

UNITED FIRE GROUP INC  
Form 10-Q  
August 08, 2012  
Table of Contents

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

FORM 10-Q

---

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

for the quarterly period ended June 30, 2012

Commission File Number 001-34257

---

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

---

Iowa  
(State of Incorporation)

45-2302834  
(IRS Employer Identification No.)

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

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

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

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

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

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

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

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

As of August 6, 2012, 25,435,181 shares of common stock were outstanding.

---

Table of Contents

United Fire Group, Inc.

Index to Quarterly Report on Form 10-Q

June 30, 2012

	Page
<u>Forward-Looking Information</u>	<u>1</u>
<u>Part I. Financial Information</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Balance Sheets as of June 30, 2012 (unaudited) and December 31, 2011</u>	<u>2</u>
<u>Consolidated Statements of Income and Comprehensive Income (unaudited) for the three and six month periods ended June 30, 2012 and 2011</u>	<u>3</u>
<u>Consolidated Statement of Stockholders' Equity (unaudited) for the six month period ended June 30, 2012</u>	<u>4</u>
<u>Consolidated Statements of Cash Flows (unaudited) for the six month periods ended June 30, 2012 and 2011</u>	<u>5</u>
<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>6</u>
<u>Report of Independent Registered Public Accounting Firm</u>	<u>29</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>31</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>47</u>
<u>Item 4. Controls and Procedures</u>	<u>47</u>
<u>Part II. Other Information</u>	
<u>Item 1. Legal Proceedings</u>	<u>48</u>
<u>Item 1A. Risk Factors</u>	<u>48</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>48</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>48</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>48</u>
<u>Item 5. Other Information</u>	<u>48</u>
<u>Item 6. Exhibits</u>	<u>49</u>
<u>Signatures and Certifications</u>	<u>50</u>
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	

Exhibit 32.1

Exhibit 32.2

---

Table of Contents

FORWARD-LOOKING INFORMATION

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

Table of ContentsPART I — FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTSUnited Fire Group, Inc.  
Consolidated Balance Sheets

(In Thousands, Except Per Share Amounts)	June 30, 2012 (unaudited)	December 31, 2011
<b>ASSETS</b>		
Investments		
Fixed maturities		
Held-to-maturity, at amortized cost (fair value \$3,927 in 2012 and \$4,161 in 2011)	\$3,864	\$4,143
Available-for-sale, at fair value (amortized cost \$2,657,938 in 2012 and \$2,562,786 in 2011)	2,800,624	2,697,248
Equity securities, at fair value (amortized cost \$68,663 in 2012 and \$68,559 in 2011)	174,359	159,451
Trading securities, at fair value (amortized cost \$14,263 in 2012 and \$13,429 in 2011)	14,249	13,454
Mortgage loans	4,732	4,829
Policy loans	7,393	7,209
Other long-term investments	24,399	20,574
Short-term investments	1,100	1,100
Total investments	\$3,030,720	\$2,908,008
Cash and cash equivalents	\$101,978	\$144,527
Accrued investment income	32,750	32,219
Premiums receivable (net of allowance for doubtful accounts of \$728 in 2012 and \$825 in 2011)	211,205	172,348
Deferred policy acquisition costs	107,058	106,654
Property and equipment (primarily land and buildings, at cost, less accumulated depreciation of \$34,510 in 2012 and \$35,248 in 2011)	44,098	45,644
Reinsurance receivables and recoverables	152,898	128,574
Prepaid reinsurance premiums	3,315	6,191
Income taxes receivable	14,454	26,742
Goodwill and intangible assets	29,530	30,801
Other assets	13,257	17,216
<b>TOTAL ASSETS</b>	<b>\$3,741,263</b>	<b>\$3,618,924</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Liabilities		
Future policy benefits and losses, claims and loss settlement expenses		
Property and casualty insurance	\$960,291	\$945,051
Life insurance	1,504,178	1,476,281
Unearned premiums	330,297	288,991
Accrued expenses and other liabilities	140,883	138,210
Deferred income taxes	25,252	13,624
Debt	45,000	45,000
Trust preferred securities	—	15,626

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

TOTAL LIABILITIES	\$3,005,901	\$2,922,783
Stockholders' Equity		
Common stock, \$0.001 par value; authorized 75,000,000 shares; 25,432,681 and 25,505,350 shares issued and outstanding in 2012 and 2011, respectively	\$25	\$25
Additional paid-in capital	212,171	213,045
Retained earnings	426,744	400,485
Accumulated other comprehensive income, net of tax	96,422	82,586
TOTAL STOCKHOLDERS' EQUITY	\$735,362	\$696,141
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$3,741,263	\$3,618,924

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

Table of Contents

United Fire Group, Inc.

Consolidated Statements of Income and Comprehensive Income (Unaudited)

(In Thousands, Except Per Share Amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues</b>				
Net premiums earned	\$170,090	\$152,210	\$331,593	\$266,414
Investment income, net of investment expenses	28,749	27,741	57,895	54,804
Net realized investment gains				
Other-than-temporary impairment charges	(4 )	—	(4 )	—
All other net realized gains	568	1,124	3,362	3,777
Net realized investment gains	564	1,124	3,358	3,777
Other income	243	729	499	885
Total revenues	\$199,646	\$181,804	\$393,345	\$325,880
<b>Benefits, Losses and Expenses</b>				
Losses and loss settlement expenses	\$106,766	\$135,811	\$198,250	\$211,993
Future policy benefits	8,356	7,880	18,494	16,062
Amortization of deferred policy acquisition costs	34,179	43,732	68,730	69,778
Other underwriting expenses	20,541	14,720	42,535	30,777
Interest on policyholders' accounts	10,627	10,657	21,283	21,327
Total expenses	\$180,469	\$212,800	\$349,292	\$349,937
Income (loss) before income taxes	\$19,177	\$(30,996 )	\$44,053	\$(24,057 )
Federal income tax expense (benefit)	4,461	(13,082 )	10,153	(11,953 )
Net income (loss)	\$14,716	\$(17,914 )	\$33,900	\$(12,104 )
<b>Other comprehensive income</b>				
Change in net unrealized appreciation on investments	8,667	21,439	22,270	22,939
Adjustment for net realized gains included in income	(564 )	(1,124 )	(3,358 )	(3,777 )
Adjustment for employee benefit costs included in expense	1,732	732	2,375	1,286
	\$9,835	\$21,047	\$21,287	\$20,448
Income tax effect of components of other comprehensive income	(3,442 )	(7,366 )	(7,451 )	(7,157 )
	\$6,393	\$13,681	\$13,836	\$13,291
Comprehensive income (loss)	\$21,109	\$(4,233 )	\$47,736	\$1,187
Weighted average common shares outstanding	25,476,220	26,101,842	25,491,091	26,148,438
Basic earnings (loss) per common share	\$0.58	\$(0.69 )	\$1.33	\$(0.46 )
Diluted earnings (loss) per common share	0.58	(0.69 )	1.33	(0.46 )
Cash dividends declared per common share	0.15	0.15	0.30	0.30

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





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

(In Thousands, Except Per Share Data)	Six Months Ended June 30, 2012
Common stock	
Balance, beginning of year	\$25
Shares repurchased (101,901 shares)	(1 )
Shares issued for stock-based awards (29,232 shares)	1
Balance, end of period	\$25
Additional paid-in capital	
Balance, beginning of year	\$213,045
Compensation expense and related tax benefit for stock-based award grants	859
Shares repurchased	(2,133 )
Shares issued for stock-based awards	400
Balance, end of period	\$212,171
Retained earnings	
Balance, beginning of year	\$400,485
Net income	33,900
Dividends on common stock (\$0.30 per share)	(7,641 )
Balance, end of period	\$426,744
Accumulated other comprehensive income, net of tax	
Balance, beginning of year	\$82,586
Change in net unrealized investment appreciation <sup>(1)</sup>	12,292
Change in liability for underfunded employee benefit plans	1,544
Balance, end of period	\$96,422
Summary of changes	
Balance, beginning of year	\$696,141
Net income	33,900
All other changes in stockholders' equity accounts	5,321
Balance, end of period	\$735,362

(1)The change in net unrealized appreciation is net of reclassification adjustments.

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

Table of Contents

United Fire Group, Inc.

Consolidated Statements of Cash Flows (Unaudited)

(In Thousands)

	Six Months Ended June 30,	
	2012	2011
Cash Flows From Operating Activities		
Net income (loss)	\$33,900	\$(12,104)
Adjustments to reconcile net income to net cash provided by operating activities		
Net accretion of bond premium	7,127	3,768
Depreciation and amortization	3,671	1,708
Stock-based compensation expense	916	939
Net realized investment gains	(3,358)	(3,777)
Net cash flows from trading investments	(748)	(2,104)
Deferred income tax expense (benefit)	6,626	(7,571)
Changes in:		
Accrued investment income	(531)	507
Premiums receivable	(38,857)	(29,226)
Deferred policy acquisition costs	(4,520)	(6,373)
Reinsurance receivables	(24,324)	(5,883)
Prepaid reinsurance premiums	2,876	(602)
Income taxes receivable	12,288	(4,029)
Other assets	3,959	(806)
Future policy benefits and losses, claims and loss settlement expenses	34,345	52,813
Unearned premiums	41,306	29,542
Accrued expenses and other liabilities	5,048	25,493
Deferred income taxes	(2,448)	(1,019)
Other, net	(2,131)	(486)
Total adjustments	\$41,245	\$52,894
Net cash provided by operating activities	\$75,145	\$40,790
Cash Flows From Investing Activities		
Proceeds from sale of available-for-sale investments	\$13,412	\$21,367
Proceeds from call and maturity of held-to-maturity investments	285	709
Proceeds from call and maturity of available-for-sale investments	302,334	316,235
Proceeds from short-term and other investments	2,875	1,554
Purchase of available-for-sale investments	(414,828)	(292,808)
Purchase of short-term and other investments	(4,650)	(1,706)
Net purchases and sales of property and equipment	(857)	3,486
Acquisition of property and casualty company, net of cash acquired	—	(172,619)
Net cash used in investing activities	\$(101,429)	\$(123,782)
Cash Flows From Financing Activities		
Policyholders' account balances		
Deposits to investment and universal life contracts	\$78,313	\$71,489
Withdrawals from investment and universal life contracts	(69,521)	(57,263)
Borrowings of short-term debt	—	79,900
Repayment of trust preferred securities	(15,626)	—
Payment of cash dividends	(7,641)	(7,840)
Repurchase of common stock	(2,134)	(6,082)
Issuance of common stock	401	139
Tax impact from issuance of common stock	(57)	6

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

Net cash (used in) provided by financing activities	\$(16,265	)	\$80,349	
Net Change in Cash and Cash Equivalents	\$(42,549	)	\$(2,643	)
Cash and Cash Equivalents at Beginning of Period	144,527		180,057	
Cash and Cash Equivalents at End of Period	\$101,978		\$177,414	

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

5

---

Table of Contents

United Fire Group, Inc.

Notes to Unaudited Consolidated Financial Statements

NOTE 1. NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Business

The terms “United Fire,” “we,” “us,” or “our” refer to United Fire Group, Inc., and its consolidated subsidiaries and affiliates, as the context requires. We are engaged in the business of writing property and casualty insurance and life insurance and selling annuities through a network of independent agencies. We report our operations in two business segments: property and casualty insurance and life insurance. We are licensed as a property and casualty insurer in 43 states plus the District of Columbia and as a life insurer in 36 states.

Basis of Presentation

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

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

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

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

In the opinion of the management of United Fire, the accompanying unaudited Consolidated Financial Statements contain all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows for the periods presented. All significant intercompany transactions have been eliminated in consolidation. The results reported for the interim periods are not necessarily indicative of the results of operations that may be expected for the year. The unaudited Consolidated Financial Statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2011. The review report of Ernst & Young LLP as of and for the three- and six-month periods ended June 30, 2012, accompanies the unaudited Consolidated Financial Statements included in Part I, Item 1 “Financial Statements.”

Cash and Cash Equivalents

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

For the six-month periods ended June 30, 2012 and 2011, we made payments for income taxes totaling \$8.9 million and \$0.6 million, respectively. For the six-month period ended June 30, 2012, we received a federal tax refund of \$15.5 million that resulted from the utilization of our 2009 net operating losses and net capital losses in the

Table of Contents

carryback period. No tax refunds were received for the six-month period ended June 30, 2011.

For the six-month periods ended June 30, 2012 and 2011, we made interest payments totaling \$0.8 million and \$0.4 million, respectively. These payments exclude interest credited to policyholders' accounts.

Deferred Policy Acquisition Costs

The costs associated with underwriting new business – primarily commissions, premium taxes and variable underwriting and policy issue expenses associated with successful acquisition efforts – are deferred and amortized over the terms of the underlying policies. The following table shows the reconciliation of the components of our deferred policy acquisition costs asset, including the related amortization recognized for the six-month period ended June 30, 2012.

(In Thousands)	Property & Casualty	Life Insurance	Total
Recorded asset at December 31, 2011	\$60,668	\$45,986	\$106,654
Amortization of value of business acquired	(1,674 )	—	(1,674 )
Underwriting costs deferred	69,742	3,508	73,250
Amortization of deferred policy acquisition costs	(62,621 )	(4,435 )	(67,056 )
	\$66,115	\$45,059	\$111,174
Change in "shadow" deferred policy acquisition costs	—	(4,116 )	(4,116 )
Recorded asset at June 30, 2012	\$66,115	\$40,943	\$107,058

In October 2010, the Financial Accounting Standards Board ("FASB") issued updated accounting guidance to address the diversity in practice for the accounting for costs associated with acquiring or renewing insurance contracts. This guidance modifies the definition of acquisition costs to specify that a cost must be incremental and directly related to the successful acquisition of a new or renewal insurance contract in order to be deferred. Acquisition costs that are not eligible for deferral are to be charged to expense in the period incurred. If application of this guidance would result in the capitalization of acquisition costs that had not previously been capitalized by a reporting entity, the entity may elect not to capitalize those costs.

Effective January 1, 2012, we elected to adopt the updated accounting guidance on a prospective basis. As a result of the adoption, the amount of underwriting expenses eligible for deferral has decreased. After consideration of our normal recoverability assessment, which we refer to as a premium deficiency charge, and the amortization pattern of our deferred policy acquisition costs, we recognized approximately \$8.1 million of pretax expense in the six-month period ended June 30, 2012 that we would not have recognized had the guidance remained the same. The impact of the adoption on the Consolidated Statements of Income and Comprehensive Income for the six-month period ended June 30, 2012 was an increase to other underwriting expenses of \$13.9 million, a decrease to deferred policy acquisition cost amortization of \$5.8 million and a decrease to net income of \$5.3 million. This represents a reduction to net income of \$0.21 per share.

The impact of the updated accounting guidance on our results for the full year will be influenced by a number of factors including: the volume of premiums written; our assessment of successful acquisition efforts; the profitability of our lines of property and casualty business, which impacts the level of premium deficiency charge recorded; and the normal amortization pattern of these deferred policy acquisition costs, which is generally over one year. The greatest impact will be experienced in the most current quarter as the recorded deferred policy acquisitions costs would amortize to expense in succeeding quarters to offset a portion of the initial impact when assessed on an annual basis. Accordingly, the impact of the updated accounting guidance on our results reported for the six-month period ended June 30, 2012 should not be considered to be representative of the impact for the full year.



## Table of Contents

### Income Taxes

Deferred tax assets and liabilities are established based on differences between the financial statement bases of assets and liabilities and the tax bases of those same assets and liabilities, using the currently enacted statutory tax rates. Deferred income tax expense is measured by the year-to-year change in the net deferred tax asset or liability, except for certain changes in deferred tax amounts that affect stockholders' equity and do not impact federal income tax expense.

We reported a federal income tax expense of \$10.2 million and a federal income tax benefit of \$12.0 million for the six-month periods ended June 30, 2012 and 2011, respectively. Our effective tax rate is different than the federal statutory rate of 35.0 percent due principally to the effect of tax-exempt municipal bond interest income and non-taxable dividend income.

We have recognized no liability for unrecognized tax benefits at June 30, 2012 or December 31, 2011. In addition, we have not accrued for interest and penalties related to unrecognized tax benefits. However, if interest and penalties would need to be accrued related to unrecognized tax benefits, such amounts would be recognized as a component of federal income tax expense.

We file a consolidated federal income tax return. We also file income tax returns in various state jurisdictions. We are no longer subject to federal or state income tax examination for years before 2006.

### Recently Issued Accounting Standards

#### Adopted Accounting Standards

### Comprehensive Income

In June and December 2011, the FASB issued guidance amending the presentation of comprehensive income and its components. Under the new guidance, a reporting entity has the option to present comprehensive income in a single continuous statement or in two separate but consecutive statements. This new guidance is to be applied retrospectively. We adopted the new guidance in the first quarter of 2012 by electing to report comprehensive income in a single continuous statement as shown in the accompanying Consolidated Statements of Income and Comprehensive Income. The adoption of the new guidance affects presentation only and therefore had no impact on our results of operations or financial position.

### Fair Value Measurements

In May 2011, the FASB issued updated accounting guidance that changed the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements to ensure consistency between GAAP and International Financial Reporting Standards. The guidance also requires additional disclosures for fair value measurements that are estimated using significant unobservable (i.e., Level 3) inputs. We adopted the updated guidance on a prospective basis effective January 1, 2012, and we have provided the additional disclosures required in "Note 3. Fair Value of Financial Instruments". The adoption of the new guidance did not have any impact on our financial position or results of operations.

### NOTE 2. SUMMARY OF INVESTMENTS

#### Fair Value of Investments

A reconciliation of the amortized cost (cost for equity securities) to fair value of investments in held-to-maturity and available-for-sale fixed maturity and equity securities as of June 30, 2012 and December 31, 2011, is as follows:



Table of Contents

June 30, 2012	(Dollars in Thousands)			
Type of Investment	Cost or Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
<b>HELD-TO-MATURITY</b>				
Fixed maturities				
Bonds				
States, municipalities and political subdivisions	\$3,556	\$44	\$—	\$3,600
Mortgage-backed securities	280	18	—	298
Collateralized mortgage obligations	28	1	—	29
Total Held-to-Maturity Fixed Maturities	\$3,864	\$63	\$—	\$3,927
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. Treasury	\$42,364	\$1,140	\$—	\$43,504
U.S. government agency	39,722	490	—	40,212
States, municipalities and political subdivisions	699,803	58,080	269	757,614
Foreign bonds	226,172	10,089	627	235,634
Public utilities	241,811	15,203	55	256,959
Corporate bonds				
Energy	178,831	7,718	1	186,548
Industrials	307,282	12,987	484	319,785
Consumer goods and services	209,643	9,232	271	218,604
Health care	120,500	7,130	7	127,623
Technology, media and telecommunications	123,527	5,910	106	129,331
Financial services	299,318	10,538	1,746	308,110
Mortgage-backed securities	33,884	1,130	22	34,992
Collateralized mortgage obligations	129,515	6,644	301	135,858
Asset-backed securities	5,188	432	151	5,469
Redeemable preferred stocks	378	3	—	381
Total Available-For-Sale Fixed Maturities	\$2,657,938	\$146,726	\$4,040	\$2,800,624
Equity securities				
Common stocks				
Public utilities	\$7,231	\$7,952	\$172	\$15,011
Energy	5,094	6,679	—	11,773
Industrials	13,032	18,206	240	30,998
Consumer goods and services	10,394	7,701	134	17,961
Health care	8,212	10,018	187	18,043
Technology, media and telecommunications	5,367	5,822	134	11,055
Financial services	15,699	50,549	342	65,906
Nonredeemable preferred stocks	3,634	119	141	3,612
Total Available-for-Sale Equity Securities	\$68,663	\$107,046	\$1,350	\$174,359
Total Available-for-Sale Securities	\$2,726,601	\$253,772	\$5,390	\$2,974,983



Table of Contents

December 31, 2011	(Dollars in Thousands)			
Type of Investment	Cost or Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value
<b>HELD-TO-MATURITY</b>				
Fixed maturities				
Bonds				
States, municipalities and political subdivisions	\$3,739	\$52	\$61	\$3,730
Mortgage-backed securities	356	25	—	381
Collateralized mortgage obligations	48	2	—	50
Total Held-to-Maturity Fixed Maturities	\$4,143	\$79	\$61	\$4,161
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. Treasury	\$42,530	\$1,421	\$—	\$43,951
U.S. government agency	95,813	582	—	96,395
States, municipalities and political subdivisions	687,039	61,076	8	748,107
Foreign bonds	206,872	8,766	823	214,815
Public utilities	254,822	15,562	313	270,071
Corporate bonds				
Energy	189,902	7,567	277	197,192
Industrials	285,696	10,631	650	295,677
Consumer goods and services	203,948	8,872	646	212,174
Health care	109,219	6,497	45	115,671
Technology, media and telecommunications	108,315	4,951	318	112,948
Financial services	258,526	9,075	2,300	265,301
Mortgage-backed securities	34,353	1,041	4	35,390
Collateralized mortgage obligations	79,545	3,490	184	82,851
Asset-backed securities	5,801	495	—	6,296
Redeemable preferred stocks	405	4	—	409
Total Available-For-Sale Fixed Maturities	\$2,562,786	\$140,030	\$5,568	\$2,697,248
Equity securities				
Common stocks				
Public utilities	\$7,231	\$7,602	\$98	\$14,735
Energy	5,094	7,116	—	12,210
Industrials	12,678	16,153	275	28,556
Consumer goods and services	10,750	7,982	168	18,564
Health care	8,212	8,008	232	15,988
Technology, media and telecommunications	5,368	4,796	146	10,018
Financial services	15,592	41,041	543	56,090
Nonredeemable preferred stocks	3,634	40	384	3,290
Total Available-for-Sale Equity Securities	\$68,559	\$92,738	\$1,846	\$159,451
Total Available-for-Sale Securities	\$2,631,345	\$232,768	\$7,414	\$2,856,699



Table of Contents**Maturities**

The amortized cost and fair value of held-to-maturity, available-for-sale and trading securities at June 30, 2012, by contractual maturity, are shown in the following table. 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.

(In Thousands)	Held-To-Maturity		Available-For-Sale		Trading	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
June 30, 2012						
Due in one year or less	\$406	\$416	\$241,061	\$245,155	\$490	\$520
Due after one year through five years	3,150	3,184	1,051,843	1,107,127	7,376	7,171
Due after five years through 10 years	—	—	1,054,621	1,123,705	1,844	1,776
Due after 10 years	—	—	141,826	148,318	4,553	4,782
Asset-backed securities	—	—	5,188	5,469	—	—
Mortgage-backed securities	280	298	33,884	34,992	—	—
Collateralized mortgage obligations	28	29	129,515	135,858	—	—
	\$3,864	\$3,927	\$2,657,938	\$2,800,624	\$14,263	\$14,249

**Net Realized Investment Gains and Losses**

Net realized gains (losses) on disposition of investments are computed using the specific identification method and recognized as a component of earnings for the current period. A summary of net realized investment gains (losses) resulting from investment sales and calls is as follows:

(In Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net realized investment gains (losses)				
Fixed maturities	\$792	\$1,048	\$2,323	\$2,434
Equity securities	(4 )	218	697	1,334
Trading securities	(224 )	(38 )	338	278
Other long-term investments	—	(104 )	—	(269 )
Total net realized investment gains	\$564	\$1,124	\$3,358	\$3,777

The proceeds and gross realized gains and losses on the sale of available-for-sale securities are as follows:

(In Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Proceeds from sales	\$10,412	\$16,520	\$13,412	\$21,367
Gross realized gains	8	261	478	351
Gross realized losses	—	172	25	688

There were no sales of held-to-maturity securities during the six-month periods ended June 30, 2012 and 2011.

Our investment portfolio includes trading securities with embedded derivatives. These securities, which are primarily convertible redeemable preferred debt securities, 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 and losses. Our portfolio of trading securities had a fair value of \$14.2 million and \$13.5 million at June 30, 2012 and December 31, 2011, respectively.

**Off-Balance Sheet Arrangements**

Pursuant to an agreement with one of our limited liability partnership investments, we are contractually committed



Table of Contents

to make capital contributions up to \$15.0 million, upon request by the partnership, through December 31, 2017. Our remaining potential contractual obligation was \$7.4 million at June 30, 2012.

## Unrealized Appreciation and Depreciation

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

(In Thousands)	Six Months Ended June 30,	
	2012	2011
Change in net unrealized investment appreciation		
Available-for-sale fixed maturities and equity securities	\$23,028	\$19,419
Deferred policy acquisition costs	(4,116 )	(257 )
Income tax effect	(6,620 )	(6,707 )
Total change in net unrealized investment appreciation, net of tax	\$12,292	\$12,455

In the above table, the amount reported as changes in deferred policy acquisition costs pertains to our life insurance segment and represents the impact of fluctuations that occur in the interest rate environment from time to time.

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. 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 at June 30, 2012 and December 31, 2011. 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 June 30, 2012, if future events or information cause us to determine that a decline in fair value is other-than-temporary.

We believe the unrealized depreciation in value of securities in our fixed maturity portfolio is primarily attributable to changes in market interest rates and not the credit quality of the issuer. We have no intent to sell and it is more likely than not that we will not be required to sell these securities until such time as the fair value recovers to at least equal our cost basis or the securities mature.

We have evaluated the unrealized losses reported for all of our equity securities at June 30, 2012, and have concluded that the duration and severity of these losses do not warrant the recognition of an OTTI charge at June 30, 2012. Our largest unrealized loss greater than 12 months on an individual equity security at June 30, 2012 was \$0.2 million. We have no intention to sell any of these securities prior to a recovery in value, but will continue to monitor the fair value reported for these securities as part of our overall process to evaluate investments for OTTI recognition.

Table of Contents

(In Thousands)

June 30, 2012

Type of Investment	Less than 12 months			12 months or longer			Total Fair Value	Gross Unrealized Depreciation
	Number of Issues	Fair Value	Gross Unrealized Depreciation	Number of Issues	Fair Value	Gross Unrealized Depreciation		
<b>AVAILABLE-FOR-SALE</b>								
Fixed maturities								
Bonds								
States, municipalities and political subdivisions	36	\$21,466	\$ 269	—	\$—	\$ —	\$21,466	\$ 269
Foreign bonds	14	23,083	488	2	3,982	139	27,065	627
Public utilities	1	989	11	1	1,117	44	2,106	55
Corporate bonds								
Energy	1	2,526	1	—	—	—	2,526	1
Industrials	9	27,584	381	1	2,897	103	30,481	484
Consumer goods and services	12	17,088	252	1	1,379	19	18,467	271
Health care	1	1,715	7	—	—	—	1,715	7
Technology, media and telecommunications	3	10,589	47	1	2,135	59	12,724	106
Financial services	16	24,317	340	22	22,061	1,406	46,378	1,746
Mortgage-backed securities	6	5,034	22	—	—	—	5,034	22
Collateralized mortgage obligations	5	18,857	117	7	303	184	19,160	301
Asset-backed securities	1	96	151	—	—	—	96	151
Total Available-For-Sale Fixed Maturities	105	\$153,344	\$ 2,086	35	\$33,874	\$ 1,954	\$187,218	\$ 4,040
Equity securities								
Common stocks								
Public utilities	4	\$462	\$ 172	—	\$—	\$ —	\$462	\$ 172
Industrials	9	876	123	6	504	117	1,380	240
Consumer goods and services	5	94	16	6	345	118	439	134
Health care	3	446	18	5	789	169	1,235	187
Technology, media and telecommunications	10	200	16	4	528	118	728	134
Financial services	4	663	125	7	1,018	217	1,681	342
Nonredeemable preferred stocks	—	—	—	3	1,135	141	1,135	141
Total Available-for-Sale Equity Securities	35	\$2,741	\$ 470	31	\$4,319	\$ 880	\$7,060	\$ 1,350
Total Available-for-Sale Securities	140	\$156,085	\$ 2,556	66	\$38,193	\$ 2,834	\$194,278	\$ 5,390



Table of Contents

(In Thousands)

December 31, 2011	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>HELD-TO-MATURITY</b>								
Fixed maturities								
Bonds								
States, municipalities and political subdivisions	—	\$—	\$—	1	\$473	\$ 61	\$473	\$ 61
Total Held-to-Maturity Fixed Maturities	—	\$—	\$—	1	\$473	\$ 61	\$473	\$ 61
<b>AVAILABLE-FOR-SALE</b>								
Fixed maturities								
Bonds								
States, municipalities and political subdivisions	6	\$3,555	\$ 6	1	\$619	\$ 2	\$4,174	\$ 8
Foreign bonds	13	18,001	488	6	14,123	335	32,124	823
Public utilities	6	9,579	160	1	1,068	153	10,647	313
Corporate bonds								
Energy	2	5,436	53	1	5,223	224	10,659	277
Industrials	9	25,664	359	3	8,135	291	33,799	650
Consumer goods and services	5	5,360	514	5	3,932	132	9,292	646
Health care	2	5,027	45	—	—	—	5,027	45
Technology, media and telecommunications	13	14,148	318	—	—	—	14,148	318
Financial services	23	20,073	292	26	28,892	2,008	48,965	2,300
Mortgage-backed securities	5	684	4	—	—	—	684	4
Collateralized mortgage obligations	7	4,466	141	3	5,209	43	9,675	184
Total Available-For-Sale Fixed Maturities	91	\$111,993	\$ 2,380	46	\$67,201	\$ 3,188	\$179,194	\$ 5,568
Equity securities								
Common stocks								
Public utilities	3	\$210	\$ 98	—	\$—	\$—	\$210	\$ 98
Industrials	7	975	155	8	577	120	1,552	275
Consumer goods and services	12	625	150	3	431	18	1,056	168
Health care	5	768	94	4	455	138	1,223	232
Technology, media and telecommunications	7	571	124	2	144	22	715	146
Financial services	16	1,876	319	6	746	224	2,622	543
Nonredeemable preferred stocks	3	1,171	31	2	878	353	2,049	384
Total Available-for-Sale Equity Securities	53	\$6,196	\$ 971	25	\$3,231	\$ 875	\$9,427	\$ 1,846
Total Available-for-Sale Securities	144	\$118,189	\$ 3,351	71	\$70,432	\$ 4,063	\$188,621	\$ 7,414
Total	144	\$118,189	\$ 3,351	72	\$70,905	\$ 4,124	\$189,094	\$ 7,475



Table of Contents

NOTE 3. FAIR VALUE OF FINANCIAL INSTRUMENTS

We estimate the fair value of our financial instruments based on relevant market information or by discounting estimated future cash flows at estimated current market discount rates appropriate to the specific asset or liability. In most cases, 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 fair values 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.

The fair value of our mortgage loans is determined by modeling performed by us based on the stated principal and coupon payments provided for in the loan agreement. These cash flows are then discounted using an appropriate risk-adjusted discount rate to determine the security's fair value, which is a Level 3 fair value measurement.

The estimated fair value of policy loans is equivalent to carrying value. 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 holdings in limited liability partnership funds that are valued by the various fund managers and are recorded on the equity method of accounting. In management's opinion, these values represent fair value.

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.

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, 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.

The fair value of our debt approximates carrying value due to the variable interest rates and short-term nature of these financial instruments.

Table of Contents

A summary of the carrying value and estimated fair value of our financial instruments at June 30, 2012 and December 31, 2011 is as follows:

(In Thousands)	June 30, 2012		December 31, 2011	
	Fair Value	Carrying Value	Fair Value	Carrying Value
Assets				
Investments				
Held-to-maturity fixed maturities	\$3,927	\$3,864	\$4,161	\$4,143
Available-for-sale fixed maturities	2,800,624	2,800,624	2,697,248	2,697,248
Trading securities	14,249	14,249	13,454	13,454
Equity securities	174,359	174,359	159,451	159,451
Mortgage loans	5,234	4,732	5,219	4,829
Policy loans	7,393	7,393	7,209	7,209
Other long-term investments	24,399	24,399	20,574	20,574
Short-term investments	1,100	1,100	1,100	1,100
Cash and cash equivalents	101,978	101,978	144,527	144,527
Accrued investment income	32,750	32,750	32,219	32,219
Liabilities				
Policy reserves				
Annuity (accumulations) <sup>(1)</sup>	\$1,114,522	\$1,008,607	\$1,074,661	\$999,534
Annuity (benefit payments)	144,274	98,579	133,921	94,465
Debt	45,000	45,000	45,000	45,000

(1) Annuity accumulations represent deferred annuity contracts that are currently earning interest.

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.

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.

Table of Contents

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. In our opinion, the pricing obtained at June 30, 2012 was reasonable.

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.

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.

The following tables present the categorization for our financial instruments measured at fair value on a recurring basis in our Consolidated Balance Sheets at June 30, 2012 and December 31, 2011:

Table of Contents

(In Thousands) Description	June 30, 2012	Fair Value Measurements		
		Level 1	Level 2	Level 3
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. Treasury	\$43,504	\$—	\$43,504	\$—
U.S. government agency	40,212	—	40,212	—
States, municipalities and political subdivisions	757,614	—	756,799	815
Foreign bonds	235,634	—	234,798	836
Public utilities	256,959	—	256,959	—
Corporate bonds				
Energy	186,548	—	186,548	—
Industrials	319,785	—	316,887	2,898
Consumer goods and services	218,604	—	217,225	1,379
Health care	127,623	—	127,623	—
Technology, media and telecommunications	129,331	—	129,331	—
Financial services	308,110	—	295,888	12,222
Mortgage-backed securities	34,992	—	34,992	—
Collateralized mortgage obligations	135,858	—	135,858	—
Asset-backed securities	5,469	—	5,154	315
Redeemable preferred stocks	381	381	—	—
Total Available-For-Sale Fixed Maturities	\$2,800,624	\$381	\$2,781,778	\$18,465
Equity securities				
Common stocks				
Public utilities	\$15,011	\$15,011	\$—	\$—
Energy	11,773	11,773	—	—
Industrials	30,998	30,923	75	—
Consumer goods and services	17,961	17,961	—	—
Health care	18,043	18,043	—	—
Technology, media and telecommunications	11,055	11,055	—	—
Financial services	65,906	62,251	—	3,655
Nonredeemable preferred stocks	3,612	3,372	240	—
Total Available-for-Sale Equity Securities	\$174,359	\$170,389	\$315	\$3,655
Total Available-for-Sale Securities	\$2,974,983	\$170,770	\$2,782,093	\$22,120
<b>TRADING</b>				
Bonds				
Foreign bonds	\$2,801	\$—	\$2,801	\$—
Corporate bonds				
Industrials	1,327	—	1,327	—

Table of Contents

Consumer goods and services	1,563	—	1,563	—
Health care	1,814	—	1,814	—
Technology, media and telecommunications	2,387	—	2,387	—
Financial services	2,265	—	2,265	—
Redeemable preferred stocks	2,092	2,092	—	—
Total Trading Securities	\$14,249	\$2,092	\$12,157	\$—
Short-Term Investments	\$1,100	\$1,100	\$—	\$—
Money Market Accounts	\$38,414	\$38,414	\$—	\$—
Total Assets Measured at Fair Value	\$3,028,746	\$212,376	\$2,794,250	\$22,120

Table of Contents

(In Thousands) Description	December 31, 2011	Fair Value Measurements		
		Level 1	Level 2	Level 3
<b>AVAILABLE-FOR-SALE</b>				
Fixed maturities				
Bonds				
U.S. Treasury	\$43,951	\$—	\$43,951	\$—
U.S. government agency	96,395	—	96,395	—
States, municipalities and political subdivisions	748,107	—	747,227	880
Foreign bonds	214,815	—	213,979	836
Public utilities	270,071	—	270,071	—
Corporate bonds				
Energy	197,192	—	197,192	—
Industrials	295,677	—	292,780	2,897
Consumer goods and services	212,174	—	210,759	1,415
Health care	115,671	—	115,671	—
Technology, media and telecommunications	112,948	—	112,948	—
Financial services	265,301	—	249,328	15,973
Mortgage-backed securities	35,390	—	35,390	—
Collateralized mortgage obligations	82,851	—	82,851	—
Asset-backed securities	6,296	—	5,981	315
Redeemable preferred stocks	409	409	—	—
<b>Total Available-For-Sale Fixed Maturities</b>	<b>\$2,697,248</b>	<b>\$409</b>	<b>\$2,674,523</b>	<b>\$22,316</b>
Equity securities				
Common stocks				
Public utilities	\$14,735	\$14,735	\$—	\$—
Energy	12,210	12,210	—	—
Industrials	28,556	28,556	—	—
Consumer goods and services	18,564	18,564	—	—
Health care	15,988	15,988	—	—
Technology, media and telecommunications	10,018	10,018	—	—
Financial services	56,090	52,564	—	3,526
Nonredeemable preferred stocks	3,290	3,032	258	—
<b>Total Available-for-Sale Equity Securities</b>	<b>\$159,451</b>	<b>\$155,667</b>	<b>\$258</b>	<b>\$3,526</b>
<b>Total Available-for-Sale Securities</b>	<b>\$2,856,699</b>	<b>\$156,076</b>	<b>\$2,674,781</b>	<b>\$25,842</b>
<b>TRADING</b>				
Bonds				
Foreign bonds	\$2,906	\$—	\$2,906	\$—
Corporate bonds				
Industrials	1,443	—	1,443	—
Consumer goods and services	1,059	—	1,059	—
Health care	1,450	—	1,450	—
Technology, media and telecommunications	1,458	—	1,458	—





Table of Contents

Financial services	2,063	—	2,063	—
Redeemable preferred stocks	3,075	1,659	1,416	—
Total Trading Securities	\$13,454	\$1,659	\$11,795	\$—
Short-Term Investments	\$1,100	\$1,100	\$—	\$—
Money Market Accounts	\$62,899	\$62,899	\$—	\$—
Total Assets Measured at Fair Value	\$2,934,152	\$221,734	\$2,686,576	\$25,842

Table of Contents

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

The fair value of securities that are categorized as Level 2 is determined by management after reviewing market prices obtained from independent pricing services and brokers. Such estimated fair values do not necessarily represent the values for which these securities could have been sold at the reporting date. Our independent pricing services and brokers obtain prices from reputable pricing vendors in the marketplace. They continually monitor and review the external pricing sources, while actively participating to resolve any pricing issues that may arise.

For the six-month period ended June 30, 2012, the change in our available-for-sale securities categorized as Level 1 and Level 2 is the result of investment purchases, which were made using funds held in our money market accounts, disposals and the change in unrealized gains on both fixed maturities and equity securities. There were no significant transfers of securities between Level 1 and Level 2 during the period.

Securities categorized as Level 3 include holdings in certain private placement fixed maturity and equity securities and certain other securities that were determined to be other-than-temporarily impaired in a prior period and 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. If pricing could not be obtained from these sources, which occurs on a limited basis, management performed an analysis of the contractual cash flows of the underlying security to estimate fair value.

The fair value of our Level 3 impaired securities was determined primarily based upon management's assumptions regarding the timing and amount of future cash inflows. If a security has been written down or the issuer is in bankruptcy, management relies in part on outside opinions from rating agencies, our lien position on the security, general economic conditions and management's expertise to determine fair value. We have the ability and the positive intent to hold securities until such time that we are able to recover all or a portion of our original investment. If there is no market for the impaired security at the balance sheet date, management will estimate the security's fair value based on other securities in the market. Management will continue to monitor securities after the balance sheet date to confirm that their estimated fair value is reasonable.

The following table provides a summary of the changes in fair value of our Level 3 securities for the three-month period ended June 30, 2012:

(In Thousands)	States, municipalities and political subdivisions	Foreign bonds	Corporate bonds	Asset-backed securities	Equities	Total
Balance at March 31, 2012	\$ 880	\$ 836	\$ 20,075	\$ 315	\$ 3,476	\$ 25,582
Realized gains <sup>(1)</sup>	—	—	646	—	—	646
Unrealized losses <sup>(1)</sup>	—	—	(408 )	—	—	(408 )
Purchases	—	—	—	—	179	179
Disposals	(65 )	—	(3,814 )	—	—	(3,879 )
Balance at June 30, 2012	\$ 815	\$ 836	\$ 16,499	\$ 315	\$ 3,655	\$ 22,120

(1) Realized gains (losses) are recorded as a component of earnings whereas unrealized gains (losses) are recorded as a component of comprehensive income.

The reported disposals relate to receipt of principal on calls or sinking fund bonds, in accordance with the indentures, and a bond that was called by the issuer.

Table of Contents

The following table provides a summary of the changes in fair value of our Level 3 securities for the six-month period ended June 30, 2012:

(In Thousands)	States, municipalities and political subdivisions	Foreign bonds	Corporate bonds	Asset-backed securities	Equities	Total
Balance at December 31, 2011	\$ 880	\$ 836	\$ 20,285	\$ 315	\$ 3,526	\$ 25,842
Realized gains <sup>(1)</sup>	—	—	646	—	—	646
Unrealized losses <sup>(1)</sup>	—	—	(368 )	—	—	(368 )
Purchases	—	—	—	—	179	179
Disposals	(65 )	—	(4,064 )	—	(50 )	(4,179 )
Balance at June 30, 2012	\$ 815	\$ 836	\$ 16,499	\$ 315	\$ 3,655	\$ 22,120

(1) Realized gains (losses) are recorded as a component of earnings whereas unrealized gains (losses) are recorded as a component of comprehensive income.

The reported disposals relate to the sale of an equity security and receipt of principal on calls or sinking fund bonds, in accordance with the indentures, and a bond that was called by the issuer.

## NOTE 4. EMPLOYEE BENEFITS

## Net Periodic Benefit Cost

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

(In Thousands)	Pension Plan		Postretirement Benefit Plan	
Three Months Ended June 30,	2012	2011	2012	2011
Net periodic benefit cost				
Service cost	\$ 1,278	\$ 870	\$ 496	\$ 614
Interest cost	1,334	1,237	398	439
Expected return on plan assets	(1,360 )	(1,512 )	—	—
Amortization of prior service cost	—	3	(8 )	(2 )
Amortization of net loss	1,684	639	56	92
Net periodic benefit cost	\$ 2,936	\$ 1,237	\$ 942	\$ 1,143

(In Thousands)	Pension Plan		Postretirement Benefit Plan	
Six Months Ended June 30,	2012	2011	2012	2011
Net periodic benefit cost				
Service cost	\$ 2,069	\$ 1,583	\$ 992	\$ 993
Interest cost	2,524	2,380	796	795
Expected return on plan assets	(2,682 )	(2,644 )	—	—
Amortization of prior service cost	3	6	(17 )	(16 )
Amortization of net loss	2,276	1,184	112	112
Net periodic benefit cost	\$ 4,190	\$ 2,509	\$ 1,883	\$ 1,884

## Employer Contributions

We previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011 that we expected to contribute \$7.0 million to the pension plan for the 2012 plan year. For the six-month period ended June 30, 2012,

we contributed \$3.3 million to the pension plan. We anticipate that the total contribution for the 2012 plan year will not vary significantly from our expected contribution.

Table of Contents

## NOTE 5. STOCK-BASED COMPENSATION

## Non-qualified Employee Stock Award Plan

The United Fire Group, Inc. 2008 Stock Plan (the "2008 Stock Plan") authorizes the issuance of restricted and unrestricted stock awards, stock appreciation rights, incentive stock options, and non-qualified stock options for up to 1,900,000 shares of United Fire common stock to employees, with 564,716 authorized shares available for future issuance at June 30, 2012. The 2008 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 2008 Stock Plan. Pursuant to the 2008 Stock Plan, the Board of Directors may, at its sole discretion, grant awards to our employees who are in positions of substantial responsibility with United Fire.

Options granted pursuant to the 2008 Stock Plan are granted to buy shares of United Fire's common stock at the market value of the stock on the date of grant. All outstanding option awards vest and are exercisable in installments of 20.0 percent of the number of shares covered by the option award each year from the grant date, unless the Board of Directors authorizes the acceleration of vesting. 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 2008 Stock Plan are granted at the market value of our stock on the date of the grant. Restricted stock awards fully vest after 5 years from the date of issuance, unless accelerated upon the approval of the Board of Directors, at which time United Fire common stock will be issued to the awardee. All awards are generally granted free of charge to the eligible employees of United Fire as designated by the Board of Directors.

The activity in the 2008 Stock Plan is displayed in the following table:

Authorized Shares Available for Future Award Grants	Six Months Ended June 30, 2012	Inception to Date
Beginning balance	653,511	1,900,000
Number of awards granted	(97,895 )	(1,443,584 )
Number of awards forfeited or expired	9,100	108,300
Ending balance	564,716	564,716
Number of option awards exercised	20,025	198,042
Number of unrestricted stock awards granted	895	3,380
Number of restricted stock awards vested	—	—

## 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 and unrestricted stock awards and non-qualified stock options to purchase shares of United Fire's common stock to non-employee directors. At June 30, 2012, we had 130,012 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 and unrestricted 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. The Board of Directors may also take any action it deems necessary and appropriate for the administration of the Director Plan.

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

Table of Contents

Authorized Shares Available for Future Award Grants	Six Months Ended June 30, 2012	Inception to Date
Beginning balance	160,009	300,000
Number of awards granted	(29,997 )	(175,991 )
Number of awards forfeited or expired	—	6,003
Ending balance	130,012	130,012
Number of option awards exercised	—	—

## Stock-Based Compensation Expense

For the three-month periods ended June 30, 2012 and 2011, we recognized stock-based compensation expense of \$0.5 million and \$0.5 million, respectively. For the six-month periods ended June 30, 2012 and 2011, we recognized stock-based compensation expense of \$0.9 million and \$0.9 million, respectively.

As of June 30, 2012, we had \$3.7 million 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 2012 and subsequent years according to the following table, 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.

(In Thousands)

2012	\$800
2013	1,139
2014	863
2015	646
2016	191
2017	23
Total	\$3,662

## NOTE 6. SEGMENT INFORMATION

We have two reportable business segments in our operations: property and casualty insurance and life insurance. The property and casualty insurance segment has six domestic locations from which it conducts its business. All offices target a similar customer base, market the same products and use the same marketing strategies and are therefore aggregated. The life insurance segment operates from our home office. Because all of our insurance is sold domestically, we have no revenues allocable to foreign operations.

We evaluate the two segments on the basis of both statutory accounting practices prescribed or permitted by our states of domicile and GAAP. We analyze results based on profitability (i.e., loss ratios), expenses, and return on equity. The basis we use to determine and analyze segments and to measure segment profit or loss have not changed from that reported in our Annual Report on Form 10-K for the year ended December 31, 2011.

The following tables for the three-month periods ended June 30, 2012 and 2011 have been reconciled to the amounts reported in our unaudited Consolidated Financial Statements to adjust for intersegment eliminations.

Table of Contents

(In Thousands)	Property and Casualty Insurance	Life Insurance	Total
Three Months Ended June 30, 2012			
Net premiums earned	\$ 153,914	\$ 16,287	\$ 170,201
Investment income, net of investment expenses	11,762	17,029	28,791
Net realized investment gains (losses)	(582	) 1,193	611
Other income	96	147	243
Total reportable segment	\$ 165,190	\$ 34,656	\$ 199,846
Intersegment eliminations	(89	) (111	) (200
Total revenues	\$ 165,101	\$ 34,545	\$ 199,646
Net income	\$ 13,355	\$ 1,361	\$ 14,716
Assets	\$ 1,947,895	\$ 1,793,368	\$ 3,741,263
Invested assets	\$ 1,323,303	\$ 1,707,417	\$ 3,030,720
Three Months Ended June 30, 2011			
Net premiums earned	\$ 139,009	\$ 13,293	\$ 152,302
Investment income, net of investment expenses	9,495	18,350	27,845
Net realized investment gains	393	731	1,124
Other income	530	199	729
Total reportable segment	\$ 149,427	\$ 32,573	\$ 182,000
Intersegment eliminations	(44	) (152	) (196
Total revenues	\$ 149,383	\$ 32,421	\$ 181,804
Net income (loss)	\$ (19,574	) \$ 1,660	\$ (17,914
Assets	\$ 1,902,215	\$ 1,719,719	\$ 3,621,934
Invested assets	\$ 1,284,623	\$ 1,582,787	\$ 2,867,410



Table of Contents

The following tables for the six-month periods ended June 30, 2012 and 2011 have been reconciled to the amounts reported in our unaudited Consolidated Financial Statements to adjust for intersegment eliminations.

(In Thousands)	Property and Casualty Insurance	Life Insurance	Total
<b>Six Months Ended June 30, 2012</b>			
Net premiums earned	\$300,670	\$31,145	\$331,815
Investment income, net of investment expenses	22,440	35,537	57,977
Net realized investment gains	551	2,807	3,358
Other income	196	303	499
Total reportable segment	\$323,857	\$69,792	\$393,649
Intersegment eliminations	(82	) (222	) (304
Total revenues	\$323,775	\$69,570	\$393,345
Net income	\$29,991	\$3,909	\$33,900
Assets	\$1,947,895	\$1,793,368	\$3,741,263
Invested assets	\$1,323,303	\$1,707,417	\$3,030,720
<b>Six Months Ended June 30, 2011</b>			
Net premiums earned	\$240,773	\$25,825	\$266,598
Investment income, net of investment expenses	18,276	36,679	54,955
Net realized investment gains	1,601	2,176	3,777
Other income	538	347	885
Total reportable segment	\$261,188	\$65,027	\$326,215
Intersegment eliminations	(88	) (247	) (335
Total revenues	\$261,100	\$64,780	\$325,880
Net income (loss)	\$(16,224	) \$4,120	\$(12,104
Assets	\$1,902,215	\$1,719,719	\$3,621,934
Invested assets	\$1,284,623	\$1,582,787	\$2,867,410

Table of Contents

## NOTE 7. 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 and restricted stock 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 June 30, 2012 and 2011:

(In Thousands Except Per Share Data)	Three Months Ended June 30,			
	2012		2011	
	Basic	Diluted	Basic	Diluted
Net income (loss)	\$14,716	\$14,716	\$(17,914)	\$(17,914)
Weighted-average common shares outstanding	25,476	25,476	26,102	26,102
Add dilutive effect of restricted stock awards	—	57	—	—
Add dilutive effect of stock options	—	25	—	—
Weighted-average common shares for EPS calculation	25,476	25,558	26,102	26,102
Earnings (loss) per common share	\$0.58	\$0.58	\$(0.69)	\$(0.69)
Awards excluded from diluted EPS calculation <sup>(1)</sup>	—	1,103	—	1,206

(1) Outstanding awards excluded from the diluted earnings per share calculation because the effect of including them would have been anti-dilutive.

The components of basic and diluted earnings per share were as follows for the six-month periods ended June 30, 2012 and 2011:

(In Thousands Except Per Share Data)	Six Months Ended June 30,			
	2012		2011	
	Basic	Diluted	Basic	Diluted
Net income (loss)	\$33,900	\$33,900	\$(12,104)	\$(12,104)
Weighted-average common shares outstanding	25,491	25,491	26,148	26,148
Add dilutive effect of restricted stock awards	—	57	—	—
Add dilutive effect of stock options	—	31	—	—
Weighted-average common shares for EPS calculation	25,491	25,579	26,148	26,148
Earnings (loss) per common share	\$1.33	\$1.33	\$(0.46)	\$(0.46)
Awards excluded from diluted EPS calculation <sup>(1)</sup>	—	1,103	—	1,206

(1) Outstanding awards excluded from the diluted earnings per share calculation because the effect of including them would have been anti-dilutive.



Table of Contents

NOTE 8. DEBT

In the fourth quarter of 2011, United Fire entered into a credit agreement with a syndicate of financial institutions as lenders, KeyBank National Association as administrative agent, lead arranger, sole book runner, swingline lender, and letter of credit issuer, and Bankers Trust Company as syndication agent. The four-year credit agreement provides for a \$100.0 million unsecured revolving credit facility that includes a \$20.0 million letter of credit subfacility and a swing line subfacility in the amount of up to \$5.0 million.

During the term of this credit facility, we have the right to increase the total facility from \$100.0 million up to \$125.0 million if no event of default has occurred and is continuing and certain other conditions are satisfied. The credit facility is available for general corporate purposes, including working capital, acquisitions and liquidity purposes. Principal of the credit facility is due in full at maturity, on December 22, 2015. The interest rate is based on our monthly choice of either a base rate or the London Interbank Offered Rate (“LIBOR”) plus, in each case, a calculated margin amount. A commitment fee on each lender's unused commitment under the credit facility is also payable quarterly.

The credit agreement contains customary representations, covenants and events of default, including certain covenants that limit or restrict our ability to engage in certain activities. Subject to certain exceptions, these activities include restricting our ability to sell or transfer assets or enter into a merger or consolidate with another company, grant certain types of security interests, incur certain types of liens, impose restrictions on subsidiary dividends, enter into leaseback transactions, or incur certain indebtedness. The credit agreement contains certain financial covenants including covenants that require us to maintain a minimum consolidated net worth, a debt to capitalization ratio and minimum stockholders' equity.

The outstanding balance on the line of credit was \$45.0 million at June 30, 2012 at an interest rate of 2.0% percent. For the six-month period ended June 30, 2012, we have incurred \$0.6 million in interest expense related to this line of credit. We were in compliance with all covenants for the credit agreement at June 30, 2012.

In connection with our acquisition of Mercer Insurance Group, we acquired three issuances of trust preferred securities with an outstanding balance as of the acquisition date of \$15.5 million. During the six-month period ended June 30, 2012, we redeemed each of the issuances in full. We incurred \$0.5 million of interest expense related to these trust preferred securities for the six-month period ended June 30, 2012.

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
United Fire Group, Inc.

We have reviewed the consolidated balance sheet of United Fire Group, Inc. as of June 30, 2012, and the related consolidated statements of income and comprehensive income for the three-month and six-month periods ended June 30, 2012 and 2011, the consolidated statements of cash flows for the six-month periods ended June 30, 2012 and 2011, and the consolidated statement of stockholders' equity for the six-month period ended June 30, 2012. These financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information 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 Public Company Accounting Oversight Board, 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.

Based on our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above 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), the consolidated balance sheet of United Fire Group, Inc. as of December 31, 2011, and the related consolidated statements of income, stockholders' equity, and cash flows for the year then ended, not presented herein, and in our report dated March 15, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2011, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP  
Ernst & Young LLP

Chicago, Illinois  
August 8, 2012



made. Except as required under the federal securities laws and the rules and regulations of the Securities and Exchange Commission, 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

**CRITICAL ACCOUNTING ESTIMATES**

Critical accounting estimates 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 results of operations and financial condition on the amounts reported in our Consolidated Financial Statements, which we have prepared in accordance with 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 estimates are: the valuation of investments; the valuation of reserves for losses, claims, and loss settlement expenses and the related valuation of reinsurance recoverable on paid and unpaid losses; the valuation of reserves for future policy benefits; the calculation of the deferred policy acquisition costs asset; the recoverability of goodwill and other intangible assets; and the valuation of pension and postretirement benefit obligations. These critical accounting estimates are more fully described in our Management's Discussion and Analysis of Results of Operations and Financial Condition presented in our Annual Report on Form 10-K for the year ended December 31, 2011.

**INTRODUCTION**

The purpose of the Management's Discussion and Analysis is to provide an understanding of our results of operations and consolidated financial position. Our Management's Discussion and Analysis should be read in conjunction with our consolidated financial statements and related notes, including those in our Annual Report on Form 10-K for the year ended December 31, 2011. When we provide information on a statutory basis, we label it as such, otherwise, all other data is presented in accordance with GAAP.

This discussion and analysis is presented in these sections:

Our Business

Consolidated Financial Highlights

Results of Operations for Property and Casualty Insurance, Life Insurance and Investment Portfolio

Liquidity and Capital Resources

Measurement of Results

**OUR BUSINESS**

Founded in 1946 as United Fire & Casualty Company, we provide insurance protection for individuals and businesses through several regional companies. We are licensed as a property and casualty insurer in 43 states plus the District of Columbia and are represented by more than 1,200 independent agencies. Our life insurance subsidiary is licensed in 36 states and is represented by more than 900 independent agencies.

**Segments**

We operate two business segments, each with a wide range of products:

-



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

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

## Table of Contents

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

For the six-month period ended June 30, 2012, property and casualty business accounted for 90.7 percent of our net premiums earned, of which 89.7 percent was generated from commercial lines. Life insurance business made up 9.3 percent of our net premiums earned, of which 68.7 percent was generated from traditional life insurance products.

### Pooling Arrangement

All of our property and casualty insurance subsidiaries, with the exception of Texas General Indemnity Company, are members of an intercompany reinsurance pooling arrangement. The insurance entities of Mercer Insurance Group participated in their own pooling arrangement in 2011, which was in place when we acquired Mercer Insurance Group on March 28, 2011. Effective January 1, 2012, one pooling arrangement covers all participating insurance subsidiaries of United Fire Group, Inc. Pooling arrangements permit the participating companies to rely on the capacity of the entire pool's capital and surplus, rather than being limited to policy exposures of a size commensurate with each participant's own surplus level.

### Geographic Concentration

For the six-month period ended June 30, 2012, more than half of our property and casualty direct premiums were written in Iowa, Texas, California, New Jersey, and Missouri, and over three-fourths of our life insurance premiums, excluding annuities, were written in Iowa, Nebraska, Illinois, Wisconsin, and Minnesota.

### Segment Revenue and Expense

We evaluate segment profit or loss based upon operating and investment results. Segment profit or loss described in the following sections of the Management's Discussion and Analysis is reported on a pre-tax basis. Additional segment information is presented in Part I, Item 1, Note 6 "Segment Information" to the unaudited Consolidated Financial Statements.

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

#### Profit Factors

The profitability of our company is influenced by many factors, including price, competition, economic conditions, interest rates, catastrophic events and other natural disasters, man-made disasters, state regulations, court decisions, and changes in the law. Unless a connection between future increased extreme weather events and climate change is ultimately proven true, management believes that climate change considerations will not have a material impact on our profitability.

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, and effective and efficient use of technology.

Table of Contents

## CONSOLIDATED FINANCIAL HIGHLIGHTS

(In Thousands)	Three Months Ended June 30,			Six Months Ended June 30,				
	2012	2011	%	2012	2011 <sup>(1)</sup>	%		
Revenues								
Net premiums earned	\$ 170,090	\$ 152,210	11.7	%	\$ 331,593	\$ 266,414	24.5	%
Investment income, net of investment expenses	28,749	27,741	3.6		57,895	54,804	5.6	
Net realized investment gains								
Other-than-temporary impairment charges	(4 )	—	NM <sup>(2)</sup>		(4 )	—	NM <sup>(2)</sup>	
All other net realized gains	568	1,124	(49.5 )		3,362	3,777	(11.0 )	
Net realized investment gains	564	1,124	(49.8 )		3,358	3,777	(11.1 )	
Other income	243	729	(66.7 )		499	885	(43.6 )	
	\$ 199,646	\$ 181,804	9.8	%	\$ 393,345	\$ 325,880	20.7	%
Benefits, Losses and Expenses								
Losses and loss settlement expenses	\$ 106,766	\$ 135,811	(21.4 )	%	\$ 198,250	\$ 211,993	(6.5 )	%
Future policy benefits	8,356	7,880	6.0		18,494	16,062	15.1	
Amortization of deferred policy acquisition costs	34,179	43,732	(21.8 )		68,730	69,778	(1.5 )	
Other underwriting expenses	20,541	14,720	39.5		42,535	30,777	38.2	
Interest on policyholders' accounts	10,627	10,657	(0.3 )		21,283	21,327	(0.2 )	
	\$ 180,469	\$ 212,800	(15.2 )	%	\$ 349,292	\$ 349,937	(0.2 )	%
Income (loss) before income taxes	\$ 19,177	\$ (30,996 )	161.9	%	\$ 44,053	\$ (24,057 )	NM <sup>(2)</sup>	
Federal income tax expense (benefit)	4,461	(13,082 )	134.1		10,153	(11,953 )	184.9	%
Net income (Loss)	\$ 14,716	\$ (17,914 )	182.1	%	\$ 33,900	\$ (12,104 )	NM <sup>(2)</sup>	

(1) The information presented for 2011 includes Mercer Insurance Group's results after the March 28, 2011 acquisition date.

(2) Not meaningful.

The following is a summary of our financial performance for the three- and six-month periods ended June 30, 2012:

## Consolidated Results of Operations

- For the three-month period ended June 30, 2012, net income was \$14.7 million, compared to a net loss of \$17.9 million for the same period of 2011. The improvement is primarily due to the following:

Net premiums earned increased to \$170.1 million, compared to \$152.2 million for the same period of 2011. This increase represents organic growth and is the result of a combination of rate increases across most commercial and personal lines, modest growth in premium audit collections, and new business writings.

Losses and loss settlement expenses decreased to \$106.8 million, compared to \$135.8 million for the same period of 2011. This decrease is due primarily to reduced catastrophe loss experience. In 2011 we incurred significant catastrophe losses from storms that occurred in the southern states and Joplin, Missouri.

For the six-month period ended June 30, 2012, net income was \$33.9 million, compared to a net loss of \$12.1 million for the same period of 2011. The improvement is primarily due to the following:

Net premiums earned increased to \$331.6 million, compared to \$266.4 million for the same period of 2011 due primarily to the acquisition of Mercer Insurance Group in March 2011, which accounted for \$34.9 million of additional earned premium. Our organic growth was \$30.3 million over the same period of 2011.

Table of Contents

Losses and loss settlement expenses decreased to \$198.3 million for the six-month period ended June 30, 2012, compared to \$212.0 million for the same period of 2011. The decrease is due to reduced catastrophe loss experience offset in part by the acquisition of Mercer Insurance Group in March 2011, which accounted for \$24.7 million of additional incurred losses and loss settlement expenses as compared to the same period of 2011.

Pre-tax catastrophe losses totaled \$12.0 million and \$26.1 million for the three- and six-month periods ended June 30, 2012, compared to \$36.9 million and \$53.1 million in the same periods of 2011. In 2011 we incurred significant catastrophe losses from storms that occurred in the southern states and Joplin, Missouri, as well as assumed reinsurance losses related to the New Zealand earthquakes and the earthquake and tsunami in Japan.

Effective January 1, 2012, we elected to adopt the updated accounting guidance that limits the amount of underwriting expenses eligible for deferral on a prospective basis. The adoption of the updated accounting guidance resulted in the recognition of approximately \$8.1 million (\$7.2 million for our property and casualty insurance segment; \$0.9 million for our life insurance segment) of expense in the six-month period ended June 30, 2012 that we would not have recognized had the accounting guidance remained unchanged. This represents a reduction to net income of \$0.21 per share. Refer to the results of operations section of this item for further discussion of the impact of the updated accounting guidance related to deferred policy acquisition costs on our reported results.

Consolidated Financial Condition

Deferred annuity deposits decreased 13.0 percent and increased 13.0 percent for the three- and six-month periods ended June 30, 2012, compared to the same periods of 2011. We attribute the fluctuations to the impact of the low interest rate environment on credited interest rates and customer demand. While deferred annuity deposits are not recorded as a component of net premiums written or net premiums earned, they do generate investment income.

Net cash outflow related to our annuity business was \$5.3 million and \$5.6 million in the three- and six-month periods ended June 30, 2012, compared to a net cash inflow of \$3.6 million and a net cash outflow of \$2.6 million in the same periods of 2011. We attribute this to the activity described in the prior bullet point.

As of June 30, 2012, the book value per share of our common stock was \$28.91. We repurchased 101,901 shares in the three- and six-month periods ended June 30, 2012. Under our share repurchase program, which expires in August 2014, we are authorized to purchase an additional 1,367,978 shares of common stock.

Net unrealized investment gains totaled \$136.7 million as of June 30, 2012, an increase of \$12.3 million, net of tax, or 9.9 percent since December 31, 2011. The increase in unrealized gains resulted from an increase in the fair value of both our fixed maturity and equity portfolios.

Our stockholders' equity increased to \$735.4 million at June 30, 2012, from \$696.1 million at December 31, 2011. The increase was primarily attributable to net income of \$33.9 million and net unrealized investment gains of \$12.3 million, net of tax, less stockholder dividends of \$7.6 million.

Table of Contents

## RESULTS OF OPERATIONS

## Property and Casualty Insurance Segment Results

(In Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011 <sup>(1)</sup>
Net premiums written <sup>(2)</sup>	\$180,237	\$159,027	\$344,870	\$269,753
Net premiums earned	\$153,914	\$139,009	\$300,670	\$240,773
Losses and loss settlement expenses	(100,220 )	(130,124 )	(187,530 )	(201,789 )
Amortization of deferred policy acquisition costs	(31,882 )	(41,086 )	(64,295 )	(65,116 )
Other underwriting expenses	(16,153 )	(11,800 )	(34,021 )	(24,526 )
Underwriting gain (loss) <sup>(2)</sup>	\$5,659	\$(44,001 )	\$14,824	\$(50,658 )
Investment income, net of investment expenses	11,720	9,451	22,358	18,188
Net realized investment gains (losses)				
Other-than-temporary impairment charges	(4 )	—	(4 )	—
All other net realized gains (losses)	(625 )	393	555	1,601
Net realized investment gains (losses)	(629 )	393	551	1,601
Other income	96	530	196	538
Income (loss) before income taxes	\$16,846	\$(33,627 )	\$37,929	\$(30,331 )
GAAP Ratios:				
Net loss ratio	57.3	% 67.1	% 53.7	% 61.8
Catastrophes - effect on net loss ratio	7.8	26.5	8.7	22.0
Net loss ratio	65.1	% 93.6	% 62.4	% 83.8
Expense ratio <sup>(3)</sup>	31.2	38.1	32.7	37.2
Combined ratio	96.3	% 131.7	% 95.1	% 121.0

(1) The information presented for 2011 includes Mercer Insurance Group's results after the March 28, 2011 acquisition date.

(2) The Measurement of Results section of this report defines data prepared in accordance with statutory accounting practices, which is a comprehensive basis of accounting other than U.S. GAAP.

(3) Includes policyholder dividends.

Net premiums earned increased 10.7 percent in the second quarter of 2012, compared to the second quarter of 2011, due to:

Organic growth - The increase in our net premiums earned is the result of a combination of rate increases across most lines, modest growth in premium audit collections, and new business writings.

Commercial lines renewal pricing was steady to slightly higher for the third consecutive quarter, with average increases in the mid-single digits. Competitive market conditions continued to ease on renewals, but persisted on new business during the quarter.

Personal lines pricing has improved, with larger mid- to upper-single digit increases for homeowners and smaller increases for personal auto.

Policy retention rates remained strong for both commercial and personal lines.

GAAP combined ratio decreased by 35.4 percentage points and 25.9 percentage points for the three- and six-month periods ended June 30, 2012, compared with the same periods in 2011. This improvement is attributable to the following:

Net loss ratio, a component of the combined ratio, decreased by 28.5 percentage points and 21.4 percentage points in the three- and six-month periods ended June 30, 2012, as compared to the

Table of Contents

same periods in 2011. The improvement is due primarily to reduced catastrophe loss experience. In 2011 we incurred significant catastrophe losses from storms that occurred in the southern states and Joplin, Missouri as well as assumed reinsurance losses related to the New Zealand earthquakes and the earthquake and tsunami in Japan.

Expense ratio, a component of the combined ratio, decreased 6.9 percentage points and 4.5 percentage points for the three- and six-month periods ended June 30, 2012, as compared to the same periods in 2011. The expenses associated with the acquisition of the Mercer Insurance Group increased the 2011 reported expense ratio.

Accounting rules related to deferred policy acquisition costs - Effective January 1, 2012, we elected to adopt the updated accounting guidance related to deferred policy acquisition costs on a prospective basis. As a result, the amount of underwriting expenses eligible for deferral has decreased. After consideration of our normal recovery assessment, which we refer to as a premium deficiency charge, and the amortization pattern of our deferred policy acquisition costs, we recognized approximately \$3.5 million and \$7.2 million of expense in the three- and six-month periods ended June 30, 2012 that we would not have recognized had the guidance remained unchanged.

The impact of the adoption of the updated accounting guidance on our results for the full year will be influenced by a number of factors including: the volume of premiums written; our assessment of successful acquisition efforts; the profitability of our lines of property and casualty business, which impacts the level of premium deficiency charge recorded; and the normal amortization pattern of these deferred policy acquisition costs, which is generally over one year. The greatest impact will be experienced in the most current quarter as the recorded deferred policy acquisitions costs would amortize to expense in succeeding quarters to offset a portion of the initial impact when assessed on an annual basis. Accordingly, the impact of the adoption of the updated accounting guidance on our results reported for the three- and six-month periods ended June 30, 2012 should not be considered to be representative of the impact for the full year.

For a detailed discussion of our consolidated investment results, refer to the “Investment Portfolio” section of this item.



Table of Contents

The following tables display our premiums earned, losses and loss settlement expenses and loss ratio by line of business:

Three Months Ended June 30,

(In Thousands)	2012			2011 <sup>(4)</sup>			Loss Ratio	
	Net Premiums Earned	Losses and Loss Settlement Expenses Incurred	Loss Ratio	Net Premiums Earned	Losses and Loss Settlement Expenses Incurred	Loss Ratio		
<b>Commercial lines</b>								
Other liability <sup>(1)</sup>	\$48,597	\$19,866	40.9	% \$42,897	\$21,944	51.2	%	
Fire and allied lines <sup>(2)</sup>	32,245	31,489	97.7	30,394	55,694	183.2		
Automobile	33,089	27,919	84.4	29,891	17,697	59.2		
Workers' compensation	16,853	7,835	46.5	13,457	11,668	86.7		
Fidelity and surety	4,118	(311 )	(7.6 )	3,844	28	0.7		
Miscellaneous	245	63	25.7	208	168	80.8		
<b>Total commercial lines</b>	<b>\$135,147</b>	<b>\$86,861</b>	<b>64.3</b>	<b>% \$120,691</b>	<b>\$107,199</b>	<b>88.8</b>	<b>%</b>	
<b>Personal lines</b>								
Fire and allied lines <sup>(3)</sup>	\$10,079	\$7,257	72.0	% \$9,789	\$17,310	176.8	%	
Automobile	5,056	4,301	85.1	4,918	4,107	83.5		
Miscellaneous	234	(69 )	(29.5 )	222	101	45.5		
<b>Total personal lines</b>	<b>\$15,369</b>	<b>\$11,489</b>	<b>74.8</b>	<b>% \$14,929</b>	<b>\$21,518</b>	<b>144.1</b>	<b>%</b>	
Reinsurance assumed	\$3,398	\$1,870	55.0	% \$3,389	\$1,407	41.5	%	
<b>Total</b>	<b>\$153,914</b>	<b>\$100,220</b>	<b>65.1</b>	<b>% \$139,009</b>	<b>\$130,124</b>	<b>93.6</b>	<b>%</b>	

(1) "Other liability" is business insurance covering bodily injury and property damage arising from general business operations, accidents on the insured's premises, and products manufactured or sold.

(2) "Fire and allied lines" includes fire, allied lines, commercial multiple peril, and inland marine.

(3) "Fire and allied lines" includes fire, allied lines, homeowners, and inland marine.

(4) The Form 10-Q we filed on August 5, 2011 and the Form 8-K we filed on August 6, 2012, contained a misclassification between two lines of business for net premiums earned and losses and loss settlement expenses incurred. The two lines of business affected were other liability and fire and allied lines. Those reports showed net premiums earned, losses and loss settlement expenses incurred, and loss ratio of \$29,021, \$10,629 and 36.6%, respectively, for other liability, and net premiums earned, losses and loss settlement expenses incurred, and loss ratio of \$44,270, \$67,009 and 151.4%, respectively, for fire and allied lines. The reclassification for these lines shown in this table reflect a reclassification to other liability from fire and allied lines of \$13,876 in net premiums earned and \$11,315 in losses and loss settlement expenses incurred. The reclassification had no impact on net income.

Table of Contents

Six Months Ended June 30,

	2012			2011 <sup>(1)(3)</sup>				
(In Thousands)	Net	Losses and Loss Settlement		Net	Losses and Loss Settlement			
Unaudited	Premiums	Expenses	Loss	Premiums	Expenses	Loss		
Commercial lines	Earned	Incurred	Ratio	Earned	Incurred	Ratio		
Other liability	\$94,717	\$42,214	44.6	%	\$70,826	\$33,125	46.8	%
Fire and allied lines	63,791	57,331	89.9		54,292	75,362	138.8	
Automobile	64,698	51,188	79.1		52,585	31,355	59.6	
Workers' compensation	32,462	13,327	41.1		25,095	21,559	85.9	
Fidelity and surety	8,415	(355)	(4.2)	)	7,905	19	0.2	
Miscellaneous	477	64	13.4		411	385	93.7	
Total commercial lines	\$264,560	\$163,769	61.9	%	\$211,114	\$161,805	76.6	%
Personal lines								
Fire and allied lines	\$20,232	\$10,875	53.8	%	\$16,036	\$19,509	121.7	%
Automobile	10,185	7,437	73.0		8,662	5,970	68.9	
Miscellaneous	456	116	25.4		345	103	29.9	
Total personal lines	\$30,873	\$18,428	59.7	%	\$25,043	\$25,582	102.2	%
Reinsurance assumed	\$5,237	\$5,333	101.8	%	\$4,616	\$14,402	NM <sup>(2)</sup>	
Total	\$300,670	\$187,530	62.4	%	\$240,773	\$201,789	83.8	%

(1) The information presented for 2011 includes Mercer Insurance Group's results after the March 28, 2011 acquisition date.

(2) Not meaningful

(3) The Form 10-Q we filed on August 5, 2011 and the Form 8-K we filed on August 6, 2012, contained a misclassification between two lines of business for net premiums earned and losses and loss settlement expenses incurred. The two lines of business affected were other liability and fire and allied lines. Those reports showed net premiums earned, losses and loss settlement expenses incurred, and loss ratio of \$56,950, \$21,810 and 38.3%, respectively, for other liability, and net premiums earned, losses and loss settlement expenses incurred, and loss ratio of \$68,168, \$86,677 and 127.2%, respectively, for fire and allied lines. The reclassification for these lines shown in this table reflect a reclassification to other liability from fire and allied lines of \$13,876 in net premiums earned and \$11,315 in losses and loss settlement expenses incurred. The reclassification had no impact on net income.

Commercial fire and allied lines - The loss ratio improved by 85.5 percentage points and 48.9 percentage points to 97.7 percent and 89.9 percent in the three- and six-month periods ended June 30, 2012, compared to the same periods of 2011. The improvement in this line was due to the reduction in our catastrophe loss experience.

Commercial automobile - The loss ratio deteriorated by 25.2 percentage points and 19.5 percentage points to 84.4 percent and 79.1 percent in the three- and six-month periods ended June 30, 2012, compared to the same periods of 2011. The deterioration in this line was due to an influx of severe losses in the West Coast commercial automobile book of business.

- Workers' compensation - The loss ratio improved by 40.2 percentage points and 44.8 percentage points to 46.5 percent and 41.1 percent in the three- and six-month periods ended June 30, 2012, compared to the same

periods of 2011. The improvement in this line reflects the high severity and frequency that occurred in 2011, as well as adverse development incurred in 2011 on claims that occurred in 2010.

Personal fire and allied lines - The loss ratio improved by 104.8 percentage points and 67.9 percentage points to 72.0 percent and 53.8 percent in the three- and six-month periods ended June 30, 2012, compared to the same periods of 2011. The improvement in this line was due to the reduction in our catastrophe loss experience.

Table of Contents

## Life Insurance Segment Results

(In Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
<b>Revenues</b>				
Net premiums earned	\$16,176	\$13,201	\$30,923	\$25,641
Investment income, net	17,029	18,290	35,537	36,616
Net realized investment gains	1,193	731	2,807	2,176
Other income	147	199	303	347
<b>Total revenues</b>	<b>\$34,545</b>	<b>\$32,421</b>	<b>\$69,570</b>	<b>\$64,780</b>
<b>Benefits, Losses and Expenses</b>				
Losses and loss settlement expenses	\$6,546	\$5,687	\$10,720	\$10,204
Future policy benefits	8,356	7,880	18,494	16,062
Amortization of deferred policy acquisition costs	2,297	2,646	4,435	4,662
Other underwriting expenses	4,388	2,920	8,514	6,251
Interest on policyholders' accounts	10,627	10,657	21,283	21,327
<b>Total benefits, losses and expenses</b>	<b>\$32,214</b>	<b>\$29,790</b>	<b>\$63,446</b>	<b>\$58,506</b>
<b>Income before income taxes</b>	<b>\$2,331</b>	<b>\$2,631</b>	<b>\$6,124</b>	<b>\$6,274</b>

Net income decreased by \$0.3 million and \$0.2 million in the three- and six-month periods ended June 30, 2012, respectively, as compared to the same periods of 2011 as a result of the following factors:

Net premiums earned increased 22.5 percent and 20.6 percent in the three- and six-month periods ended June 30, 2012, respectively, as compared to the same periods of 2011. This was due to increased sales of our single premium whole life product.

Investment income decreased 6.9 percent and 2.9 percent in the three- and six-month periods ended June 30, 2012, respectively, as compared to the same periods of 2011. Interest rates continued to remain at historically low levels, reducing both our investment income and margin on earnings. We are maintaining our investment philosophy of purchasing quality investments rated investment grade or better and are more closely matching the duration of our investment portfolio to our liabilities. Additionally, we regularly review our annuity products to ensure we are pricing them appropriately for this low interest rate environment.

Loss and loss settlement expenses increased 15.1 percent and 5.1 percent in the three- and six-month periods ended June 30, 2012, respectively, as compared to the same periods of 2011, due to an increase in both annuity benefits and traditional life insurance death benefits.

Future policy benefits increased 6.0 percent and 15.1 percent in the three- and six-month periods ended June 30, 2012, respectively, as compared to the same periods of 2011, due to an increase in sales as mentioned above and the demographics of our insureds.

Deferred annuity deposits decreased 13.0 percent for the three-month period ended June 30, 2012 and increased 13.0 percent for the six-month period ended June 30, 2012, as compared with the same periods in 2011; this reflects the impact on pricing of the low interest rate environment. While deferred annuity deposits are not recorded as a component of net premiums written or net premiums earned, they do generate investment income.

Net cash outflow related to our annuity business was \$5.3 million and \$5.6 million in the three- and six-month periods ended June 30, 2012, compared to a net cash inflow of \$3.6 million and a net cash outflow of \$2.6 million in the same periods of 2011. We attribute this to the activity described in the prior bullet point.

Table of Contents

## Investment Portfolio

Our invested assets totaled \$3,030.7 million at June 30, 2012, compared to \$2,908.0 million at December 31, 2011, an increase of \$122.7 million, which is due primarily to an overall change in strategy to keep less cash on hand in the low interest rate environment. If extra cash is needed we have an ability to borrow funds available under our revolving credit facility.

At June 30, 2012, fixed maturity securities and equity securities comprised 93.0 percent and 5.8 percent of the value of our investment portfolio, respectively. Because the primary purpose of our investment portfolio is to fund future claims payments, we follow 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.

## 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 and regulatory requirements. 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.

The composition of our investment portfolio at June 30, 2012, is presented at carrying value in the following table:

(Dollars in Thousands)	Property & Casualty Insurance Segment		Life Insurance Segment		Total			
		Percent of Total		Percent of Total		Percent of Total		
Fixed maturities <sup>(1)</sup>	\$ 1,130,954	85.5	% \$ 1,673,534	98.0	% \$ 2,804,488	92.5	%	
Equity securities	155,937	11.8	18,422	1.1	174,359	5.8		
Trading securities	14,249	1.1	—	—	14,249	0.5		
Mortgage loans	—	—	4,732	0.3	4,732	0.2		
Policy loans	—	—	7,393	0.4	7,393	0.2		
Other long-term investments	21,063	1.5	3,336	0.2	24,399	0.8		
Short-term investments	1,100	0.1	—	—	1,100	—		
Total	\$ 1,323,303	100.0	% \$ 1,707,417	100.0	% \$ 3,030,720	100.0	%	

(1) Available-for-sale fixed maturities are carried at fair value. Held-to-maturity fixed maturities are carried at amortized cost.

At June 30, 2012, we classified \$2,800.6 million, or 99.4 percent, of our fixed maturities portfolio as available-for-sale, compared to \$2,697.2 million, or 99.4 percent, at December 31, 2011. We classify our remaining fixed maturities as held-to-maturity or trading. We record held-to-maturity securities at amortized cost. We record trading securities, primarily convertible redeemable preferred debt securities, at fair value, with any changes in fair value recognized in earnings.

As of June 30, 2012 and December 31, 2011, we did not have direct exposure to investments in subprime mortgages or other credit enhancement vehicles.

## Credit Quality

The following table shows the composition of fixed maturity securities held in our available-for-sale, held-to-maturity and trading security portfolios, by credit rating at June 30, 2012 and December 31, 2011. Information contained in the table is generally based upon the issue credit ratings provided by Moody's, unless the rating is unavailable, in which

case we obtain it from Standard & Poor's.

41

---

Table of Contents

(In Thousands)	June 30, 2012		December 31, 2011		
Rating	Carrying Value	% of Total	Carrying Value	% of Total	
AAA	\$397,533	14.1	\$409,124	15.0	%
AA	639,768	22.7	631,250	23.3	
A	683,869	24.3	626,927	23.1	
Baa/BBB	1,009,607	35.8	929,188	34.2	
Other/Not Rated	87,960	3.1	118,356	4.4	
	\$2,818,737	100.0	\$2,714,845	100.0	%

## Duration

Our investment portfolio is comprised primarily of 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 claims liabilities. If our invested assets and claims 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 claims 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.

## Group

The weighted average effective duration of our portfolio of fixed maturity securities, at June 30, 2012, is 4.0 years compared to 3.6 years at December 31, 2011.

## Property and Casualty Insurance Segment

The weighted average effective duration of our portfolio of fixed maturity securities, at June 30, 2012, is 4.2 years compared to 4.0 years at December 31, 2011.

## Life Insurance Segment

The weighted average effective duration of our portfolio of fixed maturity securities, at June 30, 2012 is 3.9 years compared to 3.4 years at December 31, 2011.

## 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, changes in 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. In our life insurance segment, net investment income decreased 6.9 percent and 2.9 percent in the three- and six-month periods ended June 30, 2012, compared with the same periods of 2011, due to historically low yields that reduce both our investment income and margin on earnings. We are maintaining our investment philosophy of purchasing quality investments rated investment grade or better, and we are more closely matching the duration of our investment portfolio to our liabilities.

In our property and casualty insurance segment, our acquisition of Mercer Insurance Group and an increase in the value of our investments in limited liability partnerships contributed to the increase of 24.0 percent and 22.9 percent in net investment income in the three- and six-month periods ended June 30, 2012, respectively, compared to with the same periods of 2011. The increases were somewhat offset by the impact of low interest rates. Our property and casualty insurance segment holds certain investments in limited liability partnerships that are accounted for under the



equity method of accounting, with changes in the value of these investments recorded in investment income. We regularly monitor the difference between our cost basis and the estimated fair value of our investments. Our

Table of Contents

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 June 30, 2012, are temporary based upon our current analysis of the issuers of the securities that we hold and current market events. It is possible that we could recognize impairment charges in future periods on securities that we own at June 30, 2012, 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.

**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 premiums, annuity deposits, reinsurance recoveries, sales or maturities of investments, and investment income. Cash provided from these sources is used primarily to fund the payment of losses and loss settlement expenses, policyholder benefits under life insurance contracts, annuity withdrawals, operating expenses, dividends, pension plan contributions, and in recent years, common stock repurchases. 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 correlate to the anticipated timing of payments for losses and loss settlement expenses of the underlying insurance policies. The majority of our assets are invested in available-for-sale fixed maturity securities.

The following table displays a summary of cash sources and uses in 2012 and 2011.

Cash Flow Summary (In Thousands)	Six Months Ended June 30,	
	2012	2011
Cash provided by (used in)		
Operating activities	\$75,145	\$40,790
Investing activities	(101,429)	(123,782)
Financing activities	(16,265)	80,349
Net decrease in cash and cash equivalents	\$(42,549)	\$(2,643)
Operating Activities		

Net cash flows provided by operating activities totaled \$75.1 million and \$40.8 million for the six-month periods ended June 30, 2012 and 2011, respectively. Cash flows for the six-month period ended June 30, 2012, reflected a higher level of property and casualty insurance premiums collected, which was offset by loss and loss settlement expense payments and operating expenses paid, compared to the same period of 2011.

Our cash flows from operations were sufficient to meet our liquidity needs for the six-month periods ended June 30, 2012 and 2011.



Table of Contents

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 discussion of our investments, including our philosophy and portfolio, see the "Investment Portfolio" section contained in this item. 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, \$1.3 billion, or 45.2 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 June 30, 2012, our cash and cash equivalents included \$38.4 million related to these money market accounts, compared to \$62.9 million at December 31, 2011.

Net cash flows used in investing activities totaled \$101.4 million and \$123.8 million for the six-month periods ended June 30, 2012 and 2011, respectively. In the six-month period ended June 30, 2012, we had cash inflows from scheduled and unscheduled investment maturities, redemptions, prepayments, and sales of investments that totaled \$318.9 million compared to \$339.9 million for the same period in 2011.

Our cash outflows for investment purchases totaled \$419.5 million for the six-month period ended June 30, 2012, compared to \$294.5 million for the same period in 2011. In 2012, we purchased a higher level of fixed maturity securities than we have historically purchased. Such securities are more profitable than other investment vehicles when market interest rates are low.

Financing Activities

Net cash flows used in financing activities totaled \$16.3 million for the six-month period ended June 30, 2012 compared to net cash flows provided of \$80.3 million for the six-month period ended June 30, 2011. In the six-month period ended June 30, 2012 we fully repaid the \$15.6 million of trust preferred securities outstanding at December 31, 2011. For further discussion of our outstanding debt at June 30, 2012, please see Part I, Item 1, Note 8 "Debt." In the six-month period ended June 30, 2011, we borrowed short-term debt totaling \$79.9 million related to our acquisition of Mercer Insurance Group.

In the six-month period ended June 30, 2012, net cash inflows from our life insurance segment's annuity and universal life deposits totaled \$8.8 million, compared to \$14.2 million for the same period of 2011. This reflects the impact on pricing of the low interest rate environment.

## Table of Contents

### Credit Facilities

In the fourth quarter of 2011, United Fire entered into a credit agreement with a syndicate of financial institutions as lenders, KeyBank National Association as administrative agent, lead arranger, sole book runner, swingline lender and letter of credit issuer, and Bankers Trust Company as syndication agent. The four-year credit agreement provides for a \$100.0 million unsecured revolving credit facility that includes a \$20.0 million letter of credit subfacility and a swing line subfacility in the amount of up to \$5.0 million.

During the term of this credit facility, we have the right to increase the total facility from \$100.0 million up to \$125.0 million if no event of default has occurred and is continuing and certain other conditions are satisfied. The credit facility is available for general corporate purposes, including working capital, acquisitions and liquidity purposes. Principal of the credit facility is due in full at maturity, on December 22, 2015. The interest rate is based on our monthly choice of either a base rate or the London Interbank Offered Rate ("LIBOR") plus, in each case, a calculated margin amount. A commitment fee on each lender's unused commitment under the credit facility is also payable quarterly.

The credit agreement contains customary representations, covenants and events of default, including certain covenants that limit or restrict our ability to engage in certain activities. Subject to certain exceptions, these activities include restricting our ability to sell or transfer assets or enter into a merger or consolidate with another company, grant certain types of security interests, incur certain types of liens, impose restrictions on subsidiary dividends, enter into leaseback transactions, or incur certain indebtedness. The credit agreement contains certain financial covenants including covenants that require us to maintain a minimum consolidated net worth, a debt to capitalization ratio and minimum stockholders' equity.

As of June 30, 2012, we were in compliance with all covenants of the credit agreement.

### Stockholders' Equity

Stockholders' equity increased 5.6 percent to \$735.4 million at June 30, 2012, from \$696.1 million at December 31, 2011. The increase was primarily attributable to net income of \$33.9 million and an increase in net unrealized investment gains of \$12.3 million, net of tax, less stockholder dividends of \$7.6 million. As of June 30, 2012, the book value per share of our common stock was \$28.91 compared to \$27.29 at December 31, 2011.

### Off-Balance Sheet Arrangements

Pursuant to an agreement with one of our limited liability partnership investments, we are contractually committed to make capital contributions up to \$15.0 million, upon request by the partnership, through December 31, 2017. Our remaining potential contractual obligation was \$7.4 million at June 30, 2012.

## MEASUREMENT OF RESULTS

Our consolidated financial statements are prepared on the basis of GAAP. We also prepare financial statements for each of our insurance subsidiaries based on statutory accounting principles and file them with insurance regulatory authorities in the states where they do business.

Management evaluates our operations by monitoring key measures of growth and profitability. We believe that disclosure of certain Non-GAAP financial measures enhances investor understanding of our financial performance.

The following provides further explanation of the key measures management uses to evaluate our results:

Premiums written is a statutory measure of our overall business volume. Premiums written is an important measure of business production for the period under review. Net premiums written comprise direct and assumed premiums written, less ceded premiums written. Direct premiums written is the amount of premiums charged for policies issued during the period. For the property and casualty insurance segment there are no differences between direct statutory premiums written and direct premiums written under GAAP. However, for the life insurance segment, deferred annuity deposits (i.e., sales) are included in direct statutory premiums written, whereas they are excluded

Table of Contents

for GAAP.

Assumed premiums written is consideration or payment we receive in exchange for insurance we provide to other insurance companies. We report these premiums as revenue as they are earned over the underlying policy period.

Ceded premiums written is the portion of direct premiums written that we cede to our reinsurers under our reinsurance contracts.

(In Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011 <sup>(1)</sup>
Net premiums written	\$196,395	\$172,196	\$375,775	\$295,355
Net change in unearned premium	(26,078 )	(20,453 )	(41,306 )	(29,543 )
Net change in prepaid reinsurance premium	(227 )	467	(2,876 )	602
Net premiums earned	\$170,090	\$152,210	\$331,593	\$266,414

(1) The information presented for 2011 includes Mercer Insurance Group's results after the March 28, 2011 acquisition date.

Combined ratio is a commonly used statutory financial measure of property and casualty underwriting performance. The combined ratio is the sum of two separately calculated ratios, the loss and loss settlement expense ratio (the “net loss ratio”) and the underwriting expense ratio (the “expense ratio”). A combined ratio below 100.0 percent generally indicates a profitable book of business. If the combined ratio is at or above 100.0 percent, an insurance company is not underwriting profitably and may not be profitable unless investment income is sufficient to offset underwriting losses. When prepared in accordance with GAAP, the net loss ratio is calculated as the ratio of losses and loss settlement expenses incurred to net premiums earned, and measures the underwriting profitability of a company’s insurance business. 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 Consolidated Financial Statements.

When prepared in accordance with GAAP, the underwriting expense ratio is calculated as the ratio of amortization of deferred policy acquisition costs and nondeferred underwriting expenses to net premiums earned. The underwriting expense ratio measures a company’s operational efficiency in producing, underwriting and administering its insurance business.

When prepared in accordance with statutory accounting principles, the net loss ratio is calculated by dividing the sum of losses and loss settlement expenses by net premiums earned, and the expense ratio is calculated by dividing underwriting expenses by net premiums written.

Catastrophe losses is a commonly used non-GAAP financial measure, which utilize the designations of the Insurance Services Office (ISO) and are reported with loss 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 catastrophic 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 segment, 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 periodic earnings.

Table of Contents

(In Thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
ISO catastrophes	\$10,061	\$34,480	\$24,049	\$38,646
Non-ISO catastrophes <sup>(1)</sup>	1,894	2,371	2,004	14,436
Total catastrophes	\$11,955	\$36,851	\$26,053	\$53,082

(1) This number includes international assumed losses.

**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 June 30, 2012, we did not hold investments in sub-prime mortgages, credit default swaps, or other credit-enhancement exposures.

While our primary market risk exposure is to changes in interest rates, we do have 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, 2011.

**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 Securities Exchange Act of 1934, as amended) 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 Securities and Exchange Commission'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

We consider all our litigation pending as of June 30, 2012, to be ordinary, routine, and incidental to our business.

## ITEM 1A. RISK FACTORS

Our business is subject to a number of risks, including those identified in Part I, Item 1A of our 2011 Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 15, 2012, 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 document 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 United Fire 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, economic and general market conditions, and corporate and regulatory requirements. We will generally consider repurchasing our common stock on the open market if (i) the trading price on NASDAQ drops below 130 percent of its book value, (ii) sufficient excess capital is available to purchase the stock, and (iii) we are optimistic about future market trends and the performance of our company. Our Share Repurchase Program may be modified or discontinued at any time.

We are authorized to purchase 1,367,978 shares at June 30, 2012. Our stock repurchase program is scheduled to end in August 2014.

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 Securities Exchange Act of 1934, during the three-month period ended June 30, 2012.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as a Part of Publicly Announced Plans or Programs	Maximum Number of Shares that may be Purchased Under the Plans or Programs
4/1/2012 - 4/30/2012	—	\$—	—	469,879
5/1/2012 - 5/31/2012	83,874	20.94	83,874	1,386,005
6/1/2012 - 6/30/2012	18,027	20.95	18,027	1,367,978

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

None.

## ITEM 5. OTHER INFORMATION

None.



Table of Contents

## ITEM 6. EXHIBITS

Exhibit number	Exhibit description	Filed herewith
11	Statement Re Computation of Per Share Earnings. All information required by Exhibit 11 is presented within Note 7 of the Notes to Unaudited Consolidated Financial Statements, in accordance with the FASB guidance on Earnings per Share	X
31.1	Certification of Randy A. Ramlo pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X
31.2	Certification of Dianne M. Lyons pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X
32.1	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	X
32.2	Certification of Dianne M. Lyons pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X
101.1	The following financial information from United Fire Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 formatted in XBRL: (i) Consolidated Balance Sheets at June 30, 2012 (unaudited) and December 31, 2011; (ii) Consolidated Statements of Income and Comprehensive Income (unaudited) for the three months and six months ended June 30, 2012 and 2011; (iii) Consolidated Statement of Stockholders' Equity (unaudited) for the six months ended June 30, 2012; (iv) Consolidated Statements of Cash Flows (unaudited) for the six months ended June 30, 2012 and 2011; and (v) Notes to Unaudited Consolidated Financial Statements, tagged as a block of text.	X

Table of Contents

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

/s/ Dianne M. Lyons  
Dianne M. Lyons  
Vice President, Chief Financial Officer and  
Principal Accounting Officer

August 8, 2012  
(Date)

August 8, 2012  
(Date)