agreements. These cash flows are then discounted using an appropriate risk-adjusted discount rate to determine the security's fair value.

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The fair value of our policy loans is equivalent to carrying value, which is a reasonable estimate of fair value and is classified as Level 2. We do not make policy loans for amounts in excess of the cash surrender value of the related policy. In all instances, the policy loans are fully collateralized by the related liability for future policy benefits for traditional insurance policies or by the policyholders' account balance for non-traditional policies.

Our other long-term investments consist primarily of our interests in limited liability partnerships that are recorded on the equity method of accounting. The fair value of the partnerships is obtained from the fund managers, which is based on the fair value of the underlying investments held in the partnerships. In management's opinion, these values represent a reasonable estimate of fair value. We have not adjusted the net asset value provided by the fund managers. For cash and cash equivalents and accrued investment income, carrying value is a reasonable estimate of fair value due to the short-term nature of these financial instruments.

The Company formed a rabbi trust in 2014 to fund obligations under the United Fire & Casualty Company Supplemental Executive Retirement and Deferral Plan (the "Executive Retirement Plan"). Within the rabbi trust, corporate-owned life insurance ("COLI") policies are utilized as an investment vehicle and source of funding for the Company's Executive Retirement Plan. The COLI policies invest in mutual funds, which are priced daily by independent sources. As of September 30, 2018, the cash surrender value of the COLI policies was \$4,998, which is equal to the fair value measured using Level 2 inputs, based on the underlying assets of the COLI policies, and is included in other assets in the Consolidated Balance Sheets.

Policy reserves are developed and recorded for deferred annuities, which is an interest-sensitive product, and income annuities. The fair value of the reserve liability for these annuity products is based upon an estimate of the discounted pretax cash flows that are forecast for the underlying business, which is a Level 3 fair value measurement. We base the discount rate on the current U.S. Treasury spot yield curve, which is then risk-adjusted for nonperformance risk and, for interest-sensitive business and market risk factors. The risk-adjusted discount rate is developed using interest rates that are available in the market and representative of the risks applicable to the underlying business.

A summary of the carrying value and estimated fair value of our financial instruments from continuing operations at September 30, 2018 and December 31, 2017 is as follows:

|                                | <b>September 30,<br/>2018</b> |                           | December 31,<br>2017 |                   |
|--------------------------------|-------------------------------|---------------------------|----------------------|-------------------|
|                                | <b>Fair<br/>Value</b>         | <b>Carrying<br/>Value</b> | Fair<br>Value        | Carrying<br>Value |
| <b>Assets</b>                  |                               |                           |                      |                   |
| Investments                    |                               |                           |                      |                   |
| Fixed maturities:              |                               |                           |                      |                   |
| Held-to-maturity securities    | \$ —                          | \$ —                      | \$ 150               | \$ 150            |
| Available-for-sale securities  | <b>1,730,031</b>              | <b>1,730,031</b>          | 1,535,070            | 1,535,070         |
| Trading securities             | <b>14,399</b>                 | <b>14,399</b>             | 16,842               | 16,842            |
| Equity securities              | <b>276,253</b>                | <b>276,253</b>            | 287,344              | 287,344           |
| Mortgage loans                 | <b>14,749</b>                 | <b>14,896</b>             | —                    | —                 |
| Other long-term investments    | <b>40,432</b>                 | <b>40,432</b>             | 49,352               | 49,352            |
| Short-term investments         | <b>175</b>                    | <b>175</b>                | 175                  | 175               |
| Cash and cash equivalents      | <b>52,252</b>                 | <b>52,252</b>             | 95,562               | 95,562            |
| Corporate-owned life insurance | <b>4,998</b>                  | <b>4,998</b>              | 4,029                | 4,029             |





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A summary of the carrying value and estimated fair value of our financial instruments from discontinued operations at September 30, 2018 and December 31, 2017 is as follows:

|                               | September 30,<br>2018 |                   | December 31, 2017 |                   |
|-------------------------------|-----------------------|-------------------|-------------------|-------------------|
|                               | Fair<br>Value         | Carrying<br>Value | Fair<br>Value     | Carrying<br>Value |
| <b>Assets</b>                 |                       |                   |                   |                   |
| Investments                   |                       |                   |                   |                   |
| Fixed maturities:             |                       |                   |                   |                   |
| Held-to-maturity securities   | \$ —                  | \$ —              | —\$34             | \$ 34             |
| Available-for-sale securities | —                     | —                 | 1,430,025         | 1,430,025         |
| Equity securities:            |                       |                   |                   |                   |
| Available-for-sale securities | —                     | —                 | 23,653            | 23,653            |
| Mortgage loans                | —                     | —                 | 3,594             | 3,435             |
| Policy loans                  | —                     | —                 | 5,815             | 5,815             |
| Other long-term investments   | —                     | —                 | 16,437            | 16,437            |
| Cash and cash equivalents     | —                     | —                 | 15,851            | 15,851            |
| <b>Liabilities</b>            |                       |                   |                   |                   |
| Policy reserves               |                       |                   |                   |                   |
| Annuity (accumulations)       | \$ —                  | \$ —              | —\$591,702        | \$ 611,866        |
| Annuity (benefit payments)    | —                     | —                 | 147,038           | 93,560            |

Note: The sale of the life insurance business was completed on March 30, 2018.

The following tables present the categorization for our financial instruments measured at fair value on a recurring basis. The table includes financial instruments from both continuing and discontinued operations at September 30, 2018 and December 31, 2017:

| September 30, 2018                                | Description            | Total     | Fair Value Measurements |                    |
|---|------------------------|-----------|-------------------------|--------------------|
|   |                        |           | Level 1                 | Level 2<br>Level 3 |
| <b>AVAILABLE-FOR-SALE</b>                         |                        |           |                         |                    |
| Fixed maturities:                                 |                        |           |                         |                    |
| Bonds   |                        |           |                         |                    |
|   | U.S. Treasury          | \$ 26,841 | \$ —                    | \$ 26,841          |
|   | U.S. government agency | 206,990   | —                       | 206,990            |
| States, municipalities and political subdivisions |                        |           |                         |                    |
| General obligations                               |                        |           |                         |                    |
|   | Midwest                | 98,238    | —                       | 98,238             |
|   | Northeast              | 37,351    | —                       | 37,351             |
|   | South                  | 113,214   | —                       | 113,214            |
|   | West                   | 106,638   | —                       | 106,638            |
| Special revenue                                   |                        |           |                         |                    |
|   | Midwest                | 139,327   | —                       | 139,327            |
|   | Northeast              | 62,097    | —                       | 62,097             |
|   | South                  | 235,441   | —                       | 235,441            |
|   | West                   | 142,398   | —                       | 142,398            |
|   | Foreign bonds          | 9,747     | —                       | 9,747              |
|   | Public utilities       | 53,544    | —                       | 53,544             |
|   | Corporate bonds        |           |                         |                    |
|   | Energy                 | 26,686    | —                       | 26,686             |

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|                             |        |   |        |   |
|-----------------------------|--------|---|--------|---|
| Industrials                 | 55,531 | — | 55,531 | — |
| Consumer goods and services | 51,677 | — | 51,677 | — |

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|  |                    |            |                    |              |
|--|--------------------|------------|--------------------|--------------|
| Health care                                      | 17,986             | —          | 17,986             | —            |
| Technology, media and telecommunications         | 26,122             | —          | 26,122             | —            |
| Financial services                               | 76,064             | —          | 75,814             | 250          |
| Mortgage-backed securities                       | 7,738              | —          | 7,738              | —            |
| Collateralized mortgage obligations              |                    |            |                    |              |
| Government national mortgage association         | 75,316             | —          | 75,316             | —            |
| Federal home loan mortgage corporation           | 105,716            | —          | 105,716            | —            |
| Federal national mortgage association            | 51,854             | —          | 51,854             | —            |
| Asset-backed securities                          | 3,515              | —          | 2,883              | 632          |
| <b>Total Available-for-Sale Fixed Maturities</b> | <b>\$1,730,031</b> | <b>\$—</b> | <b>\$1,729,149</b> | <b>\$882</b> |

**TRADING**

Fixed maturities:

Bonds

|  |                 |                |                 |            |
|--|-----------------|----------------|-----------------|------------|
| U.S. Treasury                            | \$200           | \$—            | \$200           | \$—        |
| Corporate bonds                          |                 | —              | —               | —          |
| Industrials                              | 1,812           | —              | 1,812           | \$—        |
| Consumer goods and services              | 1,750           | —              | 1,750           | —          |
| Health care                              | 3,182           | —              | 3,182           | —          |
| Technology, media and telecommunications | 2,694           | —              | 2,694           | —          |
| Financial services                       | 2,114           | —              | 2,114           | —          |
| Redeemable preferred stocks              | 2,647           | 2,647          | —               | —          |
| <b>Total Trading Securities</b>          | <b>\$14,399</b> | <b>\$2,647</b> | <b>\$11,752</b> | <b>\$—</b> |

**EQUITY SECURITIES**

Common stocks

|  |                    |                  |                    |                |
|--|--------------------|------------------|--------------------|----------------|
| Public utilities                           | \$15,563           | \$15,563         | \$—                | \$—            |
| Energy                                     | 13,647             | 13,647           | —                  | —              |
| Industrials                                | 62,741             | 62,741           | —                  | —              |
| Consumer goods and services                | 25,870             | 25,870           | —                  | —              |
| Health care                                | 22,991             | 22,991           | —                  | —              |
| Technology, media and telecommunications   | 15,047             | 15,047           | —                  | —              |
| Financial services                         | 114,708            | 114,708          | —                  | —              |
| Nonredeemable preferred stocks             | 5,686              | 5,091            | —                  | 595            |
| <b>Total Equity Securities</b>             | <b>\$276,253</b>   | <b>\$275,658</b> | <b>\$—</b>         | <b>\$595</b>   |
| <b>Short-Term Investments</b>              | <b>\$175</b>       | <b>\$175</b>     | <b>\$—</b>         | <b>\$—</b>     |
| <b>Money Market Accounts</b>               | <b>\$3,824</b>     | <b>\$3,824</b>   | <b>\$—</b>         | <b>\$—</b>     |
| <b>Corporate-Owned Life Insurance</b>      | <b>\$4,998</b>     | <b>\$—</b>       | <b>\$4,998</b>     | <b>\$—</b>     |
| <b>Total Assets Measured at Fair Value</b> | <b>\$2,029,680</b> | <b>\$282,304</b> | <b>\$1,745,899</b> | <b>\$1,477</b> |

Note: The sale of the life insurance business was completed on March 30, 2018.

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| December 31, 2017<br>Description                  | Total               | Fair Value Measurements |                     |                 |
|---|---------------------|-------------------------|---------------------|-----------------|
|   |                     | Level 1                 | Level 2             | Level 3         |
| <b>AVAILABLE-FOR-SALE</b>                         |                     |                         |                     |                 |
| Fixed maturities:                                 |                     |                         |                     |                 |
| Bonds   |                     |                         |                     |                 |
| U.S. Treasury                                     | \$ 16,891           | \$—                     | \$ 16,891           | \$—             |
| U.S. government agency                            | 122,168             | —                       | 122,168             | —               |
| States, municipalities and political subdivisions |                     |                         |                     |                 |
| General obligations                               |                     |                         |                     |                 |
| Midwest   | 109,696             | —                       | 109,696             | —               |
| Northeast   | 48,641              | —                       | 48,641              | —               |
| South   | 141,519             | —                       | 141,519             | —               |
| West  | 113,011             | —                       | 113,011             | —               |
| Special revenue                                   |                     |                         |                     |                 |
| Midwest   | 158,744             | —                       | 158,744             | —               |
| Northeast   | 79,760              | —                       | 79,760              | —               |
| South   | 263,512             | —                       | 263,512             | —               |
| West  | 158,307             | —                       | 158,307             | —               |
| Foreign bonds                                     | 52,753              | —                       | 52,753              | —               |
| Public utilities                                  | 209,144             | —                       | 209,144             | —               |
| Corporate bonds                                   |                     |                         |                     |                 |
| Energy  | 95,053              | —                       | 95,053              | —               |
| Industrials                                       | 221,707             | —                       | 221,707             | —               |
| Consumer goods and services                       | 186,257             | —                       | 185,589             | 668             |
| Health care                                       | 75,408              | —                       | 75,408              | —               |
| Technology, media and telecommunications          | 148,979             | —                       | 148,979             | —               |
| Financial services                                | 283,151             | —                       | 275,474             | 7,677           |
| Mortgage-backed securities                        | 13,691              | —                       | 13,691              | —               |
| Collateralized mortgage obligations               |                     |                         |                     |                 |
| Government national mortgage association          | 157,483             | —                       | 157,483             | —               |
| Federal home loan mortgage corporation            | 199,152             | —                       | 199,152             | —               |
| Federal national mortgage association             | 105,432             | —                       | 105,432             | —               |
| Asset-backed securities                           | 4,636               | —                       | 3,989               | 647             |
| <b>Total Available-for-Sale Fixed Maturities</b>  | <b>\$ 2,965,095</b> | <b>\$—</b>              | <b>\$ 2,956,103</b> | <b>\$ 8,992</b> |
| Equity securities:                                |                     |                         |                     |                 |
| Common stocks                                     |                     |                         |                     |                 |
| Public utilities                                  | \$ 22,439           | \$ 22,439               | \$—                 | \$—             |
| Energy  | 14,565              | 14,565                  | —                   | —               |
| Industrials                                       | 66,519              | 66,517                  | 2                   | —               |
| Consumer goods and services                       | 25,688              | 25,688                  | —                   | —               |
| Health care                                       | 40,103              | 40,103                  | —                   | —               |
| Technology, media and telecommunications          | 17,508              | 17,508                  | —                   | —               |
| Financial services                                | 116,447             | 116,447                 | —                   | —               |

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|   |                    |                  |                    |                |
|---|--------------------|------------------|--------------------|----------------|
| Nonredeemable preferred stocks                    | 1,297              | 415              | —                  | 882            |
| <b>Total Available-for-Sale Equity Securities</b> | <b>\$304,566</b>   | <b>\$303,682</b> | <b>\$2</b>         | <b>\$882</b>   |
| <b>Total Available-for-Sale Securities</b>        | <b>\$3,269,661</b> | <b>\$303,682</b> | <b>\$2,956,105</b> | <b>\$9,874</b> |

**TRADING**

Fixed maturities:

Bonds

Corporate bonds

|  |         |       |         |     |
|--|---------|-------|---------|-----|
| Industrials                              | \$2,220 | \$—   | \$2,220 | \$— |
| Consumer goods and services              | 1,535   | —     | 1,535   | —   |
| Health care                              | 3,741   | —     | 3,741   | —   |
| Technology, media and telecommunications | 1,221   | —     | 1,221   | —   |
| Financial services                       | 5,566   | —     | 5,566   | —   |
| Redeemable preferred stocks              | 2,559   | 2,559 | —       | —   |

Equity securities:

|                                |       |       |   |   |
|--------------------------------|-------|-------|---|---|
| Public utilities               | 874   | 874   | — | — |
| Energy                         | 190   | 190   | — | — |
| Industrials                    | 989   | 989   | — | — |
| Consumer goods and services    | 1,314 | 1,314 | — | — |
| Health care                    | 325   | 325   | — | — |
| Financial services             | 198   | 198   | — | — |
| Nonredeemable preferred stocks | 2,541 | 2,541 | — | — |

**Total Trading Securities** \$23,273 \$8,990 \$14,283 \$—**Short-Term Investments** \$175 \$175 \$— \$—**Money Market Accounts** \$16,824 \$16,824 \$— \$—**Corporate-Owned Life Insurance** \$4,029 \$— \$4,029 \$—**Total Assets Measured at Fair Value** \$3,313,962 \$329,671 \$2,974,417 \$9,874

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The following tables are a reconciliation for both continuing and discontinued operations of the presentation of the categorization for our financial instruments measured at fair value on a recurring basis at September 30, 2018 and December 31, 2017:

| September 30, 2018<br>Description                | Fair Value Measurements |                  |                    |                |
|--|-------------------------|------------------|--------------------|----------------|
|  | Total                   | Level 1          | Level 2            | Level 3        |
| <b>AVAILABLE-FOR-SALE</b>                        |                         |                  |                    |                |
| Fixed maturities:                                |                         |                  |                    |                |
| Continuing operations                            | \$1,730,031             |                  | \$1,729,149        | \$882          |
| Discontinued operations                          | —                       | —                | —                  | —              |
| <b>Total Available-for-Sale Fixed Maturities</b> | <b>\$1,730,031</b>      | <b>\$—</b>       | <b>\$1,729,149</b> | <b>\$882</b>   |
| <b>TRADING</b>                                   |                         |                  |                    |                |
| Fixed maturities:                                |                         |                  |                    |                |
| Continuing operations                            | \$14,399                | \$2,647          | \$11,752           | \$—            |
| Discontinued operations                          | —                       | —                | —                  | —              |
| <b>Total Trading Securities</b>                  | <b>\$14,399</b>         | <b>\$2,647</b>   | <b>\$11,752</b>    | <b>\$—</b>     |
| <b>EQUITY SECURITIES</b>                         |                         |                  |                    |                |
| Continuing operations                            | \$276,253               | \$275,658        | \$—                | \$595          |
| Discontinued operations                          | —                       | —                | —                  | —              |
| <b>Total Equity Securities</b>                   | <b>\$276,253</b>        | <b>\$275,658</b> | <b>\$—</b>         | <b>\$595</b>   |
| <b>SHORT-TERM INVESTMENTS</b>                    |                         |                  |                    |                |
| Continuing operations                            | \$175                   | \$175            |                    |                |
| Discontinued operations                          | —                       | —                | —                  | \$—            |
| <b>Short-Term Investments</b>                    | <b>\$175</b>            | <b>\$175</b>     | <b>\$—</b>         | <b>\$—</b>     |
| <b>MONEY MARKET ACCOUNTS</b>                     |                         |                  |                    |                |
| Continuing operations                            | \$3,824                 | \$3,824          |                    |                |
| Discontinued operations                          | —                       | —                | —                  | —              |
| <b>Money Market Accounts</b>                     | <b>\$3,824</b>          | <b>\$3,824</b>   | <b>\$—</b>         | <b>\$—</b>     |
| <b>CORPORATE-OWNED LIFE INSURANCE</b>            |                         |                  |                    |                |
| Continuing operations                            | \$4,998                 |                  | \$4,998            |                |
| Discontinued operations                          | —                       | —                | —                  | —              |
| <b>Corporate-Owned Life Insurance</b>            | <b>\$4,998</b>          | <b>\$—</b>       | <b>\$4,998</b>     | <b>\$—</b>     |
| <b>Total Assets Measured at Fair Value</b>       | <b>\$2,029,680</b>      | <b>\$282,304</b> | <b>\$1,745,899</b> | <b>\$1,477</b> |

Note: The sale of the life insurance business was completed on March 30, 2018.

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| December 31, 2017<br>Description                 | Fair Value Measurements |                   |                     |                 |
|--|-------------------------|-------------------|---------------------|-----------------|
|  | Total                   | Level 1           | Level 2             | Level 3         |
| <b>AVAILABLE-FOR-SALE</b>                        |                         |                   |                     |                 |
| Fixed maturities:                                |                         |                   |                     |                 |
| Continuing operations                            | \$ 1,535,070            | \$—               | \$ 1,534,323        | \$ 747          |
| Discontinued operations                          | 1,430,025               | —                 | 1,421,780           | 8,245           |
| <b>Total Available-for-Sale Fixed Maturities</b> | <b>\$ 2,965,095</b>     | <b>\$—</b>        | <b>\$ 2,956,103</b> | <b>\$ 8,992</b> |
| Equity securities:                               |                         |                   |                     |                 |
| Continuing operations                            | \$ 280,913              | \$ 280,031        | \$—                 | \$ 882          |
| Discontinued operations                          | 23,653                  | 23,651            | 2                   | —               |
| <b>Total Equity Securities</b>                   | <b>\$ 304,566</b>       | <b>\$ 303,682</b> | <b>\$ 2</b>         | <b>\$ 882</b>   |
| <b>Total Available-for-Sale Securities</b>       | <b>\$ 3,269,661</b>     | <b>\$ 303,682</b> | <b>\$ 2,956,105</b> | <b>\$ 9,874</b> |
| <b>TRADING</b>                                   |                         |                   |                     |                 |
| Fixed maturities:                                |                         |                   |                     |                 |
| Continuing operations                            | \$ 16,842               | \$ 2,559          | \$ 14,283           | \$—             |
| Discontinued operations                          | —                       | —                 | —                   | —               |
| Equity securities:                               |                         |                   |                     |                 |
| Continuing operations                            | 6,431                   | 6,431             | —                   | —               |
| Discontinued operations                          | —                       | —                 | —                   | —               |
| <b>Total Trading Securities</b>                  | <b>\$ 23,273</b>        | <b>\$ 8,990</b>   | <b>\$ 14,283</b>    | <b>\$—</b>      |
| <b>SHORT-TERM INVESTMENTS</b>                    |                         |                   |                     |                 |
| Continuing operations                            | \$ 175                  | \$ 175            | \$—                 | \$—             |
| Discontinued operations                          | —                       | —                 | —                   | —               |
| <b>Short-Term Investments</b>                    | <b>\$ 175</b>           | <b>\$ 175</b>     | <b>\$—</b>          | <b>\$—</b>      |
| <b>MONEY MARKET ACCOUNTS</b>                     |                         |                   |                     |                 |
| Continuing operations                            | \$ 6,147                | \$ 6,147          | \$—                 | \$—             |
| Discontinued operations                          | 10,677                  | 10,677            | —                   | —               |
| <b>Money Market Accounts</b>                     | <b>\$ 16,824</b>        | <b>\$ 16,824</b>  | <b>\$—</b>          | <b>\$—</b>      |
| <b>CORPORATE-OWNED LIFE INSURANCE</b>            |                         |                   |                     |                 |
| Continuing operations                            | \$ 4,029                | \$—               | \$ 4,029            | \$—             |
| Discontinued operations                          | —                       | —                 | —                   | —               |
| <b>Corporate-Owned Life Insurance</b>            | <b>\$ 4,029</b>         | <b>\$—</b>        | <b>\$ 4,029</b>     | <b>\$—</b>      |
| <b>Total Assets Measured at Fair Value</b>       | <b>\$ 3,313,962</b>     | <b>\$ 329,671</b> | <b>\$ 2,974,417</b> | <b>\$ 9,874</b> |

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The fair value of securities that are categorized as Level 1 is based on quoted market prices that are readily and regularly available.

We use a market-based approach for valuing all of our Level 2 securities and submit them primarily to a third-party valuation service provider. Any of these securities not valued by this service provider are submitted to another third-party valuation service provider. Both service providers use a market approach to find pricing of similar financial instruments. The market inputs our service providers normally seek to value our securities include the following, listed in approximate order of priority: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data including market research publications. The method and inputs for these securities classified as Level 2 are the same regardless of industry category, credit quality, duration, geographical concentration or economic characteristics. For our mortgage-backed securities, collateralized mortgage obligations and asset-backed securities, our service providers use additional market inputs to value these securities, including the following: new issue data, periodic payment information, monthly payment information, collateral performance and real estate analysis from third parties. Our service providers prioritize inputs based on market conditions, and not all inputs listed are available for use in the valuation process for each security on any given day.

At least annually, we review the methodologies and assumptions used by our valuation service providers and verify that they are reasonable and representative of the fair value of the underlying securities held in the investment portfolio. We validate the prices obtained from independent pricing services and brokers prior to their use for reporting purposes by evaluating their reasonableness on a monthly basis. Our validation process includes a review for unusual fluctuations. Unusual fluctuations outside of our expectations are independently corroborated with additional third-party sources that use similar valuation techniques as discussed above. In addition, we also randomly select securities and independently corroborate the valuations obtained from our third-party valuation service providers. In our opinion, the pricing obtained at September 30, 2018 and December 31, 2017 was reasonable.

For the three- and nine-month periods ended September 30, 2018, the change in our available-for-sale securities categorized as Level 1 and Level 2 is the result of investment purchases that were made using funds held in our money market accounts, disposals and the change in unrealized gains on both fixed maturities and equity securities. During the three- and nine-month periods ended September 30, 2018, there were no securities transferred between Level 1 and Level 2.

Securities categorized as Level 3 include holdings in certain private placement fixed maturity and equity securities for which an active market does not currently exist. The fair value of our Level 3 private placement securities is determined by management relying on pricing received from our independent pricing services and brokers consistent with the process to estimate fair value for Level 2 securities. However, securities are categorized as Level 3 if these quotes cannot be corroborated by other market observable data due to the unobservable nature of the brokers' valuation processes. If pricing cannot be obtained from these sources, which occurs on a limited basis, management will perform a discounted cash flow analysis, using an appropriate risk-adjusted discount rate, on the underlying security to estimate fair value. During the three- and nine-month periods ended September 30, 2018, there were no securities transferred in or out of Level 3.

The following table provides a summary of the changes in fair value of our Level 3 securities from continuing operations for the three-month period ended September 30, 2018:

|  | Corporate<br>bonds | Asset-backed<br>securities | Equities | Total    |
|--|--------------------|----------------------------|----------|----------|
| Balance at June 30, 2018                     | \$ 100             | \$ 639                     | \$ 669   | \$ 1,408 |
| Net unrealized gains (losses) <sup>(1)</sup> | 150                | (7 )                       | (74 )    | 69       |
| Balance at September 30, 2018                | \$ 250             | \$ 632                     | \$ 595   | \$ 1,477 |

(1) Net unrealized gains (losses) are recorded as a component of comprehensive income.





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The following table provides a summary of the changes in fair value of our Level 3 securities from continuing operations for the nine-month period ended September 30, 2018:

|  | Corporate<br>bonds | Asset-backed<br>securities | Equities | Total    |
|--|--------------------|----------------------------|----------|----------|
| Balance at January 1, 2018                   | \$ 100             | \$ 647                     | \$ 882   | \$ 1,629 |
| Net unrealized gains (losses) <sup>(1)</sup> | 150                | (15 )                      | (287 )   | (152 )   |
| Balance at September 30, 2018                | \$ 250             | \$ 632                     | \$ 595   | \$ 1,477 |

(1) Net unrealized losses are recorded as a component of comprehensive income.

**Commercial Mortgage Loans**

The following tables present the carrying value of our commercial mortgage loans and additional information at September 30, 2018 and December 31, 2017:

**Commercial Mortgage Loans**

|  | September 30,<br>2018 | December 31,<br>2017 |
|--|-----------------------|----------------------|
| Loan-to-value                          | Carrying<br>Value     | Carrying<br>Value    |
| Less than 65%                          | \$ 14,896             | —                    |
| <b>Total commercial mortgage loans</b> | <b>\$ 14,896</b>      | <b>\$ —</b>          |

**Mortgage Loans by Region**

|                             | September 30,<br>2018 | December 31,<br>2017 |                   |                     |
|-----------------------------|-----------------------|----------------------|-------------------|---------------------|
|                             | Carrying<br>Value     | Percent<br>of Total  | Carrying<br>Value | Percent<br>of Total |
| East North Central          | \$ 3,245              | 21.8 %               | \$ —              | — %                 |
| Southern Atlantic           | 6,651                 | 44.7                 | —                 | —                   |
| East South Central          | 5,000                 | 33.5                 | —                 | —                   |
| <b>Total mortgage loans</b> | <b>\$ 14,896</b>      | <b>100.0 %</b>       | <b>\$ —</b>       | <b>— %</b>          |

**Mortgage Loans by Property Type**

|                             | September 30,<br>2018 | December 31,<br>2017 |                   |                     |
|-----------------------------|-----------------------|----------------------|-------------------|---------------------|
|                             | Carrying<br>Value     | Percent<br>of Total  | Carrying<br>Value | Percent<br>of Total |
| Commercial                  |                       |                      |                   |                     |
| Multifamily                 | \$ 3,245              | 21.8 %               | \$ —              | — %                 |
| Office                      | 11,651                | 78.2                 | —                 | —                   |
| <b>Total mortgage loans</b> | <b>\$ 14,896</b>      | <b>100.0 %</b>       | <b>\$ —</b>       | <b>— %</b>          |

The commercial mortgage loans originate with an initial loan-to-value ratio to provide sufficient collateral to absorb losses should a loan be required to foreclose. Mortgage loans are evaluated on a quarterly basis for impairment on an individual basis through a monitoring process and review of key credit indicators, such as economic trends, delinquency rates, property valuations, occupancy and rental rates and loan-to-value ratios. A loan is considered impaired when the Company believes it will not collect the contractual principal and interest set forth in the contractual terms of the loan. A valuation allowance is established on each loan recognizing a loss for amounts which we believe will not be collected according to the contractual terms of the respective loan agreement. As of September 30, 2018 there were no mortgage loan impairments.



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**NOTE 4. RESERVES FOR LOSSES AND LOSS SETTLEMENT EXPENSES**

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 losses 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. Because property and casualty insurance reserves are estimates of the unpaid portions of incurred losses that have been reported to us, as well as losses that have been incurred but not reported, the establishment of appropriate reserves, including reserves for catastrophes, is an inherently uncertain and complex process. The ultimate cost of losses and related loss settlement expenses may vary materially from recorded amounts. We regularly update our reserve estimates as new information becomes available and as events unfold that may affect the resolution of unsettled claims. Changes in prior year reserve estimates, which may be material, are reported as a component of losses and loss settlement expenses incurred in the period such changes are determined.

The determination of reserves (particularly those relating to liability lines of insurance that have relatively longer lag in 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. We engage an independent actuary, Regnier Consulting Group, Inc., to render an opinion as to the reasonableness of our statutory reserves annually. The actuarial opinion is filed in those states where we are licensed.

On a quarterly basis, UFG's internal actuary performs a detailed actuarial review of IBNR reserves. This review includes a comparison of results from the most recent analysis of reserves completed by both our internal and external actuaries. Senior management meets with our internal actuary to review, on a regular and quarterly basis, the adequacy of carried reserves based on results from this actuarial analysis. There are two fundamental types or sources of IBNR reserves. We record IBNR reserves for "normal" types 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 establishing 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.

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The following table provides an analysis of changes in our property and casualty losses and loss settlement expense reserves at September 30, 2018 and December 31, 2017 (net of reinsurance amounts):

|  | <b>September 30,<br/>2018</b> | December 31,<br>2017 |
|--|-------------------------------|----------------------|
| Gross liability for losses and loss settlement expenses at beginning of year | <b>\$ 1,224,183</b>           | \$ 1,123,896         |
| Ceded losses and loss settlement expenses                                    | <b>(59,871 )</b>              | (59,794 )            |
| Net liability for losses and loss settlement expenses at beginning of year   | <b>\$ 1,164,312</b>           | \$ 1,064,102         |
| Losses and loss settlement expenses incurred for claims occurring during     |                               |                      |
| Current year   | <b>\$ 575,214</b>             | \$ 779,966           |
| Prior years  | <b>(47,673 )</b>              | (54,253 )            |
| Total incurred   | <b>\$ 527,541</b>             | \$ 725,713           |
| Losses and loss settlement expense payments for claims occurring during      |                               |                      |
| Current year   | <b>\$ 212,138</b>             | \$ 311,972           |
| Prior years  | <b>263,552</b>                | 313,531              |
| Total paid   | <b>\$ 475,690</b>             | \$ 625,503           |
| Net liability for losses and loss settlement expenses at end of year         | <b>\$ 1,216,163</b>           | \$ 1,164,312         |
| Ceded loss and loss settlement expenses                                      | <b>61,914</b>                 | 59,871               |
| Gross liability for losses and loss settlement expenses at end of period     | <b>\$ 1,278,077</b>           | \$ 1,224,183         |

There are a multitude of factors that can impact loss reserve development. Those factors include, but are not limited to: historical data, the potential impact of various loss reserve development factors and trends including historical loss experience, legislative enactments, judicial decisions, legal developments in imposition of damages, experience with alternative dispute resolution, results of our medical bill review process, the potential impact of salvage and subrogation and changes and trends in general economic conditions, including the effects of inflation. All of these factors influence our estimates of required reserves and for long tail lines these factors can change over the course of the settlement of the claim. However, there is no precise method for evaluating the specific monetary impact of any individual factor on the development of reserves.

For the three-month period ended September 30, 2018 the majority of unfavorable development came from two lines, commercial liability and commercial automobile with a partial offset coming from favorable development for the three lines of reinsurance assumed, workers compensation and fidelity and surety. All other lines combined contributed a relatively minimal amount of overall unfavorable development during this three-month period. The unfavorable development for the quarter is attributable to the combination of latent emergence of commercial automobile claims that increased sufficiently to also generate an umbrella liability claim combined with a very large but independent general liability claim. For the nine-month period ended September 30, 2018 the majority of favorable development came from four lines: workers compensation, commercial automobile, commercial liability, and reinsurance assumed. Each of the other individual lines also contributed favorable development during this nine-month period (none were unfavorable).

The significant drivers of the favorable reserve development in 2017 were our commercial liability and workers compensation lines of business. Much of the favorable commercial other liability development came from loss adjustment expense and is attributed to our continued litigation management efforts combined with some favorable development coming from decreases in reserves, which were more than sufficient to pay claims as they closed.

Workers compensation favorable development was due to the combined effects of decreases in claim reserves along with favorable changes affecting loss adjustment expense. Our personal lines also contributed favorable development. The lines that experienced adverse development during the year, which partially offset the favorable development mentioned earlier, were assumed reinsurance and commercial automobile. The adverse development for assumed reinsurance is due to increases in prior year reserves for unpaid claims while the adverse development for commercial automobile is due to paid losses which were greater than reductions in reported loss reserves and

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reserves for claims incurred but not reported. No other single line of business contributed a significant portion of the total development.

Generally, we base reserves for each claim on the estimated ultimate exposure for that claim. We believe that it is appropriate and reasonable to establish a best estimate for reserves within a range of reasonable estimates, especially when we are reserving for claims for bodily injury, disabilities and similar claims, for which settlements and verdicts can vary widely. Our reserving philosophy may result in favorable reserve development in future years that will decrease losses and loss settlement expenses for prior year claims in the year of adjustment. We realize that this philosophy, coupled with what we believe to be aggressive and successful claims management and loss settlement practices, has resulted in year-to-year redundancies in reserves. We believe our approach produces recorded reserves that are reasonably consistent as to their relative position within a range of reasonable reserves from year-to-year. However, conditions and trends that have affected the reserve development for a given year do change. Therefore, such development cannot be used to project future reserve redundancies or deficiencies.

We are not aware of any significant contingent liabilities related to environmental issues. Because of the type of property coverage we write, we have potential exposure to environmental pollution, mold and asbestos claims. Our underwriters are aware of these exposures and use riders or endorsements to limit exposure.

**NOTE 5. EMPLOYEE BENEFITS****Net Periodic Benefit Cost**

The components of the net periodic benefit cost for our pension and postretirement benefit plans are as follows:

|                                      | <b>Pension Plan</b> |         | <b>Postretirement Benefit Plan</b> |         |
|--------------------------------------|---------------------|---------|------------------------------------|---------|
| Three Months Ended September 30,     | <b>2018</b>         | 2017    | <b>2018</b>                        | 2017    |
| Net periodic benefit cost            |                     |         |                                    |         |
| Service cost                         | <b>\$2,175</b>      | \$1,714 | <b>\$750</b>                       | \$505   |
| Interest cost                        | <b>1,875</b>        | 1,765   | <b>502</b>                         | 482     |
| Expected return on plan assets       | <b>(2,626)</b>      | (2,413) | —                                  | —       |
| Amortization of prior service credit | —                   | —       | <b>(1,352)</b>                     | (1,352) |
| Amortization of net loss             | <b>1,072</b>        | 891     | <b>589</b>                         | 462     |
| Net periodic benefit cost            | <b>\$2,496</b>      | \$1,957 | <b>\$489</b>                       | \$97    |

|                                      | <b>Pension Plan</b> |         | <b>Postretirement Benefit Plan</b> |         |
|--------------------------------------|---------------------|---------|------------------------------------|---------|
| Nine Months Ended September 30,      | <b>2018</b>         | 2017    | <b>2018</b>                        | 2017    |
| Net periodic benefit cost            |                     |         |                                    |         |
| Service cost                         | <b>\$6,525</b>      | \$5,141 | <b>\$2,249</b>                     | \$1,515 |
| Interest cost                        | <b>5,625</b>        | 5,295   | <b>1,506</b>                       | 1,446   |
| Expected return on plan assets       | <b>(7,877)</b>      | (7,237) | —                                  | —       |
| Amortization of prior service credit | —                   | —       | <b>(4,056)</b>                     | (4,056) |
| Amortization of net loss             | <b>3,215</b>        | 2,673   | <b>1,767</b>                       | 1,384   |
| Net periodic benefit cost            | <b>\$7,488</b>      | \$5,872 | <b>\$1,466</b>                     | \$289   |

**Employer Contributions**

We previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017 that we expected

to contribute \$6,400 to the pension plan in 2018. For the nine-month period ended September 30, 2018, we contributed \$16,400 to the pension plan. In September 2018, the Company contributed an additional \$10,000 to the pension plan to reduce future obligations.



Table of Contents**NOTE 6. STOCK-BASED COMPENSATION****Non-Qualified Employee Stock Award Plan**

The United Fire Group, Inc. 2008 Stock Plan (the "2008 Stock Plan") authorized the issuance of restricted and unrestricted stock awards, restricted stock units, stock appreciation rights, incentive stock options, and non-qualified stock options for up to 1,900,000 shares of UFG common stock to employees. In May 2014, the Registrant's shareholders approved an additional 1,500,000 shares of UFG common stock issuable at any time and from time to time pursuant to the 2008 Stock Plan, among other amendments, and renamed such plan as the United Fire Group, Inc. Stock Plan (as amended, the "Stock Plan"). At September 30, 2018, there were 879,913 authorized shares remaining available for future issuance. The Stock Plan is administered by the Board of Directors, which determines those employees who will receive awards, when awards will be granted, and the terms and conditions of the awards. The Board of Directors may also take any action it deems necessary and appropriate for the administration of the Stock Plan. Pursuant to the Stock Plan, the Board of Directors may, at its sole discretion, grant awards to our employees who are in positions of substantial responsibility with UFG.

Options granted pursuant to the Stock Plan are granted to buy shares of UFG's common stock at the market value of the stock on the date of grant. All outstanding option awards have graded vesting over 3 years or 5 years from the grant date, unless the Board of Directors authorizes acceleration of vesting. Performance stock units cliff-vest after 3 years and the certification of performance results by UFG's Compensation Committee. To the extent not exercised, vested option awards accumulate and are exercisable by the awardee, in whole or in part, in any subsequent year included in the option period, but not later than 10 years from the grant date. Restricted and unrestricted stock awards granted pursuant to the Stock Plan are granted at the market value of UFG's common stock on the date of the grant. Restricted stock units fully vest after 3 years or 5 years from the date of issuance, unless accelerated upon the approval of the Board of Directors, at which time UFG common stock will be issued to the awardee.

The activity in the Stock Plan is displayed in the following table:

| <b>Authorized Shares Available for Future Award Grants</b> | <b>Nine<br/>Months<br/>Ended<br/>September<br/>30, 2018</b> | <b>From<br/>Inception<br/>to<br/>September<br/>30, 2018</b> |
|--|---|---|
| Beginning balance  | <b>996,828</b>  | 1,900,000   |
| Additional shares authorized                               | —   | 1,500,000   |
| Number of awards granted                                   | <b>(157,188 )</b>   | (3,029,159 )  |
| Number of awards forfeited or expired                      | <b>40,273</b>   | 509,072   |
| Ending balance   | <b>879,913</b>  | 879,913   |
| Number of option awards exercised                          | <b>211,789</b>  | 1,297,684   |
| Number of unrestricted stock awards granted                |   | 8,470   |
| Number of restricted stock awards vested                   | <b>19,658</b>   | 57,826  |

**Non-Qualified Non-Employee Director Stock Option and Restricted Stock Plan**

The United Fire Group, Inc. 2005 Non-Qualified Non-Employee Director Stock Option and Restricted Stock Plan (the "Director Plan") authorizes the issuance of restricted stock awards and non-qualified stock options to purchase shares of UFG's common stock to non-employee directors. At September 30, 2018, we had 49,163 authorized shares available for future issuance.

The Board of Directors has the authority to determine which non-employee directors receive awards, when options and restricted stock shall be granted, the option price, the option expiration date, the date of grant, the vesting schedule of options or whether the options shall be immediately vested, the terms and conditions of options and restricted stock (other than those terms and conditions set forth in the plan) and the number of shares of common stock to be issued pursuant to an option agreement or restricted stock agreement (subject to limits set forth in the plan). The Board of Directors may also take any action it deems necessary and appropriate for the administration of the Director Plan.



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The activity in the Director Plan is displayed in the following table:

| <b>Authorized Shares Available for Future Award Grants</b> | <b>Nine<br/>Months<br/>Ended<br/>September<br/>30, 2018</b> | <b>From<br/>Inception<br/>to<br/>September<br/>30, 2018</b> |
|--|---|---|
| Beginning balance  | <b>61,813</b>   | 300,000   |
| Number of awards granted                                   | <b>(12,650 )</b>  | (274,840 )  |
| Number of awards forfeited or expired                      |   | 24,003  |
| Ending balance   | <b>49,163</b>   | 49,163  |
| Number of option awards exercised                          | <b>24,953</b>   | 114,234   |
| Number of restricted stock awards vested                   | <b>17,269</b>   | 71,541  |

**Stock-Based Compensation Expense**

For the three-month periods ended September 30, 2018 and 2017, we recognized stock-based compensation expense of \$1,320 and \$1,202, respectively. For the nine-month periods ended September 30, 2018 and 2017, we recognized stock-based compensation expense of \$4,040 and \$3,456, respectively. Stock-based compensation expense is recognized over the vesting period of the stock options.

As of September 30, 2018, we had \$8,287 in stock-based compensation expense that has yet to be recognized through our results of operations. We expect this compensation to be recognized over the remainder of 2018 and subsequent years according to the table below, except with respect to awards that are accelerated by the Board of Directors, in which case we will recognize any remaining compensation expense in the period in which the awards are accelerated.

|       |         |
|-------|---------|
| 2018  | \$1,318 |
| 2019  | 4,032   |
| 2020  | 2,355   |
| 2021  | 544     |
| 2022  | 38      |
| Total | \$8,287 |

**NOTE 7. SEGMENT INFORMATION**

On September 19, 2017, the Company announced that it had agreed to sell its subsidiary, United Life, to Kuvare. The sale closed on March 30, 2018. As a result, the life insurance business has been considered held for sale and reported as discontinued operations in the Consolidated Financial Statements and all comparable prior periods have been presented to conform to the current period presentation. For more information, refer to Note 11. Discontinued Operations.

Prior to the announcement to sell United Life, we had two reportable business segments in our operations: property and casualty insurance and life insurance. The property and casualty insurance business has six domestic locations from which it conducts its business. The life insurance segment operated from our home office in Cedar Rapids, Iowa. Because all of our insurance is sold domestically, we have no revenues from foreign operations.

After the announcement of the United Life transaction, our continuing operations, the property and casualty insurance business, was reported as one reportable segment. The property and casualty insurance business profit or loss is consistent with consolidated reporting as disclosed on the Consolidated Statements of Income and Comprehensive Income. We analyze the property and casualty insurance business results based on profitability (i.e., loss ratios), expenses and return on equity. The Company's property and casualty insurance business was determined using a

management approach to make decisions on operating matters, including allocating resources, assessing performance, determining which products to market and sell, determining distribution networks with insurance agents and monitoring the regulatory environment. The property and casualty insurance business products have similar economic characteristics and use a similar marketing and distribution strategy with our independent agents. The property and casualty insurance business geographic concentration did not change after the announcement of

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the sale of the life insurance business. We will continue to evaluate our continuing operations on the basis of both statutory accounting principles prescribed or permitted by our states of domicile and GAAP.

**NOTE 8. EARNINGS PER COMMON SHARE**

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding during the reporting period. Diluted earnings per share gives effect to all dilutive common shares outstanding during the reporting period. The dilutive shares we consider in our diluted earnings per share calculation relate to our outstanding stock options, restricted stock awards and restricted stock unit awards.

We determine the dilutive effect of our outstanding stock options using the "treasury stock" method. Under this method, we assume the exercise of all of the outstanding stock options whose exercise price is less than the weighted-average market value of our common stock during the reporting period. This method also assumes that the proceeds from the hypothetical stock option exercises are used to repurchase shares of our common stock at the weighted-average market value of the stock during the reporting period. The net of the assumed stock options exercised and assumed common shares repurchased represents the number of dilutive common shares, which we add to the denominator of the earnings per share calculation.

The components of basic and diluted earnings per share were as follows for the three-month periods ended September 30, 2018 and 2017:

| <i>(In Thousands, Except Share Data)</i>                                   | <b>Three Months Ended September</b> |                   |             |             |
|--|-------------------------------------|-------------------|-------------|-------------|
|  | <b>30,</b>                          |                   |             |             |
|  | <b>2018</b>                         |                   | 2017        |             |
|  | Basic                               | Diluted           | Basic       | Diluted     |
| Net income (loss) from continuing operations                               | <b>\$11,070</b>                     | <b>\$ 11,070</b>  | \$(19,082 ) | \$(19,082 ) |
| Weighted-average common shares outstanding                                 | <b>25,052,627</b>                   | <b>25,052,627</b> | 24,960,086  | 24,960,086  |
| Add dilutive effect of restricted stock unit awards                        | —                                   | <b>279,636</b>    | —           | —           |
| Add dilutive effect of stock options                                       | —                                   | <b>294,688</b>    | —           | —           |
| Weighted-average common shares outstanding                                 | <b>25,052,627</b>                   | <b>25,626,951</b> | 24,960,086  | 24,960,086  |
| Earnings (loss) per common share from continuing operations                | <b>\$0.44</b>                       | <b>\$ 0.43</b>    | \$(0.77 )   | \$(0.77 )   |
| Earnings per common share from discontinued operations                     | —                                   | —                 | 0.05        | 0.05        |
| Earnings (loss) per common share   | <b>\$0.44</b>                       | <b>\$ 0.43</b>    | \$(0.72 )   | \$(0.72 )   |
| Awards excluded from diluted earnings per share calculation <sup>(1)</sup> | —                                   | —                 | —           | —           |

(1) Outstanding awards that are not "in-the-money" are excluded from the diluted earnings per share calculation because the effect of including them would have been anti-dilutive.

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The components of basic and diluted earnings per share were as follows for the nine-month periods ended September 30, 2018 and 2017:

| <i>(In Thousands, Except Share Data)</i>                                   | <b>Nine Months Ended September 30,</b> |                   |             |            |
|--|--|-------------------|-------------|------------|
|  | <b>2018</b>                            |                   | <b>2017</b> |            |
|  | Basic                                  | Diluted           | Basic       | Diluted    |
| Net income (loss) from continuing operations                               | <b>\$31,591</b>                        | <b>\$31,591</b>   | \$(389)     | \$(389)    |
| Weighted-average common shares outstanding                                 | <b>24,982,155</b>                      | <b>24,982,155</b> | 25,177,133  | 25,177,133 |
| Add dilutive effect of restricted stock unit awards                        | —                                      | <b>279,636</b>    | —           | 253,082    |
| Add dilutive effect of stock options                                       | —                                      | <b>345,514</b>    | —           | 236,190    |
| Weighted-average common shares outstanding                                 | <b>24,982,155</b>                      | <b>25,607,305</b> | 25,177,133  | 25,666,405 |
| Earnings (loss) per common share from continuing operations                | <b>\$1.26</b>                          | <b>\$1.23</b>     | \$(0.01)    | \$(0.01)   |
| Earnings per common share from discontinued operations                     | <b>(0.08)</b>                          | <b>(0.07)</b>     | 0.21        | 0.21       |
| Gain on sale of discontinued operations, net of taxes                      | <b>1.10</b>                            | <b>1.07</b>       | —           | —          |
| Earnings per common share  | <b>\$2.28</b>                          | <b>\$2.23</b>     | \$0.20      | \$0.20     |
| Awards excluded from diluted earnings per share calculation <sup>(1)</sup> | —                                      | <b>2,681</b>      | —           | —          |

(1) Outstanding awards that are not "in-the-money" are excluded from the diluted earnings per share calculation because the effect of including them would have been anti-dilutive.

**NOTE 9. CREDIT FACILITY**

On February 2, 2016, the Company, as borrower, entered into a Credit Agreement (the "Credit Agreement") by and among the Company, with the lenders from time to time party thereto and KeyBank National Association ("Key Bank"), as administrative agent, swingline lender and letter of credit issuer. The Credit Agreement provides for a \$50,000 four-year unsecured revolving credit facility that includes a \$20,000 letter of credit subfacility and a swingline subfacility in the amount up to \$5,000. The Credit Agreement allows the Company to increase the aggregate amount of the commitments thereunder by up to \$100,000, provided that no event of default has occurred and is continuing and certain other conditions are satisfied.

The Credit Agreement is available for the Company's general corporate purposes, including liquidity, acquisitions and working capital. All unpaid principal and accrued interest under the Credit Agreement is due and payable in full at maturity on February 2, 2020. Based on the type of loan, advances under the Credit Agreement would bear interest on either the London interbank offered rate ("LIBOR") or a base rate plus, in each case, a calculated margin amount. The unused commitments under the Credit Agreement will be subject to a commitment fee that will be calculated at a per annum rate. The applicable margins for borrowings under the Credit Agreement and the commitment fee thereunder will be determined by reference to a pricing grid based on the Company's issuer credit rating by A.M. Best Company, Inc.

The Credit Agreement contains customary representations, conditions to borrowing, covenants and events of default, including certain covenants that limit or restrict, subject to certain exceptions, the ability of the Company and its subsidiaries to sell or transfer assets, enter into a merger or consolidate with another company, create liens, impose restrictions on subsidiary dividends, enter into sale-leaseback transactions, make investments or acquisitions, enter into certain reinsurance agreements, pay dividends during any period of default, enter into transactions with affiliates, change the nature of its business, or incur indebtedness. The Credit Agreement also includes financial covenants that require the Company to (i) maintain a minimum consolidated net worth, (ii) maintain a minimum consolidated statutory surplus and (iii) not exceed a 0.35 to 1.0 debt to total capitalization ratio.

There was no outstanding balance on the Credit Agreement at September 30, 2018 and 2017, respectively. For the nine-month periods ended September 30, 2018 and 2017, we did not incur any interest expense related to either credit facility. We were in compliance with all covenants of the Credit Agreement at September 30, 2018.



Table of Contents**NOTE 10. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

The following table shows the changes in the components of our accumulated other comprehensive income (loss), net of tax, for the three-month period ended September 30, 2018:

|   | Net<br>unrealized<br>appreciation<br>on<br>investments | Liability for<br>underfunded<br>employee<br>benefit<br>costs <sup>(1)</sup> | Total        |
|---|--|---|--------------|
| Balance as of June 30, 2018   | \$ (15,370 )   | \$ (43,928 )  | \$ (59,298 ) |
| Change in accumulated other comprehensive income before reclassifications       | (12,157 )  | —   | (12,157 )    |
| Reclassification adjustments from accumulated other comprehensive income (loss) | 392  | 1,312   | 1,704        |
| Balance as of September 30, 2018  | \$ (27,135 )   | \$ (42,616 )  | \$ (69,751 ) |

(1) The preparation of financial statements in conformity with GAAP requires us to make various estimates and assumptions that affect the reporting of net periodic benefit cost, plan assets and plan obligations for each plan at the date of the financial statements. Actual results could differ from these estimates. One significant estimate relates to the calculation of the benefit obligation for each plan. We annually establish the discount rate, which is an estimate of the interest rate at which these benefits could be effectively settled, that is used to determine the present value of the respective plan's benefit obligations as of December 31.

The following table shows the changes in the components of our accumulated other comprehensive income (loss), net of tax, for the nine-month period ended September 30, 2018:

|   | Net<br>unrealized<br>appreciation<br>on<br>investments | Liability for<br>underfunded<br>employee<br>benefit<br>costs <sup>(1)</sup> | Total        |
|---|--|---|--------------|
| Balance as of January 1, 2018   | \$ 214,865   | \$ (46,551 )  | \$ 168,314   |
| Cumulative effect of change in accounting principle                             | (191,244 )   | —   | (191,244 )   |
| Change in accumulated other comprehensive income before reclassifications       | (51,274 )  | —   | (51,274 )    |
| Reclassification adjustments from accumulated other comprehensive income (loss) | 518  | 3,935   | 4,453        |
| Balance as of September 30, 2018  | \$ (27,135 )   | \$ (42,616 )  | \$ (69,751 ) |

(1) The preparation of financial statements in conformity with GAAP requires us to make various estimates and assumptions that affect the reporting of net periodic benefit cost, plan assets and plan obligations for each plan at the date of the financial statements. Actual results could differ from these estimates. One significant estimate relates to the calculation of the benefit obligation for each plan. We annually establish the discount rate, which is an estimate of the interest rate at which these benefits could be effectively settled, that is used to determine the present value of the respective plan's benefit obligations as of December 31.

**NOTE 11. DISCONTINUED OPERATIONS**

On September 18, 2017, we signed a definitive agreement to sell our subsidiary, United Life, to Kuvare for \$280,000 in cash, less a \$21 adjustment as set forth in the definitive agreement, for a net amount of \$279,979. The sale closed on March 30, 2018 and we reported an after-tax gain on the sale of discontinued operations of \$27,307. The life insurance business (previously reported as a separate segment) was considered held for sale and reported as discontinued operations and its financial position, results of operations and cash flows were reported separately for all periods presented, as applicable, unless otherwise noted.

UFG has agreed to provide services to Kuvare through a transition services agreement ("TSA"). The TSA ensures a seamless transfer of the business between UFG and Kuvare. The TSA includes, among other considerations,





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accounting management, human resources, legal and information technology services, from the closing date for up to 24 months. Since the close date, the Company has received \$317 as part of the TSA agreement. The assets and liabilities associated with discontinued operations prior to the closing of the sale have been presented separately in our Consolidated Balance Sheets. The major assets and liability categories were as follows as of the dates indicated:

## Discontinued Operations Balance Sheets

| <i>(In Thousands, Except Share Data)</i>   | <b>September<br/>30,<br/>2018</b> | December<br>31,<br>2017 |
|--|-----------------------------------|-------------------------|
|  | <i>(unaudited)</i>                |                         |
| <b>Assets</b>  |                                   |                         |
| Investments  |                                   |                         |
| Fixed maturities   |                                   |                         |
| Held-to-maturity, at amortized cost (fair value \$0 in 2018 and \$34 in 2017)          | \$                                | — \$34                  |
| Available-for-sale, at fair value (amortized cost \$0 in 2018 and \$1,412,291 in 2017) | —                                 | 1,430,025               |
| Equity Securities at fair value (cost \$0 in 2018 and \$5,099 in 2017)                 | —                                 | 23,653                  |
| Mortgage loans   | —                                 | 3,435                   |
| Policy loans   | —                                 | 5,815                   |
| Other long-term investments  | —                                 | 16,437                  |
|  | —                                 | 1,479,399               |
| Cash and cash equivalents  | —                                 | 15,851                  |
| Deferred policy acquisition costs  | —                                 | 71,151                  |
| Other assets   | —                                 | 19,733                  |
| <b>Total assets held for sale</b>  | <b>\$</b>                         | <b>— \$1,586,134</b>    |
| <b>Liabilities</b>   |                                   |                         |
| Future policy benefits and losses  | \$                                | — \$1,320,401           |
| Deferred income taxes  | —                                 | 18,716                  |
| Accrued expenses and other liabilities   | —                                 | 8,018                   |
| <b>Total liabilities held for sale</b>   | <b>\$</b>                         | <b>— \$1,347,135</b>    |

Note: The sale of the life insurance business was completed on March 30, 2018.

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Summary operating results of discontinued operations were as follows for the periods indicated:

### Discontinued Operations Statements of Income (Unaudited)

|   | <b>Three<br/>Months<br/>Ended<br/>September<br/>30,<br/>2018</b> | <b>Nine Months<br/>Ended September<br/>30,<br/>2018</b> | 2017            |
|---|--|---|-----------------|
| <i>(In Thousands, Except Share Data)</i>                              |  |   |                 |
| <b>Revenues</b>   |  |   |                 |
| Net premiums earned   | \$—14,230  | \$13,003  | \$45,999        |
| Investment income, net of investment expenses                         | —12,354  | 12,663  | 37,230          |
| Net realized investment gains (losses)                                | —296   | (1,057)   | 3,600           |
| Other income  | —174   | 146   | 498             |
| <b>Total revenues</b>   | <b>\$—27,054</b>   | <b>\$24,755</b>   | <b>\$87,327</b> |
| <b>Benefits, Losses and Expenses</b>                                  |  |   |                 |
| Losses and loss settlement expenses                                   | \$—10,506  | \$10,823  | \$30,679        |
| Increase in liability for future policy benefits                      | —5,481   | 5,023   | 19,341          |
| Amortization of deferred policy acquisition costs                     | —2,156   | 1,895   | 5,524           |
| Other underwriting expenses   | —2,444   | 3,864   | 9,452           |
| Interest on policyholders' accounts                                   | —4,587   | 4,499   | 13,982          |
| <b>Total benefits, losses and expenses</b>                            | <b>\$—25,174</b>   | <b>\$26,104</b>   | <b>\$78,978</b> |
| Income (loss) from discontinued operations before income taxes        | \$—1,880   | \$(1,349)   | \$8,349         |
| Federal income tax expense  | —662   | 563   | 2,930           |
| <b>Net income (loss) from discontinued operations</b>                 | <b>\$—1,218</b>  | <b>\$(1,912)</b>  | <b>\$5,419</b>  |
| <b>Earnings (loss) per common share from discontinued operations:</b> |  |   |                 |
| <b>Basic</b>  | <b>\$—0.05</b>   | <b>\$(0.08)</b>   | <b>\$0.21</b>   |
| <b>Diluted</b>  | <b>—0.05</b>   | <b>(0.07)</b>   | <b>0.21</b>     |

Note: The sale of the life insurance business was completed on March 30, 2018.

The Company's Consolidated Statement of Cash Flows presents operating, investing and financing cash flows of the discontinued operations separately. The Company's cash management and financial management of both continued and discontinued operations is consolidated as a centralized corporate function in our Finance Department.

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**Review Report of Independent Registered Public Accounting Firm**

To the Stockholders and Board of Directors of United Fire Group, Inc.

**Results of Review of Interim Financial Statements**

We have reviewed the accompanying consolidated balance sheet of United Fire Group, Inc. (the "Company") as of September 30, 2018, and the related consolidated statements of income and comprehensive income for the three- and nine-month periods ended September 30, 2018 and 2017, the consolidated statements of cash flows for the nine-month periods ended September 30, 2018 and 2017, the consolidated statement of stockholders' equity for the nine-month period ended September 30, 2018, and the related notes (collectively referred to as the "consolidated interim financial statements"). Based on our reviews, we are not aware of any material modifications that should be made to the consolidated interim financial statements for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheet of the Company as of December 31, 2017, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year then ended, and the related notes and schedules (not presented herein); and in our report dated February 28, 2018, we expressed an unqualified audit opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2017 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

**Basis for Review Results**

These financial statements are the responsibility of the Company's management. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the SEC and the PCAOB. We conducted our review in accordance with the standards of the PCAOB. A review of interim financial statements consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the PCAOB, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

/s/  
Ernst  
&  
Young  
LLP  
Ernst  
&  
Young  
LLP

Des Moines, Iowa  
November 7, 2018



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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with Part I, Item 1 "Financial Statements."

**CRITICAL ACCOUNTING POLICIES**

Critical accounting policies are defined as those that are representative of significant judgments and uncertainties and that potentially may result in materially different results under different assumptions and conditions. We base our discussion and analysis of our consolidated financial condition and results of operations on the amounts reported in our Consolidated Financial Statements, which we have prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). As we prepare these Consolidated Financial Statements, we must make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses for the reporting period. We evaluate our estimates on an ongoing basis. We base our estimates on historical experience and on other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. Our critical accounting policies are more fully described in our Management's Discussion and Analysis of Financial Condition and Results of Operations presented in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2017. There have been no changes in our critical accounting policies from December 31, 2017.

**INTRODUCTION**

The purpose of this Management's Discussion and Analysis is to provide an understanding of our results of operations and consolidated financial condition. Our Management's Discussion and Analysis should be read in conjunction with our Consolidated Financial Statements and related notes, including those in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2017. Our Consolidated Financial Statements are prepared on the basis of GAAP. We also prepare financial statements for each of our insurance company subsidiaries based on statutory accounting principles and file them with insurance regulatory authorities in the states where they do business.

When we provide information on a statutory or other basis, we label it as such, otherwise all other data is presented in accordance with GAAP.

**BUSINESS OVERVIEW**

Founded in 1946 as United Fire & Casualty Company, United Fire Group, Inc. ("UFG," the "Registrant," the "Company," "we," "us," or "our") and its consolidated insurance subsidiaries provide insurance protection for individuals and businesses through several regional offices. Our property and casualty insurance company subsidiaries are licensed in 46 states plus the District of Columbia and are represented by approximately 1,100 independent agencies.

Our primary sources of revenue are premiums and investment income. Major categories of expenses include losses and loss settlement expenses, future policy benefits, underwriting and other operating expenses and interest on policyholders' accounts.

**Discontinued Operations**

On September 18, 2017, the Company signed a definitive agreement to sell its subsidiary, United Life Insurance Company ("United Life"), to Kuvare US Holdings, Inc. ("Kuvare"). The sale closed on March 30, 2018. The life insurance business has been considered held for sale and accounted for as discontinued operations in the Consolidated Balance Sheets, Consolidated Statements of Income and Comprehensive Income and Consolidated Statements of Cash Flows. All periods presented have been revised to show results from continuing and discontinued operations, as

applicable, unless otherwise noted. For more information, refer to Part I, Item 1, Note

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11. "Discontinued Operations."

### **Reportable Segments**

Prior to the announcement of the sale of the life insurance business, we have historically reported our operations in two business segments, each with a wide range of products:

• property and casualty insurance, which includes commercial lines insurance, personal lines insurance, surety bonds and assumed reinsurance; and

• life insurance, which includes deferred and immediate annuities, universal life products and traditional life (primarily single premium whole life) insurance products.

We managed these business segments separately, as they generally do not share the same customer base, and each has different products, pricing, and expense structures.

Subsequent to the announcement of the sale of the life insurance business on September 19, 2017, we operate and report as one business segment, which contains our continuing operations. The life insurance business has been considered held for sale and is reported as discontinued operations for all periods presented in this Form 10-Q, as applicable, unless otherwise noted. For more information, refer to Part I, Item 1, Note 7. "Segment Information."

### **Pooling Arrangement**

All of our property and casualty insurance subsidiaries are members of an intercompany reinsurance pooling arrangement. The Company's pooling arrangement permits 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.

### **Geographic Concentration**

For the nine-month period ended September 30, 2018, approximately 48.6 percent of our property and casualty premiums were written in Texas, California, Iowa, Missouri and Colorado.

### **Profit Factors**

Our profitability is influenced by many factors, including price, competition, economic conditions, investment returns, interest rates, catastrophic events and other natural disasters, man-made disasters, state regulations, court decisions, and changes in the law. To manage these risks and uncertainties, we seek to achieve consistent profitability through strong agency relationships, exceptional customer service, fair and prompt claims handling, disciplined underwriting, superior loss control services, prudent management of our investments, appropriate matching of assets and liabilities, effective use of ceded reinsurance and effective and efficient use of technology.





Table of Contents**FINANCIAL HIGHLIGHTS**

| <i>(In Thousands, Except Ratios)</i>                                | <b>Three Months Ended September 30, 2018</b> |                    |                 | <b>Nine Months Ended September 30, 2018</b> |                    |                 |
|---|--|--------------------|-----------------|---|--------------------|-----------------|
|   | 2017   | %                  |                 | 2017  | %                  |                 |
| <b>Revenues</b>   |  |                    |                 |   |                    |                 |
| Net premiums earned   | \$264,747                                    | \$255,758          | 3.5 %           | \$766,767                                   | \$737,424          | 4.0 %           |
| Investment income, net of investment expenses                       | 13,192                                       | 13,792             | (4.4 )          | 43,933                                      | 38,561             | 13.9            |
| Net realized investment gains (losses)                              |  |                    |                 |   |                    |                 |
| Change in the value of equity securities                            | 14,381                                       | (124 )             | NM              | 5,498                                       | 232                | NM              |
| All other net realized gains  | (410 )                                       | 191                | NM              | 1,906                                       | 3,165              | (39.8 )         |
| Net realized investment gains                                       | 13,971                                       | 67                 | NM              | 7,404                                       | 3,397              | 118.0           |
| <b>Total revenues</b>   | <b>\$291,910</b>                             | <b>\$269,617</b>   | <b>8.3 %</b>    | <b>\$818,104</b>                            | <b>\$779,382</b>   | <b>5.0 %</b>    |
| <b>Benefits, Losses and Expenses</b>                                |  |                    |                 |   |                    |                 |
| Losses and loss settlement expenses                                 | \$193,667                                    | \$223,208          | (13.2 )%        | \$527,541                                   | \$568,356          | (7.2 )%         |
| Amortization of deferred policy acquisition costs                   | 51,758                                       | 52,986             | (2.3 )          | 152,207                                     | 154,845            | (1.7 )          |
| Other underwriting expenses   | 33,887                                       | 25,817             | 31.3            | 105,994                                     | 69,900             | 51.6            |
| <b>Total benefits, losses and expenses</b>                          | <b>\$279,312</b>                             | <b>\$302,011</b>   | <b>(7.5 )%</b>  | <b>\$785,742</b>                            | <b>\$793,101</b>   | <b>(0.9 )%</b>  |
| <b>Income (loss) from continuing operations before income taxes</b> | <b>\$12,598</b>                              | <b>\$(32,394 )</b> | <b>(138.9 )</b> | <b>\$32,362</b>                             | <b>\$(13,719 )</b> | <b>(335.9)%</b> |
| Federal income tax expense (benefit)                                | 1,528  | (13,312 )          | (111.5 )        | 771   | (13,330 )          | (105.8 )        |
| <b>Net income from continuing operations</b>                        | <b>\$11,070</b>                              | <b>\$(19,082 )</b> | <b>(158.0)%</b> | <b>\$31,591</b>                             | <b>\$(389 )</b>    | <b>NM</b>       |
| <b>Income (loss) from discontinued operations, net of tax</b>       | <b>—</b>                                     | <b>1,218</b>       | <b>(100.0)%</b> | <b>(1,912 )</b>                             | <b>5,419</b>       | <b>(135.3)%</b> |
| <b>Gain on sale of discontinued operations, net of tax</b>          | <b>—</b>                                     | <b>—</b>           | <b>— %</b>      | <b>27,307</b>                               | <b>—</b>           | <b>NM</b>       |
| <b>Net income</b>   | <b>\$11,070</b>                              | <b>\$(17,864 )</b> | <b>(162.0)%</b> | <b>\$56,986</b>                             | <b>\$5,030</b>     | <b>NM</b>       |
| <b>GAAP Ratios:</b>   |  |                    |                 |   |                    |                 |
| Net loss ratio (without catastrophes)                               | 68.6   | % 75.3             | % (8.9 )%       | 64.8  | % 67.8             | % (4.4 )%       |
| Catastrophes - effect on net loss ratio                             | 4.6  | 12.0               | (61.7 )%        | 4.0   | 9.3                | (57.0 )%        |
| Net loss ratio <sup>(1)</sup>                                       | 73.2   | % 87.3             | % (16.2 )%      | 68.8  | % 77.1             | % (10.8 )%      |
| Expense ratio <sup>(2)</sup>  | 32.3   | 30.8               | 4.9 %           | 33.7  | 30.5               | 10.5 %          |
| Combined ratio <sup>(3)</sup>                                       | 105.5  | % 118.1            | % (10.7 )%      | 102.5                                       | % 107.6            | % (4.7 )%       |

(1) The net loss ratio is calculated by dividing the sum of losses and loss settlement expenses by net premiums earned. We use the net loss ratio as a measure of the overall underwriting profitability of the insurance business we write and to assess the adequacy of our pricing. Our net loss ratio is meaningful in evaluating our financial results as reported in our unaudited Consolidated Financial Statements.

(2) The expense ratio is calculated by dividing nondeferred underwriting expenses and amortization of deferred policy acquisition costs by net premiums earned. The expense ratio measures a company's operational efficiency in producing, underwriting and administering its insurance business.

(3) The combined ratio is a commonly used financial measure of property and casualty underwriting performance. A combined ratio below 100.0 percent generally indicates a profitable book of business. The combined ratio is the sum of the net loss ratio and the underwriting expense ratio.

NM = Not meaningful

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The following is a summary of our financial performance from continuing operations for the three- and nine-month periods ended September 30, 2018:

**RESULTS OF OPERATIONS**

For the three-month period ended September 30, 2018, the net income from continuing operations was \$11.1 million compared to net loss from continuing operations of \$19.1 million for the same period of 2017. In the three-month period ended September 30, 2018, there was an increase in net premiums earned from continued organic growth from new business writings and geographical expansion and rate increases; an increase in net realized investment gains due to the change in value of our equity securities; and a decrease in losses and loss settlement expenses due to lower catastrophe losses and improvement of our core loss ratio, all partially offset by an increase in other underwriting expenses primarily due to continued investment in upgrading our underwriting technology platforms. Net premiums earned increased to \$264.7 million compared to \$255.8 million for the same period of 2017,

For the nine-month period ended September 30, 2018, the net income from continuing operations was \$31.6 million compared to net loss from continuing operations of \$0.4 million for the same period of 2017. This increase was driven by an increase in net premiums earned from continued organic growth from new business writings and geographical expansion and rate increases; an increase in investment income due to an increase in invested assets; an increase in net realized investment gains due to the change in value of our equity securities; and a decrease in losses and loss settlement expenses from a decrease in catastrophe losses and improvement of our core loss ratio as compared to the same period in 2017. Net premiums earned increased to \$766.8 million compared to \$737.4 million for the same period of 2017. These results were all partially offset by an increase in other underwriting expenses primarily from continued investment in upgrading our underwriting technology platforms and acceleration of the amortization of deferred acquisition costs in our commercial and personal automobile lines of business due to lower than expected profitability in these lines.

Losses and loss settlement expenses decreased by 13.2 percentage points during the three-month period ended September 30, 2018 compared to the same period of 2017. The decrease was primarily due to a decrease in catastrophe losses and an improvement in our core loss ratio from a decrease in frequency of losses, partially offset by an increase in severity of non-catastrophe losses. Pre-tax catastrophe losses for the three-month period ended September 30, 2018 were \$12.3 million compared to \$30.7 million in the same period of 2017.

Losses and loss settlement expenses decreased by 7.2 percentage points during the nine-month period ended September 30, 2018 compared to the same period of 2017. This decrease was driven by a decrease in catastrophe losses; an increase in prior year favorable reserve development primarily on our workers compensation, commercial automobile, assumed reinsurance, other liability and commercial fire and allied lines of business; and an improvement in our core loss ratio from a decrease in frequency of losses, partially offset by an increase in severity of non-catastrophe losses. Pre-tax catastrophe losses for the nine-month period ended September 30, 2018 were \$30.7 million compared to \$68.8 million in the same period of 2017.

Investment income decreased by \$0.6 million and increased \$5.4 million during the three- and nine-month periods ended September 30, 2018, compared to the same periods of 2017. The change in net investment income for the three-month period ended September 30, 2018 was due to a decrease in the value of our investments in limited liability partnerships, partially offset by an increase in invested assets. The change in net investment income in the nine-month period ended September 30, 2018 was driven by an increase in invested assets and not due to a change in our investment philosophy. The valuation of these investments in limited liability partnerships varies from period to period due to current equity market conditions, specifically related to financial institutions.

The combined ratio decreased 12.6 percentage points and 5.1 percentage points to 105.5 percent and 102.5 percent, respectively, for the three- and nine-month periods ended September 30, 2018, compared to 118.1 percent and 107.6 percent for the same periods of 2017. The decrease in the combined ratio in the three- and nine-month periods ended September 30, 2018 was primarily due to a decrease in the net loss ratio with a decrease in catastrophe losses offset by an increase in the expense ratio as compared to the same periods of 2017.

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The net loss ratio, a component of the combined ratio, decreased by 14.1 percentage points and 8.3 percentage points to 73.2 percent and 68.8 percent in the three- and nine-month periods ended September 30, 2018, respectively, as compared to the same periods of 2017. The decrease in net loss ratio was primarily driven by a decrease in catastrophe losses and an improvement in our core loss ratio from a decrease in frequency of losses, partially offset by an increase in severity of non-catastrophe losses.

The expense ratio, a component of the combined ratio, was 32.3 percent and 33.7 percent, respectively, for the three- and nine-month periods ended September 30, 2018, an increase of 1.5 percentage points and 3.2 percentage points, respectively, as compared with the same periods of 2017. The increase in the three-month period ended September 30, 2018 is primarily due to our continued investment in our multi-year Oasis project. The increase in the nine-month period ended September 30, 2018 was primarily split between two items. First, we continued to invest in our multi-year Oasis project to upgrade our technology platform to enhance core underwriting decisions, selection of risks and productivity. The expectation is this project will add 1.0 to 2.0 percentage points annually to the expense ratio for the duration of the project. Second, the acceleration of the amortization of our deferred acquisition costs in our underperforming commercial and personal auto lines of business which resulted from lower than expected profitability in these lines as discussed in prior quarters.

On March 30, 2018, the sale of United Life closed, resulting in a gain on sale of discontinued operations after-tax of \$27.3 million.

For a detailed discussion of our investment results, refer to the "Investment Portfolio" section below.

### *Reserve Development*

For many liability claims, significant periods of time, ranging up to several years, and for certain construction defect claims, more than a decade, may elapse between the occurrence of the loss, the reporting of the loss to us and the settlement or other disposition of the claim. As a result, loss experience in the more recent accident years for the long-tail liability coverages has limited statistical credibility in our reserving process because a relatively small proportion of losses in these accident years are reported claims and an even smaller proportion are paid losses. In addition, long-tail liability claims are more susceptible to litigation and can be significantly affected by changing contract interpretations and the legal environment. Consequently, the estimation of loss reserves for long-tail coverages is more complex and subject to a higher degree of variability. Reserves for these long-tail coverages represent a significant portion of our overall carried reserves.

When establishing reserves and monitoring reserve adequacy, we analyze historical data and consider the potential impact of various loss development factors and trends, including historical loss experience, legislative enactments, judicial decisions, legal developments in imposition of damages, experience with alternative dispute resolution, results of our medical bill review process, the potential impact of salvage and subrogation and changes and trends in general economic conditions, including the effects of inflation. All of these factors influence our estimates of required reserves and for long-tail lines these factors can change over the course of the settlement of the claim. However, there is no precise method for evaluating the specific dollar impact of any individual factor on the development of reserves.

Our reserving philosophy is to reserve claims to their ultimate expected loss amount as soon as practicable after information about a claim becomes available. This approach tends to produce, on average, prudently conservative case reserves, which we expect to result in some level of favorable development over the course of settlement.

### *2018 Development*

The property and casualty insurance business experienced \$0.7 million of unfavorable and \$47.7 million of favorable development in our net reserves for prior accident years for the three- and nine-month periods ended September 30,

2018, respectively. For the three-month period ended September 30, 2018 the two lines contributing the majority of unfavorable development were commercial other liability with \$7.5 million unfavorable development and commercial automobile with \$6.6 million unfavorable development. The unfavorable development for the three-

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month period ended September 30, 2018 is attributable to the combination of latent emergence of commercial automobile claims that increased sufficiently to also generate an umbrella liability claim and also a very large but independent general liability claim. During the three-month period ended September 30, 2018 the three lines contributing the majority of favorable development which partially offset the unfavorable development noted above were reinsurance assumed with \$6.5 million of favorable development, workers compensation with \$5.4 million of favorable development, and fidelity and surety with \$1.6 million of favorable development.

For the nine-month period ended September 30, 2018 the majority of favorable development came from four lines, workers compensation with \$19.9 million favorable development, commercial automobile with \$8.4 million favorable development, commercial other liability with \$5.2 million favorable development, and reinsurance assumed with \$5.5 million of favorable development. During the nine-month period ended September 30, 2018 every individual line experienced favorable development. The favorable development in the nine-month period ended September 30, 2018 is attributable to our continued litigation management efforts as well as favorable runoff of reserves for reported claims, reserves for incurred but not reported ("IBNR") claims, and reserve for general loss adjustment expenses.

*2017 Development*

The property and casualty insurance business experienced \$3.2 million of unfavorable and \$38.0 million of favorable development in our net reserves for prior accident years for the three- and nine-month periods ended September 30, 2017, respectively. For the three-month period ended September 30, 2017 the majority of unfavorable development came from two lines, commercial automobile with \$2.8 million unfavorable development and commercial liability with \$7.4 million unfavorable development, which was partially offset by favorable development from two other lines, workers compensation with \$4.4 million favorable development and personal fire and allied lines with \$2.2 million favorable development. During the three-month period ended September 30, 2017 all other lines combined contributed \$0.4 million favorable development. Commercial automobile and other liability were the primary sources of unfavorable development which is attributable to latent development of more severe claims than what we have historically seen which manifested itself as increased payments and less favorable changes in reserves for unpaid claims.

For the nine-month period ended September 30, 2017 the majority of favorable development came from two lines, commercial liability with \$23.6 million favorable development and workers compensation with \$14.2 million favorable development, which was partially offset by unfavorable development from assumed reinsurance with \$6.2 million unfavorable development. During the nine-month period ended September 30, 2017 all other lines combined contributed \$6.4 million favorable development. Much of the favorable year-to-date long-tail liability development continued to come from loss adjustment expense and is attributed to our continued litigation management efforts. There was also a reduction in reserves for incurred but not reported claims because our long tail liability has experienced fewer late reported claims than what was initially anticipated. The majority of the favorable workers compensation development is due to reductions in reserves for reported claims which were greater than what was necessary to offset claim payments.

Development amounts can vary significantly from quarter-to-quarter and year-to-year depending on a number of factors, including the number of claims settled and the settlement terms, and are subject to reallocation between accident years and lines of business. At September 30, 2018, our total reserves were within our actuarial estimates.





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The following table displays our net premiums earned, net losses and loss settlement expenses and net loss ratio from continuing operations by line of business:

|                                      | Three Months Ended September 30, 2018 |  |                | 2017                |  |                |
|--------------------------------------|---------------------------------------|--|----------------|---------------------|--|----------------|
|                                      | Net Premiums Earned                   | Net Losses and Loss Settlement Expenses Incurred | Net Loss Ratio | Net Premiums Earned | Net Losses and Loss Settlement Expenses Incurred | Net Loss Ratio |
| <i>(In Thousands, Except Ratios)</i> |                                       |  |                |                     |  |                |
| Unaudited                            |                                       |  |                |                     |  |                |
| Commercial lines                     |                                       |  |                |                     |  |                |
| Other liability                      | \$78,943                              | \$53,581   | 67.9 %         | \$77,955            | \$54,598   | 70.0 %         |
| Fire and allied lines                | 59,056                                | 40,514   | 68.6           | 58,568              | 44,996   | 76.8           |
| Automobile                           | 72,773                                | 68,892   | 94.7           | 64,470              | 71,674   | 111.2          |
| Workers compensation                 | 24,127                                | 17,776   | 73.7           | 26,387              | 23,573   | 89.3           |
| Fidelity and surety                  | 5,929                                 | 1,379  | 23.3           | 6,430               | (350 )   | (5.4 )         |
| Miscellaneous                        | 436                                   | (29 )  | (6.7 )         | 459                 | 107  | 23.3           |
| Total commercial lines               | \$241,264                             | \$182,113  | 75.5 %         | \$234,269           | \$194,598  | 83.1 %         |
| Personal lines                       |                                       |  |                |                     |  |                |
| Fire and allied lines                | \$10,416                              | \$11,423   | 109.7 %        | \$10,730            | \$8,461  | 78.9 %         |
| Automobile                           | 7,450                                 | 6,731  | 90.3           | 6,878               | 8,046  | 117.0          |
| Miscellaneous                        | 307                                   | 25   | 8.1            | 294                 | 161  | 54.8           |
| Total personal lines                 | \$18,173                              | \$18,179   | 100.0 %        | \$17,902            | \$16,668   | 93.1 %         |
| Reinsurance assumed                  | \$5,310                               | \$(6,625 )                                       | (124.8)%       | \$3,587             | \$11,942   | 332.9 %        |
| Total                                | \$264,747                             | \$193,667  | 73.2 %         | \$255,758           | \$223,208  | 87.3 %         |

|                                      | Nine Months Ended September 30, 2018 |  |                | 2017                |  |                |
|--------------------------------------|--------------------------------------|--|----------------|---------------------|--|----------------|
|                                      | Net Premiums Earned                  | Net Losses and Loss Settlement Expenses Incurred | Net Loss Ratio | Net Premiums Earned | Net Losses and Loss Settlement Expenses Incurred | Net Loss Ratio |
| <i>(In Thousands, Except Ratios)</i> |                                      |  |                |                     |  |                |
| Unaudited                            |                                      |  |                |                     |  |                |
| Commercial lines                     |                                      |  |                |                     |  |                |
| Other liability                      | \$230,845                            | \$117,387  | 50.9 %         | \$228,250           | \$87,941   | 38.5 %         |
| Fire and allied lines                | 174,451                              | 125,844  | 72.1           | 168,506             | 150,108  | 89.1           |
| Automobile                           | 209,176                              | 188,929  | 90.3           | 183,688             | 202,303  | 110.1          |
| Workers compensation                 | 71,101                               | 46,838   | 65.9           | 78,092              | 55,885   | 71.6           |
| Fidelity and surety                  | 17,144                               | 2,328  | 13.6           | 18,041              | 308  | 1.7            |
| Miscellaneous                        | 1,289                                | 348  | 27.0           | 1,374               | 272  | 19.8           |
| Total commercial lines               | \$704,006                            | \$481,674  | 68.4 %         | \$677,951           | \$496,817  | 73.3 %         |
| Personal lines                       |                                      |  |                |                     |  |                |
| Fire and allied lines                | \$31,250                             | \$28,183   | 90.2 %         | \$32,300            | \$29,836   | 92.4 %         |
| Automobile                           | 21,686                               | 18,701   | 86.2           | 20,031              | 22,278   | 111.2          |
| Miscellaneous                        | 903                                  | (247 )   | (27.4)         | 860                 | 118  | 13.7           |
| Total personal lines                 | \$53,839                             | \$46,637   | 86.6 %         | \$53,191            | \$52,232   | 98.2 %         |
| Reinsurance assumed                  | \$8,922                              | \$(770 )   | (8.6 )%        | \$6,282             | \$19,307   | 307.3%         |
| Total                                | \$766,767                            | \$527,541  | 68.8 %         | \$737,424           | \$568,356  | 77.1 %         |



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Below are explanations regarding significant changes in the net loss ratios by line of business:

**Other liability** - The net loss ratio improved 2.1 and deteriorated 12.4 percentage points in the three and nine-month periods ended September 30, 2018, respectively, compared to the same periods of 2017. The deterioration is attributable to reductions in loss IBNR that occurred during both the first and second quarters of 2017 which provided a benefit to 2017 compared with no IBNR reduction during the first quarter of 2018 and IBNR increases during the second and third quarters of 2018. The change in reserves for reported claims increased more in 2018 vs. the same nine-month period of 2017. Paid loss was lower in 2018 than in 2017 while paid loss adjustment expense was comparable for 2018 as compared to the same period of 2017.

**Commercial fire and allied lines** - The net loss ratio improved 8.2 and 17.0 percentage points in the three and nine-month periods ended September 30, 2018, respectively, compared to the same periods of 2017. The improvement in the three-month and nine-month periods is attributable to a decrease in catastrophe losses, a decrease in frequency of claims partially offset by an increase in severity of losses, a decrease in paid losses and a lower increase in reserves for incurred but not reported claims.

**Commercial automobile** - The net loss ratio improved 16.5 and 19.8 percentage points in the three and nine-month periods ended September 30, 2018, compared to the same periods of 2017. This improvement is attributable to a decrease in frequency of losses in the three-month period ended September 30, 2018 along with changes in loss IBNR compared to the same period in 2017. We continue to make progress in improving our core loss ratio, however, the performance of this line of business remains below our expectation. Our strategy to improve profitability continues to be: aggressively seeking rate increases, focusing on loss control initiatives and reviewing our book of business for underperforming accounts.

**Workers compensation** - The net loss ratio improved 15.6 and 5.7 percentage points in the three and nine-month periods ended September 30, 2018 compared to the same periods of 2017. This improvement in the three-month period ended September 30, 2018 is attributable to a decrease in paid losses along with decline in the increase in reserves for reported claims. The improvement in the nine-month period ended September 30, 2018 was somewhat muted by an increase in severity of losses with a portion of the severe losses from auto-related claims.

**Personal fire and allied lines** - The net loss ratio deteriorated 30.8 and improved 2.2 percentage points in the three and nine-month periods ended September 30, 2018, compared to the same periods of 2017. The deterioration for the quarterly results is attributable to changes in loss IBNR which decreased significantly during the third quarter of 2017 due to favorable reserve development compared to a smaller decrease during the three-month period ended September 30, 2018.

- **Personal automobile** - The net loss ratio improved 26.7 and 25.0 percentage points in the three and nine-month periods ended September 30, 2018, compared to the same periods of 2017. This improvement is attributable to a reduction in paid losses as well as changes in reserves for reported claims which increased less in 2018 compared to the same period of 2017.

**Reinsurance assumed** - The net loss ratio improved in the three and nine-month periods ended September 30, 2018, compared to the same periods of 2017. This improvement in the three-month period ended September 30, 2018 is attributable to a decline in catastrophe losses as compared to the same period in 2017, which was impacted by three large hurricanes (Harvey, Irma and Maria) and a decrease in paid losses along with reductions in reserves for reported claims and reductions in loss IBNR which occurred in 2018 as compared to increases in the same period of 2017. Year-to-date improvement is attributable to the decrease in catastrophe losses mentioned above, reductions in reserves for reported claims which occurred in 2018 as compared to increases in the same period of 2017 along with changes in loss IBNR which increased less in 2018 as compared to 2017.



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***Financial Condition***

Our stockholders' equity decreased to \$884.2 million at September 30, 2018, from \$973.4 million at December 31, 2017. The decrease was attributable to shareholder dividends of \$97.6 million (of which \$75 million or \$3.00 per share was a special cash dividend paid to shareholders on August 20, 2018), a decrease in net unrealized investment gains of \$50.8 million, net of tax, and share repurchases of \$5.4 million, partially offset by net income of \$57.0 million, which includes a \$27.3 million gain on the sale of discontinued operations.

At September 30, 2018, the book value per share of our common stock was \$35.27. During the nine-month period ended September 30, 2018, 120,372 shares of common stock were repurchased under our share repurchase program at a total cost of \$5.4 million and an average share price of \$44.90. No shares were repurchased during the three-month period ended September 30, 2018. Under our share repurchase program, which is scheduled to expire on August 31, 2020, we were authorized to repurchase an additional 2,116,200 shares of our common stock as of September 30, 2018.

Table of Contents**Discontinued Operations Results**

|  | <b>Three<br/>Months<br/>Ended<br/>September<br/>30,<br/>2017</b> | <b>Nine Months<br/>Ended September<br/>30,<br/>2018</b> | 2017           |
|--|--|---|----------------|
| <i>(In Thousands)</i>  |  |   |                |
| <b>Revenues</b>  |  |   |                |
| Net premiums earned  | \$—14,230  | \$13,003  | \$45,999       |
| Investment income, net of investment expenses                          | —12,354  | 12,663  | 37,230         |
| Net realized investment gains (losses)                                 | —296   | (1,057 )  | 3,600          |
| Other income   | —174   | 146   | 498            |
| Total revenues   | \$—27,054  | \$24,755  | \$87,327       |
| <b>Benefits, Losses and Expenses</b>                                   |  |   |                |
| Losses and loss settlement expenses                                    | \$—10,506  | \$10,823  | \$30,679       |
| Increase in liability for future policy benefits                       | —5,481   | 5,023   | 19,341         |
| Amortization of deferred policy acquisition costs                      | —2,156   | 1,895   | 5,524          |
| Other underwriting expenses  | —2,444   | 3,864   | 9,452          |
| Interest on policyholders' accounts                                    | —4,587   | 4,499   | 13,982         |
| Total benefits, losses and expenses                                    | \$—25,174  | \$26,104  | \$78,978       |
| <b>Income (loss) from discontinued operations, before income taxes</b> | <b>\$—1,880</b>  | <b>\$(1,349 )</b>                                       | <b>\$8,349</b> |

The sale of our discontinued operations closed on March 30, 2018, and therefore no income was earned in the third quarter of 2018. For the nine-month period ended September 30, 2018, our discontinued operations had a loss before income taxes of \$1.3 million, compared to income before income taxes of \$8.3 million for the same period of 2017.

**Investment Portfolio**

Our invested assets from continuing operations totaled \$2.1 billion at September 30, 2018, compared to \$1.9 billion at December 31, 2017, an increase of \$187.3 million. At September 30, 2018, fixed maturity securities and equity securities made up 84.0 percent and 13.3 percent of the value of our investment portfolio, respectively. Because the primary purpose of our investment portfolio is to fund future claims payments, we use a conservative investment philosophy, investing in a diversified portfolio of high-quality, intermediate-term taxable corporate bonds, taxable U.S. government bonds and tax-exempt U.S. municipal bonds. Our overall investment strategy is to keep our cash on hand low in the current interest rate environment. If additional cash is needed, we can borrow funds available under our revolving credit facility.

**Composition**

We develop our investment strategies based on a number of factors, including estimated duration of reserve liabilities, short- and long-term liquidity needs, projected tax status, general economic conditions, expected rates of inflation, regulatory requirements, interest rates and credit quality of assets. We administer our investment portfolio based on investment guidelines approved by management and the investment committee of our Board of Directors that comply with applicable statutory regulations.



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The composition of our investment portfolio at September 30, 2018 is presented at carrying value in the following table:

|                                      | <b>Total</b>       | Percent      |          |
|--------------------------------------|--------------------|--------------|----------|
| <i>(In Thousands, Except Ratios)</i> |                    | of Total     |          |
| Fixed maturities <sup>(1)</sup>      |                    |              |          |
| Available-for-sale                   | \$ 1,730,031       | 83.3         | %        |
| Trading securities                   | 14,399             | 0.7          |          |
| Equity securities                    | 276,253            | 13.3         |          |
| Mortgage loans                       | 14,896             | 0.7          |          |
| Other long-term investments          | 40,432             | 2.0          |          |
| Short-term investments               | 175                | —            |          |
| <b>Total</b>                         | <b>\$2,076,186</b> | <b>100.0</b> | <b>%</b> |

(1) Available-for-sale securities and trading fixed maturities are carried at fair value.

At both September 30, 2018 and December 31, 2017, we classified \$1.7 billion, or 99.2 percent, and \$1.5 billion, or 98.9 percent, respectively, of our fixed maturities portfolio as available-for-sale. We classify our remaining fixed maturities as held-to-maturity or trading. We record held-to-maturity securities at amortized cost. We record available-for-sale fixed maturity securities at fair value, with any changes in fair value recognized in accumulated other comprehensive income. We record trading securities, primarily convertible redeemable preferred debt securities, at fair value, with any changes in fair value recognized in earnings.

As of September 30, 2018 and December 31, 2017, we did not have direct exposure to investments in subprime mortgages or other credit enhancement vehicles.

***Credit Quality***

The table below shows the composition of fixed maturity securities held in our available-for-sale, held-to-maturity and trading security portfolios, by credit rating for both continuing and discontinued operations at September 30, 2018 and December 31, 2017. Information contained in the table is generally based upon the issued credit ratings provided by Moody's, unless the rating is unavailable, in which case we obtain credit ratings from Standard & Poor's.

| Rating          | <b>September 30, 2018</b> |                   | December 31, 2017 |            |
|-----------------|---------------------------|-------------------|-------------------|------------|
|                 | <b>Carrying Value</b>     | <b>% of Total</b> | Carrying Value    | % of Total |
| AAA             | <b>\$722,204</b>          | <b>41.4 %</b>     | \$885,000         | 29.7 %     |
| AA              | <b>696,948</b>            | <b>40.0</b>       | 839,210           | 28.0       |
| A               | <b>172,681</b>            | <b>9.9</b>        | 616,787           | 20.7       |
| Baa/BBB         | <b>144,814</b>            | <b>8.3</b>        | 585,968           | 19.6       |
| Other/Not Rated | <b>7,783</b>              | <b>0.4</b>        | 55,156            | 1.9        |
|                 | <b>\$1,744,430</b>        | <b>100.0 %</b>    | \$2,982,121       | 100.0 %    |

***Duration***

Our investment portfolio is invested primarily in fixed maturity securities whose fair value is susceptible to market risk, specifically interest rate changes. Duration is a measurement used to quantify our inherent interest rate risk and analyze our ability to match our invested assets to our reserve liabilities. If our invested assets and reserve liabilities have similar durations, then any change in interest rates will have an equal effect on these accounts. The primary purpose for matching invested assets and reserve liabilities is liquidity. With appropriate matching, our investments will mature when cash is needed, preventing the need to liquidate other assets prematurely. Mismatches in the duration of assets and liabilities can cause significant fluctuations in our results of operations.





Table of Contents***Investment Results***

We invest the premiums received from our policyholders and annuitants in order to generate investment income, which is an important component of our revenues and profitability. The amount of investment income that we are able to generate is affected by many factors, some of which are beyond our control. Some of these factors are volatility in the financial markets, economic growth, inflation, interest rates, world political conditions, terrorist attacks or threats of terrorism, adverse events affecting other companies in our industry or the industries in which we invest and other unpredictable national or world events. Our net investment income from continuing operations decreased by 4.4 percent and increased by 13.9 percent in the three- and nine-month periods ended September 30, 2018, compared with the same period of 2017. The change in net investment income for the three-month period ended September 30, 2018 was due to a decrease in the value of our investments in limited liability partnerships, partially offset by an increase in invested assets. The change in net investment income in the nine-month period ended September 30, 2018 was driven by an increase in invested assets, partially offset by the change in the value of our investments in limited liability partnerships and not due to a change in our investment philosophy. The valuation of these investments in limited liability partnerships varies from period to period due to current equity market conditions, specifically related to financial institutions.

We hold certain investments in limited liability partnerships that are recorded on the equity method of accounting, with changes in value of these investments recorded in investment income. In the three- and nine-month periods ended September 30, 2018, the change in value of our investments in limited liability partnerships from continuing operations resulted in investment losses of \$0.6 million and investment income of \$3.4 million, respectively, as compared to an increase of \$2.0 million and \$3.3 million, respectively in investment income in the same periods of 2017. This resulted in a decrease of \$2.6 million and an increase of \$0.1 million in investment income in the three- and nine-month periods ended September 30, 2018.

Our net realized investment gains from continuing operations were \$14.0 million and \$7.4 million, respectively, during the three- and nine-month periods ended September 30, 2018, as compared with net realized investment gains of \$0.1 million and \$3.4 million, respectively, in the same periods of 2017. \$5.5 million of the \$4.0 million change in the nine-months period ended September 30, 2018 as compared to the same period in 2017 is due to the change in the value of equity securities which is now required to be recognized in net income rather than in accumulated other comprehensive income due to the change in accounting principles adopted on January 1, 2018.

We regularly monitor the difference between our cost basis and the estimated fair value of our investments. Our accounting policy for impairment recognition requires other-than-temporary impairment charges to be recorded when we determine that it is more likely than not that we will be unable to collect all amounts due according to the contractual terms of the fixed maturity security or that the anticipated recovery in fair value of the equity security will not occur in a reasonable amount of time. Impairment charges on investments are recorded based on the fair value of the investments at the measurement date. Factors considered in evaluating whether a decline in value is other-than-temporary include: the length of time and the extent to which fair value has been less than cost; the financial condition and near-term prospects of the issuer; our intention to hold the investment; and the likelihood that we will be required to sell the investment.

Changes in unrealized gains and losses on available-for-sale securities do not affect net income and earnings per share but do impact comprehensive income, stockholders' equity and book value per share. We believe that any unrealized losses on our available-for-sale securities at September 30, 2018 are temporary based upon our current analysis of the issuers of the securities that we hold and current market conditions. It is possible that we could recognize impairment charges in future periods on securities that we own at September 30, 2018 if future events and information cause us to determine that a decline in value is other-than-temporary. However, we endeavor to invest in high-quality assets to provide protection from future credit quality issues and corresponding other-than-temporary impairment write-downs. In the nine-month periods ended September 30, 2018 and 2017, there were no other-than-temporary impairment write-downs.



Table of Contents**LIQUIDITY AND CAPITAL RESOURCES**

Liquidity measures our ability to generate sufficient cash flows to meet our short- and long-term cash obligations. Our cash inflows are primarily a result of the receipt of premiums, reinsurance recoveries, sales or maturities of investments, and investment income. Cash provided from these sources is used to fund the payment of losses and loss settlement expenses, the purchase of investments, operating expenses, dividends, pension plan contributions, and in recent years, common stock repurchases.

We monitor our capital adequacy to support our business on a regular basis. The future capital requirements of our business will depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Our ability to underwrite is largely dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. In particular, we require (1) sufficient capital to maintain our financial strength ratings, as issued by various rating agencies, at a level considered necessary by management to enable our insurance company subsidiaries to compete and (2) sufficient capital to enable our insurance company subsidiaries to meet the capital adequacy tests performed by regulatory agencies in the United States.

Cash outflows may be variable because of the uncertainty regarding settlement dates for losses. In addition, the timing and amount of individual catastrophe losses are inherently unpredictable and could increase our liquidity requirements. The timing and amount of reinsurance recoveries may be affected by reinsurer solvency and reinsurance coverage disputes.

Historically, we have generated substantial cash inflows from operations. It is our policy to invest the cash generated from operations in securities with maturities that, in the aggregate, correlate to the anticipated timing of payments for losses and loss settlement expenses. The majority of our assets are invested in available-for-sale fixed maturity securities.

The following table displays a consolidated summary of cash sources and uses for the nine-month periods ended September 30, 2018 and 2017 from continuing and discontinued operations:

| Cash Flow Summary                                    | Nine Months Ended |           |
|--|-------------------|-----------|
|  | September 30,     |           |
| (In Thousands)                                       | 2018              | 2017      |
| Cash provided by (used in)                           |                   |           |
| Operating activities                                 | \$69,214          | \$116,296 |
| Investing activities                                 | 2,491             | (4,361 )  |
| Financing activities                                 | (108,195 )        | (93,427 ) |
| Net increase (decrease) in cash and cash equivalents | \$(36,490)        | \$18,508  |

In the Consolidated Statement of Cash Flows, cash flows from discontinued operations are shown in separate lines in each of the operating, investing and financing sections of the Cash Flow Statement. Our cash flows from continuing operations were sufficient to meet our current liquidity needs for the nine-month periods ended September 30, 2018 and 2017 and we anticipate they will be sufficient to meet our future liquidity needs.

**Operating Activities**

Net cash flows provided by operating activities totaled \$69.2 million and \$116.3 million for the nine-month periods ended September 30, 2018 and 2017, respectively. Cash flows from discontinued operations provided by operating activities totaled \$4.0 million and \$23.8 million for the nine-month periods ended September 30, 2018 and 2017, respectively.

**Investing Activities**

Cash in excess of operating requirements is generally invested in fixed maturity securities and equity securities. Fixed maturities provide regular interest payments and allow us to match the duration of our liabilities. Equity securities provide dividend income, potential dividend income growth and potential appreciation. For further

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discussion of our investments, including our philosophy and our strategy for our portfolio, see the "Investment Portfolio" section of this Item 2.

In addition to investment income, possible sales of investments and proceeds from calls or maturities of fixed maturity securities also can provide liquidity. During the next five years, \$264.3 million, or 15.2 percent, of our fixed maturity portfolio will mature.

We invest funds required for short-term cash needs primarily in money market accounts, which are classified as cash equivalents. At September 30, 2018, our cash and cash equivalents included \$3.8 million related to these money market accounts, compared to \$16.8 million at December 31, 2017.

Net cash flows provided by investing activities was \$2.5 million and used in investing activities was \$4.4 million for the nine-month periods ended September 30, 2018 and 2017, respectively. For the nine-month periods ended September 30, 2018 and 2017, we had cash inflows from scheduled and unscheduled investment maturities, redemptions, prepayments, and sales of investments, from continuing operations of \$240.2 million and \$142.7 million, respectively. We also had net cash inflows from the sale of discontinued operations of \$276.1 million for the nine-month period ended September 30, 2018.

were \$504.4 million for the nine-month period ended September 30, 2018, compared to \$167.0 million for the same period of 2017.

**Financing Activities**

Net cash flows used in financing activities from continuing operations was \$96.6 million for the nine-month period ended September 30, 2018 which increased \$49.4 million compared to \$47.2 million used in the nine-month period ended September 30, 2017 primarily due to an increase in shareholder dividends partially offset by a decrease in share repurchases.

**Credit Facilities**

On February 2, 2016, the Company, as borrower, entered into a credit agreement by and among the Company, with the lenders from time to time party thereto and KeyBank National Association, as administrative agent, swingline lender and letter of credit issuer. As of September 30, 2018 and 2017, there were no balances outstanding under this credit agreement. For further discussion of our credit agreement, refer to Part I, Item 1, Note 9. "Credit Facility."

**Dividends**

Dividends paid to shareholders totaled \$97.6 million and \$20.4 million in the nine-month periods ended September 30, 2018 and 2017, respectively. The increase in dividends paid to shareholders is primarily due to a special cash dividend of \$3.00 per share paid to shareholders on August 20, 2018. Our practice has been to pay quarterly cash dividends, which we have paid every quarter since March 1968.

Payments of any future dividends and the amounts of such dividends will depend upon factors such as net income, financial condition, capital requirements, and general business conditions. We will only pay dividends if declared by our Board of Directors out of legally available funds.

As a holding company with no independent operations of its own, we rely on dividends received from our insurance company subsidiaries in order to pay dividends to our common shareholders. Dividends payable by our insurance subsidiaries are governed by the laws in the states in which they are domiciled, and if applicable, commercially domiciled. In all cases, these state laws permit the payment of dividends only from earned surplus arising from business operations. For example, under Iowa law, the maximum dividend or distribution that may be paid within a 12-month period without prior approval of the Iowa Insurance Commissioner is generally restricted to the greater of 10 percent of statutory surplus as of the preceding December 31, or net income of the preceding calendar year on a statutory basis, not greater than earned statutory surplus. Other states in which our insurance company subsidiaries are domiciled may impose similar restrictions on dividends and distributions. Based on these restrictions, at September 30, 2018, UFG's sole direct insurance company subsidiary, United Fire & Casualty Company, was not

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able to make dividend payments without prior regulatory approval. These restrictions will not have a material impact in meeting the cash obligations of UFG.

**Stockholders' Equity**

Stockholders' equity decreased 9.2 percent to \$884.2 million at September 30, 2018, from \$973.4 million at December 31, 2017. The decrease was primarily attributed to shareholder dividends of \$97.6 million, a decrease in net unrealized investment gains of \$50.8 million, net of tax, during the first nine months of 2018 and share repurchases of \$5.4 million, partially offset by net income of \$57.0 million, which includes \$27.3 million of gain on the sale of discontinued operations. At September 30, 2018, the book value per share of our common stock was \$35.27 compared to \$39.06 at December 31, 2017.

**OFF BALANCE SHEET ARRANGEMENTS****Funding Commitments**

Pursuant to an agreement with one of our limited liability partnership investments, we are contractually committed through July 31, 2028, to make capital contributions upon request of the partnership. Our remaining potential contractual obligation was \$23.7 million at September 30, 2018.

**MEASUREMENT OF RESULTS**

Management evaluates our operations by monitoring key measures of growth and profitability. The following section provides further explanation of the key measures management uses to evaluate our results.

**Catastrophe losses** is a commonly used financial measure that uses the designations of the Insurance Services Office (ISO) and are reported with losses and loss settlement expense amounts net of reinsurance recoverables, unless specified otherwise. According to the ISO, a catastrophe loss is defined as a single unpredictable incident or series of closely related incidents that result in \$25.0 million or more in U.S. industry-wide direct insured losses to property and that affect a significant number of insureds and insurers ("ISO catastrophe"). In addition to ISO catastrophes, we also include as catastrophes those events ("non-ISO catastrophes"), which may include U.S. or international losses that we believe are, or will be, material to our operations, either in amount or in number of claims made. Management, at times, may determine for comparison purposes that it is more meaningful to exclude extraordinary catastrophe losses and resulting litigation. The frequency and severity of catastrophe losses we experience in any year affect our results of operations and financial position. In analyzing the underwriting performance of our property and casualty insurance business, we evaluate performance both including and excluding catastrophe losses. Portions of our catastrophe losses may be recoverable under our catastrophe reinsurance agreements. We include a discussion of the impact of catastrophes because we believe it is meaningful for investors to understand the variability in our periodic earnings.

|                                     | <b>Three Months</b>    |          | <b>Nine Months</b>     |          |
|-------------------------------------|------------------------|----------|------------------------|----------|
|                                     | <b>Ended September</b> |          | <b>Ended September</b> |          |
|                                     | <b>30,</b>             |          | <b>30,</b>             |          |
| <i>(In Thousands)</i>               | <b>2018</b>            | 2017     | <b>2018</b>            | 2017     |
| ISO catastrophes                    | <b>\$12,441</b>        | \$25,628 | <b>\$30,990</b>        | \$62,170 |
| Non-ISO catastrophes <sup>(1)</sup> | <b>(173)</b>           | 5,077    | <b>(245)</b>           | 6,596    |
| Total catastrophes                  | <b>\$12,268</b>        | \$30,705 | <b>\$30,745</b>        | \$68,766 |

(1) This number includes international assumed losses.

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**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We have exposure to market risk arising from potential losses in our investment portfolio due to adverse changes in interest rates and market prices. However, we have the ability to hold fixed maturity investments to maturity. Our investment guidelines define the overall framework for managing our market and other investment risks, including accountability and controls. In addition, each of our subsidiaries has specific investment policies that delineate the investment limits and strategies that are appropriate given each entity's liquidity, surplus, product, and regulatory requirements. We respond to market risk by managing the character of investment purchases.

It is our philosophy that we do not utilize financial hedges or derivative financial instruments to manage risks, nor do we enter into any swap, forward or option contracts, but attempt to mitigate our exposure through active portfolio management. In addition, we place the majority of our investments in high-quality, liquid securities and limit the amount of credit exposure to any one issuer. At September 30, 2018, we did not have direct exposure to investments in sub-prime mortgages or other credit-enhancement exposures.

While our primary market risk exposure is to changes in interest rates, we do have limited exposure to changes in equity prices and limited exposure to foreign currency exchange rates.

There have been no material changes in our market risk or market risk factors from what we reported in our Annual Report on Form 10-K for the year ended December 31, 2017.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures, as of the end of the period covered by this report, were designed and functioning effectively to provide reasonable assurance that the information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

**Changes in Internal Control Over Financial Reporting**

Our management, including our Chief Executive Officer and Chief Financial Officer, has evaluated our internal control over financial reporting to determine whether any changes occurred during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on this evaluation, no such change in our internal control over financial reporting occurred during the fiscal quarter to which this report relates.

Table of Contents**PART II - OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

In the normal course of its business, the Company is a party to a variety of legal proceedings. While the final outcome of these legal proceedings cannot be predicted with certainty, management believes all of the proceedings pending as of September 30, 2018 to be ordinary and routine and does not expect these legal proceedings to have a material adverse effect on the Company's financial condition or results of operations.

**ITEM 1A. RISK FACTORS**

Our business is subject to a number of risks, including those identified in Part I, Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 28, 2018, that could have a material effect on our business, results of operations, financial condition, and/or liquidity and that could cause our operating results to vary significantly from period to period. The risks described in the above mentioned report are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial could also have a material effect on our business, results of operations, financial condition and/or liquidity.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Under our share repurchase program, first announced in August 2007, we may purchase UFG common stock from time to time on the open market or through privately negotiated transactions. The amount and timing of any purchases will be at our discretion and will depend upon a number of factors, including the share price, general economic and market conditions, and corporate and regulatory requirements.

The following table provides information with respect to purchases of shares of common stock made by or on our behalf or by any "affiliated purchaser," as defined in Rule 10b-18(a)(3) under the Exchange Act, during the three-month period ended September 30, 2018:

| Period               | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as a Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number of<br>Shares that<br>may yet be<br>Purchased<br>Under the<br>Plans or<br>Programs <sup>(1)</sup> |
|----------------------|---|---------------------------------------|--|--|
|                      |   |                                       | Plans or<br>Programs   | Programs <sup>(1)</sup>  |
| 7/1/2018 - 7/31/2018 | —   | \$ —                                  | —  | 2,116,200  |
| 8/1/2018 - 8/31/2018 | —   | —                                     | —  | 2,116,200  |
| 9/1/2018 - 9/30/2018 | —   | —                                     | —  | 2,116,200  |
| Total                | —   | \$ —                                  | —  | 2,116,200  |

(1) Our share repurchase program was originally announced in August 2007. In August 2016, our Board of Directors authorized the repurchase of up to an additional 1,500,000 shares of common stock through the end of August 2018. This is in addition to the 1,528,886 shares of common stock remaining under its previous authorizations. In August 2018, our Board of Directors extended our share repurchase program through the end of August, 2020. As of September 30, 2018 we remained authorized to repurchase 2,116,200 shares of common stock.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

None.



**ITEM 5. OTHER INFORMATION**

None.

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Table of Contents**ITEM 6. EXHIBIT INDEX**

| Exhibit number | Exhibit description  | Furnished herewith | Filed herewith |
|----------------|--|--------------------|----------------|
| 31.1           | <u>Certification of Randy A. Ramlo pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>  |                    | X              |
| 31.2           | <u>Certification of Dawn M. Jaffray pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.</u>   |                    | X              |
| 32.1           | <u>Certification of Randy A. Ramlo pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>   | X                  |                |
| 32.2           | <u>Certification of Dawn M. Jaffray pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u>  | X                  |                |
| 101.1          | <u>The following financial information from United Fire Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 formatted in XBRL: (i) Consolidated Balance Sheets as of September 30, 2018 (unaudited) and December 31, 2017; (ii) Consolidated Statements of Income and Comprehensive Income (unaudited) for the three and nine months ended September 30, 2018 and 2017; (iii) Consolidated Statement of Stockholders' Equity (unaudited) for the nine months ended September 30, 2018; (iv) Consolidated Statements of Cash Flows (unaudited) for the nine months ended September 30, 2018 and 2017; and (v) Notes to Unaudited Consolidated Financial Statements, tagged as a block of text.</u> |                    | X              |

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UNITED FIRE GROUP, INC.  
(Registrant)

/s/ Randy A. Ramlo  
Randy A. Ramlo  
President, Chief Executive Officer,  
Director and Principal Executive Officer

November 7, 2018  
(Date)

/s/ Dawn M. Jaffray  
Dawn M. Jaffray  
Senior Vice President, Chief Financial  
Officer and  
Principal Accounting Officer

November 7, 2018  
(Date)