Karin Daly – Vice President, The Equity Group Inc.

Good morning and thank you for joining us today. This morning, Donegal Group issued its Second Quarter 2023 Earnings Release outlining its results. The release and a supplemental investor presentation are available in the Investor Relations section of Donegal's website at www.donegalgroup.com. Please be advised that today's conference was pre-recorded and all participants are in listen-only mode. Additionally, we requested and received questions in advance of today's call and have worked answers to these questions into our prepared remarks, as appropriate.

Speaking today will be President and Chief Executive Officer, Kevin Burke; Chief Financial Officer, Jeff Miller; Chief Underwriting Officer, Jeff Hay; and Chief Investment Officer, Tony Viozzi.

Please be aware that statements made during this call that are not historical facts, are "forward-looking statements" and necessarily involve risks and uncertainties that could cause actual results to vary materially. These factors can be found in Donegal Group's filings with the Securities and Exchange Commission, including its annual report on Form 10-K and quarterly reports on Form 10-Q. The Company disclaims any obligation to update or publicly announce the results of any revisions that they may make to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

With that, it is my pleasure to turn it over to Mr. Kevin Burke. Kevin?

Kevin Burke – President and Chief Executive Officer

Thank you Karin, and welcome everyone.

I'll begin with a few comments on industry market conditions that provide some perspective before we discuss our quarterly results. A number of our larger industry peers have announced significant impacts from catastrophic weather events, with some characterizing the industry impact of the quarterly cat losses as historic, or at least, the highest for any second quarter since 2011.

The timing of that elevated weather impact was particularly challenging in light of ongoing inflationary pressures on auto and property loss costs, with a continuation of elevated claim severity as the costs for auto repairs and replacement vehicles remain historically high, in spite of some indications that those pressures are beginning to ease.

While we are far from pleased with our quarterly results, some underlying factors provide a level of optimism that we are making progress toward our objective of sustained excellent financial performance. First, total weather-related losses contributed 9.1 percentage points to our second quarter loss ratio, which was actually lower than the 9.6 percentage points for the second quarter of 2022, in spite of the significant increase in catastrophe events throughout the country. We attribute the reduction to our ongoing data-driven strategy to manage and refine our geographical spread of risk, across our regional operating footprint. While there is much work to accomplish, we are pleased with the advancements in data analytics that we have made in the last few years and we are beginning to see the benefits in our enhanced risk-evaluation and underwriting decisions.

While loss cost inflation remains a challenge, we aggressively began taking rate actions in late 2021 and accelerated the level of rate increases throughout 2022 and continuing into 2023. Jeff Hay will cover the details in a few minutes, but we were pleased to see improvements in our core loss ratios across all of our major lines of business during the second quarter. We view those improvements as the indicators of the recovery we expect will accelerate as the year continues and earned premiums begin to reflect the benefit of the rate increases we implemented over the past 18 months. In addition to the rate increases, we have numerous profit-improvement initiatives in flight. Many of those initiatives are defensive in nature and have resulted in lower levels of commercial premium growth than we had targeted for 2023. Again, Jeff Hay will speak to some of those details, but I want to convey that we are focused on the long-term and positioning ourselves to grow profitably in 2024 and beyond.

With the successful rollout of our new small commercial business agency portal along with new and enhanced commercial lines products, we now live in all of the 22 states in which we offer commercial lines and we are well-positioned to work with our agency partners to grow that segment of our commercial business. We are pleased to have the ability to compete effectively for smaller commercial accounts, which have historically performed well for us. Our agents are now fully trained and actively quoting new business on the new platform, and I am pleased to report that early agency feedback has been very favorable. We have developed comprehensive dashboards to monitor incoming quote and issuance levels to ensure that we are achieving straight-through-processing levels that will lead to higher agency engagement and new business growth. As those monitoring routines mature over the next few months, our commercial underwriting team will ramp up activities in preparation for development of our last major commercial systems modernization initiative that will include a new commercial package policy and modernize the other commercial products remaining on our legacy systems. We expect the work on the major software releases to continue throughout 2024, with deployment in early 2025. In the meantime, our project team is actively engaged in the conversion of several legacy personal lines products to the new platform, which is the beginning of a process that will continue on a parallel track with the commercial releases over the next few years.

We look forward to our state strategy sessions which are occurring in early August, when our home office and regional marketing, underwriting and claims leadership team will get together for several days to review our performance and develop detailed action plans for each state in which we operate. We have refined and enhanced the data and analysis we will utilize to develop action plans for each state and support our 2024 business plan. While we have taken intentional actions to slow our overall growth, we are committed to achieving rate adequacy and meeting our targeted loss ratios for each line of business and we believe we are well on our way to accomplishing those goals.

At this point, I'll turn the call over to Jeff Miller for a review of our financial results.

Jeff Miller – Chief Financial Officer

Thank you Kevin. Net premiums earned increased 5.9% to $216.3 million for the second quarter of 2023. Net premiums written increased by 3.7%, with accelerating premium rate increases and strong retention offset partially by lower new business volume and planned attrition in states we are exiting or have targeted for profit improvement. In addition, net premiums written and earned in the second quarter of 2023 included a reduction of $3.6 million related to reinsurance reinstatement premiums that resulted from our utilization of reinsurance for several large commercial property losses. Due to the challenging reinsurance environment when we renewed our contracts for 2023, we reduced the number of prepaid reinstatements within our property per risk reinsurance program compared to the 2022 contract terms in order to reduce the cost of our property reinsurance.

The combined ratio of 104.7% for the second quarter of 2023 was comparable to the 105% combined ratio for the prior-year quarter, with both periods reflecting elevated weather-related losses. Our core loss ratio decreased by over two full percentage points from the prior-year quarter, but that improvement was more than offset by lower net favorable reserve development for prior-year losses.

As Kevin mentioned, weather-related losses were $19.7 million, or 9.1 percentage points of the loss ratio for the second quarter of 2023, compared to $19.6 million, or 9.6 percentage points for the second quarter of 2022. Homeowners impact was $9.5 million, and commercial property impact was $4.3 million, with the remainder in the auto and other lines. In spite of the fact that our insurance subsidiaries did not incur losses from any single event that exceeded their $3 million catastrophe reinsurance retention with Donegal Mutual, the frequency of smaller storms drove the total second quarter weather claim impact higher than the previous five-year average for the second quarter of 8.9 percentage points.

Large fire losses (which we define as over $50,000 in damages) contributed 5.9 percentage points to the loss ratio for the second quarter of 2023, which was lower than 6.6 percentage points for the prior-year quarter. A modest increase in the frequency of commercial fire losses was more than offset by decreases in the severity of both commercial and home fire losses compared to the prior-year quarter.

Our insurance subsidiaries experienced virtually no net development of reserves for losses incurred in prior accident years for the second quarter of 2023, compared to net favorable development of $7.9 million, or a 3.9 percentage point reduction in the loss ratio, for the prior-year quarter. Diving deeper into the line of business impact, we had favorable development of $2 million for commercial auto, $1 million for homeowners and $500,000 for personal auto that was offset by unfavorable development of $1.8 million for workers' compensation and $1.5 million spread across other lines of business. We attribute the modest unfavorable development in workers' compensation and other lines primarily to the timing of a small number of case reserve increases for 2021 and 2022 claims. Outside of that unusual timing, prior-period reserve development for the second quarter of 2023 generally fell within our expectations.

The expense ratio of 34.2% for the second quarter of 2023 declined sequentially from 36.4% for the first quarter of 2023, and was slightly lower than the 35% expense ratio for the prior-year quarter. The decrease from both of those comparable periods was primarily due to lower underwriting-based incentive costs for our agents and employees.

In summary, the underwriting loss we incurred offset investment income earned for the second quarter of 2023, with net income of $2.0 million equal to after-tax net investment gains in the value of equity securities we held at June 30, 2023. That modest decline of net income compared favorably to an $8.2 million net loss for the second quarter of 2022 that primarily resulted from net investment losses due to a decline in the value of equity securities we held at June 30, 2022.

Last week, our board of directors declared a regular quarterly cash dividend of 17 cents per share of our Class A common stock and 15.25 cents per share of our Class B common stock. The dividends are payable on August 15th to stockholders of record as of the close of business on August 1st.

With that, I will turn the call over to Jeff Hay to provide more details about our commercial and personal lines segment results.

Jeff Hay – Chief Underwriting Officer

Thanks, Jeff. During the second quarter of 2023, we continued to face a challenging environment – including both increased frequency of weather-related events and ongoing inflationary impacts across the property and automobile segments. We are continuing to respond to these challenges to improve the performance of the overall book of business and we are taking appropriate rating actions while working with our agents to retain the best-performing accounts.

While many of our actions over the past year have been defensive, Donegal is becoming more forward-looking each day and our teams are preparing to grow new business in the future, as both rate levels and loss trends improve. We intend to remain an active participant in the market for new business but with a keener eye on risk-appropriate selections in order to expand our margin and profitability. Across our business, we are utilizing increasingly advanced analytics to be proactive, as opposed to reactive, in this challenging market. As we have discussed on previous calls, we continue to identify and target the most profitable opportunities across our geographic footprint, lines of businesses and industry classes. We will share more information to these strategies as they develop and mature in future periods.

Now turning to our segment details: Our commercial lines business remains strong with renewal premium retention at approximately 89% and renewal rate increases in the low-to-mid teens percentage range, when excluding workers' compensation. With expanded use of external data and valuation tools, we're working with our agents and policyholders to ensure appropriate insurance to value at each renewal effective date, as replacement property values have increased at a rate that exceeded automated inflation adjustments in many cases over the past few years.

Commercial lines net premiums written decreased by 3.2%, reflecting substantial attrition from our previously announced strategic exits from Georgia and Alabama for commercial business. While the official beginning date for non-renewal was July 1, agents started moving accounts at their renewal dates after we communicated our intention to exit. Simultaneously, we have been working with our agents and policyholders to increase both property values and deductible levels in response to the increasing costs for property repairs and replacement – which trends have been seen by many property insurance carriers. We are utilizing external data and valuation tools to inform our actions and expect to ramp up this "insurance-to-value" initiative throughout the remainder of the year. As a result of our continuing rate actions and efforts to increase coverage to appropriate levels, we expect to see increasing premiums across our entire book (excluding the impact of the commercial lines exit from Georgia and Alabama).

Our commercial lines statutory combined ratio was 103.6% in the quarter. While weather-related events in the quarter did not reach catastrophic levels, the frequency of smaller storms increased. There were several notable events, including wind and hail events in April and June, and 10-days of severe weather in Texas and New Mexico. Our core loss ratios have improved from the prior-year quarter across all of our major commercial lines of business and we look forward to further improvement as we continue to realize the benefits of the ongoing rate and profit improvement actions I mentioned earlier.

Taking a deeper dive into the lines of business from a loss trend perspective: Workers' compensation continues to perform favorably, with continuing favorable claim frequency trends. Medical inflation remains in-line, but we continue to monitor signs of pressure on indemnity severity driven by recent wage inflation. Commercial Auto Liability and General Liability loss trends also remain fairly stable, as frequency appears to be leveling off and we are seeing moderating levels of increases in severity. Property severity continues to be our biggest challenge to overcome but we are combating this through the several initiatives that I previously discussed.

Now turning to Personal lines, the double-digit premium growth during the second quarter was entirely driven by strong premium retention that exceeded 100%, reflecting double-digit renewal rate increases and exposure increases. More specifically, those increases averaged 11.5% for Personal Auto and 17% for Homeowners during the quarter. We expect rate increases to continue to grow as the year progresses. The number of policies-in-force is relatively flat year-over-year, as we intentionally slowed-down the pace of taking on new business while we work to restore rate adequacy and improve profitability by limiting exposure, particularly during this uncertain time of inflated loss trends.

The personal lines statutory combined ratio improved to 104.3% from 107.5% in the prior-year second quarter as Personal Auto continued to perform largely within expectations, based on the time lag until achieved rate increases will be reflected in earned premiums. Homeowners continues to be a challenge from a loss perspective, as the frequency of weather-related losses ticked-up from the first quarter volume as a result of the storm events I discussed earlier. However, reduced exposures resulting from our ongoing personal lines exit from the state of Iowa contributed to lower weather-related losses relative to the prior-year quarter. Large fire losses decreased nearly 25% from the second quarter of 2022, driven by lower severity. Similar to commercial lines, our core loss ratios for the second quarter of 2023 have improved compared to the prior-year quarter, for both personal auto and homeowners, mostly as a result of rate increases that are beginning to earn in.

It is important to note that while we are taking steps to limit new business growth, there have been record-levels of personal lines insurance shoppers in the marketplace, so the demand is there. We will continue to be an active player in the ten states in which we write personal lines, but we have tightened our underwriting guidelines and are aggressively implementing rate increases to ensure we build and maintain a long-term profitable book of business.

At this time, I'd like to turn it over to Tony Viozzi for an update on our investment portfolio.

Tony Viozzi – Chief Investment Officer

Thank you, Jeff. We are pleased to report the fifth consecutive quarter of higher investment income, driven by the ongoing increases in average investment yield as compared to the prior-year period. During the second quarter of 2023, the average tax-equivalent yield was 3.20%, the highest level of yields we have seen in nearly ten years. Short-term cash rates, close to 5.0% were higher than both the second quarter of 2022 and the preceding quarter. Of note, the average bond reinvestment yield was 5.12%, or approximately 145 basis points higher than the bond yields coming off the books in the quarter, including recent asset allocation changes.

Net investment income increased 24% to $10.2 million during the second quarter. This increase was the result of continued higher cash equivalent yields and higher market reinvestment rates for fixed income bonds. As noted in last quarters' call, we continued to make strategic asset allocation changes from U.S. Treasuries and tax-free bonds, into MBS and agency debt, in order to capture more attractive yields in the current rising interest rate environment. These wider-spread investments, driven by tighter credit markets, should continue to assist in improving our investment income in the second half of 2023.

Net investment gains were $2.5 million in the quarter, compared to net investment losses of $8.4 million in the prior-year quarter. The gains in the second quarter were primarily related to unrealized gains in the fair value of equity securities we held at June 30, 2023. Our equity portfolio represents a modest 3% of our total investments, up slightly from December 31, 2022 but down from one year ago. Maintaining our conservative investing approach, we will continue to limit our equity exposure until we believe there is more certainty within the domestic macro-economic environment.

During the first half of the year, after-tax unrealized losses within our available-for-sale bonds increased by $3.6 million, reducing our book value per share by 11 cents. Book value per share was $14.68 at June 30, 2023, incrementally lower than $14.79 at December 31, 2022.

With that, I will now turn it back to Kevin Burke for closing remarks.

Kevin Burke – President and Chief Executive Officer

Thanks, Tony. We are pleased with the ongoing execution of the various strategic initiatives during this time of transformation within our business operations. We believe that the continued implementation of our strategies will benefit all stakeholders of Donegal Group – our staff, our management, our agents, our policyholders and, of course, our shareholders, in the years to come. Thank you for your continued interest and support, and I'll now turn it over to Karin.

Karin Daly – Vice President, The Equity Group Inc.

Thank you, Kevin. If there are any questions, please feel free to reach out to us.
This now concludes our second quarter 2023 earnings webcast. You may now disconnect.