UNITED FIRE & CASUALTY CO
Form 10-K405/A
April 04, 2002
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

X Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2001

__ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from to

Commission File Number 2-39621

UNITED FIRE & CASUALTY COMPANY
(Exact name of registrant as specified in its charter)

Iowa	**42-0644327**
(State of Incorporation)	**(IRS Employer Identification No.)**
118 Second Avenue, S.E.	
Cedar Rapids, Iowa	**52407-3909**
(Address of principal executive offices)	**(Zip Code)**

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

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

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

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 X NO __

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

As of February 1, 2002, 10,036,819 shares of common stock were outstanding. The aggregate market value of voting stock held by non-affiliates of the registrant as of February 1, 2002, was approximately $187,166,190.

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PART I.

ITEM 1. BUSINESS

GENERAL DESCRIPTION

The terms United Fire, we, us, or our refer to United Fire & Casualty Company or United Fire & Casualty Company and its consolidated subsidiaries and affiliate, as the context requires. We are engaged in the business of writing property and casualty insurance and life insurance. We are an Iowa corporation incorporated in January 1946. Our principal executive office is located at 118 Second Avenue SE, P.O. Box 73909, Cedar Rapids, Iowa 52407-3909. Telephone: 319-399-5700.

Our property and casualty segment includes the following companies:

Addison Insurance Company, an Illinois property and casualty insurer; Lafayette Insurance Company, a Louisiana property and casualty insurer; and American Indemnity Financial Corporation, a Delaware holding company, all of which are wholly owned by United Fire & Casualty Company.

American Indemnity Financial Corporation owns substantially all of American Indemnity Company, a Texas property and casualty insurer. American Indemnity Company has two wholly owned insurance subsidiaries, Texas General Indemnity Company, a Colorado property and casualty insurer, and United Fire & Indemnity Company, a Texas property and casualty insurer. United Fire Lloyds, a Texas property and casualty insurer, is an affiliate of and operationally and financially controlled by American Indemnity Company.

Addison Insurance Company is the sole owner of Addison Insurance Agency, an Illinois general agency.

Lafayette Insurance Company is the sole owner of Insurance Brokers & Managers, Inc., a Louisiana general agency.

Our life insurance segment consists of United Life Insurance Company, a wholly-owned subsidiary of United Fire & Casualty Company.

A table reflecting premiums, operating results and assets attributable to our segments is included in Note 11 of the Notes to Consolidated Financial Statements. As of December 31, 2001, we employed 719 full-time employees.

MARKETING

We market our products principally through our home office in Cedar Rapids, Iowa and in four regional locations: Westminster, Colorado, a suburb of Denver; Lincoln, Nebraska; New Orleans, Louisiana; and Galveston, Texas.

We are licensed as a property and casualty insurer in 40 states, primarily in the Midwest, West and South. Approximately 1,220 independent agencies represent United Fire and our property and casualty subsidiaries. Our life insurance subsidiary is licensed in 25 states, primarily in the Midwest and West, and is represented by approximately 1,470 independent agencies.

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

We compete in the United States property and casualty insurance market with more than 3,400 other insurers. The industry is highly competitive, with insurers competing on the basis of service, price and coverage. Because we rely heavily on independent agencies, we utilize a profit-sharing plan as an incentive to place high-quality property and casualty business with us. In 2002, we estimate property and casualty agencies will receive profit-sharing commissions of $8,423,000 based on business the agencies did in 2001.

Our life insurance segment also operates in a highly competitive industry. We encounter significant competition in all lines of business from other life insurance companies and from other providers of financial services. The life segment utilizes competitive commission rates and other sales incentives to attract and maintain its relationship with independent agencies.

To enhance our ability to compete, we utilize technology in a variety of ways to assist our agents and improve the delivery of service to our policyholders. For example, on our public access Web site that provides general company and product information, we provide a section accessible exclusively to our agents where they can receive quotes, report claims on-line, make online applications and receive policy approval.

Our agents can also use the agent-only portion of our Web site to access detailed information about our products, order sales literature, and download applications, questionnaires and other forms. Our life agents can view the status of clients' applications and access detailed information on our annuity, universal life, term life and whole life policies. We electronically scan and store our documents, allowing them to be easily retrieved and viewed by multiple users simultaneously. Additionally, for our policyholders, we provide secure online access to their account information. We believe our investment in technology allows us to provide enhanced service to our agents and policyholders.

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In 2001, direct premium writings on a statutory basis by state were as follows.

	Property and Casualty Insurance Segment		Life, Accident and Health Insurance Segment, Including Annuities (1)	
	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in Thousands)			
Alabama	$ 4,190	1.0%		
Arkansas	8,031	2.1		
California	7,404	2.0		
Colorado	27,141	7.2	$ 5,147	2.6%
Florida	7,753	2.1		
Idaho	2,714	0.7		
Illinois	29,888	8.0	13,195	6.7
Indiana	3,636	1.0		
Iowa	50,807	13.5	82,904	42.0
Kansas	15,851	4.2	6,971	3.5
Louisiana	43,599	11.6		
Michigan	2,151	0.6	5,941	3.0
Minnesota	21,419	5.7	19,992	10.1
Mississippi	8,751	2.3		
Missouri	31,939	8.5	5,486	2.8
Nebraska	17,558	4.7	11,632	5.9
Oklahoma			6,971	3.4
New Mexico	1,361	0.4		
North Dakota	4,260	1.1	9,988	5.1
South Dakota	11,609	3.1	3,353	1.7
Texas	52,489	14.2	6,151	3.1
Utah	2,785	0.7		
Wisconsin	12,206	3.2	15,118	7.7
Wyoming	4,534	1.2	1,167	0.6
Other	3,521	0.9	3,600	1.8
	$ 375,597	100.0%	$ 197,616	100.0%

(1) Under statutory accounting principles, deposits from policyholders for universal life and annuity products are recognized as premiums when they are collected. Under generally accepted accounting principles, the deposits are reflected as a liability with the profits earned over the lives of the contracts.

PRODUCTS

Property and casualty insurance segment

We write both commercial and personal lines of property and casualty insurance. We focus on our commercial lines, which represented approximately 82 percent of our direct property and casualty premiums written for the year ended December 31, 2001. Our primary commercial lines are tailored business packages that include the following coverages: fire and allied lines, automobile, workers compensation and fidelity and surety. We also write multiple peril, inland marine and specialty lines for our commercial policyholders.

Our personal lines, which represented approximately 18 percent of our direct property and casualty premiums written for the year ended December 31, 2001, primarily consist of automobile and fire and allied lines coverage. Additionally, we write policies covering recreational vehicles and watercraft.

The table on the following page shows the apportionment of our property and casualty direct premiums written by major category and is presented in accordance with generally accepted accounting principles.

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Years Ended December 31	2001	Percent of Total	2000	Percent of Total	1999	Percent of Total
	(Dollars in Thousands)					
Commercial lines:						
Fire and allied lines (1)	$ 104,370	27.8%	$ 83,846	26.0%	$ 55,911	22.8%
Other liability (2)	77,525	20.6	64,962	20.2	47,142	19.2
Automobile	70,788	18.9	59,620	18.5	39,188	16.0
Workers compensation	29,528	7.9	27,755	8.6	21,710	8.9
Fidelity and surety	25,146	6.7	20,776	6.4	19,751	8.1
Miscellaneous	845	0.2	682	0.2	488	0.2
Total commercial lines	$ 308,202	82.1%	$ 257,641	79.9%	$ 184,190	75.2%
Personal lines:						
Automobile	$ 36,056	9.6%	$ 32,906	10.2%	$ 30,013	12.3%
Fire and allied lines (3)	30,576	8.1	30,893	9.6	29,881	12.2
Miscellaneous	763	0.2	838	0.3	789	0.3
Total personal lines	$ 67,395	17.9%	$ 64,637	20.1%	$ 60,683	24.8%
Total	$ 375,597		$ 322,278		$ 244,873	

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

(2) 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.

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

The following table shows loss ratios, expense ratios and combined ratios for the periods indicated for us and for the property and casualty industry. The ratios have been prepared on a statutory basis. The industry figures, determined on a statutory basis, in the following table were obtained from A.M. Best Company.

Years Ended December 31	2001	Industry (1)	2000	Industry	1999	Industry
Loss ratio	74.4%	90.1%	74.2%	81.2%	75.6%	78.6%
Expense ratio (2)	30.3	26.9	31.9	28.9	33.6	29.2
Combined ratio	104.7%	117.0%	106.1%	110.1%	109.2%	107.8%

(1) A.M. Best Company estimate.

(2) Adjusted for policyholder dividends.

The following table shows our loss ratios, expense ratios and combined ratios for the periods indicated. The ratios are presented in accordance with generally accepted accounting principles. Industry ratios are unavailable because they are not normally calculated in accordance with generally accepted accounting principles.

	Year ended December 31,				
	2001	2000	1999	1998	1997
Loss ratio	73.9%	73.6%	75.2%	81.2%	66.2%
Expense ratio (1)	30.7	33.5	35.0	34.0	33.0
Combined ratio	104.6%	107.1%	110.2%	115.2%	99.2%

(1) Adjusted for policyholder dividends.

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Life insurance segment

United Life Insurance Company underwrites all of our life insurance business. Our principal life insurance products are single premium annuities and universal life products. For the year ended December 31, 2001, single premium annuities accounted for approximately 83 percent of our life insurance premium revenues determined on the basis of statutory accounting principles and universal life products accounted for approximately 7 percent of that revenue. Under statutory accounting principles, deposits for policyholders for universal life and annuity products are recognized as premiums when they are collected. Under generally accepted accounting principles, the deposits are earned over the life of the contracts. We also underwrite and market single premium whole life insurance, term life insurance, credit life insurance and disability insurance products. Additionally, we offer an individual disability income rider that may be attached to our life insurance products.

Total life insurance in force, before reinsurance, is $4,066,238,000 as of December 31, 2001. Universal life insurance represents 45 percent of insurance in force at December 31, 2001, compared to 47 percent at December 31, 2000.

REINSURANCE

Property and casualty insurance segment

Our property and casualty segment follows the industry practice of reinsuring a portion of its exposure by ceding to reinsurers a portion of the premium received and a portion of the risk under the policies reinsured. Reinsurance is purchased to reduce the net liability on individual risks to predetermined limits and to protect against catastrophic losses from a single catastrophe, such as a hurricane or tornado. Catastrophe protection is purchased on both direct and assumed business.

We use many reinsurers, both domestic and foreign; this helps us to avoid concentrations of credit risk associated with our reinsurance. Our principal reinsurers include Employers Reinsurance Corporation, AXA Reassurance, Continental Casualty Company, Hanover Re and Partner Reinsurance Company of the U.S.

Because catastrophe losses are by their nature unpredictable, the frequency and severity of catastrophic losses experienced in any year could potentially be material to our results of operations and financial position. Typical catastrophes experienced by our policyholders include windstorms, hailstorms, tornados and hurricanes. Other catastrophes include earthquakes, wildfires and terrorist acts. The severity of a particular catastrophe for us is a function of various factors, including how many policies we have written in the area of the catastrophe and the severity of the event. We continually assess and improve how we manage our exposure to catastrophe losses; we do this through individual risk selection, by limiting the concentration of insurance written in certain areas and through the purchase of catastrophe reinsurance.

Historically, we have acted as a reinsurer, assuming both property and casualty reinsurance from other insurance or reinsurance companies. Most of the business we have assumed is property reinsurance with an emphasis on catastrophe coverage. During the second quarter of 2000, we began to significantly reduce our assumed reinsurance business. Most of our reinsurance business expired on or before December 31, 2000. We have reduced our assumed business by limiting our reinsurance contracts to a very limited number of brokers. We will continue to have exposure related to the assumed reinsurance contracts that we have elected to continue to write.

Our property and casualty insurance segment limits the direct risk that it retains by reinsuring direct risks in excess of our retention limits. For our property and casualty lines of business, our retention for 2001 was $1,000,000, which means we have reinsurance for any single claim over $1,000,000. Our loss retention was $1,000,000 for losses that pertain to years 1995 through 2001 and $750,000 or less for losses that pertain to years prior to 1995. We also have reinsurance that limits the total direct loss we may incur from a single catastrophe. The total direct loss we may incur from a single catastrophe, after reinsurance, is $5,000,000 for years 1993 through 2001.

The ceding of reinsurance does not legally discharge us from primary liability under our policies, and we must pay the loss if the reinsurer fails to meet its obligation. We monitor the financial condition of our reinsurers. At December 31, 2001 and 2000 there are no uncollectable reinsurance balances that would result in a material impact on our financial statements. In accordance with generally accepted accounting principles and industry practice, we account for insurance written and losses incurred net of reinsurance ceded.

The table below sets forth the aggregate direct and assumed premiums written, ceded reinsurance and net premiums written for the three years ended December 31, 2001, 2000 and 1999, and is presented in accordance with generally accepted accounting principles.

	Years ended December 31					
	2001	Percent of total	2000	Percent of total	1999	Percent of total
	(Dollars in Thousands)					

Fire and allied lines (1)	$ 134,275	36.7%	$ 116,429	35.8%	$ 87,594	34.5%
Automobile	106,863	29.2	90,747	27.9	69,557	27.4
Other liability (2)	78,288	21.4	65,801	20.2	48,157	18.9
Workers compensation	30,662	8.4	28,385	8.7	22,192	8.7
Fidelity and surety	25,146	6.9	20,776	6.4	19,751	7.8
Reinsurance assumed	14,021	3.8	24,179	7.4	29,950	11.8
Miscellaneous	2,050	0.6	1,483	0.5	1,044	0.4
Aggregate direct and assumed premiums written	$ 391,305	107.0%	$ 347,800	106.9%	$ 278,245	109.5%
Reinsurance ceded	25,167	7.0	22,748	6.9	24,031	9.5
Net premiums written	$ 366,138	100.0%	$ 325,052	100.0%	$ 254,214	100.0%

(1) Fire and allied lines in this table includes fire, allied lines, homeowners, commercial multiple peril and inland marine.

(2) 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.

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Life insurance segment

United Life Insurance Company follows the industry practice of reinsuring a portion of its exposure by ceding to reinsurers a portion of the premium received and risk under the policies reinsured. Reinsurance is purchased to reduce the net liability on individual risks. United Life Insurance Company's maximum retention is $200,000 per life, and it reinsures the remaining liability.

The ceding of reinsurance does not legally discharge United Life Insurance Company from primary liability under its policies. United Life Insurance Company must pay the loss if the reinsurer fails to meet its obligations. United Life Insurance Company's primary reinsurance companies are ERC Reinsurance Company, RGA Reinsurance Company and Business Men's Assurance Company of America. These companies insure both life and disability risks.

At December 31, 2001 and 2000, there are no uncollectable reinsurance balances that would result in a material impact on our financial statements.

RESERVES

Property and casualty insurance segment

We and our property and casualty subsidiaries are required by applicable insurance laws to maintain reserves for losses and loss adjustment expenses with respect to both reported and unreported losses. Loss reserves are estimates at a given time of the ultimate amount expected to be paid on losses that are, in fact, incurred. Reserves for loss adjustment expenses are intended to cover the actual cost of investigating losses and defending lawsuits arising from losses. These reserves are continuously revised based on historical analysis and management's expectations. Estimates of losses are based on facts and circumstances known when the estimates are made.

Loss and loss adjustment expense reserves have two components: reported reserves, which are reserves for reported losses, and reserves for incurred but not reported events. We estimate reserves for reported losses in one of two ways. For some classes of reported losses under $5,000, reserves are set based upon a schedule determined by averaging similar claims paid over a recent 13 month period. The estimate is revised in response to changes in experience or as investigations progress and further information is received. All other reserves for reported losses are established on an individual case basis. Our claims personnel establish reported reserves based on a variety of factors, including the type of each claim, our knowledge of the circumstances surrounding each loss, the policy provisions relating to the type of loss, trends in the legal system and other factors.

For incurred but not reported losses, we estimate the amount of reserves for each line of business on the basis of historical and statistical information. We consider historical patterns of paid and reported claims, industry data and the probable number and nature of losses arising from occurrences which have not yet been reported.

The process of estimating loss reserves and loss adjustment expense reserves involves a considerable degree of judgment by our claims personnel. Because reserves are estimates of the amount expected to be paid based on facts and circumstances known at any given time, we continuously review our loss and loss adjustment expense reserves. During the claims settlement period, which may extend over a long period of time, our claims personnel may become aware of additional facts regarding claims and trends which cause us to refine and adjust our estimates of ultimate liability. Consequently, actual loss and loss adjustment expenses may deviate from estimates reflected in our Consolidated Financial Statements. Such deviations may be significant.

We do not discount reserves based on the time value of money. We implicitly provide for inflation in the reserving process by reviewing cost trends and historical reserving results and projecting future economic conditions.

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The following table shows the calendar year development of net loss and loss adjustment expense reserve liabilities and payments for us and our property and casualty subsidiaries for the years 1992 through 2001. The top line of the table shows the estimated liability for unpaid losses and loss adjustment expenses recorded at the end of each of the indicated years. This liability represents the estimated amount of losses and loss adjustment expenses for losses arising in all prior years that are unpaid at the end of each year, including losses that had been incurred but not yet reported, net of applicable ceded reinsurance. The upper portion of the table shows the re-estimated amount of the previously recorded liability based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the losses for individual years. Conditions and trends that have affected development of the liability in the past may not necessarily occur in the future. Accordingly, it may not be appropriate to extrapolate future redundancies or deficiencies based on this table. The second half of the table displays cumulative losses paid and loss adjustment expenses paid for each of the years indicated on the basis of generally accepted accounting principles.

	Years Ended December 31									
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
	(Dollars in Thousands)									
Net Liability for Unpaid Losses and LAE	$ 158,825	$ 170,798	$ 180,653	$ 188,700	$ 209,876	$ 218,912	$ 243,006	$ 310,637	$ 320,506	$ 326,910
Liability re-estimated as of:										
One year later	154,572	153,691	160,776	159,571	176,332	192,297	213,047	273,706	273,469	
Two years later	148,507	142,572	172,546	145,486	169,348	185,700	233,325	261,217		
Three years later	144,159	158,312	164,133	142,877	164,030	198,298	226,353			
Four years later	134,309	155,313	161,961	140,639	172,366	198,931				
Five years later	132,075	154,849	162,424	147,412	176,411					
Six years later	132,747	157,005	169,472	152,134						
Seven years later	135,559	161,898	172,807							
Eight years later	140,038	164,591								
Nine years later	142,576									
Redundancy (Deficiency)	$ 16,249	$ 6,207	$ 7,846	$ 36,566	$ 33,465	$ 19,981	$ 16,653	$ 49,420	$ 47,037	
Cumulative amount of liability paid through:										
One year later	$ 54,291	$ 51,550	$ 80,246	$ 56,618	$ 61,694	$ 62,988	$ 71,251	$ 97,021	$ 110,516	
Two years later	84,074	102,637	109,281	83,071	93,599	97,142	123,965	154,886		
Three years later	96,976	119,349	123,469	97,763	110,531	122,818	155,622			
Four years later	107,420	127,333	132,414	106,770	122,413	143,216				
Five years later	112,360	133,531	137,597	112,456	134,193					
Six years later	116,929	137,295	141,524	119,400						
Seven years later	119,657	140,127	145,170							
Eight years later	121,861	143,080								
Nine years later	124,071									

We believe the reserves for our property and casualty segment at December 31, 2001 are appropriate. However, the determination of property and casualty insurance and reinsurance reserves, particularly those relating to liability lines, reflects significant judgment factors. If, during the course of our regular monitoring of reserves, we determine that coverages previously written were incurring higher than expected losses with respect to either reported losses or losses incurred but not yet reported, we would take action which could include increasing the related reserves. Any adjustments we make to reserves are reflected in operating results in the year in which we make those adjustments. As required by state law, we engage an independent actuary to render an opinion as to the adequacy of the statutory reserves we establish. The actuarial opinion is filed in those states where we are licensed. There are no material differences between our statutory loss reserves and those established under generally accepted accounting principles.

Life insurance segment

Reserves for the life insurance segment are based upon applicable Iowa insurance laws. Our life insurance subsidiary's reserves meet, or exceed, the minimum statutory requirements. The reserves reflected in our Consolidated Financial Statements are calculated in accordance with generally accepted accounting principles. Reserves determined on the basis of generally accepted accounting principles are based upon our best estimates of mortality and morbidity, persistency, expenses and investment income. Reserves determined for statutory purposes are based upon mortality rates and interest rates specified by state law. All of our reserves are developed and analyzed annually by independent consulting actuaries.

INVESTMENTS

We must comply with state insurance laws that prescribe the kind, quality and concentration of investments that may be made by insurance companies. We determine the mix of our investment portfolio based upon these state laws, liquidity needs, tax position and general market conditions. We also consider the timing of our obligations, as cash must be available when obligations are due to be paid. We make modifications to our investment portfolio as the conditions listed above change. We manage internally all but a small portion of our investment portfolio.

Assets relating to the property and casualty segment are invested to meet liquidity needs and maximize after-tax returns with appropriate risk diversification. Assets relating to the life insurance segment are invested to meet liquidity needs, maximize the investment return and achieve a matching of assets and liabilities.

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Investment results for the periods indicated are summarized in the following table, and are presented in accordance with generally accepted accounting principles.

	Years Ended December 31		
	Average Invested Assets (1)	Investment Income, Net (2)	Annualized Yield on Average Invested Assets
	(Dollars in Thousands)		
2001	$ 1,481,999	$ 98,909	6.7%
2000	1,316,906	86,867	6.6
1999	1,157,414	75,317	6.5

(1) Average of amounts at beginning and end of year.

(2) Investment income after deduction of investment expenses, but before applicable income tax. Realized gains and losses are excluded.

ITEM 2. PROPERTIES

We own two buildings and related parking facilities in Cedar Rapids, Iowa, which we use as our home office. We occupy all of a five-story office building and the top seven floors of an eight-story office building in which the first floor is leased to tenants. The two buildings are connected by a skywalk. We also lease additional adjacent space in Cedar Rapids.

Lafayette Insurance Company owns and occupies a two-story building in New Orleans, Louisiana, which serves as its home office.

American Indemnity Company, a subsidiary of American Indemnity Financial Corporation, owns two adjacent and connected buildings in Galveston, Texas, which serve as its home office. One building is seven stories and the other is three stories. These buildings are occupied primarily by American Indemnity Company with a small amount of office space leased to tenants.

ITEM 3. LEGAL PROCEEDINGS

All pending litigation of the registrant is considered to be ordinary, routine and incidental to its business.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of the shareholders during the fourth quarter of 2001.

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PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

United Fire s common stock is traded on the Nasdaq National Market System under the symbol UFCS. On February 1, 2002, there were 891 holders of record of United Fire common stock. The following table sets forth, for the calendar periods indicated, the high and low bid quotations for the common stock and cash dividends declared. These quotations reflect inter-dealer prices without retail markups, markdowns or commissions and may not necessarily represent actual transactions.

Our policy has been to pay quarterly cash dividends, and we intend to continue that policy. The table set forth below shows the quarterly dividends paid in 2000 and 2001.

Payments of any future dividends and the amounts of such dividends, however, will depend upon factors such as net income, financial condition, capital requirements and general business conditions. We have paid dividends every quarter since March 1968.

State law permits the payment of dividends only from statutory accumulated earned profits arising from business. Furthermore, under Iowa law, we may pay dividends only if after giving effect to the payment, either we are able to pay our debts as they become due in the usual course of business or our total assets would be equal to or more than the sum of our total liabilities. Our subsidiaries are also subject to state law restrictions on dividends. See Note 8 in the Notes to Consolidated Financial Statements for a description of these restrictions.

	Share Price		Cash Dividends Declared
	High	Low	
2001			
Quarter Ended			
March 31	$ 25.00	$ 19.25	$0.18
June 30	34.51	19.50	0.18
September 30	31.85	19.00	0.18
December 31	31.42	24.58	0.18
2000			
Quarter Ended			
March 31	$ 23.31	$ 17.38	$0.17
June 30	19.69	15.50	0.18
September 30	20.50	15.50	0.18
December 31	20.63	16.19	0.18

ITEM 6. SELECTED FINANCIAL DATA

	Years Ended December 31				
	2001	2000	1999	1998	1997
	(Dollars in Thousands Except Per Share Data)				
Total assets	$ 1,851,839	$ 1,674,109	$ 1,467,716	$ 1,250,594	$ 1,157,922
Operating revenues					
Net premiums earned	372,019	333,365	273,051	245,727	244,939
Investment income, net	98,909	86,867	75,317	67,928	61,686
Realized investment gains (losses) and other income	(84)	(1,825)	2,936	22,796	2,676
Commission and policy fee income	2,108	2,172	1,912	1,815	1,829
Net income	24,093	15,527	15,384	23,677	28,732
Basic and diluted earnings per common share	2.40	1.55	1.53	2.28	2.68
Cash dividends declared per common share	0.72	0.71	0.68	0.67	0.63

The selected financial data herein has been derived from the financial statements of United Fire and its subsidiaries. The data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related Notes .

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ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations for the Year Ended December 31, 2001, Compared to the Year Ended December 31, 2000

For the year ended December 31, 2001, our consolidated net operating income, which excludes net realized gains and losses on securities, was $24,214,000, or $2.41 per share, compared to $16,713,000, or $1.67 per share, for the year ended December 31, 2000. The most significant factors contributing to the increase were growth in net premiums earned, growth in net investment income and favorable development in our property and casualty loss reserves.

Net premiums earned increased by $38,654,000, or 12 percent, to $372,019,000, due primarily to premium rate increases in our property and casualty insurance segment. Net investment income increased by $12,042,000, or 14 percent, to $98,909,000, with more than $9,000,000 of the increase contributed by our life insurance segment. Annuity deposits increased our life insurance segment s investment portfolio, leading to higher investment earnings. During 2001, we experienced a decrease in estimated losses for property and casualty claims that occurred in prior years, as described in Property and Casualty Insurance Segment, below.

During the third quarter of 2001, we began a review of our exposure to the events of September 11, 2001. Because we do not write direct premiums in the eastern United States, we knew that we did not have any material direct exposure as a result of these events. However, we did have assumed reinsurance claims related to the terrorist attacks, resulting in after-tax charges in 2001 of $4,479,000, or $0.45 per share.

We recorded reserves for the September 11 events based upon the one event theory. If the insurance industry or the judicial system determines that the events of September 11 were multiple events, our estimate, based upon information currently available to us, is that our reserves for the September 11 catastrophe would increase by approximately $3,000,000.

The rates we pay for reinsurance increased on our reinsurance contracts that renewed on January 1, 2002, and those contracts now limit or exclude coverage for terrorist activities. We will utilize terrorist exclusions on our direct policies, as such exclusions are approved by state regulators. We expect price increases to occur in the property and casualty insurance industry due to the anticipated industry-wide increase in reinsurance rates, and we have already begun our own price increases.

On a consolidated basis, net income, which is net operating income plus net realized gains and losses on securities, was $24,093,000, or $2.40 per share in 2001, compared to $15,527,000, or $1.55 per share, in 2000. We recorded net realized after-tax losses of $121,000 in 2001 and $1,186,000 in 2000. In both years, other-than-temporary impairments on a small number of fixed income securities contributed to realized losses.

Property and Casualty Insurance Segment

Our property and casualty insurance segment recorded net income of $15,559,000 in 2001, compared to net income of $9,810,000 in 2000. Net premiums earned grew by $39,311,000, or 13 percent, to $346,582,000. Much of the net premium written growth was generated by premium rate increases throughout a majority of our lines of business. In 2001, Texas became our largest state in terms of direct premium volume, with direct premiums written of $52,489,000. Iowa was our second largest state, with direct premiums written of $50,807,000.

Our liability lines of business, such as commercial automobile liability, other liability and workers compensation, are considered long-tail lines of business due to the length of time which may elapse before claims are finally settled. Therefore, we may not know our final development on individual claims for many years. Our estimates for losses, particularly in these long-tail lines, are dependent upon many factors, such as our estimate of the severity of the claim, the legal environment, inflation and medical costs. We consider all of these factors, as

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well as others, in estimating our loss reserves. As conditions or trends with respect to these factors change, we change our estimate for loss reserves accordingly.

Our property and casualty insurance segment incurred losses of $256,145,000 in 2001, compared to $226,168,000 in 2000. In 2001, favorable development of $47,037,000 on prior years losses resulted from either the settlement of claims for less than the amounts reserved or a reduction in loss reserves due to additional information on individual claims that occurred prior to 2001. In 2001, favorable development was concentrated in our commercial automobile liability and other liability lines of business. For both lines of business, favorable development was concentrated with respect to accidents occurring in years 1998 through 2000. Off-setting favorable development were incurred losses totaling $303,182,000 for accidents occurring in 2001.

In 2000, favorable development contributed $36,931,000 to our results, while claims for accidents occurring in 2000 resulted in incurred losses of $263,099,000 in 2000. Several of our liability lines of business contributed to favorable development in 2000, primarily for accidents occurring in 1998 through 2000.

For both 2001 and 2000, favorable development was caused by a change in a number of our loss estimating factors, primarily in our estimate of the severity of claims.

As a measure of our underwriting profitability, we calculate a combined ratio, which is the sum of two ratios, the loss ratio and the expense ratio. On a statutory basis of accounting, the loss ratio is calculated by dividing net losses and net loss adjustment expenses incurred by net premiums earned, because losses occur over the life of a policy. On a statutory basis of accounting, the expense ratio is stated as a percentage of premiums written rather than premiums earned, because most underwriting expenses are paid when policies are written and are not amortized over the policy period. The statutory underwriting profit margin is the extent to which the combined ratio is less than 100 percent. In 2001, our statutory combined ratio was 104.7 percent, which compares favorably with the industry statutory combined ratio of 117.0 percent, as estimated by A.M. Best Company, a leading insurance industry rating agency and data provider. Our statutory combined ratio was 106.1 percent in 2000. Without the effect of catastrophes, our statutory combined ratio was 97.0 percent in 2001 and 98.2 percent in 2000.

Under generally accepted accounting principles, the loss ratio is computed in the same manner as under the statutory basis of accounting, but the expense ratio is determined by matching underwriting expenses to the period when net premiums were earned, rather than by when net premiums were written. In 2001, our combined ratio, calculated on the basis of generally accepted accounting principles, was 104.6 percent, compared to 107.1 percent in 2000. Without the effect of catastrophes, our combined ratio calculated according to generally accepted accounting principles was 96.8 percent in 2001 and 99.2 percent in 2000.

After-tax charges in 2001 for catastrophes, including the September 11 events, were $17,524,000, or $1.75 per share, compared to $15,778,000, or $1.57 per share, in 2000.

Losses and loss adjustment expenses incurred represent actual payments made and changes in estimated future payments to be made, including expenses required to settle both reported and unreported losses. For reported losses, we establish reserves based upon policy provisions, accident facts, injury or damage exposure, trends in the legal system, historical results and other factors. For unreported losses, we establish reserves for each line of business based on the probable number and nature of losses, determined on the basis of historical and statistical information. Once we have established reserves, we closely monitor and adjust them as losses develop. We regularly review our reserve calculations and, as required by state law, we engage an independent actuary to render opinions as to the adequacy of the statutory reserves we establish. We file the actuarial opinions in those states where we are licensed. There are no material differences between our statutory reserves and those established under generally accepted accounting principles.

To establish loss and loss adjustment expense reserves, we make estimates and assumptions that affect the amounts of assets, liabilities, revenues and expenses reported in our financial statements. Actual results could

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differ materially from those estimates. The estimate of these reserves is subjective and complex and requires us to make estimates about the future payout of claims, which is inherently uncertain. When we establish and adjust reserves, we do so given our knowledge of the circumstances and claim facts. Upon notice of a claim, we establish a case reserve for loss and loss adjustment expenses based on the claims information reported to us at that time. Subsequently, we conduct an investigation of each reported claim, a process that may extend over a long period of time, which allows us to more fully understand the factors contributing to the loss and our potential exposure. As our investigations of claims develop and as our claims personnel identify trends in claim activity, we refine and adjust our estimates of case reserves. We track and monitor all claims until they are settled and paid in full and all salvage and subrogation claims are resolved, which helps us to evaluate and refine our overall reserving process.

For incurred but not reported losses, we estimate the amount of reserves for each line of business on the basis of historical and statistical information. We consider historical patterns of paid and reported claims, industry data, and the probable number and nature of losses arising from claims that have occurred but have not yet been reported for a given accident year.

Over the course of the last ten accident years, our reserves for losses and loss adjustment expenses have exceeded our incurred losses and loss adjustment expenses. We attribute this redundancy to many factors, including the following:

- Claims negotiation utilized in the claims settlement process to control the size of settlements;

- Loss prevention services that focus on workplace safety and accident and illness prevention;

- Claims management services including return-to-work programs, case management by nurses for serious injuries and management of medical provider services and billings; and

- Investigation and legal services provided to policyholders for the prevention of fraud and assistance in favorably resolving litigated claims.

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In 2001, our loss ratio was 73.9 percent, compared to 73.6 percent in 2000. The pure loss ratio, which is net losses incurred without loss adjustment expenses incurred divided by net premiums earned, was 61.4 percent in 2001 and 59.9 percent in 2000. We use the pure loss ratio to measure our profitability by line and make pricing and underwriting decisions based upon these results. In the following table, we present the pure loss ratio for each of the last three years for each of our lines of business. The information in the following table is presented in accordance with generally accepted accounting principles.

	Year Ended December 31,		
	2001	2000	1999
	(Dollars in thousands)		
Fire and allied lines (1)			
Net premiums earned	$ 111,367	$ 96,894	$ 76,557
Net losses incurred	80,914	60,076	40,176
Pure loss ratio	72.7%	62.0%	52.5%
Automobile			
Net premiums earned	$ 98,215	$ 85,323	$ 64,558
Net losses incurred	60,220	53,412	44,824
Pure loss ratio	61.3%	62.6%	69.4%
Other liability (2)			
Net premiums earned	$ 68,434	$ 57,720	$ 38,922
Net losses incurred	24,806	18,667	17,266
Pure loss ratio	36.2%	32.3%	44.4%
Workers compensation			
Net premiums earned	$ 29,475	$ 25,858	$ 20,524
Net losses incurred	21,338	12,567	15,119
Pure loss ratio	72.4%	48.6%	73.7%
Fidelity and surety			
Net premiums earned	$ 20,481	$ 18,087	$ 18,129
Net losses incurred	2,879	2,138	387
Pure loss ratio	14.1%	11.8%	2.1%
Reinsurance			
Net premiums earned	$ 17,504	$ 22,539	$ 27,739
Net losses incurred	22,291	36,547	34,003
Pure loss ratio	127.3%	162.2%	122.6%
Miscellaneous			
Net premiums earned	$ 1,106	$ 850	$ 625
Net losses incurred	449	712	66
Pure loss ratio	40.6%	83.8%	10.6%
Total property and casualty			
Net premiums earned	$ 346,582	$ 307,271	$ 247,054
Net losses incurred	212,897	184,119	151,841
Pure loss ratio	61.4%	59.9%	61.5%

(1) Fire and allied lines in this table includes fire, allied lines, homeowners, commercial multiple peril and inland marine.

(2) 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.

Improvement in our commercial automobile business more than offset deterioration in our personal automobile business. In our commercial automobile business, we have imposed stricter underwriting guidelines and aggressively pursued rate increases. We also continue to increase rates and tighten eligibilities for our personal automobile business.

Our reinsurance line of business improved in 2001 with a pure loss ratio of 127.3 percent, compared to 162.2 percent in 2000. The impact from the September 11 events is included in the 2001 results. While reserves related to the September 11 events increased the pure loss ratio in this line of business, a decrease in assumed loss reserves

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partially offset these charges. We decreased assumed loss reserves due to our reduced number of contracts and exposure in assumed reinsurance business. We continue to have exposure, primarily catastrophe coverages, related to assumed reinsurance contracts written prior to 2001. We believe that as of December 31, 2001 our loss reserves established for the assumed reinsurance business are appropriate. We anticipate that we will decrease the assumed loss reserves each year as the non-renewed assumed reinsurance contracts are further into the run-off period.

Other liability insurance covers businesses for liability for bodily injury and property damage arising from general business operations, accidents on their premises and products manufactured or sold. Our pure loss ratio in the other liability line of business has been favorable when compared with our other lines of business. Our pure loss ratio was 36.2 percent in 2001 and 32.3 percent in 2000. Appropriate pricing, and restrictive underwriting guidelines have contributed to the favorable results in the other liability line of business.

The pure loss ratio deteriorated, or increased, to 72.7 percent in 2001 compared to 62.0 percent in 2000 in the fire and allied lines business, which includes fire, allied lines, homeowners, commercial multiple peril and inland marine. In 2001, we experienced a greater number of fire losses than in 2000. In 2000, our homeowners business was negatively affected by a hailstorm that swept through the New Orleans area in January 2000.

The existence of certain airborne mold spores resulting from moisture trapped in confined areas has been alleged to cause severe health and environmental hazards. In 2001, Texas homeowners claims related to mold increased. While mold is a potential problem in several states, Texas has been at the forefront of mold insurance issues. Until recently, Texas was unlike many states because it did not permit insurance companies to exclude mold coverage from homeowners policies. In response, some property and casualty insurers no longer write homeowners insurance in Texas. In 2001, we responded to the mold issue by implementing more stringent underwriting guidelines, new claims handling procedures and price increases.

We have current and potential future exposure to mold claims in both our commercial and personal lines of business. We have recently received approval from the Texas Department of Insurance to adopt an exclusion in our homeowners policies and a $25,000 limitation in our commercial general liability policies with respect to claims arising from mold. We are investigating a mold exclusion for our commercial property policies. As market conditions permit, we plan to implement any coverage reforms permitted by the Texas Department of Insurance that would enable us to reduce our exposure in Texas to claims related to mold. Due to the uncertainty of future changes in Texas regulation, we cannot estimate our future probable liability for mold claims. Also, as case law expands, we may be subject to mold losses beyond those intended by policy coverage and not addressed by exclusionary or limiting language. We believe it is unlikely that any such loss would have a material adverse effect on our financial condition or our cash flows. However, loss reserve additions arising from future unfavorable expansion of case law cannot be reasonably estimated at the present time, and future increases may emerge that would adversely affect our financial position. Management believes we have adequately reserved losses for our future probable liability for mold claims, based upon current regulations.

The pure loss ratio for our workers compensation line of business deteriorated to 72.4 percent in 2001, from 48.6 percent in 2000. Results in 2000 were unusually favorable because we settled many workers compensation cases favorably, which led to lower payments than were reserved. In 2001, the frequency and severity of the claims reported to us increased, and many of our workers compensation cases have not settled favorably. We carefully continue to underwrite this line of business and have further tightened our eligibility guidelines.

Our fidelity and surety bond business had some deterioration in 2001 when compared to 2000. The pure loss ratio was 14.1 percent in 2001 and 11.8 percent in 2000. This line continues to be our most profitable. However, for the past several years a soft surety insurance market and competitive pressures have contributed to depressed rates for this line of business. We have recently initiated rate increases and stricter underwriting guidelines to address the conditions in this line.

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The second component of the statutory combined ratio is the expense ratio. In 2001, our expense ratio improved to 30.3 percent, compared to 31.9 percent in 2000. Through a consolidation of functions we have been able to reduce underwriting expenses incurred relative to premiums written.

Life Insurance Segment

Our life insurance segment s earnings are derived primarily from premium revenues plus investment results, including net realized gains and losses, reduced by interest credited, benefits to policyholders and expenses. In 2001, our life insurance segment recorded net income of $8,534,000, compared to net income of $5,717,000 in 2000. The results were driven in both years primarily by investment results. Net investment income earned in 2001 was $70,682,000, compared to $61,468,000 in 2000. Annuity deposits increased our life segment s investment portfolio, leading to higher investment earnings. In 2001 and 2000, a small number of fixed income securities held by the life segment were written down as a result of other-than-temporary declines in market value. These write-downs were the primary reason for net realized losses, after-tax, of $1,346,000 recorded in 2001 and $3,089,000 recorded in 2000.

After intercompany eliminations, net premiums earned by the life segment in 2001 totaled $25,437,000, compared to $26,094,000 in 2000. Annuity deposits collected are not reflected in net premiums earned. Rather, revenues for annuities consist of policy surrender charges and investment income earned. Annuity deposits are invested and recorded as liabilities for future policy benefits. In 2001, annuity deposits were $163,115,000, compared to $165,181,000 in 2000.

In 2001, we credited interest of $48,213,000 to annuity and universal life policyholder accounts, compared to $42,410,000 in 2000. We establish our interest crediting rates based upon current market conditions and maintain a favorable spread because our average crediting rates on our policyholder account balances are less than the ratio of net investment income to average invested assets. We decreased interest crediting rates during 2001 for new deposits. The increase in our expense for interest on policyholders accounts for the year was primarily a result of the interest credited on existing account balances. We believe that annuity growth continues to be driven by our ability to distribute and service this product as well as by general market conditions during the current year, as private investors shift their focus from variable to non-variable annuity products.

Investment Results

Premium rate increases and new annuity deposits resulted in additional funds to be invested in 2001. This led to growth in our investment portfolio and resulted in an increase in net investment income earned during the year. In 2001, net investment income was $98,909,000, compared to $86,867,000 in 2000, an increase of 14 percent. More than 90 percent of our investment income originates from interest on fixed income securities. Our remaining investment income is derived from dividends on equity securities, interest on other long-term investments, interest on policy loans and rent earned from tenants in our home office. The investment yield, which is investment income divided by average invested assets, was 6.7 percent in 2001 and 6.6 percent in 2000.

Our accounting policy for impairment recognition requires other-than-temporary impairment charges to be recorded when we determine that we are unable to recover our cost basis in an investment. Impairment charges on investments are included in net realized gains and losses. Factors considered in evaluating whether a decline in value is other-than-temporary include: the length of time and the extent to which the fair value has been less than cost; the financial conditions and near-term prospects of the issuer; and our intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery.

In 2001 and 2000, we wrote down a small amount of holdings in our fixed income portfolio as a result of other-than-temporary declines in market value and recognized a net realized loss, before tax, of $3,841,000 in 2001 and $2,932,000 in 2000. We continue to review the other-than-temporarily impaired securities for appropriate valuation on an ongoing basis. Based on the existing status and condition of these securities, we do

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not currently anticipate additional losses, but continued credit deterioration of some securities is possible, which may result in further write-downs.

Although we do have loss exposure to below investment grade fixed income securities, we are committed to minimizing credit risks and maintaining a high quality portfolio. As of December 31, 2001, 89 percent of our fixed income securities were investment grade, as defined by the National Association of Insurance Commissioners Securities Valuation Office, and had ratings of Class 1 or Class 2.

The composition of our investment portfolio at December 31, 2001 is presented in the following table in accordance with generally accepted accounting principles:

	Property and Casualty Segment		Life Segment		Total	
		Percent of Total		Percent of Total		Percent of Total
			(Dollars in thousands)			
Fixed income securities (1)	$ 376,433	71.0%	$ 1,007,797	97.0%	$ 1,384,230	88.0%
Equity securities	104,715	20.0	5,642	1.0	110,357	7.0
Policy loans			8,201	1.0	8,201	1.0
Short-term investments	37,333	7.0	10,675	1.0	48,008	3.0
Other	10,166	2.0			10,166	1.0
Total	$ 528,647	100.0%	$ 1,032,315	100.0%	$ 1,560,962	100.0%

(1) Available-for-sale fixed income securities are carried at fair value, while held-to-maturity fixed income securities are carried at amortized cost.

Federal Income Taxes

Our effective income tax rate of 16 percent was less than the applicable federal tax rate of 35 percent due primarily to our portfolio of tax-deductible securities and a reduction in deferred tax liabilities.

In 2001, we eliminated a deferred tax liability of $1,143,000 which we had established in connection with a Revenue Agent Review and other tax contingencies related to the 1999 purchase of American Indemnity Financial Corporation. The Revenue Agent Review has been settled, and we believe that the reserve for other tax contingencies is unnecessary at December 31, 2001. The effect of the elimination was a reduction of deferred tax liabilities and a reduction in federal income tax expense of $1,143,000.

At December 31, 2001, we had $26,605,000 of net operating loss carryforwards acquired in the purchase of American Indemnity Financial Corporation in August 1999. The utilization of these net operating losses is limited by the Internal Revenue Code. The net operating losses began to expire prior to our purchase of American Indemnity Financial Corporation and will continue to expire in various future years through 2019. Realization of the deferred tax asset associated with the net operating loss carryforwards is dependent on generating sufficient taxable income to utilize the net operating losses prior to their expiration.

Due to uncertainty of the realizable value of the deferred tax asset, we recorded a valuation allowance of $8,934,000. The valuation allowance recorded on our deferred tax asset decreased $2,436,000 from 2000, due primarily to the utilization of net operating loss carryforwards. In the future, if we can use the net operating losses acquired in the purchase of American Indemnity Financial Corporation, the related reduction in the valuation allowance will be recorded as a reduction to goodwill until goodwill has been eliminated, at which point the reduction in the allowance will reduce federal income tax expense.

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**Results of Operations for the Year Ended
December 31, 2000, Compared to the Year Ended December 31, 1999**

For the year ended December 31, 2000, net income was $15,527,000, or $1.55 per share, compared to $15,384,000, or $1.53 per share, for 1999. A hailstorm occurring in New Orleans on January 23, 2000 contributed $3,829,000 of after-tax net losses to the 2000 results. Net operating income, which is after-tax net income, excluding realized investment gains and losses and other income, improved in 2000 to $16,713,000, or $1.67 per share, from $13,476,000, or $1.34 per share, in the prior year. This improvement resulted primarily from increased premium revenue and a reduction of operating expenses due to our purchase of American Indemnity Financial Corporation, a group of property and casualty insurers, in August 1999 and to the consolidation of certain of our functions.

Net premiums earned in 2000 were $333,365,000, an increase of $60,314,000, or 22 percent, from 1999. This increase was due primarily to the inclusion in 2000 of twelve months of results of American Indemnity Financial Corporation, instead of only five months in 1999. The purchase of American Indemnity Financial Corporation also contributed significantly to the reduction of our underwriting expenses as a percentage of premiums written from 33.6 percent in 1999 to 31.9 percent in 2000. This reduction was primarily the result of economies of scale that we realized by consolidating the operations of American Indemnity Financial Corporation with our operations.

However, after-tax realized investment losses and other income of $(1,186,000) in 2000, compared to after-tax realized investment gains and other income of $1,908,000 in 1999, weakened net income for the year ended December 31, 2000. In 2000, we wrote down a small number of holdings in our fixed income portfolio as a result of other-than-temporary declines in market value and recognized a net realized loss, before tax, of $2,932,000 in 2000 compared to investment impairment write-downs in 1999 of $760,000.

Property and Casualty Insurance Segment

For the year 2000, our property and casualty segment recorded net income of $9,810,000, compared to net income of $6,062,000 for 1999. Despite the New Orleans hailstorm catastrophe, our property and casualty results improved in 2000 in several lines of business. The pure loss ratio decreased, which means that it showed improvement, in our automobile, other liability and workers compensation lines of business. Improvements in our underwriting function and a decrease in the severity of claims led to enhanced profitability in these lines.

Three lines of business deteriorated in 2000, compared to 1999:

Fire and allied lines business, with a pure loss ratio of 62.0 percent in 2000, compared to 52.5 percent in 1999, was negatively affected by the New Orleans hailstorm.

The fidelity and surety line of business had a pure loss ratio of 11.8 percent in 2000, compared to 2.1 percent in 1999. Despite this increase, our results in the fidelity and surety line were considerably better in 2000 than those reported for the fidelity and surety industry by A.M. Best Company. The 2000 pure loss ratio for the fidelity and surety industry was 31.3 percent. The continued growth of construction projects, coupled with shortages in the construction labor market, contributed to increased losses in these lines, for us as well as for the industry as a whole.

Our reinsurance line of business also deteriorated, with a pure loss ratio of 162.2 percent in 2000, compared to 122.6 percent in 1999. The bulk of the business we assumed was property reinsurance, with an emphasis on catastrophe coverage. In response to the tighter margins in this particular line, we decided to significantly reduce our writings in assumed reinsurance business. A majority of the business expired in 2000; however, we renewed certain of these contracts to write assumed reinsurance business with a very limited number of brokers. We will continue to have exposure, primarily with respect to catastrophe coverage, related to the assumed reinsurance contracts that we previously wrote. We believe that as of December 31, 2000, the loss reserves established for the assumed reinsurance

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business were appropriate. The assumed reinsurance reserves will be adjusted as additional facts become known.

Net premiums, which are direct premiums plus assumed reinsurance less ceded reinsurance, written by the property and casualty segment increased by $70,838,000 to $325,052,000 between 2000 and 1999, due to price increases, new and renewal business and twelve months of business from American Indemnity Company. Net premiums written increased in every line of business, with the exception of reinsurance. The largest dollar growth in net premiums written was reported in fire and allied lines, which increased from $77,270,000 in 1999 to $103,385,000 in 2000. The largest percentage growth was in other liability, with a 43 percent increase in net premiums written, due in part to the stabilization of prices in the commercial lines of business.

In 2000, direct premiums written by the property and casualty segment increased $77,405,000, or 32 percent, over 1999. Iowa was the segment s largest volume state, with direct premiums of $44,533,000. In 2000, as a result of our acquisition of American Indemnity Financial Corporation, Texas became our third largest volume state, with direct premiums of $40,596,000, compared to $13,730,000 in 1999.

In 2000, the segment s statutory combined ratio was 106.1 percent compared to 109.2 percent in 1999. The improvement resulted from the growth in premiums and a lower expense ratio, due in part to the consolidation of functions and the closing of the branch offices of the American Indemnity group of companies. Catastrophes, including the New Orleans hailstorm, negatively affected the statutory combined ratio, adding 7.9 percent to the ratio in 2000 and 6.0 percent in 1999, and resulted in after-tax net incurred losses and expenses of $15,778,000, or $1.57 per share, in 2000, compared to $9,561,000, or $0.95 per share, in 1999.

Life Insurance Segment

Our life insurance segment reported net income of $5,717,000 for 2000, compared to $9,322,000 for 1999. During the third quarter of 2000, write-downs on two fixed income securities contributed significantly to the segment s realized investment gains (losses) and other income of $(3,089,000), net of tax. Net premiums earned by the life segment after intercompany eliminations in 2000 totaled $26,094,000, compared to $25,997,000 in 1999. On a statutory basis, annuity deposits increased to $165,181,000, compared to $145,810,000 in 1999. Premium revenue reported on the basis of generally accepted accounting principles does not reflect annuity deposits. Revenues for annuities determined on the basis of generally accepted accounting principles consist of policy surrender charges and investment income earned.

Our life segment s largest expenditure is interest credited to annuities and universal life policies. In 2000, two primary factors, growth in new and existing account balances and higher interest rates, contributed to the increase in interest credited of $42,410,000, which was a 31 percent increase from $32,286,000 in 1999.

Investment Results

We reported net investment income of $86,867,000 in 2000, compared to $75,317,000 in 1999, primarily as a result of growth in our investment portfolio. The portfolio balance grew by $124,761,000. Over 90 percent of our net investment income originated in 2000 from interest on fixed income securities. We derived the remaining amount from dividends on equity securities, interest on other long-term investments, interest on policy loans and rent earned from tenants in our home office. The investment yield, which is investment income divided by average invested assets, was 6.6 percent in 2000 and 6.5 percent in 1999.

Our realized investment gains (losses) and other income, after tax, was $(1,186,000) in 2000, compared to $1,908,000 in 1999. Losses we recognized on the sale of securities held by the American Indemnity group of companies and two security write-downs were the major factors of the decline in 2000. We included as other income interest income of $257,000 in 2000 and $632,000 in 1999. This interest income related to a refund in connection with a federal income tax Revenue Agent Review for previous tax years.

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Federal Income Taxes

Our provision for Federal income taxes was $1,822,000 for 2000 and $1,834,000 for 1999. Pre-tax income was very similar between the two years, as were the components of federal income tax expense. At December 31, 2000, we had $29,709,000 of net operating loss carryforwards, the utilization of which is limited by the Internal Revenue Code. These net operating losses were acquired in the purchase of American Indemnity Financial Corporation in August 1999 and will expire in various future years through 2019. We recorded a net deferred tax liability of $12,245,000 at December 31, 2000 and $7,430,000 at December 31, 1999. The deferred tax liability increased primarily due to net unrealized appreciation on investment securities. We had a valuation allowance of $11,370,000 as of December 31, 2000 related to American Indemnity Financial Corporation net operating losses. The valuation allowance recorded on our deferred tax asset decreased $3,769,000 between years, due primarily to the utilization of net operating loss carryforwards. If we determine that the benefit of the American Indemnity Financial Corporation net operating losses can be realized in the future, the related reduction in the deferred tax asset valuation allowance will be recorded as a reduction to goodwill.

Financial Condition

As of December 31, 2001, when compared to December 31, 2000, our assets increased 11 percent, our liabilities increased 11 percent and our stockholders equity increased 8 percent. Invested assets, primarily fixed income securities, increased $157,927,000, or 11 percent, from 2000. Of this growth, $18,314,000 was attributable to changes in the market prices of our securities classified as available-for-sale and other invested assets, both of which are reported at fair value. The unrealized appreciation from these investments is reported net of tax as a separate component of stockholders equity.

As of December 31, 2001, 89 percent of our fixed income securities were investment grade, as defined by the National Association of Insurance Commissioners Securities Valuation Office, and had ratings of Class 1 or Class 2. We are able to hold a majority of our fixed income securities to maturity, but we have moved toward an increased concentration of available-for-sale fixed income securities to take advantage of constantly changing market conditions. At December 31, 2001, $1,142,614,000, or 83 percent, of our fixed income security portfolio was classified as available-for-sale, compared to $928,947,000, or 77 percent, at December 31, 2000. Our remaining fixed income securities are classified as held-to-maturity and are reported at amortized cost. We did not have securities classified as trading securities at December 31, 2001 or December 31, 2000.

We defer and capitalize, to the extent recoverable, commissions and other costs of underwriting insurance, which vary with and are primarily related to the production of our property and casualty lines of business. To attain a matching of revenue to expense, the deferred acquisition costs asset is amortized over the life of the insurance policies written. Growth in premiums written will typically result in an increase of the deferred acquisition costs asset. However, the deferred